Accounting implications of the impacts of COVID - 19

An Overview of IFRS Requirements

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Background

The World Health Organization declared Corona Virus (COVID-19) to be a public health emergency on January 30, 2020. As at March 31, 2020, almost the whole of Pakistan is in some state of lock down. The federal and provincial governments and other federating units have implemented various measures to contain the spread of the COVID - 19, including restricting the flight operations at the airports, curtailing intercity movements through buses and trains, temporary closing of businesses, schools etc.

On March 31, 2020, the Pakistan Stock Exchange (PSX) 100 index closed at 29,231 points and the Index has shed more than 27% from December 31, 2019. Further the translation rate of USD / PKR closed at Rs 166+. Many of the listed entities operating in textile, cement, chemicals, steel and other sectors have given notices to the Pakistan Stock Exchange for temporary suspension of their operations.

Impacts such as business and production disruptions, supply-chain interruptions, volatility in the equity and debt markets, reduced revenue and cash flows and other economic consequences also have accounting and financial implications. While this document focuses on issues that are likely to be the most frequently encountered, many others are certain to arise. As the situation continues to evolve, so too will the consequential accounting issues. For these reasons, the following is not an exhaustive list of all relevant accounting considerations;

- Impairment under IAS 36 “Impairment of Assets”
- Financial Instruments
    - Classification of assets
    - Expected Credit Losses (ECL)
    - Considerations specific to ECL computed under the simplified approach
    - ECL considerations specific to the banks
    - Fair Valuation
- Modification of financial assets and liabilities
- Revenue Recognition
- Leases
- Going Concern
- Other Financial Reporting Considerations
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    - Provisions under IAS 37
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    - Interim Financial Statement Disclosures
    - Financial reporting relaxations allowed by the Securities and Exchange Commission of Pakistan (SECP)

1. Impairment under IAS 36

IAS 36 "Impairment of Assets" requires an entity to assess, at the end of each reporting period, whether there is any impairment for an entity's non-financial assets. For goodwill and intangible assets with indefinite useful lives, the standard requires an annual impairment test and when indicators of impairment exist. For other classes of assets within the scope of the standard, an entity is required to assess at each reporting date whether there are any indications of impairment. The impairment test has to be carried out only if there are such indications.

The impact of reduced economic activity, lock downs and lower revenues are likely to affect many entities and might also indicate impairment. Therefore, entities should assess for each of their non-financial assets, where there is an indicator of impairment such as fall of stock and commodity prices, manufacturing plant shutdowns, shop closures, reduced demand and selling prices for goods and services, etc. In situations where an entity has concluded the existence of impairment indicators and has decided to carry out the assessment of recoverable value based on value in use, the management should consider whether:

- the assumptions and cash flow forecasts used to test for impairment should be updated to reflect the potential impacts of the COVID-19;
- an expected cash flow approach (multiple probability-weighted scenarios) might be a better way to estimate recoverable amount than a single predicted outcome to capture the increased risk and uncertainty; and
- the factors used to determine the discount rate, however the recoverable amount is determined, should be revised to reflect the impact of the COVID - 19 and the measures taken to control it. Management should ensure that appropriate risk is reflected in either the cash flows or the discount rate.

Where the recoverable amounts are based on fair value less cost to sell, the specific considerations have been discussed later in this document.

Management should also consider specifically the disclosure requirements under IAS 36 to disclose assumptions and sensitivities in the context of testing goodwill and intangible assets having an indefinite life. The disclosure requirements for other non-financial assets is applicable only when an impairment is recorded thereof. Specific consideration should also be given to the estimation uncertainty in the context of the COVID - 19.

Temporarily ceasing operations or suffering an immediate decline in demand or prices and profitability are clearly events that might indicate impairment.

2. Financial instruments

Classification of assets

Under the current scenario, an entity may decide to sell some of its financial assets previously carried at amortised cost under the business model of "Held to Collect" Model. In accordance with IFRS 9, an increase in the frequency or value of sale of financial assets in a particular period is not necessarily inconsistent with an objective to hold financial assets in order to collect contractual cash flows, if an entity can explain the reasons for those sales and demonstrate why those sale of financial assets do not reflect a change in entity's business model. IFRS 9 gives an example that when an entity expects that it will sell a particular portfolio of financial assets only in a stress case scenario, that scenario would not affect entity's assessment of the business model for those assets if entity reasonably expects that such a scenario will not occur. Similarly, entities may also decide to sell some of the securities because of the change in underlying credit risk on those securities. Such sale of financial assets does not affect the business model classification of the existing 'Held to Collect' securities.

Expected Credit Losses (ECL)

"Entities should not continue to apply their existing ECL methodology mechanically." (IASB)

Where an entity has any financial instruments that are within the scope of IFRS 9's expected credit loss (ECL) model, management should consider the impact of the COVID-19 on the ECL. Instruments to be considered include loans, trade and other receivables, debt instruments not measured at fair value through profit or loss, contract assets, lease receivables, financial guarantees and loan commitments. While the uncertainties arising from the COVID-19 are substantial and circumstances are certain to change, we do not expect this to preclude entities from estimating their ECLs. In March 2020, the IASB also issued a short document to provide guidance on accounting for expected credit losses in the light of current uncertainty resulting from the COVID - 19 pandemic.

Staging of the financial assets

IFRS 9 requires lifetime ECLs be recognised when there is a significant increase in credit risk (SICR) on a financial instrument. IFRS 9 mentions certain factors to be considered for assessment of SICR including external and internal credit risk rating, existing or forecast adverse changes in business, financial and economic conditions that are expected to cause a significant change in borrower's ability to meet its debt obligations.

We suggest that the Management should consider the effects of the COVID - 19 and the significant government support measures being undertaken while assessing forecast conditions. However, the extension of payment holidays to all borrowers in particular classes of financial instruments should not automatically result in all those instruments being considered to have suffered an SICR and consideration should be given to individual credit risk.

Risk parameters under IFRS 9

Given the speed of changes in the macro economic factors, the specific effects of the COVID - 19 would be challenging to be incorporated on a reasonable and supportable basis in the ECL model. Where the effects of the COVID-19 cannot be reflected in models, post-model overlays or adjustments will need to be considered. Management's consideration for impacts of the COVID - 19 should include;

- Probability of Default (PDs) - the PDs may increase if the debtor's business is adversely impacted by the COVID-19 or for individual customers (e.g. customers of utility companies) it may increase on account of overall economic downturn, potential of layoffs, and impacts of the COVID - 19 on the individual income of households;
- Exposure at Default (EAD) - Debtors affected by the COVID-19 might draw down on existing unused borrowing facilities, or cease making discretionary over-payments, or take longer than normal to pay, resulting in a greater amount at risk; and
- Loss Given Default (LGD) - for example, this might increase if the COVID-19 results in a decrease in the fair value of a non-financial asset pledged as collateral or where the overall recovery estimates after the default event are decreased.

Forward looking factors

IFRS 9 requires that forward-looking information (including macroeconomic information) is considered while determining expected credit losses. Managements should ensure that changes in economic conditions are reflected in macroeconomic scenarios applied by entities and in their weightages. Forward-looking information might include additional downside scenarios related to the spread of the COVID-19. This might be achieved by adding one or more additional scenarios to entity's existing scenarios, amending one or more of the existing scenarios (for example, to reflect a more severe downside(s) and/or to increase their weighting), or using an 'overlay' if the impact is not included in an entity's main ECL model.

Disclosures

Management should consider the need to disclose the impact of the COVID – 19 on the impairment of financial assets. For example, disclosures required by IFRS 7, 'Financial instruments: Disclosures', that might be affected include how the impact of forward-looking information has been incorporated into the ECL estimate, details of significant changes in assumptions made in the reporting period, and changes in the ECL that result from assets moving from stage 1 to stage 2.

Considerations specific to ECL computed under the simplified approach

IFRS 9 requires the ECL for trade receivables and contract assets which do not contain a significant financing component to be computed under the simplified approach, under which a lifetime ECL is computed for the trade debts and contract assets. The standard, as a policy choice, also allows the simplified approach for lease receivables and trade debts with significant financing components. For these receivables, entities often calculate ECLs by using a provision matrix.

Managements should consider changing segmentation of its existing customers for the purpose of calculation of ECL, as the customers operating in the affected industries due to the COVID - 19 may not represent similar credit risk and characteristics. Entities may also consider to measure ECL on an individual basis for some of the significant customers operating in the affected industries.

IFRS 9 requires entities to consider multiple scenarios as ECL is a probability weighted amount that is determined by evaluating a range of possible outcomes. However, some companies may not carry this practice because it may not make a material difference to the outcome in a stable macroeconomic environment. **This approach may not be appropriate in the current scenario given the uncertainty in the macroeconomic environment in the context of the COVID - 19.**

The effect of any government initiatives will also need to be revisited in measuring ECL at the end of each reporting period.

Though a provision matrix is generally used for ECL calculation on these receivables, forward looking information is still considered in assessing the credit risk on these balances and in measuring ECL. Therefore, forward looking considerations given above should also be applied to ECL calculated using provision matrix, and management should consider to include one or more downward scenarios related to the effects of the COVID - 19.

IAS 1 requires presentation of IFRS 9 impairment losses on the face of the statement of profit or loss as a separate line item. This separate presentation might not have been given in previous years if the ECL and year on year movements were immaterial. However, there will likely be more focus on this requirement in the wake of the COVID - 19 and increasing credit risk.

ECL considerations specific to banks

IFRS 9 is applicable on banks for the financial periods starting on or after January 01, 2021. However, the State Bank of Pakistan (SBP) previously required the banks to prepare their pro forma financial statements for the year ended December 31, 2019 by April 30, 2020 and had also required for the parallel run of IFRS 9 for the period starting on or after January 01, 2020. The SBP has now extended the timelines for submission of Pro Forma financial statements to July 31, 2020, while parallel run of IFRS 9 will start from periods beginning on July 01, 2020.

The effects of the COVID - 19 should be considered as a non adjusting event for the December 31, 2019 proforma financial statements, however, these shall certainly impact the 2020 proforma financial statements. In the following paragraphs, we have discussed key considerations (in addition to those mentioned above) that apply to banks for the parallel run of IFRS 9 and / or for their internal/group reporting to their parent entities.

Staging of the Financial Assets

- While most Banks are using ORR based models for staging of their financial assets, and ORR is usually updated annually by the banks, therefore latest ORRs available with the banks would not have incorporated the impacts of the COVID – 19. Banks should review their portfolio for potential downgrading of the customers based on the impacts of the COVID – 19. Special attention should be given to customers operating in the sectors most impacted.

- For Retail and microfinance portfolios, the overall macroeconomic consideration should also be taken into account, while categorizing the borrowers under stage 1 or 2.
- The previous rebuttal of "backstop" criteria and "default definitions" should be re-evaluated under the current scenario.
- The relaxations provided by the SBP should be considered while determining staging of assets and specific consideration should be given to the individual circumstances of the borrowers.

Determination of ECL

- Banks should revaluate their previously used Cash Conversion Factor (CCF) and lifetime determined for undrawn and revolving facilities, as under the COVID – 19 impacts, the utilization of undrawn facilities and their period may increase as compared to prior periods.
- Banks should also consider their regular reporting cycle while the PDs are used based on data history with certain time-lag, banks should reassess whether risk parameters should be updated on a more frequent basis (such as monthly) given the speed of developments.
- There is little doubt that economic conditions have deteriorated, and this should be reflected in the macroeconomic scenarios applied by an institution and their weightages. In some cases, the prior period downside scenario may be an appropriate starting point for the current base case. Additional scenarios may also be factored as discussed above.
- To the extent it is not possible to reflect the impacts of the COVID-19 in an institution's models, post-model adjustments or overlays will need to be considered. Updated facts and circumstances should continue to be monitored for any new information relevant to assessing the conditions at the reporting date.

Fair valuation considerations

On March 31, 2020, the Pakistan Stock Exchange (PSX) 100 index closed at 29,231 points and the Index has shed more than 27% from December 31, 2019. The objective of "fair value" is to determine a price at which an orderly transaction would take place between market participants under conditions that existed at the measurement date. In our view, it would not be appropriate to adjust or disregard observable transactions, unless those transactions are determined to not be orderly.

The volatility of prices on various markets has increased as a result of the spread of the COVID-19. This affects the fair value measurement either directly - if fair value is determined based on market prices (for example, in case of shares or debt securities traded on an active market), or indirectly - for example, if a valuation technique is based on inputs that are derived from volatile markets.

A change in the fair value measurement affects the disclosures required by IFRS 13 "Fair value Measurement", which requires entities to disclose the valuation techniques and the inputs used in the underlying fair value measurement as well as the sensitivity of the valuation to changes in assumptions. It might also affect the sensitivity analysis required for recurring fair value measurements categorised within level 3 of the fair value hierarchy. The number of instruments classified as level 3 might increase.

Modifications of financial assets and liabilities

With the introduction of relaxations for restructurings provided by the State Bank of Pakistan, many entities may apply to commercial banks for restructuring of their existing loans and financing facilities. Both the borrowers and lenders should assess whether the change in contractual terms requires the recognition of a new financial asset or liability, or whether a modification gain or loss should be recorded under IFRS 9.

3. Revenue recognition

An entity's sales and revenue might decline as a result of the reduced economic activity following the steps taken to control the COVID - 19. There is a temporary lockdown in the country due to which many plants / units have been shut down, resulting in disruption in supply and demand of goods.

The COVID-19 outbreak might affect revenue estimates for ongoing and future contracts with customers falling within the scope of "IFRS 15 - Revenue from Contracts with Customers". Consequently, there could be an effect on the assumptions made by management in measuring the revenue from goods or services already delivered and in particular on the measurement of variable considerations.

Variable consideration

The management is generally required to estimate, at contract inception, the amount of consideration to which it will be entitled in exchange for transferring promised goods or services. The amount of variable consideration that can be included in the transaction price is constrained to the amount for which it is highly probable that a significant reversal of cumulative revenue recognised will not occur when the uncertainties related to the variability are resolved. Variable consideration takes many forms, which have been discussed below considering the COVID - 19 impacts:

Type of variable Consideration	Factors to be considered
Volume and Prompt payment discounts	Entities need to consider whether the customers who previously used to avail these discounts would continue availing these discounts as a result of cash flow constraints or a decline in demand due to the COVID - 19 outbreak and should recognise revenue accordingly.
Rebates	Customers typically pay full price for goods or services at contract inception and then receive a cash rebate in the future. Entities need to reconsider the volume of expected sales and expected rebates as a result of the COVID – 19 outbreak and revise its estimate regarding unrecognised revenue on account of future rebates.
Returns / refunds	The estimate of returns and refunds at the time of sale needs to be reassessed in the COVID - 19 situation where there is a likelihood of temporary suspension of business operations of customers both for sales already made and future sales.
Royalties	Royalty revenue recorded by a licensor based on sales or usage of a licensee needs to be reassessed as it is probable that sales revenue of licensee will be impacted in the current scenario.

Management should, therefore, reconsider both its estimate of variable consideration and whether the revenue recognition threshold is met by exercising significant judgement.

IFRS 15 requires an entity to disclose information that allows users to understand the nature, amount, timing and uncertainty of cash flows arising from revenue. Managements should consider disclosing information about the methods, inputs and assumptions used for estimating variable consideration and assessing whether an estimate of variable consideration is constrained.

Assessment of ongoing customer contracts for enforceability, impairment and modification

IFRS 15 is applied only to those contracts where management expects its customer to meet its obligations as they fall due. Management might choose to continue to supply a customer even when it is aware that the customer might not be able to pay for some or all the goods being supplied. Revenue is recognised in these circumstances only when it is probable that the customer will pay the transaction price when it is due net of any price concession.

The management should assess the need for write-offs or increase in ECL allowance on outstanding receivable balances under the requirements of IFRS 9.

4. Leases

IFRS 16 – "Leases" became effective from January 1, 2019 in Pakistan and in most cases had a significant impact on the lessee's accounting for lease contracts whereby Right of Use Assets and Lease Liability were recorded for all leases under the scope of IFRS 16 (whether finance or operating leases). The adoption of this standard requires significant management judgement in the determination of lease term i.e. whether extension or termination options available to the lessee are likely to be exercised and entities had to exercise judgement based on their business needs to assess the likelihood of exercising these options. Further, judgement was also required in estimation of the incremental borrowing rate of the lessee (IBR) applicable on transition date. As a result of the COVID - 19 outbreak, the assumptions used on December 31, 2019 may no longer hold valid. These impacts are further discussed below:

Reassessment of lease term

Due to the effects of the COVID - 19, the changes in management's intention for extensions / termination lease term could have a significant impact on the carrying amount of lease assets (right of use assets) and liabilities. Further, lease contracts with purchase options may need to be reassessed if the lessee concluded initially that exercise of the purchase option was reasonably certain. If a lessee changes its assessment of whether it is reasonably certain to exercise a renewal or purchase option, or not to exercise an option to terminate the lease early, then the lease liability is re-measured using a revised discount rate with the corresponding adjustments to right-of-use assets. This in turn will have an effect on the amount and profile of depreciation and interest expense recognised subsequently.

"Due to the effects of the COVID - 19, the management's previous assumption and intention to renew / terminate the lease contracts as at December 31, 2019 may not remain valid."

Modification of lease

On March 28, 2020, one of the biggest real estate management companies in Karachi announced that as part of relief to its tenants, it is waiving the rent for the month of April 2020 along with certain other waivers. Similar situations can also arise with various other entities whereby a lessor and a lessee might renegotiate the terms of a lease as a result of the COVID-19 or a lessor might grant a lessee a concession in connection with lease payments.

Lessees should, therefore, consider the requirements of IFRS 16 "*Leases"* and whether the concession should be accounted for as a lease modification and spread over the remaining period of the lease. The modification of the lease requires the remeasurement of the lease liability using a revised discount rate (which is usually the incremental borrowing rate of the lessee).

Impairment of right of use assets

The impairment of Right of Use Assets under these contracts are subject to impairment testing under IAS 36 – "Impairment of Assets" and would be assessed as part of a cash generating unit. Suspension of operations and reduced economic activity in respect of right of use assets can be identified as impairment triggers and hence management needs to incorporate these elements and similar conditions for impairment assessment of Right of Use Assets.

Impairment considerations for lessors

In case of operating leases, a lessor includes the underlying leased asset in the carrying amount of the CGU and applies IAS 36 for assessing the impairment thereof. While assessing the recoverable value, the lessor includes the future cash receipts in its cash flow forecasts and identifies whether any impairment needs to be recognised.

In addition, an entity applies IFRS 9 to test operating and financing lease receivables for expected credit losses. Please refer to ECL guidance on IFRS 9 and similar considerations as given in this publication.

5. Going concern

Under IAS 1 'Presentation of Financial Statements’, management is required to assess an entity’s ability to continue as a going concern. Entities are also required to disclose material uncertainties related to events or conditions that may cast significant doubt on their ability to continue as a going concern. The standards require that all available information about the future, which is at least, but not limited to, twelve months from the end of the reporting period, should be taken into account while assessing whether or not the going concern assumption is appropriate.

The impacts of the COVID - 19 have already raised concerns for many entities and some have already announced temporary suspension of operations and layoffs. While preparing the financial statements, management should;

- Consider the potential implication of the COVID – 19, including measures taken by the government and banks in its assessment of going concern; and
- Consider revising the budgets and forecasts prepared for the current year. In many cases, 2020 budgets and forecasts prepared in 2019 may now be of limited relevance given the rapidly changing economic and business circumstances and may require significant revision.

Management should also consider whether they are required to disclose the impacts of the COVID - 19 as material uncertainties that may cast significant doubt on an entity's ability to continue as a going concern. Management should also remember that events after the reporting date that indicate an entity is no longer a going concern are always adjusting events.

In accordance with IAS 10, the going concern assessment needs to be performed up to the date on which the financial statements are issued.

6. Other financial reporting considerations

Associates and joint ventures

Interests in joint ventures and associates are accounted for under the equity method and are tested for impairment in accordance with IAS 28 Investments in Associates and Joint Ventures. Entities should consider the existence of events mentioned under IAS 28, and should evaluate whether any financial difficulties or other events such as temporary suspension of business, breach of contracts etc. have occurred because of the effects of the COVID -19.A specific consideration should also be given to the fair value of listed associates and joint ventures, and where they stand in comparison to their cost and carrying amount. A significant or prolonged decline in the fair value of an investment in an equity instrument below its cost is also an objective evidence of impairment. Where impairment indicators as mentioned above are present, an impairment test for investment in these associates and joint ventures should be conducted in accordance with IAS 36.

Inventories

It might be necessary to write-down inventories to net realisable value. These write-downs could be due to reduced movement in inventory, lower commodity prices, or inventory obsolescence due to lower than expected sales.

IAS 2 Inventories requires that fixed production overheads are included in the cost of inventory based on normal production capacity. Reduced production might affect the extent to which overheads can be included in the cost of inventory.

Entities should assess the significance of any write-downs and whether they require disclosure in accordance with IAS 2.

Property Plant and Equipment

The COVID – 19 might mean that property, plant and equipment is under-utilised or not utilised for a period or that capital projects are suspended. IAS 16 Property, plant and equipment requires that depreciation continues to be charged in the statement of profit or loss while an asset is temporarily idle (unless a usage-based depreciation method is used such as numbers of hours or units produced).

IAS 23 Borrowing costs requires that the capitalisation of interest is suspended when development of an asset is suspended.

Government grants

Governments around the world have reacted to the impact of the COVID-19 with a variety of measures, including tax rebates, holidays and, in some cases, specific support for businesses to ensure that those businesses are able to support their customers. Management should consider whether these types of assistance received from a government meets the definition of a government grant in IAS 20 - “Accounting for Government Grants and Disclosure of Government Assistance” and should apply the relevant guidance thereon.

Provisions under IAS 37

IAS 37 “Provisions, Contingent liabilities and Contingent Assets”, requires a provision to be recognised only where an entity has a present obligation, it is probable that an outflow of resources is required to settle the obligation and a reliable estimate can be made.

For any restructuring plan, management would need to account for a restructuring provision. However, for a restructuring provision to be recognised, there has to be a detailed formal plan for the restructuring and by which management has raised a valid expectation to those affected that the plan will be implemented.

As a result of the COVID – 19 outbreak, entities might carry out restructuring plans which may include closure of certain plants / operations and change in compensation plans etc.

The restructuring plan approved by an entity’s board of directors (or those charged with governance) will not by itself be sufficient to recognise a restructuring provision. It has to be an announced plan whereby an entity has created valid expectations to those who are going to be affected. Termination benefits which an entity decides to pay as part of its restructuring plan are recognised in accordance with the requirements of IAS 19 "Employee Benefits" which has been discussed in the section "Employee Benefits and Share Based Plans".

It is important to note that "IAS 37" does not permit recognising provisions for future operating costs or future business recovery costs. Furthermore, an entity is required to disclose the nature of the obligation and the expected timing of the outflow of economic benefits.

Onerous contracts

"Onerous contract" is a contract in which the unavoidable costs of meeting the obligations under the contract exceed the economic benefits expected to be received under it.

The unavoidable costs under a contract reflect the least net cost of exiting from the contract, which is the lower of the cost of fulfilling it and any compensation or penalties arising from failure to fulfil it. This effectively means that the provision against onerous contract would be recognised at the lower of the amount of penalties that may be invoked due to failure to fulfil the contract or cost of fulfilling the contract from alternate sources.

The current COVID – 19 outbreak situation might affect entities to fulfill committed orders resulting in contracts becoming onerous. Provision will need to be recognised at the lower of the cost of fulfilling the contract and any compensation or penalties arising from failure to fulfil it.

The current COVID – 19 outbreak situations might affect the operations / manufacturing facilities of an entity due to which an entity may not be able to meet the committed orders. As a result, an entity might have to arrange for committed orders from third parties at a higher cost resulting in an excess of cost over the consideration to be received under the contract or pay the penalties payable under the contract. Contracts that can be cancelled without paying compensation to the other party do not become onerous as there is no obligation.

Entities will have to review their contracts in order to identify any conditions in the contract that may relieve an entity in such types of situations.

Contingent assets

There have been temporary lockdowns at various places in order to control the spread of the COVID – 19 and consequently some businesses have been closed temporarily.

An entity might have business interruption insurance and be able to recover some or all of the costs of closing down. Management should consider whether the losses arising from the COVID-19 are covered under its insurance policies. The benefit of such insurance policy is only recognised when the recovery is virtually certain. This would typically be when the insurer has accepted that there is a valid claim and management is satisfied that the insurer can meet its obligations.

The benefit of insurance is generally recognised later than the costs for which it compensates since it is compensation for those costs.

Employee benefits and share based plans

As a result of the COVID - 19, there have been temporary lockdowns which have affected the operations of entities. This might result in entity making changes or introducing new remuneration policies. For this, management will be required to consider whether any of the assumptions used to measure employee benefits and share based payments should be revised. The yields on bonds (eligible) or the risk-free interest rate have changed as a result of recent developments. Furthermore, the probability of an employee meeting the vesting conditions for bonuses or share based payments might have changed as a result of recent developments.

There can be potential impact in the following areas:

- Remeasurement of valuations required due to changes in actuarial assumptions as a result of recent developments (mainly changes in interest rates, salary increase rate and risk-free rates). Accordingly, an entity may require carrying out revised actuarial valuation.

- Employees may be required to avail existing sick or annual leaves due to current lock down and therefore an entity may need to consider the impact on the remeasurement of employee benefits – e.g. they may need to revise estimates of the likelihood and timing of employees using these entitlements. An entity may give their workforce paid absence / sick leave / annual leave in addition to existing entitlements If new paid absence entitlements do not accrue through past service and do not accumulate, then it is unlikely that entity would recognise a liability for these paid absences. Instead, it would expense the cost as absences are taken. Entity preparing interim financial statements should consider whether the net defined benefit obligations / assets need to be remeasured;

- Updated valuations may be required on account of restructurings carried out by management. This could result in termination of employee benefits. A restructuring provision can only be recognised when there is a detailed plan for restructuring and entity has made valid expectations to those affected by the plan.

- Entities with share-based payments vesting conditions may include internal parameters (non-market-based performance conditions) such as profit targets, return on equity, return on assets, growth in revenue and market-based performance conditions such as increase in share price. Entity may need to determine the number of expected instruments expected to vest based on the revised performance conditions. The impact of revised performance conditions may materially change the charge in the profit and loss over the remaining vesting period. However, expectations of achieving market performance conditions – e.g. achieving a specified total shareholder return and non-vesting conditions – and grant-date fair value are not revised. Management should consider the impact of any changes made to the terms of, for example, a share-based payment plan, to address the changes in the economic environment and the likelihood that performance conditions will be met. To the extent that such changes are beneficial to the employee, they would be accounted for as a modification and an additional expense should be recognised. Management should be aware that cancelling a share-based payment award even if the vesting conditions are unlikely to be satisfied results in the immediate recognition of the remaining expense.

Entities normally engage actuaries and provide data to actuaries with detailed assumptions before the reporting date. Entities should consider that the valuation carried by the actuary incorporates the effect of any material subsequent event upto the reporting date. The impacts of the COVID – 19 spread on entity's benefit plans might change significantly between the valuation date and the reporting date. Accordingly, the timing of its actuarial valuation reports and whether they reflect material events between the valuation and the reporting date need specific consideration.

IFRS 2 "Share-based payment" requires that entities explain modifications to share based payments, along with the incremental fair value granted, as well as information about how the incremental fair value was determined.

IAS 19 requires extensive disclosure of the assumptions used to estimate employee benefit liabilities, together with sensitivities and changes in those assumptions.

Breach of covenants

As a result of the COVID - 19, some entities might find themselves in breach of loan covenants and in some cases material adverse change clause might be triggered. This could result in loan repayment terms changing and some loans becoming repayable on demand.

Entities need to consider whether the classification of loans and other financing liabilities between non-current and current has been affected. Entities also need to consider as to whether as a result of breach of covenants, they remain a going concern or not.

It is important to highlight here that many entities may seek rescheduling / restructuring of their financial obligations with the financial institutions. Such rescheduling and restructurings might include requests to the financial institutions to give relaxation in respect of certain loan covenants. Such relaxations for loan covenants should be obtained by entities before the reporting date to continue the existing loan classification between the non-current and current. If there has been a change in classification of loans or other financing facilities as a result of the above situation then waivers obtained by entities from financial institutions after the reporting date are considered as non-adjusting events.

Income taxes

The COVID - 19 situation could affect future profits as a result of direct and indirect (effect on customers, suppliers, service providers) factors.

Asset impairment may also reduce the amount of deferred tax liabilities and /or create additional deductible temporary differences. Entities with deferred tax assets should reassess forecast profits and the recoverability of deferred tax assets in accordance with "IAS 12 Income taxes" taking into account the additional uncertainty arising from the COVID – 19 and the steps taken to control it.

There are uncertainties around the COVID - 19 and entities may find them difficult to predict the effects of the COVID - 19 on the future forecasted profits. Entities should consider disclosing potential impacts of the COVID - 19 and the risk factors below financial statements notes where such tax assets or liabilities are recognised. Management should disclose any significant judgements and estimates made in assessing the recoverability of deferred tax assets, in accordance with IAS 1.

Currently, no tax relieve package other than for construction industry has been announced by the government of Pakistan as a result of the COVID - 19. However, going forward if any tax relief package is announced then the impact of that on the current and deferred tax balances would be recorded in the financial period in which the amending legislation would be substantively enacted. Entities would also need to consider if the tax concessions are staggered over several years. In such cases incremental tax rate reductions and the expected timing of the reversal of deferred tax balances will also need to be assessed.

Events after the reporting period

As per IAS 10, "Events after the reporting period are those events, favourable and unfavourable, that occur between the end of the reporting period and the date when the financial statements are authorised for issue. Two types of events can be identified:

(a) those that provide evidence of conditions that existed at the end of the reporting period (adjusting events after the reporting period); and

(b) those that are indicative of conditions that arose after the reporting period (non-adjusting events after the reporting period)."

The situation is currently evolving, and management should consider whether the latest developments provide more information about the circumstances that existed at the reporting date. In the case of Pakistan, the events would not be adjusting events for financial statements having year / period end of December 31, 2019 as the cases of the COVID – 19 were mainly reported in February 2020. Clear disclosure of non-adjusting events is required in entities financial statements (when these are material and for entities having year / period end of December 31, 2019) whose financial statements have not been approved when the impacts of the COVID - 19 were largely discovered.

If management concludes that an event is a non-adjusting event, but the impact of it is material, the entity is required to disclose the nature of the event and an estimate of its financial effect. Such disclosure may include describing qualitatively and quantitatively, how the market volatility subsequent to year-end has affected its stated balances of assets, liabilities, equity and its operations. Examples of events that would generally result in the disclosures under IAS 10 would include:

- management's plans to deal with the effects of the COVID-19 outbreak and whether there is material uncertainty over the entity's ability to continue as a going concern;

- Potential breach of covenants, waivers or modifications of contractual terms in borrowing arrangements;
- supply chain disruptions;
- the assessment of certain purchase or sale agreements as onerous contracts;
- announcing a plan to discontinue an operation or commencing the implementation of, a major restructuring or downsizing (temporarily or permanently);
- declines in the fair value of investments held after the reporting period (e.g., pension plan investments) or other abnormally large changes in asset prices or foreign exchange rates;
- entering into significant commitments or contingencies, such as issuing significant guarantees to related parties; and
- Potential recoverability or expected bad debt issues post year end due to COVID – 19.

While all disclosures should be entity – specific and include information that is relevant to their circumstances, following are some indicative disclosures that can be used as a guidance by entities whose financial statements for December 31, 2019 have not been authorised for issue;

Indicative disclosures for December 31, 2019 financial statements

Impact on overall operations

Subsequent to the balance sheet date, the COVID – 19 has spread throughout the country and measures to reduce the spread of the COVID-19 include lockdown of businesses, suspension of flight operations, intercity movements, cancellation of major events etc. These measures have resulted in an overall economic slowdown and disruptions to various businesses. The Government of Pakistan and State Bank of Pakistan have announced several monetary and fiscal policy measures to mitigate the adverse economic impacts of the COVID 19. The aforementioned measures have also affected the business operations of the entity significantly in the form of **(write entity specific information about the impacts on financial position and operations)**.

The entity has determined that these events are non-adjusting subsequent events in accordance with the requirements of IAS 10, accordingly, these financial statements have not been adjusted to reflect the impacts of the COVID 19. Due to overall uncertain situation about the impacts and duration for which the abovementioned measures will continue, the overall impact on the entity's financial position and financial performance cannot be predicted with reasonable certainty.

Decline in fair value of equity instruments

Subsequent to the balance sheet date, the COVID – 19 has spread throughout the country and measures have been taken to reduce the spread of the COVID-19 including lockdown of businesses, suspension of flight operations, intercity movements, cancellation of major events etc. These measures have resulted in an overall economic slowdown, disruptions to various businesses and significant volatility in the Pakistan Stock Exchange. (PSX). On March 31, 2020, the Pakistan Stock Exchange (PSX) 100 index closed at 29,231 points and the Index has shed more than 27% from December 31, 2019. SECP has allowed all companies to recognize unreaslised gain / loss arising on fair value measurement of equity Instruments classified as "Fair Value through Profit or Loss" held as at March 31, 2020 in the statement of changes in equity as a separate component of equity. Therefore, an unrealized loss amounting to Rs ______ will be recorded in statement of changes in equity in the entity's financial information for the period ended March 31, 2020.

Suspension of Business operations

On March ___, 2020, the Government of _____ announced a temporary lock down as a measure to reduce the spread of the COVID – 19. Complying with the lockdown, the entity suspended its production from March ___, 2020. The lockdown has also caused disruptions in supply chain including supply of produced goods to the customers of the entity and receipt of trade debts. The daily economic loss to the entity from the suspension amounts to Rs ____ (in the form of gross profit for expected sales and production in the suspended period) and the entity is also facing liquidity problems on account of delayed payments from its customers. The entity has also applied to the commercial banks for relaxation in repayment of principal of its credit facilities by one year. The impact of measures to reduce the COVID 19 has also impacted the credit risk of the customers of the entity, which along with other macro-economic factors will also impact the expected credit losses in the subsequent periods. Due to overall uncertain situation about the impacts and duration for which the abovementioned measures will continue, the overall impact on the entity's financial position and financial performance cannot be predicted with reasonable certainty.

Insurance liabilities

Entities issuing insurance contracts are required to account for their rights and obligations under IFRS 4 'Insurance Contracts'. The current pandemic scenario may have implications on multiple insurance contracts issued in the spheres of health, life, travel and business interruption policies. As per the requirements of IFRS 4, an insurer shall assess at the end of each reporting period whether its recognised insurance liabilities are adequate, using current estimates of future cash flows under its insurance contracts. If that assessment shows that the carrying amount of its insurance liabilities (less related deferred acquisition costs and related intangible assets, is inadequate in the light of the estimated future cash flows, the entire deficiency shall be recognised in the profit or loss. Given the uncertainties about the possible impact of current situation on the business of an insurance entity, insurer needs to perform a comprehensive analysis of its portfolio of issued insurance contracts including the impacts of the interpretation of the terms and conditions of the contracts in the current scenario where there are certain relief measures being announced by the government and regulatory authorities.

In determining the insurance liabilities, insurers may need to specifically factor in the disruptions caused by the current scenario and its impacts on businesses of their customers particularly in case of insurance contracts for compensation of business interruption losses. The insurers will need to exercise judgments in determining the provision of Incurred But Not Reported (IBNR) claims and also consider the subsequent events for assessing the adequacy of IBNR reserve. In case of life insurance mortality and morbidity assumptions need to be assessed in view of the current pandemic situation.

Insurers will need to give enhanced disclosures in respect of the uncertainties existing at the reporting date and the assumptions used to estimate the insurance liabilities along with the sensitivities of the changes in key assumptions used by management.

Other financial statement and non-financial statement disclosures

Management should consider the specific requirements in IAS 1 to disclose significant accounting policies, the most significant judgements made in applying those accounting policies and the estimates that are most likely to result in an adjustment to results in future periods. All of these disclosures might be different as a result of the impacts of the COVID - 19. The extent of disclosures regarding estimation uncertainty might need to be increased. For example, the carrying amount of more items might be subject to a material change within the next year.

There might be individually significant financial effects of the COVID - 19, for example, individually material expenses such as an impairment or a modification adjustment. In addition to the disclosure requirements of individual standards, IAS 1 requires an entity to disclose separately on the face of the profit or loss or in the notes to the financial statements material items of income or expense. An entity might also disclose additional line items or sub-totals on the face of the profit or loss where this is necessary for an understanding of performance. Management should consider the specific requirements of IAS 1 if it discloses additional subtotals. There is also a requirement in IAS 1 to disclose information relevant to an understanding of the financial statements that is not otherwise disclosed.

Entities will need to disclose any changes in their financial risks such as credit risk, liquidity risk, currency risk and other price risk, or in their objectives, policies and processes for managing those risks. In particular additional disclosures about liquidity risk might be needed where the COVID – 19 has affected an entity's normal levels of cash inflows from operations or its ability to access cash in other ways such as from factoring receivables or supplier finance.

An entity's stakeholders will be interested in the impact of the COVID – 19 and the measures taken to contain its spread. Some of these stakeholder's needs might be met more appropriately by disclosure outside the financial statements. Management might consider updating its analysis of the principal risks and uncertainties. Management should also consider any specific local disclosure requirements, for example, those issued by the local regulator.

Interim financial statements

Disclosure requirement under IAS 34 – "Interim Financial Reporting"

As per the requirements of IAS 34 – Interim Financial Reporting, an entity shall include, in its interim financial report, an explanation of events and transactions that are significant to an understanding of the changes in financial position and performance of entity since the end of the last annual reporting period. Therefore, additional disclosures should be given to reflect the financial impact of the COVID-19 and the measures taken to contain it. The disclosure should be specific to entity's circumstances. Important disclosures that managements should consider may include current and future effects of the COVID - 19 on entity's operations and its assets and liabilities, how management is responding to the evolving events and the planned course of action for related uncertainties. The disclosures should include all material information for a user of the financial statements to understand the actual and potential impacts of the COVID - 19 on the financial statements of entities.

Where significant, the disclosures required by paragraph IAS 34 **should** be included, together with:

- the impact on the results, balance sheet and cash flows as a result of COVID-19 and the steps taken to control the spread;
- significant judgements that were not required previously, for example in connection with expected credit losses;
- updates to the disclosures of significant estimates; and
- events since the end of the interim period.

Comprehensive disclosures under other IFRSs (standards) where relevant information was not reflected in their recent annual reports:

Majority of entities have been recently impacted by the COVID-19 i.e., February 2020 and onwards. Management of these entities may not have included much relevant information in their recent annual reports. Management would, in this case, assess the need to include more higher-level disclosures for interim financial reporting purposes rather than disclosures in condensed form. This may also include comprehensive disclosures as required in a complete set of financial statements under relevant standards if the disclosures relate to significant events and transactions. The disclosure requirements of relevant standards other than IAS 34 may also need to be considered in these circumstances.

IAS 34 presumes that anyone who reads an entity's interim report will also have access to its most recent annual report and only events or transactions that are significant to an understanding of the changes since the end of the last annual reporting period are updated in interim financial statements.

Within the financial statements, entities should consider disclosure of risks and uncertainties and whether, how, and when events might impact the judgments inherent in their financial reporting, including those discussed above. Additionally, entities should evaluate whether subsequent events have occurred that require disclosure in the financial statements.

Disclosures may be required outside of the financial statements. Areas of focus might include disclosures about the business, risk factors, and management's discussion and analysis of results, liquidity, and capital resources (including consideration of trends and uncertainties). As events continue to unfold, decisions in these areas will likely evolve.

Financial reporting relaxations allowed by the Securities and Exchange Commission of Pakistan (SECP)

On April 01, 2020, SECP has allowed all companies to recognize unreaslised gain / loss arising on fair value measurement of equity Instruments classified as "Fair Value through Profit or Loss" held as at March 31, 2020 in the statement of changes in equity as a separate component of equity.

However, the amount so recognized shall be treated as a charge to statement of profit or loss for the purpose of distribution as dividends. The amount of unrealized gain or loss as at March 31, 2020 shall be charged to profit or loss along with any adjustments of fair valuation in the financial statements for the period / year ended June 30, 2020. SECP has also required all the companies and mutual funds who avail the relaxation to prominently disclose on the face of their Statement of Financial Position, Statement of Profit or Loss and Directors' Report the parameters used by them in the determination of the fair value of their investments and the figures arrived at under both regular and especially opted accounting treatment.

SECP has also allowed a general thirty days extension in the Holding Annual General Meeting for the year ended December 31, 2019 to all the companies. SECP has also notified that the Commission shall facilitate granting of extension in timelines for filing of first quarter financial statements based on applications sent by the companies to SECP via email. It has further specified that though the law does not provide for any relaxation in timeline for filing quarterly financial statements except for first quarterly financial statements, companies are advised to prioritize public safety, while ensuring corporate compliance, and the SECP shall give due consideration to all underlying circumstances while enforcing regulatory compliance.

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