COVID-19: ACCOUNTING IMPLICATIONS IN BOTH 2019 & 2020 FINANCIAL STATEMENTS

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MAZARS

COVID-19: ACCOUNTING IMPLICATIONS AS AT 31 DECEMBER 2019 FOR CORPORATES

COVID-19: HOW TO QUALIFY THE OUTBREAK EVENTS FROM AN ACCOUNTING PERSPECTIVE

Consensus between audit firms & stock exchange regulators!

An entity <u>shall not adjust</u> the amounts recognised in its financial statements as at 31 December 2019 to reflect the events occurring after the reporting period that are caused by the COVID-19 outbreak…

IAS 10.10:
« non-adjusting events »

… unless such events **call seriously into question the validity of the going concern assumption**
(see a little further in the presentation for assessment guidance)

IAS 10.14-16

Consequently, the COVID-19 outbreak impact on financial statements at <u>31 December 2019</u> is limited to **disclosures only**
(see dedicated slide hereafter)

COVID-19: KEY QUESTIONS

Will the business plans used for impairment tests at 2019 year-end be reviewed?

No, insofar as (i) these business plans shall be based on the existing situation as at 31 December 2019 and because (ii) at that date, there were no observable indications that the assets' value had declined due to events related to COVID-19 → **the cash flows forecasts shall therefore not take into account the effects of the outbreak**

Will the fair value (level 3) of unlisted securities that are non-consolidated be discounted?

No, insofar as (i) the assessment of fair value is conducted at a determined date and because (ii) from a market participant perspective, the information related to COVID-19 were not available at 2019 year-end closing
→ **the fair value (level 3) of unlisted securities shall therefore not be reassessed because of the outbreak**

What are the impacts on the provisioning of expected credit losses?

The erosion in credit quality of customers due to the COVID-19 outbreak is caused by events that occurred in 2020
→ **as a consequence, the impairment of trade receivables as at 31 December 2019 shall not integrate the effects of the outbreak**

COVID-19: HOW TO ASSESS THE GOING CONCERN ASSUMPTION (1/2)

1 **How to assess in practice whether the going concern assumption is still appropriate?**

EVENTS

- Consider events both before and after the reporting date, **up till the date of authorisation for the issue of the financial statements**
- Do not consider the **accounting qualification of events** (i.e. irrespective of whether those events are adjusting or non-adjusting events according to IAS 10)

FACTORS

Consider all the **existing and anticipated impacts** of the COVID-19 outbreak on the economic conditions of the entity, in view notably of the following factors:

- Significant decline in revenue
- Significant erosion of profits due to higher costs or incurrence of unforeseen expenses
- Breach of debt covenants
- Cash flow issues
- Expected impacts of announcements of governments' support to the economy

COVID-19: HOW TO ASSESS THE GOING CONCERN ASSUMPTION (2/2)

❷ **What are the accounting implications if the assessment brings to conclude that the validity of the going concern assumption is seriously undermined?**

Under IFRS

An entity shall not prepare its financial statements on a going concern basis if 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 financial statements as at 31 December 2019 shall therefore be prepared from a business termination perspective**

⇨ **IFRS do not provide guidance on how to measure assets and liabilities when the going concern assumption is not applied any more**

- **The going concern assumption shall be abandoned if the reporting entity (i.e. the mother company of the group) has no realistic alternative but to liquidate or cease trading**
- **If a subsidiary is about to be liquidated but the mother company is still able to continue as a going concern, the consolidated financial statements of all group entities shall be prepared under the going concern assumption. IFRS 5 may apply to the subsidiary that will be liquidated**

COVID-19: DISCLOSURES IN THE NOTES OF THE FINANCIAL STATEMENTS

Key principle: ensure the adequacy and the relevance of the information disclosed to assess the major sources of estimation uncertainty at the end of the reporting period

Objective: measure the risk of material adjustment to the carrying amounts of assets and liabilities within the next financial year

Under IFRS (non-exhaustive list)

- Information about **non-adjusting events** after the reporting period (IAS 10.21):
  - Nature of the event
  - Estimate of its financial effect (or a statement that such an estimate cannot be made)
- Information about the **assumptions** made for the future, and other **major sources of estimation uncertainty** at the end of the reporting period (see IAS 1.125 and following)
- Information about **going concern** (IAS 10.16):
  - ✓ The fact that the financial statements are not prepared on a going concern basis, or
  - ✓ The material uncertainties that may cast significant doubt upon the entity's ability to continue as a going concern (but without questioning the relevance of the going concern assumption)

ESMA expects issuers to provide both qualitative and quantitative information on the actual and potential impacts of the outbreak

COVID-19: ACCOUNTING IMPLICATIONS ON (ANNUAL OR INTERIM) 2020 CLOSINGS

COVID-19: ACCOUNTING IMPLICATIONS EXPECTED FOR 2020

1. EVENTS THAT OCCURRED AFTER THE REPORTING PERIOD AND GOING CONCERN
2. MEASUREMENT OF NON-FINANCIAL ASSETS
   - Impairment tests
   - Measurement of inventories
   - Depreciation of assets
3. FINANCIAL INSTRUMENTS
   - Fair value measurement
   - Estimation of expected credit losses
   - Cash and cash equivalents
   - Financial liabilities
   - Cash management & liquidity risk
   - Factoring & securitisation (off balance-sheet programs)
   - Hedge accounting
   - Disclosures on financial instruments (IFRS 7)
4. REVENUE RECOGNITION
5. PROVISIONS
   - Applying IAS 37
   - Employee benefits and measures to reduce activity
6. INCOME TAX
7. PROFIT OR LOSS PRESENTATION
8. OTHER IMPLICATIONS
   - Insurance recoveries
   - Temporary decrease in lease payments
   - Capitalisation of borrowing costs
   - Government grants

INFO

#COVID19

THE INFORMATION PRESENTED IN THIS SECTION REPRESENTS MAZARS' PRELIMINARY VIEWS. MOST SUBJECTS ARE STILL UNDER DISCUSSION WITHIN THE ACCOUNTING PROFESSION, WITH THE FRENCH NATIONAL-STANDARD SETTER, THE FRENCH REGULATOR AND REPRESENTATIVES OF COMPANIES.
WE WILL KEEP YOU INFORMED ABOUT DEVELOPMENTS IN THESE DISCUSSIONS AND THE CONSEQUENCES ON THE CORRESPONDING TECHNICAL ANALYSES.

COVID-19: ACCOUNTING IMPLICATIONS EXPECTED FOR 2020 – *EVENTS THAT OCCURRED AFTER THE REPORTING PERIOD AND GOING CONCERN*

Reminders of key dates

- **Public emergency health announced by the World Health Organisation on 30 January 2020**
- **Outbreak qualified as pandemic on 11 March 2020**
- Containment decisions taken at different times around the world
- Announcements of governments following the crisis, namely in view of the support to the economy, at different times, and measures have been specified progressively

Consequences

- Financial statements as at **31 December 2019**: **non-adjusting event**
- Financial statements as at **31 March 2020 and after**: **adjusting event**
  - Information about the crisis' magnitude are known
  - Main principles of measures of support to the economy are announced
  - ⇒ Take into account the effects of the outbreak, including those arising after the reporting date but before the financial statements are authorized for issue, to the extent they could reasonably be expected at reporting date, in the measurement of assets and liabilities
- Financial statements as at **31 January** or **29 February 2020**: **judgement call**
  - In particular for the 31January financial statements: what information were known at that time? Could one expect the international spreading of the containment and lock down measures?
  - Need to assess the particular situation of each entity, in which countries it operates, whether it suffers from supply chain disruptions…

Going concern

- The assessment of the validity of the going concern assumption shall be done **up till the date of authorisation for the issue of the IFRS financial statements**
- Assumption shall be changed only if the going concern is **definetely compromised**

COVID-19: ACCOUNTING IMPLICATIONS EXPECTED FOR 2020 – *IMPAIRMENT TESTS (IAS 36)* – 1/2

COVID-19 impacts on the existence of impairment indicators

For most entities, the COVID-19 outbreak generates situations that are indicators that the assets of the entity might be impaired.

Impairment testing is mandatory at the end of the (interim) reporting period under review when there is any indication that an asset may be impaired (do not wait until the annual testing for intangible assets with an indefinite useful life!)

- Scope of assets: goodwill, tangible & intangible assets, equity-accounted investments
- Examples of indicators to consider: fall of shares market price (below the carrying amount of securities, or below the total net assets of the entity), significant reduction in demand or prices for goods and/or services sold, factory and/or shops closures, supply chain disruptions, significant contract losses, important time lags of expansion projects…

How to estimate future cash flows?

- **Judgement call** to determine which of the post balance sheet events have to be taken into account in the expected cash flows
  - Government assistance
  - Changes in contracts / financial situation of customers
- Cash flows: shall be based on the best estimate of the economic conditions that will exist during the useful life of the assets
  - Need to update pre-COVID budgets and business plans, at least for 2020 and 2021
  - Short term previsions shall be consistent with the cash flow forecasts prepared for the liquidity risk management
- New **key assumptions** relating to COVID-19:
  - Duration of the crisis
  - Recovery curve
  - Date of normative performance again, and whether some impacts will last longer

COVID-19: ACCOUNTING IMPLICATIONS EXPECTED FOR 2020 – *IMPAIRMENT TESTS (IAS 36)* – 2/2

How to deal with uncertainties

Difficulties in making reliable forecasts does not allow not to carry out an impairment test in the event of an indicator of impairment

- Cash flows: consider the implementation of an **approach based on multiple weighted-probability scenarios**
  - Several scenarios for each key assumption
  - Worst case scenario need for sensitivity disclosures
- If it is not possible to set up several sets of assumptions, need for an adjustment of the **discount rate**
  - No decrease in the discount rate expected compared to the pre-COVID period
  - The magnitude of increase of the discount rate will depend on the forecasting method used for the cash flows, and on the market-based parameters. Need to reassess the different components (risk free rate, **risk premium** related to the asset and/or the country)
  - Do not underestimate the spot effects on the discount rate: high volatility of risk premiums

Impacts on disclosures

- New Nouvelles **key assumptions**
- Sensitivity analysis:
  - Change in the range of reasonably possible changes of key assumptions
  - Disclose the value of these key assumptions that would make the value in use of the CGU equal the book value (if the value of the key assumption is within the range of reasonably possible changes)
- Disclose the main changes in assumptions since the last reporting period

COVID-19: ACCOUNTING IMPLICATIONS EXPECTED FOR 2020 – *MEASUREMENT OF INVENTORIES (IAS 2)*

Write-down of inventories

- Indicators to be considered: perishable or seasonal nature of inventories, partial or total obsolescence, decrease in stock turnover, decrease in commodity prices, severe decrease in selling price of inventories, etc.
  - ⇨ Inventories must be written-down **at the lower** of cost and **net realizable value**

Impact on fixed overhead allocations

- Overhead resulting from « abnormal » production level: an entity may suffer production levels below the range of normal capacity due to the entity's workforce having to stay at home
  - ⇨ Excess overhead resulting from "abnormal" production levels should not be allocated to inventory
  - ⇨ **Recognition of excess overhead as period costs in the income statement**
  - ⇨ Facilities temporary vacant or idle **should continue to be depreciated** unless the facility is permanently abandoned. The "useless" depreciation is not included in stock value

COVID-19: ACCOUNTING IMPLICATIONS EXPECTED FOR 2020 – *DEPRECIATION OF ASSETS (IAS 16)*

In general

- **Depreciation based** upon an estimate of the **useful life**
- It is not possible to cease depreciating the asset when the asset is idle or retired from active use (IAS 16.55)
- May lead to increase the useful life (due to the « saving » of the asset). The impact should be insignificant but any change would be dealt with prospectively

Particular case

- **Depreciation based** upon **effective usage** of the asset (RARE)
- When the asset is not used, no depreciation expense is recognized (IAS 16.55)

Other consequences

- If the asset is not used during an extended period, the entity may have to question its recoverable amount (IAS 36.12f)
- In other words, an impairment test would be required in this case (which may not necessarily lead to an actual impairment)

COVID-19 : ACCOUNTING IMPLICATIONS EXPECTED FOR 2020 – *FINANCIAL INSTRUMENTS*

Financial assets measured at fair value under IFRS 13

Price volatility and market activity:

- ⇨ As long as a market is considered to be active, and the transactions are "non distress", observable market prices (stock market prices) must be retained despite the unusual volatility (e.g. stock market)
- ⇨ When a valuation input is no longer considered observable in an active market, a **change in the level of fair value** may need to be made and **additional information in the notes to the financial statements** may need to be disclosed (key assumptions, sensitivity analysis, major sources of uncertainty relating to the estimates used (IFRS 13.93 & IAS 1.125 et s.)).

Expected credit losses (ECL) under IFRS 9

Decrease in credit quality of debtors: the expected credit losses model requires to take into account forward-looking information (including macro-economic information).

- ⇨ **Careful monitoring of late payments,** aged trial balance review
- ⇨ **Analysis of the need to update the provision matrix** used in determining the expected credit losses in order to consider the consequences of the Covid-19 crisis. Analysis to be carried out by sector if applicable
- ⇨ Provide **qualitative** and **quantitative disclosures** in the notes to the financial statements (IFRS 7)

  For example: impact of the crisis and measures taken by public authorities on the impairment of trade receivables, how the forward-looking information relating to Covid-19 has been incorporated in the determination of expected credit losses ...

COVID-19 : ACCOUNTING IMPLICATIONS EXPECTED FOR 2020 – *FINANCIAL INSTRUMENTS*

Cash and cash equivalents

- In a context of high volatility and liquidity tension, particular attention must be paid on whether a financial asset recognized in Cash and Cash equivalent still qualifies to the conditions (i) of subject to an <u>insignificant risk of change in value</u>, and (ii) of <u>highly liquid</u> (IAS 7)
  - ⇨ If a financial asset no longer meets the definition of Cash and cash equivalents, **accounting reclassification is required and <u>may impact net debt ratios</u>**

Financial liabilities

- **Debt renegotiation:** assess <u>any significant changes in the conditions of existing debt</u> to determine whether it results in a **modification** or **extinguishment** of the financial instrument

- Monitor the validation of **debt covenants**, whether waivers have been granted or not, or whether renegotiations of covenants are needed
  - ⇨ The <u>breach of covenants</u> may have an impact on the <u>classification</u> of debts between current and non-current (unless a waiver has been obtained before the closing date) and entails a risk on liquidity
  - ⇨ Information in the notes to the financial statements must be provided in case of breach of covenant / waiver obtained

COVID-19 : ACCOUNTING IMPLICATIONS EXPECTED FOR 2020 – *FINANCIAL INSTRUMENTS*

Cash management & liquidity risk

- Pay special attention to the liquidity risk
  - ⇨ **Identify the sources of funding available** in order to secure significant future payment deadlines
  - ⇨ Specific point of attention for companies with significant use of funding by the market
  - ⇨ Take into account of moratorium granted by banks and funding guaranteed by public authorities

Factoring & Securitisation

(off balance sheet programs)

- Importance to check whether the program still meets the derecognition requirements of the transferred trade receivables, and the sustainability of the program is still valid
  - ⇨ *Examples of indicators to consider*: increase in late payment by debtors may lead to the early termination of the program, validity of credit insurance in this context of crisis, change in the credit insurance limits?
- For securitisations, check that the program has the capacity to refinance itself on the market in such context of liquidity tension

Hedge accounting

Cash Flow Hedge:

- Need to determine whether the hedged cash flows are still highly probable given the slowdown in activity
  - ⇨ If the hedged forecasted transaction ceases to be highly probable, the hedging relationship must be stopped prospectively
  - ⇨ Accounting treatment of hedging derivative gains or losses accumulated in the Cash Flow Hedge reserve (OCI) before the end of the hedging relationship:
    - If the hedged forecasted transaction is still expected to occur: that amount is **maintained into OCI until the hedged transaction impacts profit or loss**
    - If the hedged forecasted transaction is no more expected to occur : that amount is **immediately reclassified from OCI to profit or loss**

COVID-19 : ACCOUNTING IMPLICATIONS EXPECTED FOR 2020 – *FINANCIAL INSTRUMENTS*

Disclosures on financial instruments under IFRS 7

- In this context of high market volatility, liquidity tension, and short-term economic uncertainty, special attention must be paid to the disclosure to be provided in the notes to the financial statements as regards exposure to financial risks and the impact that they may have on the financial situation of the company

.

- These include liquidity risk, credit risk, foreign exchange risk, interest rate risk, market price risk, etc.

<u>Examples of information to consider in this context :</u> additional information on significant concentration of credit risk, cases where a lack of liquidity can have a significant impact on the going concern of an entity's activities, impact of a business interruption on liquidity, description of the range of available funding, sensitivity to changes in exchange rates, sensitivity to changes in interest rates, etc.

COVID-19: ACCOUNTING IMPLICATIONS EXPECTED FOR 2020 – *REVENUE (IFRS 15)* – 1/2

Existence of a contract with a customer

- There is **no contract** with customer according to IFRS 15 **if it is not probable** (i.e. < 50%) **that the entity will collect the consideration** to which it is entitled (i.e. taking account of the customer's credit risk)

⇨ Impact on backlog measurement

⇨ Need to review existing contracts in the event of significant deterioration in credit risk. If the criteria for the existence of a contract are no longer met:

  - No impact on previously recognized revenue
  - Possible impacts on the residual amount in backlog and on the **timing of revenue recognition for unrecognized revenue**

    ⇨ Revenue to be recognised for the consideration received from the customer **only in specific situations as listed by IFRS 15**

Contract modifications / Contract terminations

- Contract modifications: **different consequences** according to whether the remaining goods or services to be provided are **distinct** from those transferred on or before the date of the contract modification
- Renegotiation of payment terms: contract modification that should lead to reassess the existence of a significant financing component (if relevant)
- Need to analyze whether the **contractual clauses for early termination** in case of **force majeure** apply

COVID-19: ACCOUNTING IMPLICATIONS EXPECTED FOR 2020 – *REVENUE (IFRS 15)* – 2/2

Measurement of revenue / variable consideration

- Revenue to be recognized only if it is **virtually certain** (possibly significant judgment)

⇨ Immediate adjustment to revenue (on a cumulative catch-up basis), if variable consideration are reassessed

- Take into account the **penalties** (e.g. for late completion) in the measurement of revenue: need to review the contracts to determine whether the **force majeure clauses** apply (and whether the penalties are due)
- Year-end rebates: the **applicable rate of rebates** shall be reassessed
- Sales with a **right of return**:
  - the more extensive the right is (length of the return period, specific conditions for returns), the more difficult the estimate is => a higher degree of caution is needed when measuring the revenue that is virtually certain
  - Post-balance sheet information might be adjusting or non-adjusting and would need a complex analysis

Revenue recognition over time

- Need to assess **which expenses contribute to progress** towards completion and **which are significant inefficiencies** or costs that do not transfer anything to the customer
- An approach based on budget would not be acceptable => **inefficiencies shall be documented**
  - Staff currently not working / production facilities closed => OK
  - Under utilisation of production facilities => OK if documented
  - Staff currently working but the number of productive hours is reduced => OK on the basis of time sheets
  - Work that takes more time / that is more costly than in a normative situation => NO
  - Extension of the expected duration of a contract until completion => NO
- Costs that are not part of the performance obligation (i.e. costs that do not transfer value to the customer):
  - Extensive review of the contractual provisions by lawyers
  - Selection and qualification of new suppliers, in case of supply chain disruptions

COVID-19: ACCOUNTING IMPLICATIONS EXPECTED FOR 2020 – *PROVISIONS (IAS 37)*

Future operating losses

- Provisions shall **not be recognised** for future operating losses or for costs to be incurred to restart activities
- **Indication** that certain assets of the operation may be impaired (see IAS 36 impairment tests)

Restructuring (reduction of activities, sites closures...)

- <u>Recognition criteria for provisions for restructuring costs</u>: only if a past event has given rise to a **present obligation for the entity to restructure** (i.e. the mere decision to restructure does not create a present obligation) and if a **reliable estimate** can be made of the amount of the obligation (i.e. a detailed formal plan shall be available)
- <u>Several costs are to be excluded from the provision for restructuring costs (such as relocation costs)</u>: to be recognized in P&L when **actually incurred**
- <u>Redundancy payments</u>: accounting treatment possibly **complex** (see IAS 19) and shall be based on all relevant facts and circumstances

Onerous contracts (accounting for losses at completion)

- <u>Recognition criteria for provisions for onerous contracts (after taking account of impairment of contract-related assets, if relevant)</u> : if the **unavoidable costs** (i.e. **the lower** of the cost of fulfilling the contract and any compensation or penalties arising from failure to fulfil it) exceed the economic benefits expected to be received under the contract
  - ⇨ Assess the economic implications of **early termination clauses**
  - ⇨ If relevant, assess the legal implications of “force majeure” contractual clauses over **the rights and the obligations of the parties under the contract**
- <u>Contracts with customers</u>: take account of impacts related to re-estimates of revenue yet to be recognised (late penalties, etc.) and re-estimates of costs yet to be incurred (increase in sourcing costs, extra cost of available workforce, etc.)
  - ⇨ No impact (on the provision for onerous contracts) of significant inefficiencies already recorded

COVID-19: ACCOUNTING IMPLICATIONS EXPECTED FOR 2020 – *EMPLOYEE BENEFITS (IAS 19 AND IFRS 2)*

Costs of measures to reduce activity

- The consequences of the various measures aiming at reducing activity (containment, sick leave, reduced activity) **cannot lead to the recognition of a liability** (IAS19.13). It includes namely:
  - The wages of workers forced to stay at home who cannot work from home
  - The remaining charge for the entity related to the measures of partial activity
  - The remaining expense on sick leaves

Share-based payments

- Reassessment of **estimations linked to vesting conditions,** and adjustment of the number of instruments the entity now expects to grant:
  - Achievement of performance conditions
  - Fulfilment of presence condition if the entity considers staffing reductions
- **Change in the plan provisions**: to be taken into account if they are benefitting the employee

Measurement of pension liabilities

- If the impact is significant on interim accounts, review certain actuarial assumptions such as:
  - Discount rate,
  - Probability and settlement date by the employees of certain acquired rights
  - Link with provision for restructuring costs

COVID-19: ACCOUNTING IMPLICATIONS EXPECTED FOR 2020 – *INCOME TAX (IAS 12)*

Assessing the recoverability of Deferred Tax Assets (DTA)

- **Availability of taxable temporary differences at the end of the reporting period** (against which temporary deductible differences could be utilised): consider the **effect of new tax laws** (if they have been enacted or substantively enacted by the end of the reporting period)
- **Assessment of future taxable profits:**
  - Very little guidance in IAS 12 (but ESMA's July 2019 Public Statement on DTA from unused tax losses may be helpful for measurement and disclosure issues)
  - In projecting future taxable income, use caution as the economic environment is highly uncertain
- **Tax planning opportunities:**
  - The current economic environment may cause entities to revise their tax strategies
  - New tax laws may create additional opportunities

High risk of derecognition of deferred tax assets for companies that have previously recognised DTAs on Net Operating Losses carried forward, on the basis of expected taxable profit over the few coming years

COVID-19: ACCOUNTING IMPLICATIONS EXPECTED FOR 2020 – *ALTERNATIVE PERFORMANCE MEASURES*

European Securities and Markets Authority

ESMA has updated its Q&A on its *Guidelines on Alternative Performance Measures*

→ **Added Question 18: *Application of the APM Guidelines in the context of COVID-19***
"How should an issuer present the impact of COVID-19 for the purpose of the APM Guidelines?"

Principaux messages de l'ESMA :

→ ***APM Guidelines* require that the definition and calculation of an APM should be consistent over time:**

- Use caution when making adjustments to APMs used and/or when including new APMs solely with the objective of depicting the impacts that COVID-19 may have on their performance and cash-flows
- Need to make sure that these adjustments to APMs or new APMs provide transparent and useful information and and do not provide an incorrect depiction of the performance of the issuer which would give a misleading signal to the market

→ **According to ESMA, adjusting or introducing COVID-19 APM may not be appropriate**

- COVID-19 impacts have a pervasive effect on the overall financial performance, position and/or cash flows
- A new or adjusted COVID-19 APM may not provide reliable and more useful information to the market and may mislead users' understanding of the true and fair view of issuer's assets, liabilities, financial position and profit or loss of the issuer

→ **Improve disclosure rather than adjusing APMs / Subtotals on the face of the P&L statement**

- Narrative information in order to explain how COVID-19 impacted and/or is expected to impact their operations and performance, the level of uncertainty and the measures adopted or expected to be adopted to address the COVID-19 outbreak
- Details on how the specific circumstances related to COVID-19 affected the assumptions and estimates used in the determination of inputs to APMs, for example impairment losses, expected lease payment reductions or grants received.

COVID-19: ACCOUNTING IMPLICATIONS EXPECTED FOR 2020 – *PROFIT OR LOSS PRESENTATION (IAS 1)*

Mazars' position

- **Agree with ESMA** in its additional Q&A on APMs: all **COVID-19 impacts should not be presented** on the face of the P&L **as non-recurring** items:
  - Would not allow to present a "Recurring operating profit" comparable to that of a "normal" financial year
  - Leads to classify as non-recurring some expenses that are recurring by nature: staff costs, amortisation expenses
- Impossible to introduce some "proforma" elements to hide the COVID-19 impacts
- No disaggregation on the face of the P&L of usual line items for the purpose of extracting COVID-19 effects
- Presentation of restructuring costs and impairment losses as non-recurring if the reporting entity used to do so
- Government grants / other assistance to be presented as recurring if the expenses the grants are intended to compensate are classified as recurring as well

Discussions may take place on a local basis between preparers, auditors and regulators. We invite you to follow carefully those discussions in order to adapt your positions to the local consensus

COVID-19: ACCOUNTING IMPLICATIONS EXPECTED FOR 2020 – *INSURANCE RECOVERIES (IAS 37)*

General principle

- An insurance recovery is a **contingent asset (i.e. not recognised)** as long as it is not **virtually certain** that the damage will be covered by the insurance
  - Assuming a probability close to 100%
  - Could generate a timing difference between the accounting for the damage (through a loss or a provision) and the accounting for the insurance recovery
- The triggering event of the right to be compensated is the accounting for the damage
  => Neither asset nor contingent asset before this date
- **Disclosures in the notes** relating to contingent assets when it is **probable** that the damage will be compensated but not virtually certain

Approach

- Analysis of the insurance policy to **determine the eligibility of the damage** and the scope of the compensated losses
  - Exclusion clauses
  - Damage documentation conditions

  ⇒ Necessary for the documentation of the virtually certain criterion of the compensation

  ⇒ A **confirmation of the insurer** that the damage is in the scope of the insurance policy is a useful proof
- **Uncertainties linked to the amount** of the indemnification
  - Do not challenge recognition, but influences measurement
  - Take a prudent approach, based on the capacity to document the claim for compensation
  - If relevant, add disclosures in the notes on significant judgments and major sources of estimation uncertainties

COVID-19: ACCOUNTING IMPLICATIONS EXPECTED FOR 2020 – *RENT CONCESSIONS (IFRS 16)*

Various natures of rent concessions obtained by lessees

- **Forgiveness (or partial forgiveness) of lease payments** during a specified period
- Deferred lease payments (rentals not paid will be added to future lease payments
- X months lease payments holiday together with a corresponding increase of the lease term by X months (i.e. rent free additional period)
- The concession might be imposed by Government to lessors. In some instances, lessor acts as a government agent to award a **government grant** to the lessee

IASB Educational material
10 April 2020

- Assess whether the rent concession is a **contract modification** or **results from the existing contract**
- Contract modification: remeasurement of the lease liability, using an updated discount rate, and **adjustment of the ROU asset** accordingly
  => positive (or negative) impact spread over the residual lease term (through the ROU amortisation expense)
- Existing contract: consider **negative variable lease payments**, with immediate P&L effect

Draft amendment to IFRS 16
Board decision 17 April 2020

- Exposure draft issued on 24 April 2020 – comments to be received by 8 May 2020
- Option **for lessees** not to assess whether the rent concession is a contract modification, and to **account for all lease concessions as if they were not contract modifications**
  - Only for COVID-19 related rent concessions for rentals initially payable in 2020
  - Relief does not apply to lessors

- **IFRS 16 provisions (as described in the educational material) would probably lead to spreading over the lease term the impact of that rent concession, although it aims at compensating an immediate operating loss**
- **The Board's proposal to amend IFRS 16 would provide a significant relief in IFRS 16 implementation together with providing a better depiction of the economic effects of the transaction**

COVID-19: ACCOUNTING IMPLICATIONS EXPECTED FOR 2020 – *BORROWING COSTS (IAS 23)*

General principle	Borrowing costs are capitalised when (a) it is probable that they will generate future economic advantages and (b) costs can be measured reliably
Suspension of capitalisation of borrowing costs	Capitalisation of borrowing costs is **suspended** when active development of a qualifying asset is suspended for an extended period (IAS 23.20)

COVID-19: ACCOUNTING IMPLICATIONS EXPECTED FOR 2020 – *GOVERNMENT GRANTS (IAS 20)*

Reminder

- In general, subsidies are granted subject to the entity complying to certain conditions
- A grant may not be subject to any particular conditions (in which case grants would generally only benefit certain economic sectors)
- Scope – If a grant is subject to the level of taxable profit, then it is excluded from the scope of IAS 20 (and would normally be in the scope of IAS 12)

General principles

- **When is the grant accounted for?** – A grant is recognised when the entity has a reasonable assurance that (a) the entity will comply with conditions attached AND (b) the grant will be received
- **P&L Impact** – The grant is recognised in P&L on a systematic basis over the periods in which the entity recognises the « subsidized » expenses (i.e. matching principle)

Presentation

- If the grant is related to assets, there is an accounting choice (deducting the grant from the cost vs. deferred income). In both instances, the depreciation expense is reduced
- If the grant is related to income, there is also an accounting choice (accounted for in « other income » or deducted from the related expense)