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COVID-19 | Are revenue-cycle assets recoverable?

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What's the issue?

The COVID-19 coronavirus outbreak has had adverse effects on many companies' operations and their revenue cycles. Demand from customers may be down and customers may struggle to pay amounts owed when they become due. Companies may also be experiencing challenges in delivering goods and services to customers – e.g. due to disruption in their supply chains or imposed restrictions.

Companies need to assess whether assets related to the revenue cycle are appropriately measured to reflect these factors at the reporting date. For example, companies may need to consider the following.

– Are receivables and contract assets impaired?

– Do inventories need to be written down to net realisable value?

– Are capitalised contract costs recoverable?

These estimates may require significant judgement given the unprecedented level of uncertainty.

Getting into more detail

As part of the revenue cycle, companies may recognise receivables, contract assets, inventories and capitalised contract costs. Under IFRS® Standards, different requirements apply to the subsequent measurement of these assets.

Receivables and contract assets

Customers may struggle to pay amounts due under revenue contracts. Companies need to assess both receivables and contract assets for **impairment** under IFRS 9 *Financial Instruments* – i.e. using an expected credit loss model. Companies present any impairment losses separately from revenue from contracts with customers, and disclose them separately from impairment losses from other contracts. *[IFRS 15.107–108, 113]*

Companies also need to consider carefully whether new and existing contracts meet the **existence criteria** in IFRS 15 *Revenue from Contracts with Customers*. This may impact their assessment of whether to recognise revenue and related receivables or contract assets.

Inventories

Inventories are measured at the lower of cost and net realisable value under IAS 2 *Inventories*. Net realisable value is the estimated selling price in the ordinary course of business less the estimated costs of completion and sale. *[IAS 2.6]*

Assets related to the revenue cycle – e.g. receivables, contract assets, inventories and capitalised contract costs – may need to be written down as a result of the COVID-19 outbreak.

The COVID-19 outbreak may affect the estimated net realisable value in several ways.

- Estimated selling prices may fluctuate due to changes in customer demand.
- Estimated costs to complete may change due to increases in the cost of materials or labour.

Companies need to estimate net realisable value based on the most reliable evidence at the time the estimate is made. Companies consider the effect of events occurring after the end of the reporting period to the extent that they confirm conditions existing at the reporting date. These estimates may require significant judgement, particularly when inventories will not be realised for a long period of time. *[IAS 2.30]*

Companies disclose the amount of any write-down of inventories recognised as an expense in the period. *[IAS 2.36]*

Capitalised contract costs

Costs to obtain and costs to fulfil a contract are capitalised under IFRS 15 only if they are expected to be recovered. Companies need to consider carefully whether new costs should be capitalised in the current environment and whether costs that have been capitalised are still recoverable. *[IFRS 15.91, 95]*

Amortisation period

A company amortises capitalised contract costs on a systematic basis consistent with the pattern of transfer of the good or service to which the asset relates. This includes goods and services under an existing contract as well as specific anticipated contracts – e.g. optional renewal periods. *[IFRS 15.99]*

Companies need to consider carefully whether the COVID-19 outbreak has affected the expected timing of transfer of the goods or services to the customer. For example, are there changes in expected customer renewals or the expected timing for completion of a long-term project? A company accounts for a change in the amortisation period as a change in accounting estimate under IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* – i.e. on a prospective basis. *[IFRS 15.100]*

Impairment

Companies assess capitalised contract costs under the specific impairment requirements of IFRS 15. An impairment loss is recognised to the extent that the carrying amount exceeds the recoverable amount, which is the:

- remaining expected amount of consideration to be received in exchange for the goods or services to which the asset relates; less
- costs that relate directly to providing those goods or services and that have not been recognised as expenses.

When assessing for impairment, the expected consideration includes 'unconstrained' estimates of variable consideration and the effects of the customer's credit risk. *[IFRS 15.101–102]*

The COVID-19 outbreak may impact the amount of consideration that a company expects to receive – e.g. because of changes in **estimates** of variable consideration, increases in customer credit risk or revised expectations about whether customers will renew contracts or purchase additional goods. Companies should also update their estimates of the expected costs to provide goods or services in the current environment.

Companies disclose the amount of amortisation and any impairment losses recognised in the reporting period. *[IFRS 15.128]*

Actions for management to take now

– Assess both contract assets and receivables for impairment under IFRS 9.
– Ensure that estimates of net realisable value for inventory reflect the latest expectations of selling prices and projected costs to complete.
– Consider whether the amortisation period for capitalised contract costs needs to be updated.
– Assess capitalised contract costs for impairment under the requirements in IFRS 15, considering changes in the expected amount of consideration and projected costs to provide goods or services.
– Provide clear and meaningful disclosures about judgements and estimates made in measuring revenue-related assets.

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