FAQ 3 (Updated) [PAIB] – Economic activities of many entities are adversely affected by measures put in place to contain the COVID-19 virus. This has implications for entities preparing financial statements for financial reporting periods ending in Year 2020[1]. What are some potential areas of misstatements that an entity should be mindful of?

When preparing its financial statements, an entity should be mindful of the following potential areas of misstatements (note: this is not an exhaustive list):

- **Is the going concern assumption still appropriate when there has been a substantive change in the operational business model of the entity?**

  The going concern assumption underlies the preparation of financial statements and an entity is required to assess whether it will continue in operation for the foreseeable future.

  The pandemic and subsequent developments ~~such as measures taken by the government to control the virus~~ may have adversely affected the entity such that it resulted in the entity substantively changing its operational business model. When this happens, the entity needs to reassess whether the going concern assumption used in preparing its financial statements is still appropriate.

  For considerations when performing the going concern assessment, please refer to **FAQ 4 [Accounting] – For entities with a 31 December 2019 financial reporting date, in relation to the COVID-19 outbreak, how would they go about performing the going concern assessment?**

- **Are the fair values of the entity's investment properties overstated?**

  The current global economic crisis, projected negative global growth for 2020, technical recession in Singapore and the potentially "new normal" of remote working, among other factors, have created economic implications for the real estate industry and property markets.

  An entity whose investment property accounting policy is the fair value model under SFRS(I) 1-40 *Investment Property* should ensure that the fair value measurement of investment properties in the financial statements is appropriate, both for financial year end reporting and interim reporting.

  An entity needs to be aware that fair values of investment properties determined prior to the pandemic (e.g. as at 31 December 2019 or earlier) may no longer be appropriate for reporting during 2020. Accordingly, an entity needs to carefully assess the appropriateness of the fair values of investment properties to be reported in its balance sheet (and the corresponding change in fair values reported in profit or loss) as it issues financial reports during 2020. This may include assessing whether the inputs and assumptions used in its valuation techniques are still appropriate, whether they reflect current market conditions, and whether these need to be updated.

  An entity should consider whether expert advice is needed in the assessment, or if an updated valuation exercise is required to be performed.

[1] The guidance shared in this FAQ is also relevant for entities preparing financial statements for purposes of interim reporting in 2020

Paragraph 122 of SFRS(I) 1-1 *Presentation of Financial Statements* requires the disclosure of significant judgements that management has made in the process of applying the entity's accounting policies in the preparation of financial statements.

As significant judgement is likely to be required to be exercised in the assessment of the fair value of investment properties, an entity should ensure that appropriate disclosures of the judgements and assumptions are included in the financial statements. The disclosures should be entity-specific, clear and concise, without obscuring material information in unnecessary detail. This also applies to cases where an entity concludes that the fair value of its investment property has not changed significantly since the outbreak of COVID-19. In that case, if it is considered a significant judgement, the basis for that judgement should be clearly explained in the financial statements.

- **Have ~~Has~~ any of the entity's contracts become onerous?**

SFRS(I) 1-37 *Provisions, Contingent Liabilities and Contingent Assets* defines an onerous contract to be a contract in which the **unavoidable costs** of meeting the obligations under the contract exceed the economic benefits expected to be received under it. SFRS(I) 1-37 explains that the **unavoidable costs** ~~is~~are the lower of the cost of fulfilling the contract and any compensation or penalties arising from failure to fulfil it.

When a contract is assessed to be onerous, the entity is required by SFRS(I) 1-37 to recognise and measure the present obligation under the contract as a provision.

With disruptions to economic activities, the entity's contracts should be reviewed to determine if any contract has become onerous. For instance, the entity may be unable to fulfil a customer's order due to the shut-down of its manufacturing facilities. The entity should review the contractual terms and determine:

- whether the unavoidable costs of fulfilling the contract (lower of the cost of fulfilling the contract and any compensation arising from failure to fulfil the contract) has exceeded the consideration to be received.
- whether there are contractual terms which may relieve the entity of its obligations (for instance, force majeure clauses). If an entity can cancel a contract without any penalty or compensation made to the counter-party, the contract does not become onerous since there is no obligation.

- **Are the entity's non-financial assets (carried at cost) overstated and impairment losses required for the effects of the pandemic?**

~~The key principle under~~Under SFRS(I) 36 *Impairment of Assets* ~~is that~~, an asset must not be carried in an entity's financial statements at more than its recoverable amount (where recovery of the asset may be either by using it or selling it). The asset is impaired if its ~~carrying amount exceeds its~~ recoverable amount is below the carrying amount.

SFRS(I) 36 requires ~~impairment~~an entity to assess at the end of each reporting period whether there is any indication that an asset may be impaired. Impairment assessments to be performed on non-financial assets ~~at the end of each financial reporting period~~ as follows:

- ~~Intangible~~Goodwill and other intangible assets with indefinite useful lives~~ and goodwill~~ – to be tested for impairment at least annually or more frequently if impairment indicators exist
- Other assets (e.g. property, plant & equipment, investment properties carried at cost, investments in associates and joint ventures) – to be tested for impairment only when impairment indicators exist

With ~~the~~ recent developments~~ of the pandemic~~, there could be indicators ~~indicating~~ that assets may be impaired (e.g. shut-down of manufacturing facilities, falling demand and reduced selling prices of goods and services~~).~~) for both the financial year-end reporting and/or interim reporting.

The recoverable amount of an asset is the higher of its value in use and its fair value less costs of disposal.

When determining the recoverable amount, future cash flows are estimated based on management's best estimates of the economic conditions that will exist over the remaining useful life of the asset.

Although the above judgement can be difficult to make in light of the current uncertain situation, entities are reminded that the assumptions used should be reasonable and supportable and ~~which~~should reflect conditions existing at the financial reporting date. An entity should consider whether expert advice is needed in the assessment,

- **Are the entity's estimates of expected credit losses appropriate in light of the current uncertain situation?**

As highlighted in the IASB's publication titled "IFRS 9 and COVID-19 – Accounting for expected credit losses", IFRS 9 sets out the framework for determining the amount of expected credit losses (ECL) that should be recognised. It requires that lifetime ~~ECLs~~ECL be recognised when there is a significant increase in credit risk ~~(SICR)~~ on a financial instrument~~.~~ (and other items in scope of ECL requirements). However, IFRS 9 (and SFRS(I) 9) does not provide bright lines nor a mechanistic approach in accounting for ~~ECLs~~ECL. Accordingly, companies may need to adjust their approaches to ~~forecasting and~~ determining ~~when lifetime losses should be recognised to reflect~~ECL based on the best available information about past events, current ~~environment.~~conditions and forecast scenarios of future conditions (since the ECL model is forward-looking).

Estimating ECL can be difficult ~~to make~~ in light of the current ~~uncertain~~ situation~~, entities are reminded that the information used should be reasonable and supportable (historical, current and forward-looking to the extent possible) and which reflect conditions existing at the financial reporting date. With COVID-19, previous~~. Previous assumptions and ~~design~~designs of ~~respective~~ ECL models may ~~also~~ need to be ~~relooked at and~~revisited, reassessed, and ~~not just~~ updated.

Important note: Entities ~~are reminded to~~should take note of the following:

- Ensure appropriate and sufficient disclosures in the financial statements to enable users of the financial statements to understand the ~~impact~~material impacts of the pandemic and the various containment measures ~~imposed on~~that affected the entity.
- Be alert to 'unusual' changes to an entity's financial performance, and ensure that there are ~~valid~~appropriate explanations for such changes. ~~Do not without a reasonable basis~~

~~attribute~~Not all such changes may be validly attributed as being effects of the pandemic and/or the containment measures.

Entities may wish to note that ACRA has published **Financial Reporting Practice Guidance No. 1 of 2020** to help directors in their reviews of financial statements during the COVID-19 situation. It highlights warning signs of some possible non-compliance~~(s)~~ with accounting standards, and provides directors with questions to ask management and statutory auditors when assessing the impact from COVID-19 on the financial statements.