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Beyond the GAAP^{MAZARS'}

NEWSLETTER ON ACCOUNTING STANDARDS

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EDITORIAL

As the world faces an exceptionally severe crisis, Mazars' experts are busier than ever, ensuring that we are still here to help you with the range of accounting challenges thrown up by the COVID-19 outbreak.

Firstly, this supplement will keep you up-to-date with the position statements on the current crisis published by various market authorities and institutions, as Beyond the GAAP has always aimed to do. In this unprecedented situation, we are also introducing a new feature: the supplement will present Mazars' preliminary views on topics that are currently being discussed within the accounting profession, in conjunction with standard-setters, market regulators and corporate representatives, and that have not yet been the subject of any "official" publications.

This supplement is the first in what we hope will only be a short series. It will enable us to alert readers to new developments, even when a regular issue of Beyond the GAAP is not scheduled for publication.

We hope that, like Beyond the GAAP, it will meet your needs by providing clear, relevant and concise information.

Happy reading!

Themis Polizos, Partner

COVID-19: key institutional publications

To help you follow the accounting discussions relating to the COVID-19 outbreak, we have drawn up a list of the key European institutional publications on this topic. To date, our chronological list includes key publications from the following authorities and institutions:

- Accountancy Europe (ACE);
- the European Central Bank (ECB);
- the European Banking Authority (EBA);
- the European Financial Reporting Advisory Group (EFRAG);
- the European Securities and Markets Authority (ESMA);
- the European Banking Federation (EBF).

Finally, a link to the IASB's announcement dated 27 March (and discussed in this issue) is also included in the list of key publications.

For easy reference, publications that relate specifically to banks are marked in the table below with this symbol 

Date	Published by	Title of publication	Link
11 March	ESMA	ESMA recommends action by financial market participants for COVID-19 impact	https://www.esma.europa.eu/press-news/esma-news/esma-recommends-action-financial-market-participants-covid-19-impact
12 March	EBA 	EBA statement on actions to mitigate the impact of COVID-19 on the EU banking sector	https://eba.europa.eu/eba-statement-actions-mitigate-impact-covid-19-eu-banking-sector
12 March	ECB 	ECB announces measures to support bank liquidity conditions and money market activity	https://www.ecb.europa.eu/press/pr/date/2020/html/ecb.pr200312_2~06c32dabd1.en.html
12 March	ECB 	ECB Banking Supervision provides temporary capital and operational relief in reaction to coronavirus	https://www.ecb.europa.eu/press/pr/date/2020/html/ecb.pr200312~45417d8643.en.html
12 March	EBF 	EBF statement in response to ECB and EBA decisions	https://www.ebf.eu/ebf-media-centre/ebf-statement-in-response-to-ecb-and-eba-decisions/
20 March	ACE ¹	Coronavirus crisis: implications on reporting and auditing	https://www.accountancyeurope.eu/publications/coronavirus-crisis-implications-on-reporting-and-auditing/
20 March	ECB 	FAQs on ECB supervisory measures in reaction to the coronavirus	https://www.bankingsupervision.europa.eu/press/pr/date/2020/html/ssm.pr200320_FAQs~a4ac38e3ef.en.html
25 March	EBA 	Statement on the application of the prudential framework regarding Default, Forbearance and IFRS 9 in light of COVID-19 measures	https://eba.europa.eu/sites/default/documents/files/document_library/News%20and%20Press/Press%20Room/Press%20Releases/2020/EBA%20provides%20clarity%20to%20banks%20and%20consumers%20on%20the%20application%20of%20the%20prudential%20framework%20in%20light%20of%20COVID-19%20measures/Statement%20on%20the%20application%20of%20the%20prudential%20framework

¹ Accountancy Europe materials are not available by clicking on hyperlinks. Please copy/paste the address in your browser.



			rk%20regarding%20Default%2C%20Forbearance%20and%20IFRS9%20in%20light%20of%20COVID-19%20measures.pdf
Date	Published by	Title of publication	Link
25 March	ESMA	Accounting implications of the COVID-19 outbreak on the calculation of expected credit losses in accordance with IFRS 9 <i>(see our 'A Closer Look' features below)</i>	https://www.esma.europa.eu/sites/default/files/library/esma32-63-951_statement_on_ifrs_9_implications_of_covid-19_related_support_measures.pdf
26 March	EBF 	EBF letter to IASB on accounting implications of COVID-19	https://www.ebf.eu/wp-content/uploads/2020/03/EBF_040703-EBF-letter-to-IASB-re-Accounting-implications-of-COVID-19.pdf
27 March	ACE ²	COVID-19: 5 key steps for accountants to guide SMEs through the crisis	https://www.accountancyeurope.eu/publications/covid-19-5-key-steps-for-accountants-to-guide-smes-through-the-crisis/
27 March	ESMA	Actions to mitigate the impact of COVID-19 on the EU financial markets regarding publication deadlines under the Transparency Directive	https://www.esma.europa.eu/sites/default/files/library/esma31-67-742_public_statement_on_publication_deadlines_under_the_td.pdf
27 March	IASB	IFRS 9 and COVID-19 Accounting for expected credit losses applying IFRS 9 Financial Instruments in the light of current uncertainty resulting from the COVID-19 pandemic <i>(see our 'A Closer Look' features below)</i>	https://cdn.ifrs.org/-/media/feature/supporting-implementation/ifrs-9/ifrs-9-ecl-and-coronavirus.pdf?la=en

Finally, Accountancy Europe (ACE) has also gathered a list of publications issued by its member bodies and the public authorities in each European country, available here:

<https://www.accountancyeurope.eu/professional-matters/covid-19-resources-for-european-accountants/>

The publications dealing specifically with the banking sector are available here:

<https://www.accountancyeurope.eu/finance-investment/banks-corona-hub/>

² Accountancy Europe materials are not available by clicking on hyperlinks. Please copy/paste the address in your browser.



A Closer Look

Accounting implications of the COVID-19 outbreak on IFRS consolidated financial statements as at 31 December 2019

On 30 January 2020, the World Health Organization (WHO) declared a Public Health Emergency of International Concern over COVID-19 outbreak, which was then further qualified as pandemic on 11 March 2020. Containment decisions and announcements of governments' support to the economies were taken subsequently on different time scales around the world. In this context of major uncertainties, all European stakeholders involved in accounting standardisation³ have been mobilising to address concerns, both under IFRS and local GAAP, about the impacts of the crisis on financial statements as at 31 December 2019. This study sheds light on the key convergent positions issued for that purpose from an IFRS point of view.

1. The accounting qualification of the post balance sheet events:

- ♦ the post balance sheet events related to the COVID-19 outbreak have been unanimously qualified as **non-adjusting events** under IAS 10 at 2019 year-end, as the sudden spread of the infections and the WHO's global alert did not occur until January 2020;
- ♦ as a consequence, **IFRS preparers shall not adjust the amounts** recognised in the consolidated financial statements as at 31 December 2019, unless the entity's going concern assumption is seriously undermined (see further development below);
- ♦ the subsequent measurement of assets and liabilities shall therefore only reflect the conditions that prevailed at 31 December 2019 (i.e. irrespective of the effects of the crisis). Additional and tailored disclosures should be considered if management is already expecting that the current events will lead to material adjustments to the carrying amounts of assets and liabilities within the next financial year.

Examples of events occurring after the reporting period that do not give rise to adjustments of amounts recognised as at 31 December 2019: drop in the share price of financial assets measured at fair or actual value, banking covenants breakage, governments' actions in 2020 that could not have been anticipated at 2019 year-end...

Examples of implications of the outbreak that shall not be considered in the measurement of assets and liabilities as at 31 December 2019: impacts on inventories' net realisable value, impacts of the erosion in credit quality on loans and trade receivables, future operating losses, costs of measures of partial activity, decrease in fair value of assets, deterioration of budgets used to evaluate future cash flows for impairment tests...

2. The assessment of the going concern assumption:

- ♦ the entity should assess (i) whether there is any material uncertainty on its ability to continue as a going concern, that can result in additional disclosures (see below), or (ii) whether it is still appropriate to prepare its IFRS accounts on a going concern basis;
- ♦ thus, the going concern basis is still appropriate unless management determines after the reporting period either that it intends to liquidate the entity or to cease trading, or that it has no realistic alternative but to do so;
- ♦ the entity should consider **all available information about the future**. Regarding the timeframe, IAS 1.26 clearly states that the entity needs to consider **at least the first twelve months from the end of the reporting period**. As the going concern assessment shall be conducted **up till the date when the financial statements are authorised for issue** (to be compliant with the assessment of events after the reporting period under IAS 10), it can also be considered that the timeframe shall apply from that date. In any case, management needs to consider an appropriate timeframe that may be longer than the minimum period of twelve months while taking account of the facts and circumstances of each specific situation;
- ♦ in practice, it could be expected that the going concern basis will not be used only if COVID-19 forces a company out of business. If so, IFRS consolidated financial statements as at 31 December 2019 shall be prepared **from a business termination perspective** (e.g. on the basis of net asset values).

³ Such as CNCC & CSOEC (France), ICAEW (UK), IDW (Germany), etc.; see complete publications follow-up on [Accountancy Europe dedicated hub](#)

3. The impacts on disclosures within the notes to IFRS financial statements:

- ♦ under non-adjusting events requirements (IAS 10.21): entity-specific information shall be given on the **nature of any material non-adjusting event**, as well as an **estimate of its financial effect** (or a statement that such an estimate cannot be made);

Examples of consequences related to the COVID-19 outbreak that should be disclosed as non-adjusting events information: significant decrease in sales and operating cash flows, significant losses on contracts, trigger of application of specific material contractual clauses, banking covenants breakage, debt renegotiations, disruptions in production or supply chains, factory and/or shops closures, restructuring plans...

4. **Examples of impacts on the carrying amounts or classification of assets and liabilities in the balance sheet that should be disclosed in the notes where material:** impairment of tangible and intangible assets, impairment of trade receivables, contract assets and loans, measurement at fair value, end of hedging relationships, recoverability of deferred tax assets, reassessment of share-based payments, accounting of restructuring or onerous contracts provisions, redundancy plans, banking covenants breakage...

- ♦ under going concern requirements (IAS 1.25 & IAS 10.16):
 - if the entity does prepare its financial statements on a going concern basis, it shall disclose **any material uncertainty in connection with events or circumstances that could cast significant doubt on its ability to continue as a going concern**. The entity shall also describe the significant judgments exercised by management to conclude the going concern assumption is still appropriate despite the existing uncertainties;
 - if the entity does not prepare its financial statements on a going concern basis, **it shall disclose that fact**, together with the basis on which it prepared them (needing therefore to update its accounting policies) and **the reason why the entity is not regarded as a going concern**;
- ♦ under estimation uncertainty requirements (IAS 1.125 and following): the entity shall disclose information about the **assumptions it makes about the future**, and **other major sources of estimation uncertainty** at the end of the reporting period, that have a significant risk of resulting in a material adjustment to the carrying amounts of assets and liabilities within the next financial year.

Key points to remember

- The post balance sheet events that are caused by the COVID-19 outbreak:
 - **shall not give rise to adjustments** to the amounts recognised in IFRS consolidated financial statements as at 31 December 2019,
 - unless such events **seriously call into question the validity of the going concern assumption** for the entity (i.e. where an entity can no longer prepare its financial statements on a going concern basis).
- Consequently, the COVID-19 crisis impact on IFRS consolidated financial statements as at 31 December 2019 is limited to **disclosures only**. The information provided should enable users to assess the **major sources of estimation uncertainties** affecting the carrying amounts of assets and liabilities.



A Closer Look

IASB and ESMA provide guidance to companies on implementing the IFRS 9 impairment model in the context of the COVID-19 crisis

The COVID-19 crisis has already had a significant number of direct or indirect impacts on companies' economic environment, both through business closures to limit the spread of the virus and through government measures to support companies during the crisis.

In this context of high uncertainty and increasing short-term economic challenges for companies, questions arise as to how to implement the IFRS 9 expected credit losses impairment model. Market regulators, banking authorities and regulators, and accounting standard-setters have been working together to develop guidance to help companies implement IFRS 9 in this unprecedented situation.

In this study, we will focus primarily on recent publications from ESMA (document dated 25 March available to download [here](#)) and the IASB (document dated 27 March available to download [here](#)).

1. What are the potential IFRS 9 implementation challenges caused by the COVID-19 public health crisis?

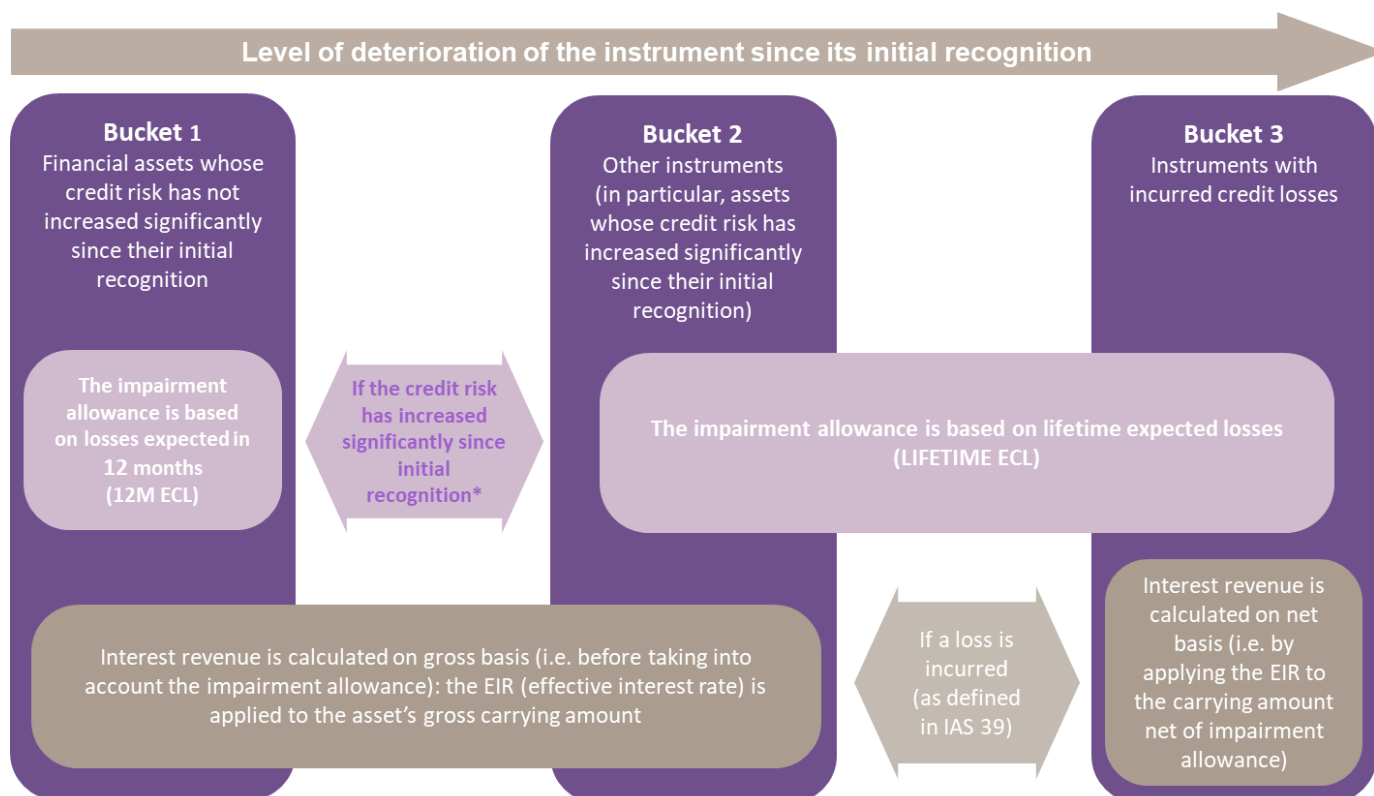
IFRS 9 is based on the principle that entities shall recognise impairment allowances for the expected credit losses on eligible financial assets (i.e. those measured at amortised cost or at fair value through other comprehensive income with recycling to P&L).

Expected credit losses are the difference between the cash flows due under the contractual terms of the financial instrument, and the cash flows that the entity actually expects to receive. To calculate ECLs, the entity must take account of all facts and circumstances, including cash flows that could arise from the realisation of collateral, as well as any available forward-looking information. In summary, expected credit losses are calculated as a probability-weighted average of the various possible scenarios which depend on company's expectations.

With a view to anticipating risks, the IFRS 9 model also involves a progressive increase in the impairment allowance to take account of changes in the credit risk of the financial instrument since initial recognition⁴.

This is achieved by means of an impairment model with three stages, or 'buckets', as shown in the diagram below:

⁴ Here we present the general model; however, readers will remember that a simplified approach is available for some short-term receivables, including trade receivables.



* - the standard contains a practical expedient for **assets having low credit risk** that may be maintained in Bucket 1 even following a significant increase in credit risk

With this in mind, the severity of the COVID-19 crisis raises a number of questions and challenges:

- what are the accounting impacts of debt moratoria?
- how should the 'significant increase in credit risk' criterion (i.e. a shift from Bucket 1 to Bucket 2) be applied in the context of liquidity stress and short-term uncertainties for a large number of companies?
- how do the public health crisis and the government measures to tackle it affect the measurement of expected credit losses?
- what financial disclosures should be presented in the notes on these topics?

2. What are the accounting impacts of debt moratoria?

Debt moratoria instigated by, or under pressure from, public authorities (the exact situation varies by country) require entities to assess whether these measures result in modification of the financial assets and, if so, whether the modification should lead to derecognition of the assets. Whether or not the asset is derecognised will depend on whether or not the modification is deemed to be substantial. If it is substantial, the asset shall be derecognised and replaced by a new financial asset. If not, the existing asset shall be retained in the balance sheet, and the modification of contractual terms may have an impact on profit or loss.

ESMA notes that the assessment of whether or not the modification is substantial should be based on both qualitative and quantitative criteria and may, in the current situation, require significant use of judgement. However, ESMA considers that if the support measures provide temporary relief to debtors affected by the outbreak and the net economic value of the loan is not significantly affected, the modification would unlikely be considered as substantial.

ESMA also emphasises the importance of presenting the following disclosures in the notes:

- the accounting policies used to determine whether a modification is substantial, if this is relevant to an understanding of the financial statements;
- the judgements made that have the most significant impact on the amounts recognised in the entity's financial statements.

3. Assessing whether there has been a significant increase in credit risk

Both the IASB and ESMA emphasise that IFRS 9 models should not be applied mechanistically when assessing whether there has been a significant increase in the credit risk of financial assets. Thus, support measures provided by governments



– such as moratoria permitting suspension or deferral of payments – should not automatically be deemed to reflect a significant increase in credit risk.

ESMA emphasises that governmental economic support programmes should be taken into account when assessing whether there has been a significant increase in the credit risk of a financial instrument, as such programmes reduce the risk of default over the lifetime of the financial instrument.

Thus, entities should carry out a case-by-case assessment, taking account of the conditions under which these measures have been implemented. Given the potential difficulties of carrying out such assessments, ESMA draws attention to various principles set out in IFRS 9 that should make it easier to assess financial instruments affected by the COVID-19 crisis:

- firstly, ESMA reminds issuers that they may use past due information if more forward-looking information is not available without undue cost or effort;
- relatedly, it also notes that it is possible to rebut the presumption that payment delays of more than 30 days automatically result in a move to Bucket 2;
- however, it also encourages issuers to carefully consider whether the specific circumstances relating to COVID-19 and the associated economic support measures constitute sufficient justification to rebut this presumption. ESMA also reminds issuers to disclose the judgement in this respect;
- assessments can be carried out on a collective basis if it is difficult to assess the impact of COVID-19 on individual financial instruments.

ESMA also adds that when forbearance measures are provided to borrowers, the facts and circumstances relating to these measures should be taken into account, in order to distinguish between:

- situations in which the credit risk of the financial instrument has increased significantly; and
- situations in which the issuer is simply facing a temporary liquidity constraint and there has been no significant increase in credit risk.

4. Impact of COVID-19 and government support measures on the measurement of expected credit losses

a) Taking account of forward-looking information in the context of COVID-19

The impairment allowances for expected credit losses shall be calculated by assessing and probability-weighting various possible scenarios, taking account of economic forecasts and forward-looking information.

With this in mind, ESMA and the IASB remind issuers that these assessments shall be carried out by taking account of the best available information about past events, current conditions and future economic forecasts, without incurring undue cost or effort.

ESMA states that issuers should assess the extent to which a high degree of uncertainty and sudden changes in the short-term economic outlook are likely to result in impacts over the entire expected lifetime of the financial instrument.

However, ESMA and the IASB acknowledge the potential challenges of actually putting this into practice and incorporating the specific effects of COVID-19 and the related government support measures in the amounts recognised for expected credit losses. Given the lack of reliable and available information in the current context, issuers are likely to have difficulty in producing robust short-term economic forecasts. To address this problem, issuers have the following options:

- the IASB states that if the effects of COVID-19 cannot be reflected directly in current models, post-model overlays or adjustments will need to be considered. It also emphasises the need for ongoing monitoring to ensure that any available new information is taken into account in this rapidly-changing environment;
- ESMA also draws attention to recent publications from the ECB (downloadable [here](#)), which recommend that, in the context of COVID-19-related uncertainty, issuers should give greater weight to a stable long-term outlook and should take account of the impact of support measures provided by public authorities (such as payment moratoria) on the credit risk of financial instruments over their whole lifetime.

b) Accounting for public guarantees on issuers' exposures

Some governments are considering providing public guarantees on issuers' exposures in order to ensure full or partial recovery of the amounts related to financial instruments affected by the crisis.

Issuers shall include cash flows relating to the realisation of collateral in the measurement of expected credit losses if the guarantees are an integral part of the contractual terms of the loan and are not recognised separately, in accordance with

the IFRS IC's decision in March 2019⁵. ESMA also reminds issuers of the observations made in December 2015 by the IASB's Transition Resource Group for Impairment of Financial Instruments⁶, namely that credit enhancements included in the measurement of expected credit losses should not be limited to those that are explicitly part of the contractual terms.

ESMA also states that the use of judgement may be required when assessing whether a public guarantee forms an integral part of the contractual terms of a financial instrument, and any such judgements should be clearly disclosed in the financial statements if they are deemed to be significant. Guarantee frameworks may, in practice, vary between countries.

5. Disclosures

ESMA and the IASB underline the need for transparency in issuers' financial reporting, particularly when greater use of judgement has been required than normal and IFRS 9 cannot simply be applied mechanistically.

In order to comply with IFRS 7, disclosures relating to the impacts of COVID-19 should allow users of financial statements to understand the assumptions and judgements used in measuring expected credit losses. In particular, disclosures should include:

- how these impacts have been incorporated into the assessment of whether a financial asset has been reclassified to Bucket 2, and into the estimate of expected credit losses;
- any forward-looking information used.

Issuers who publish interim financial statements (as defined in IAS 34) shall provide an update of the previous annual financial statements by disclosing sufficient information, given the amplitude of the recent economic changes, to allow issuers to understand the significant transactions and events that have occurred since the end of the reporting period.

Aside from financial instruments, issuers shall disclose any additional information that is necessary for users to understand the impacts of COVID-19 on the financial statements in general, in accordance with the requirements of IFRS 7 and IAS 1. This is particularly important in areas where judgement was used, which could include other parts of the financial statements in addition to financial instruments.

ESMA also emphasises that issuers are expected to disclose the risks and uncertainties they face as a result of COVID-19 in their management reports.

What about other regulators?

The publications from the IASB and ESMA refer to guidance issued by other regulators. The Committee of European Auditing Oversight Bodies (CEAOB) focused on important points relating to the audit of financial statements in the context of COVID-19 (document downloadable [here](#)).

Banking regulators have also issued statements on the impact of COVID-19 on various aspects specific to the banking sector:

- the European Banking Authority (EBA) has published a statement (document downloadable [here](#)) clarifying the impacts of COVID-19 on the prudential framework, with a particular focus on default and on forborne exposures;
- the ECB has also provided a list of FAQs on its website (available [here](#)) regarding various relief measures for issues specific to the banking industry (e.g. when a loan should be classified as non-performing, capital and liquidity requirements, etc.).

⁵ Cf. the March 2019 issue of Beyond the GAAP, IFRS highlights, "Taking account of credit enhancement in the measurement of expected credit losses", p.3

⁶ Agenda Paper 5 - Collateral and other credit enhancements and the measurement of expected credit losses



Key points to remember

- IFRS 9 is a principles-based standard that requires the use of judgement when measuring expected credit losses.
- Given the current COVID-19 outbreak and its economic impact on financial instruments, some practices and models that were developed in a very different context may no longer be useful. Companies must use their judgement to determine whether any adjustments to their methodology are required.
- In particular, issuers must ensure that the impairment policies used to take account of the impacts of the COVID-19 crisis (whether on an individual or a collective basis) do not result in financial assets being automatically transferred to Bucket 2 when there is no economic justification for this. These policies must also allow issuers to take account of the impacts of support measures implemented by public authorities.
- Public guarantees provided by governments may be incorporated into the calculation of expected credit losses if they form an integral part of the contractual terms of the loan.
- All issuers must aim for the maximum possible transparency when presenting the impacts of COVID-19 and the related economic support measures on expected credit losses and on the financial statements in general.
- Particular attention should be paid to disclosures required in the notes on the impacts of COVID-19 on the financial statements and any significant judgements made by the issuer when preparing its financial statements.



A Closer Look

What accounting impacts will the COVID-19 crisis have on 2020 financial statements of corporates?

We are not yet in a position to know or to measure all the consequences of the current public health crisis for businesses, whether they be economic, social, etc. However, some effects of the crisis are already making themselves felt on operations, as well as on companies' financial position and performance, and this has thrown up a number of accounting issues for companies issuing interim financial statements for 2020 or whose accounting period does not coincide with the calendar year.

In this uncertain and rapidly-changing environment, the information presented below represents Mazars' preliminary views. However, it should be noted that most of the topics addressed below are still under discussion within the accounting profession, in conjunction with standard-setters, market regulators and corporate representatives. In this supplementary series, the Beyond the GAAP team will keep you up-to-date with any changes relating to the various technical issues discussed below.

1. Events after the reporting period (IAS 10)

There is already a consensus that events and information which occur or are obtained after the reporting period, and which are directly linked to the COVID-19 outbreak:

- **are not adjusting events if the financial statements are established as at 31 December 2019** (i.e. the entity does not need to adjust the amounts recognised in the financial statements at 31 December 2019);
- **are adjusting events if the financial statements are established as at 31 March 2020 or any subsequent date** (i.e. the entity shall adjust the amounts recognised in its financial statements). By 31 March the extent of the crisis was known and the key economic support measures had been announced. The measurement of assets and liabilities as at 31 March 2020 (or any subsequent closing date) shall reflect the conditions existing at that date, but information received subsequently, or further details on support measures implemented by governments, may confirm or shed more light on the situation at the end of the reporting period.

For companies whose financial statements are established as at 31 January 2020 or 29 February 2020, discussions are ongoing regarding the potential need for adjustments to reflect events that took place following the WHO's declaration of a public health emergency on 30 January 2020.

Issuers should also remember that, when assessing the entity's ability to continue as a going concern, they should consider the period until the IFRS financial statements are authorised for issue. An entity may not prepare financial statements on a going concern basis if it becomes aware, between the end of the reporting period and the date when the financial statements are authorised for issue, that its ability to continue as a going concern is irredeemably compromised. If there are material uncertainties around the entity's ability to continue as a going concern, but this ability is not irredeemably compromised, the entity may still prepare financial statements on a going concern basis.

2. Impairment testing (IAS 36)

Impairment testing will inevitably be one of the major concerns for entities when closing the accounts for 2020. The COVID-19 outbreak has had a number of impacts that may constitute **indications that an asset may be impaired**, such as significant falls in demand or prices, closure of businesses, restructuring plans, supply chain disruptions and losses on significant contracts.

Companies will thus inevitably have to carry out impairment tests in accordance with IAS 36 **for the interim financial statements**, ahead of the mandatory annual tests for goodwill and indefinite life intangible assets. However, carrying out such testing could be fraught with challenges, given the difficulty of getting reliable and up-to-date budget forecasts. Thus, companies need to start thinking about the practicalities straight away. Issuers will need to consider how to assess and measure the impacts of the current upheaval on their long-term forecasts.

Discussions are ongoing between audit firms and with companies on the **procedures** to be used for impairment testing of goodwill for the interim financial statements. It would probably be difficult to carry out testing based on elaborate, multi-scenario forecasts at 30 June. Large-scale impairment testing of all an entity's activities would also be a challenge. Moreover, while short-term uncertainty is extremely high, long-term fundamentals will not necessarily be severely affected.

With this in mind, **explicit and relevant disclosures** should be presented in the notes regarding the key assumptions made by management, at both the actuarial level (parameters used to determine the discount rate for calculating future cash



flows) and the operational level (length of the crisis, rebound curve, impacts of governmental economic support measures, etc.).



3. Measurement of inventories (IAS 2)

There are a number of aspects to take into account when measuring the net realisable value of inventories in the context of the COVID-19 pandemic: whether they are perishable or seasonal, if they have become partially or wholly obsolete, a fall in turnover, a fall in commodities prices, or a substantial fall in the selling price of inventories. As inventories shall be measured at the lower of cost and net realisable value, the public health crisis could have an impact on **the measurement of inventories in the statement of financial position**.

Moreover, it is likely that the crisis will also have an impact on the allocation of general fixed costs – for example, the fact that the entity's workforce has to stay at home could mean that production levels are lower than normal capacity, resulting in fixed costs based on abnormal levels of production. These excess fixed costs **should not be included in the measurement of inventories**, but should instead be recognised as expenses in the period in which they are incurred.

Finally, vacant buildings and idle plant should continue to be depreciated, unless the assets have been permanently abandoned. "Useless" depreciation is not included in the measurement of inventories.

4. Depreciation and amortisation of assets (IAS 16, IAS 38)

Some people have suggested that depreciation and amortisation should be put on hold during the period of inactivity or shutdown.

However, it is important to remember that depreciation and amortisation reflect the loss of value of the asset in question, based on systematic allocation of the asset's cost. This leaves little room for manoeuvre, unless there are changes in the useful life or residual value of the asset.

In nearly all cases (i.e. all those in which assets are depreciated or amortised on a straight-line basis over time), it is **not possible to put depreciation or amortisation on hold** while the asset is idle. The entity may, however, be justified to extend the useful life of the asset (as it will wear out less quickly while it is idle) and may also need to review the recoverable amount of the asset. Thus, an entity must still recognise depreciation or amortisation even if the asset is not being used (unless the asset has been fully depreciated or its residual value is higher than its net carrying amount). In other words, depreciation and amortisation do not cease when an asset is not being used (IAS 16.55).

The only exception is when an entity uses the units of production method, in which case no depreciation or amortisation is recognised during the period of inactivity. However, a long period of inactivity may require the entity to carry out an impairment test.

5. Financial instruments (IFRS 9)

a) Measuring financial assets at fair value in accordance with IFRS 13

As long as markets are deemed to be active and transactions between market participants are deemed to be concluded under normal market conditions, assets at fair value (such as shares in non-consolidated listed companies) shall be measured using observable market prices (i.e. share prices) at the closing date, **despite the unusually high volatility**. A significant fall in the share price after the end of the reporting period may require a disclosure in the notes, but should not be taken into account when measuring assets in the statement of financial position.

A change in the level of the fair value hierarchy (i.e. a level 2 or 3 input instead of level 1) should only be made **if the valuation data are no longer deemed to be observable on an active market**. The entity should disclose in the notes why the change was made and what non-observable inputs were used to measure the fair value of the relevant assets.

b) Measurement of expected credit losses in accordance with IFRS 9

In the current context, past due payments may reflect a deterioration in customers' credit quality. Any such deterioration must be incorporated into the new IFRS 9 impairment model based on expected credit losses, by taking account of forward-looking information (including macroeconomic information). Thus, the entity must **closely monitor past due payments**, and should continue to do so in the future by regularly running and checking ageing analysis reports.

In practice, issuers must **consider whether they need to revise their provision matrix** (the simplified approach that is permitted by IFRS 9 and commonly used by corporates), taking account where necessary of the economic conditions in each sector. The expected positive impacts of the various economic support measures, particularly government guarantees on loans, should also be incorporated into the measurement of expected credit losses.

Relevant disclosures, including both qualitative and quantitative data, should be presented in the notes in accordance with IFRS 7 (cf. sub-section on disclosures below).



c) Impact of liquidity tensions

This unprecedented crisis is leading to a high level of uncertainty regarding entities' capacity to manage their liquidity and reduce the impact of the liquidity risk to which they are exposed. This is especially the case for companies that are heavily reliant on the short- and medium-term securities market for their financing.

The priority should be to **compile a list of available sources of funding** that the entity can draw on in order to meet significant upcoming payment deadlines. This list should include all the alternative solutions provided by governments (moratoria, guaranteed financing, etc.).

On the accounting front, particular attention should be paid to ensuring that **the criteria for classifying financial assets as cash equivalents continue to be met** (i.e. ensuring that they are readily convertible to cash and are subject to an insignificant risk of changes in value, in accordance with IAS 7). This could potentially have an impact on the calculation of net debt if assets are reclassified out of cash and cash equivalents in the statement of financial position.

d) Classification of financial debts in the statement of financial position

The following events, resulting from the current crisis, may affect the classification of financial debts in the statement of financial position:

- renegotiation of debts: any significant change in the terms of existing debts requires careful attention, and may result in a **modification or extinguishment** of the underlying financial instrument;
- breach of banking covenants: since this **may result in acceleration of the loan repayment**, the breach may affect the breakdown of financial debts between current (i.e. less than a year) and non-current, unless the entity has obtained a waiver from the bank **by the relevant closing date at the latest** or successfully renegotiated its covenants by this date. Obtaining a waiver after the closing date, but before the financial statements are authorised for issue, does not exempt the entity from reclassifying the debt in question as current debt. Whether or not the covenant is successfully renegotiated, a breach of covenant requires an **appropriate disclosure in the notes**.

e) Sustainability of arrangements for the sale of receivables resulting in derecognition (factoring & securitisation)

Entities must examine factoring-type arrangements to ensure their continued **validity and sustainability**, as these arrangements may include termination clauses in the event of exceptional circumstances.

During the COVID-19 outbreak, the following situations may result in such arrangements being modified or discontinued:

- a significant extension of payment deadlines;
- potential invalidation of credit insurance;
- changes to credit insurance ceilings (no impact on receivables that are already insured, but a potential impact on whether receivables can be insured in the future, and thus on the volume and scope of the programme going forward).

In the specific case of securitisation arrangements, liquidity tensions could affect **the conduit's ability to access refinancing via the markets** and thus to purchase the asset-backed securities issued by the entity.

In addition to the accounting issues, it is essential to assess the sustainability of these arrangements in order to determine whether the entity has viable long-term sources of financing.

f) Maintaining hedge accounting

Here, the potential impacts of the crisis are limited to assessing whether cash flow hedges continue to meet the criteria for hedge accounting. **The 'highly probable' criterion for cash flows may no longer be met** if there is a slowdown in activity, requiring a thorough review of budgets. As a reminder, if the hedged future transaction is no longer highly probable but is still expected, the hedging relationship must be discontinued prospectively (i.e. **the cumulative gains or losses on the derivative shall remain in "other comprehensive income" until the expected transaction is recognised in profit or loss**, at which point the amount is reclassified). Conversely, if the hedged transaction is no longer expected to occur, the hedging relationship is no longer relevant and the cumulative gains or losses on the derivative are **immediately** reclassified to profit or loss.

g) Disclosures required in the notes in accordance with IFRS 7

In a context of high market volatility, liquidity tension and short-term economic uncertainty, issuers must be **especially careful to provide all the necessary disclosures in the notes** regarding the nature and extent of financial risks to which they are exposed (liquidity risk, credit risk, currency or interest rate risk, market risk via commodity prices or share prices, etc.).

The key disclosures expected by users of financial statements are as follows:

- significant concentrations of credit risk, where the customer base disproportionately shares a particular characteristic;

- how the entity has incorporated forward-looking information into the measurement of expected credit losses;
- the impact of a liquidity shortage on the entity's ability to continuing operating, and conversely, the impact of a period of inactivity on liquidity;
- a description of the available sources of financing;
- an analysis of financial instruments' sensitivity to changes in exchange rates or interest rates.

6. Revenue recognition (IFRS 15)

a) Impact on identifying a contract with a customer (step 1 in the standard)

The current crisis is creating a number of risks related to revenue recognition, especially relating to customers' ability to meet their payment commitments. Thus, the first area for attention is identifying whether there is a contract as defined in IFRS 15, in particular, the criterion that involves taking account of the customer's credit risk. When determining the order book, an entity must assess whether it is probable that it will collect the consideration to which it is entitled. There is **no contract** for the purposes of IFRS 15 if the probability of collecting the consideration is **less than 50%**. If the criteria for identifying a contract are not met, the payments received from the customer can only be recognised as revenue in certain situations which are clearly defined in IFRS 15 (i.e. the entity has met all its obligations and the consideration received for that is non-refundable; or the contract has been terminated and the consideration received from the customer is non-refundable).

The current crisis may mean that suppliers and customers renegotiate contracts that have already been signed (e.g. to remove some goods or services that were originally promised in the contract). IFRS 15 specifies **different outcomes** depending on whether the remaining goods or services are distinct from those transferred on or before the date of the contract modification (the modification is accounted for retroactively if the remaining goods and services are not distinct).

b) Impact on determining the transaction price (step 3 in the standard)

The COVID-19 crisis may lead entities to re-estimate variable amounts that are implicitly or explicitly included in the contract (i.e. discounts, late penalties, returns expected from customers, etc.). An entity should only recognise revenue that it is **almost certain** to receive (i.e. it is highly probable that a significant reversal in the amount of revenue recognised will not occur in the future, once the uncertainty surrounding the transaction price is resolved). This may require significant use of judgement. Any adjustment made as a result of this re-estimate (most likely a reduction) must be recognised immediately in revenue (as a cumulative catch-up adjustment).

This point may be particularly relevant to sales with a right of return, for which the entity shall recognise revenue based on its estimate of the number of products that will actually be returned. In the current environment, historic rates of return will no longer be representative of returns expected in 2020 – especially if the right of return is unconditional and is valid for a long period. If there is significant uncertainty about future rates of return at the end of the reporting period, the amount of revenue recognised will be extremely limited in order to comply with the "highly probable" criterion, and revenue reversals may need to be recognised for sales accounted for in prior periods for which the right of return has not yet expired.

The crisis may also lead the supplier and the customer to re-negotiate the payment terms of the contract. The modified contract will require the entity to re-assess whether the contract contains a significant financing component.

c) Impact on revenue recognition (step 5 in the standard)

It should first be noted that if there has been a **significant** change in facts and circumstances it may be necessary to re-assess whether an ongoing contract still exists under IFRS 15 (e.g. if there has been a significant deterioration in a customer's credit risk). Thus, if it is no longer probable that the entity will collect substantially all of the consideration, there is **no longer a contract** for the purposes of IFRS 15. However, this is different from a situation in which an entity decides to give a customer a discount (cf. the issue around estimating variable consideration, discussed above). Thus, if the criteria for the existence of a contract with a customer are no longer met, any further consideration received from the customer may only be recognised as revenue in the strictly delimited situations described in point a) above. The remaining order book is also affected.

Moreover, cessation or disruption of production may generate **inefficiencies** that were not anticipated when determining the initial selling price in the contract with the customer. When an entity recognises revenue over time, measuring progress based on costs incurred to date as a proportion of estimated total costs, any significant inefficiencies resulting from COVID-19 should be excluded from both the numerator and the denominator.

These inefficiencies are thus **recognised immediately in profit or loss**, without giving rise to revenue recognition. Identifying significant inefficiencies requires significant use of judgement on the part of the management, and discussions are currently ongoing regarding appropriate ways of identifying such inefficiencies.



7. Provisions (IAS 37)

IAS 37 is clear that it is **not permitted** to recognise provisions for future operating losses or for costs that will need to be incurred in order to operate in the future. However, these losses may be an indication that some assets have become impaired (cf. section 2 above).

As regards slowdowns in activity, site closures and so on, **the crisis does not change the criteria for recognising a provision for restructuring costs**. Thus, a provision may only be recognised if an event has occurred that creates a present obligation for the entity to restructure (i.e. simply deciding to restructure does not create a present obligation) and if the amount of the obligation can be reliably estimated (i.e. a detailed formal plan must exist). Conversely, entities are not permitted to recognise provisions for costs relating to ongoing activities (e.g. relocation costs). These costs shall be recognised in profit or loss when they are incurred. The accounting treatment of severance pay can be complex (IAS 19 also needs to be consulted) and should take account of the facts and circumstances of each specific situation.

Losses at completion shall be accounted for in accordance with the provisions of IAS 37 on onerous contracts. Readers will remember that a provision is recognised (after recognition of any impairment loss for assets dedicated to the contract) if the unavoidable costs (i.e. **the lower** of the cost of fulfilling the contract or any compensation or penalty arising from failure to fulfil it) exceed the economic benefits expected to be received under it. In the current context, identifying onerous contracts may require an entity to assess the legal consequences of any force majeure clauses on **the rights and obligations of the parties to the contract**. The economic impact of early termination clauses should also be taken into account when determining the amount of any loss at completion.

In the specific case of contracts with customers, if an entity re-estimates the revenue yet to be recognised (late penalties, variable consideration, etc.) and the costs yet to be incurred to fulfil the contract (increased sourcing costs, additional costs of the available workforce, etc.), **this may have an impact on the identification of onerous contracts and on the amount of the provision to be recognised for losses at completion**. Significant inefficiencies identified over the period do not impact the amount of the provision for losses at completion (they are recognised immediately as expenses when they occur). Moreover, **entities are not permitted to recognise a provision** for significant inefficiencies that are expected to occur over the remainder of the contract.

8. Remuneration (IAS 19 and IFRS 2)

a) Cost of measures to reduce activity

Generally, entities will **not be permitted to recognise a provision** for the impact of a slowdown in activity as a result of measures taken in response to COVID-19 (such as self-isolation, sick leave or part-time working), since IAS 19.13 only permits an entity to recognise provisions for the rights accumulated by employees, which the employees will subsequently use. This impact relates primarily to the salaries of employees who have to stay at home and cannot work remotely, the employer's contribution to short-time working agreements, and the employer's contribution to sick pay.

b) Measurement of pension liabilities

The assumptions used to measure pension liabilities are usually reviewed once a year. If the impact on the condensed interim financial statements is significant, it may be necessary to **revise some of the actuarial assumptions** such as the discount rate, the probability that employees will use rights they have already accumulated and the date at which they will do so, etc. Companies should also consider the impact of any provisions for restructuring, which could reduce the number of employees covered by a pension plan.

c) Share-based payments

It may be necessary to revise **estimates related to vesting conditions** and hence to adjust the number of instruments that are expected to be issued. These revisions may be related to the entity's assessment of whether the performance conditions are met, and whether the service condition will be met if the entity is planning staff reductions.

If the company wishes to **modify the terms and conditions of a plan**, to lower the requirements for the performance condition or make the vesting conditions more favourable (thus ensuring that plans set up in the past continue to provide a benefit to employees), this modification shall be taken into account if it is beneficial to employees. For accounting purposes, such modifications are treated as a new grant, which requires the entity to re-estimate the fair value of the plan. The increase from the original fair value to the new fair value is recognised over the period remaining until the vesting date and does not affect the expense previously recognised.

If a company decides to **close** a plan before it vests because it is no longer beneficial to employees, it should be noted that IFRS 2 contains an "anti-abuse" provision that requires the entity to immediately recognise in profit or loss the amounts that would otherwise have been recognised over the remainder of the vesting period.



9. Income taxes (IAS 12)

a) Assessing the recoverability of deferred tax assets

The negative impacts on the economy caused by the public health crisis and the isolation measures taken in many countries (companies forced to close temporarily, risk of recession, slump in the financial markets, etc.) raise the question of the recoverability of assets, particularly deferred tax assets.

Readers will remember that deferred tax assets are only recognised to the extent that they are deemed to be recoverable, based on three potential sources of future taxable profit:

- i. the existence of taxable temporary differences at the end of the reporting period, against which the deductible temporary differences may be utilised. To identify these taxable temporary differences, an entity must consider the effect of any new tax laws that have been enacted or substantively enacted at the end of the reporting period;
- ii. an assessment of the probability that future taxable profit will be available⁷:
 - IAS 12 contains very little guidance on how to carry out this assessment. ESMA's Public Statement on deferred tax assets resulting from carry-forward of tax losses, published in July 2019⁸, may be useful on questions relating to measurement of deferred tax assets, and the disclosures required in the notes;
 - the assessment of whether future taxable profit will be available is usually carried out over a relatively short time period. The earnings outlook for 2020, and the high levels of uncertainty affecting forecasts for subsequent years, could therefore result in a significant decrease in the amount of deferred tax assets recognised in the statement of financial position.
- iii. tax planning opportunities:
 - the current economic environment may lead entities to review their tax strategies, in the light of ongoing or anticipated changes;
 - new tax laws may provide new opportunities.

b) Taking account, as required, of new tax laws enacted after the end of the reporting period

The legal and regulatory framework is constantly changing in response to the pandemic. It is therefore likely that many companies will close their accounts as the various countries in which they operate are in the process of enacting new tax laws.

Readers will remember that under IAS 12, income taxes (whether current or deferred) are measured using the tax laws that are enacted or substantively enacted at the end of the reporting period. The assessment of what is meant by "substantively enacted" must be carried out on a case-by-case basis for each jurisdiction, as it requires consideration of each country's legislative procedures and practices.

For laws enacted after the end of the reporting period (but before the date when the financial statements are authorised for issue), entities must distinguish between:

- those which, based on the legislative procedures and practices of that jurisdiction, were "substantively enacted" at the closing date: these must be taken into account when measuring income taxes;
- those which, based on the legislative procedures and practices of the jurisdiction, cannot be deemed to have been "substantively enacted" at the closing date: their enactment is a non-adjusting post-closing event (i.e. the entity does not need to adjust the amounts recognised, but should include a disclosure in the notes if the information is felt to be material to users of financial statements).

c) Calculating the income tax expense using the average annual effective income tax rate in the condensed interim financial statements (IAS 34)

For the annual financial statements, and for interim financial statements presented as a complete set (as defined in IAS 1 – Presentation of financial statements), the provisions of IAS 12 apply in full.

However, for condensed interim financial statements, the income tax expense is not measured in accordance with IAS 12, but using the "average annual effective income tax rate" method. This method, which is only used for condensed interim

⁷ If there are not sufficient taxable temporary differences at the end of the reporting period to justify recognising deferred tax assets for all deductible temporary differences.

⁸ See Beyond the GAAP no. 135, July-August 2019

financial statements, involves estimating the annual accounting tax expense and earnings, using these figures to calculate the estimated annual effective interest tax rate, and applying this to the pre-tax accounting result for the interim period.

Although it may seem simple, this method may require significant use of judgement when determining whether certain tax benefits count as a “one-off” event for a given interim period and should therefore be recognised in full in this interim period (rather than incorporated into the calculation of the average annual effective income tax rate and spread over the whole year).

10. Presentation of the income statement (IAS 1)

Some industrial and services companies that are facing the effects of the COVID-19 crisis have expressed a wish to reflect these effects in the financial statements by presenting certain costs and inefficiencies/under-production under a separate heading of the income statement (e.g. “unusual” or “non-recurring” items). This seems, in theory, to be permissible. The use of such headings is already widespread in a few countries including France.

Discussions are currently ongoing regarding the conditions that would need to be met in order to classify COVID-19 impacts outside “recurring operating profit”. In particular, questions have been raised as to whether such a classification would be appropriate given that it would only partially reflect the impacts of COVID-19 and would not enable entities to present “recurring operating profit” that is an accurate reflection of their normal business. Actually, for many companies, the main consequence of COVID-19 is a significant downturn in activity and revenue, which cannot be reflected in a “non-recurring” sub-total.

While awaiting further discussions on the topic, we believe that if a specific heading for the effects of the COVID-19 is used, classification as “non-recurring” should be limited to the following items:

- incremental costs that are directly related to protective measures implemented (cleaning of sites, protective equipment for employees, etc.);
- costs linked to under-production, **provided that** it is possible to reliably separate out the portion of general fixed costs not allocated to the cost of inventory production that is directly related to the public health crisis (e.g. costs of production facilities that are temporarily closed as a consequence of the outbreak);
- costs linked to short-time working measures due to shutdown of production sites or similar (to the extent of the net cost borne by the entity, i.e. after government subsidies have been taken into account).

In all cases, entities should be **prudent** when electing whether to present impacts of the current public health crisis outside the “recurring operating profit” and should **only do this for items that would otherwise prevent from understanding the entity’s recurring operating performance**.

11. Insurance recoveries (IAS 37)

It should first be noted that insurance recoveries are **contingent assets (not recognised)** unless it is **virtually certain** that the reimbursement will be received. Thus, for an insurance claim to be recognised as an asset, the probability of the compensation must be close to 100%. There may thus be a time delay between the recognition of the damage (as a loss or a provision) and the recognition of the insurance income. The entity has a claim to compensation (although cannot necessarily recognise it) from the point when it recognises the damage: thus, it is not possible for an asset or even a contingent asset to exist before this point. The entity shall disclose contingent assets in the notes once it is probable (but not virtually certain) that the claim will be paid out.

In practice, entities should carefully study the relevant insurance policy to determine a) **whether the damage is covered** and b) the **maximum loss insured**. Particular attention should be paid to any exclusions and any contractual conditions relating to reporting the damage, in order to provide sufficient evidence that the compensation is virtually certain. Confirmation from the insurer that the damage falls within the scope of the insurance policy is useful proof that the compensation is virtually certain.

If a reimbursement is virtually certain to be received, the entity can recognise the claim even if there are **uncertainties about the amount**; however, these uncertainties will affect the measurement of the asset recorded in the statement of financial position. A prudent approach should be used here, taking account of the entity’s ability to provide supporting evidence for its claim for compensation. Any judgements or uncertainties relating to such estimates should be disclosed in the notes.

12. Temporary reduction in lease payments (IFRS 16)

The closure of shops due to isolation measures is likely to result in some lessees requesting a reduction in lease payments from their lessors.



Generally speaking, such reductions in lease payments as a result of negotiation between the parties should be accounted for as lease modifications. In practice, this would involve an adjustment to the lease liability, taking account of the revised lease payments discounted at the appropriate rate (usually the lessee's incremental borrowing rate) at the contract revision date, and a corresponding adjustment to the right-of-use asset. Thus, the **impact** of the benefit received from the lessor will be spread over the **remainder** of the lease term.

The adjustment happens in the same way for payment deferrals; the deferred cash flows automatically impact the amount of the discounted lease liability.



However, it should be noted that the above reflects a strict application of IFRS 16 that involves spreading the positive impact of the temporary reduction in lease payments (by means of a reduction in the amortisation of the right-of-use asset), even though it is intended to compensate an immediate loss of business. **There will inevitably be a lot of debate as to whether this reading of the standard is appropriate in the circumstances, and solutions will be sought that will allow the reduction in lease payments to be recognised in profit or loss for the periods to which it relates.**

Moreover, some governments may offer lessees a discount on lease payments, by requiring lessors to offer this reduction. Under such an arrangement, the lessor would be treated as an agent of the State (i.e. the lessor is considered to be granting the discount to the lessee in accordance with instructions received). In practice, in accordance with the principle set out in IAS 20 that income from government grants should be recognised consistently with the related expenses, the impact on profit or loss may be immediate (if the expenses have already been incurred).

13.Capitalisation of borrowing costs (IAS 23)

The general principle set out in IAS 23 is that borrowing costs are capitalised as part of the cost of a qualifying asset if it is probable that they will result in future economic benefits to the entity and the costs can be measured reliably.

However, capitalisation of borrowing costs as part of the cost of an asset must be suspended if the entity suspends production or construction of the asset.

In practice, for projects that are on hold due to the coronavirus, it is likely that isolation measures and the partial shutdown of economic activity will result in suspension of capitalisation of borrowing costs.

14.Grants (IAS 20)

The first challenge here is to determine which IFRS applies. Thus, if a "grant" is conditional on a certain level of taxable profit (i.e. the benefit is purely theoretical if the entity is not generating taxable profits), it falls within the scope of IAS 12 rather than IAS 20.

The next thing to remember is that a grant is recognised when the entity has a reasonable assurance that it will comply with any conditions attached and that the grant will be received.

It should also be noted that a grant shall be recognised in profit or loss on a systematic basis over the periods in which the entity recognises as expenses the costs for which the grant is intended to compensate.

Finally, in the case of grants "related to income", i.e. grants that are not conditional on the entity's acquisition (in the broad sense) of assets, it should be noted that the entity has a choice of presentation methods and may elect to present the grant income either as "Other income" or as a deduction from the related expense.