

SOME PRACTICAL FINANCIAL REPORTING (IFRS) ASSESSMENT ASPECTS OF THE COVID-19 IMPACT ON BUSINESS

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ABSTRACT

Generally, the covid-19 pandemic has a great impact on all big, small and medium-sized business all over the world. There are analyzed International Financial Reporting Standards (IFRS) practical issues that should be considered and addressed by the top management. These financial key issues include discussing the following: IFRS 9-Financial Instruments, IAS 36 Impairment of Assets, IAS 1, IAS 2, ISA 570 (revised) -Going Concern¹. The Impairment Review of Inventory, Fixed Assets, financial instruments, also the Going Concern at the entity level must be assessed in detail in the pandemic and other difficult circumstances;

Key Words: IFRS , Covid-19 Impact, Impairment, Expected Credit Loss (ECL), NRV, ISA, Going Concern.

MAIN TEXT

IMPAIRMENT INDICATORS

Generally, the company must review for impairment at every reporting year end, but during the covid-19 pandemic the top management must pay a special attention immediately and not just waiting

1 ACCA SBR exam revising materials

to the year end, if the credit risk increased significantly due to some indicators. These **impairment indicators** can be:

- Significant changes in Loan payers' behavior;
- For Debt Provider the expected or factual decrease/deterioration of Internal Credit Rating of the Company (loan payer);
- Changes in Financial and economic activities, such as increase f. ex. in Interest Rates, Unemployment Rates;
- Changes in Operational Management of Loan Payer, such as f. ex : Decreased Income, margins, mark-ups, Working Capital deficit, liquidity, Debt/Equity ratio;
- Negative changes in the regulation framework, economic or technology field, that deteriorates the company ability to set it liabilities timely;
- Other significant changes, such as f. ex. : decrease in financial support from the parent company etc.

Expected Credit Loss (ECL) Allowance Creation

For Impairment review of Financial Instruments, **IFRS 9** requires to create the expected credit losses- called the ECL Model, ¹ including 3 stages.

This ECL can be created for²:

- ❖ Financial Assets accounted at amortized cost (when the business model is just collecting cash flows, the principal and accrued interest amounts);
- ❖ Financial Assets accounted at fair value through Other comprehensive income (OCI), (when the business model is collecting cash flows, the principal, accrued interest amounts and then sale of the asset);
- ❖ Leasing accounts receivable
- ❖ Contract Asset (IFRS 15)
- ❖ Loan payables
- ❖ Financial Guarantee Contracts

The Expected Credit loss is assessed by considering the cash

1 Accaglobal.com, IFRS 9, Financial Instruments

2 FGPA continued Education Program 2018, PwC materials;

flows, probability % of default rate.

From the ECL model, Stage 1 and 2 deals with those financial instruments that have not had a significant increase in credit risk after first recognition or that have low credit risk at financial reporting year end. At the 3d level, financial assets are already significantly credit-impaired. The events have a ***great bad influence on future cash inflows*** that is why ***Lifetime expected credit loss*** is immediately recognized and the interest revenue is calculated on the carrying amount less the ECL allowance. The details are discussed in the below model:

Table 1. ECL Model¹

	Stage 1	Stage 2	Stage 3
Impairment recognition	12-months Expected Credit Loss	Lifetime Expected Credit Loss	Lifetime Expected Credit Loss
Interest Income	On Gross CA of Asset by effective rate (without deduction expected credit loss)	On Gross CA of Asset by effective rate (without deduction expected credit loss)	On Amortized cost by the effective Interest rate (by deducting expected credit loss)
When and How	From Occurrence /purchase of Financial Instruments. 12-months Expected Credit Loss is recognized in P/L and Impairment loss allowance is created.	If the Credit Risk is increasing significantly and the changed credit quality is not regarded as low credit risk, lifetime credit loss is recognized.	If financial asset credit risk is increasing so significantly, that asset is credit impaired.

ANALYSIS

BAD DEBT REVISION¹

Moreover, when the credit risk is low, the trade receivables, contract assets and lease-accounts receivables must be accounted over its total lifetime period by deducting expected credit loss. For practical discussion, we have searched the **Pearson Company** preliminary, unaudited Financial Statements, the Condensed Consolidated Financial Statements for the year ended 31/12/2020. As it is mentioned in the Basis of Preparation “No *material* accounting impacts relating to the areas assessed were recognized in the year. The Group will continue to monitor these areas of increased judgement, estimation and risk for material changes”². However, *if we assume*, that some significant changes may take place in future, we can use its ageing information and build as an example of our probable bad debt provision.

Table 2³ Pearson- Condensed Consolidated Financial Statements for 31/12/20, Note N12

The ageing of the Group's trade receivables is as follows:

<i>all figures in £ millions</i>	2020	2019
Within due date	668	654
Up to three months past due date	70	155
Three to six months past due date	11	35
Six to nine months past due date	23	9
Nine to 12 months past due date	7	14
More than 12 months past due date	24	51
Trade receivables	803	918

The year on year reduction in trade and other receivables is primarily driven by reduced sales, a proportionate increase in provisions for bad debts, the receipt of deferred proceeds in relation to the US K12 disposal and the disposal of a lease held as an investment in finance lease receivable. This is partially offset by an increase in prepayments due to timing differences on certain significant payments.

1 Microsoft Word - Pearson 2020 Prelims Press Release - 7 March AB SJ

2 Microsoft Word - Pearson 2020 Prelims Press Release - 7 March AB SJ

3 Results, reports, webcasts & presentations | Pearson

the balance sheet after deducting total expected credit loss allowance.

GOING CONCERN

Under IAS 1, ISA 570 the company's key management is required to make an assessment of an entity's ability to continue as a going concern. If management has significant concerns about the entity's ability to continue as a going concern, the uncertainties must be disclosed. If management concludes that the entity is not a going concern, the financial statements should not be prepared on a going concern basis, in which case IAS 1 requires a series of disclosures¹. to assess if the entity can continue functioning without any doubt.

For Going Concern analysis the company must analyze the expected/*forecasted cash inflows* and outflows for the *following 12 months from the Financial reporting year end*, to assess what expenses can be avoided during the pandemic in the foreseeable future and what expenses are *unavoidable*, is there any dependence on one supplier or etc. In order to analyze and assess more in detail, much attention should be paid also to the following ratios: Working Capital, Debt/Equity Ratio, Loan Payable, and Liquidity –to understand if the company is able to set its liabilities timely.

As it seems, the Working Capital Ratio: Inventories +Trade receivables-Trade Liabilities: $35-1-26=8$ mln pounds in 2020, while in 2019 it was: $-20+59-157=-118$ mln pounds. So this ratio is quite improved next year.

Moreover, according to the *Pearson Table N 5*, the Current Liquidity ratio will be: current assets/current liabilities: in 2020- $3,267 / 1,571$ mln pounds= $2.08 > 1$; In 2019- $2,776 / 1,492$ mln pounds=1.86. So, In 2020 in comparison with 2019, the liquidity has improved; Regarding analyzing the Loan. As it seems, long-term borrowings have decreased in 2020 by 175 K pounds (1,572 K pounds-1, 397 K pounds) that is good however if we look at the current borrowings, it means that they were increased by 162 K

1 IAS 1 — Presentation of Financial Statements (iasplus.com)

Table 5¹.

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
for the year ended 31 December 2020

17. Cash flows

<i>all figures in £ millions</i>	2020	2019
Reconciliation of profit for the year to net cash generated from operations		
Profit for the year	310	266
Income tax	44	(34)
Depreciation, amortisation and impairment charges	317	389
Net profit on disposal of businesses	(184)	(16)
Other net gains and losses	6	-
Net loss on disposal of fixed assets	2	7
Net profit on disposal of right of use assets including transfers to investment in finance lease receivable	(6)	(4)
Net finance costs	57	43
Share of results of joint ventures and associates	(5)	(54)
Net foreign exchange adjustment	(34)	(21)
Investment income	-	(2)
Share-based payment costs	29	25
Pre-publication	(56)	(55)
Inventories	35	(20)
Trade and other receivables	(1)	59
Trade and other liabilities	(26)	(157)
Retirement benefit obligations	(1)	5
Provisions for other liabilities and charges	(37)	49
Net cash generated from operations	450	480

pounds (254-92) in comparison with 2019. So maybe from the long-term 175 k pounds difference, mostly 162 k pounds were reclassified as the short-term loans. This can be caused due to some maturity dates approaching or breaching loan covenants, not getting timely the disclaimer for loan repayment and etc. If we continue analyzing, there should be mentioned that there is no cash shortage in cash and cash equivalents as at 31/12/20 because the cash balance was increased in 2020 by 660 k pounds (1,097- 437) rather than in 2019. The company had enough cash to repay all borrowings, the current liquidity ratio is also above 1. So, we can conclude that this was due maybe to the loan maturity date approaching.

1 Pearson 2020 Prelims Press Release - 7 March AB

Table 6¹

CONDENSED CONSOLIDATED BALANCE SHEET
as at 31 December 2020

all figures in £ millions	note	2020	2019
Property, plant and equipment		515	518
Intangible assets	11	2,742	2,900
Investments in joint ventures and associates		6	7
Deferred income tax assets		32	59
Financial assets – derivative financial instruments		45	29
Retirement benefit assets		410	429
Other financial assets		138	122
Trade and other receivables	12	223	313
Non-current assets		4,111	4,477
Intangible assets – pre-publication		905	870
Inventories	14	129	169
Trade and other receivables	12	1,118	1,275
Financial assets – derivative financial instruments		18	25
Cash and cash equivalents (excluding overdrafts)		1,097	437
Current assets		3,267	2,776
Assets classified as held for sale	10	73	397
Total assets		7,451	7,650
Financial liabilities – borrowings		(1,397)	(1,572)
Financial liabilities – derivative financial instruments		(40)	(24)
Deferred income tax liabilities		(62)	(48)
Retirement benefit obligations		(85)	(92)
Provisions for other liabilities and charges		(8)	(13)
Other liabilities	13	(80)	(86)
Non-current liabilities		(1,672)	(1,835)
Trade and other liabilities	13	(1,196)	(1,278)
Financial liabilities – borrowings		(254)	(92)
Financial liabilities – derivative financial instruments		(12)	(15)
Current income tax liabilities		(84)	(55)
Provisions for other liabilities and charges		(25)	(52)
Current liabilities		(1,571)	(1,492)
Liabilities classified as held for sale	10	(74)	-
Total liabilities		(3,317)	(3,327)
Net assets		4,134	4,323
Share capital		188	195
Share premium		2,620	2,614
Treasury shares		(7)	(24)
Reserves		1,324	1,528
Total equity attributable to equity holders of the company		4,125	4,313
Non-controlling interest		9	10
Total equity		4,134	4,323

The condensed consolidated financial statements were approved by the Board on 7 March 2021.

Moreover, to assess going concern issues, especially during the covid-19 pandemic, the company must assess financial and other indicators (ISA 570), such as:

- Fixed- term and short-term Borrowings, their restructuring;
- Negative operating Cash flows;
- Radical Increase in Bad debts, provision;
- Greater restriction to access to necessary capital,
- Loss of key Management;
- Loss of Market share, principal clients, suppliers;

➤ Liquidity and other ratios and etc;

IMPAIRMENT OF INVENTORY

Under IAS 2 the inventory must be accounted at Financial reporting Year end at the lower of –Cost and Net Realizable Value (NRV) . NRV means sales prices less all costs associated with its selling; Especially, in the vocid-19, when the complete lockdowns was announced, sales prices were decreased due to customers loss. So, their impairment review became quite an actual topic. Discussion of Example will show how it practically happens.

Table 7 Inventory-Cost \$

So, if we take from table N6-the unit cost of Inventory and then will compare them with the Sales Price less delivery cost(NRV) in the table N7. If the Cost exceeds NRV, so impairment has occurred

Inventory			
Inventory	quantity	unit cost	Total cost
Product A	10	10	100
Product B	70	20	1400
Product C	45	15	675
Product D	300	30	9000
Product E	60	50	3000
			14,175

(IAS 36).

Table 8 Inventory -Impairment Test-\$

Impairment Test						
Inventory	Actual Sales price	Delivery Cost per unit	Sales Price-Delivery Costs	Impaired?	Impairment Loss per Unit	Total Impairment Loss
Product A	15	3	12	No	-	-
Product B	18	3	15	Yes	5	350
Product C	22	3	19	No	-	-
Product D	35	3	32	No	-	-
Product E	40	3	37	Yes	13	780
						1,130

So, to sum up, as it is shown in table N 7, only the Product B and product E were impaired, for which **total impairment loss**- 1,130 \$ must be recognized with the following accounting entry:

Debit	Inventory Impairment Loss	1,130 \$
Credit	inventory	1,130 \$

CONCLUSION

In Summary, there are discussed the key financial issues that must be addressed and evaluated per **IAS, ISA and IFRS** standards requirements every financial year end and especially when the special difficult situation/indicator occurs, such as the Covid-19 pandemic.

In the article there were analyzed those procedures, that are essential by **IFRS 9, IAS 36, IAS 1,2, ISA 570** and considering other cases. Specifically, if company's **loans** are significantly credit-impaired, so Life Time Expected Credit Loss (**ECL Model**) is recognized. Moreover, if Trade Receivables are under doubt to be collected timely, then **Bad debt provision** is created by considering the Management Assessed **Default Probability Matrix, table N 3** (please see above **Pearson Company** Example); Finally, if the company has inventory, but their unit prices were decreased, then **Impairment Test** is essential to conduct at every financial reporting year end. If the Cost of inventory exceeds the **Net Realizable Value** (NRV) per unit, then the total impairment loss is recognized in the Profit and Loss statement; So these IFRS issues must be assessed and addressed by the top management while evaluating financially the impact of the pandemic.

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9. % Rates are based on our assumption, not on the company's judgments
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**კოვიდ-19 -ის ბიზნესზე ზეგავლენის ფინანსური
ანგარიშგების საერთაშორისო სტანდარტებით
შეფასების პრაქტიკული საკითხები**

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რეზიუმე

კოვიდ-19 პანდემიამ დიდ ფინანსური ზეგავლენა მოახდინა მსოფლიოში თითქმის ყველა-დიდ, მცირე და საშუალო ბიზნესზე. სტატიაში განხილულია ფინანსური ანგარიშგების საერთაშორისო სტანდარტების (ფასს) ის პრაქტიკული საკითხები, რომლებიც უმაღლესი მენეჯმენტის მიერ აუცილებლად უნდა იქნას გაანალიზებული და შეფასებული განსაკუთრებით პანდემიის დროს. ამ ფინანსურ საკვანძო საკითხებში შედის

ფასს 9-ფინანსური ინსტრუმენტები, მათი გაუფასურებისას მოსალოდნელი საკრედიტო ზარალის აღიარების საკითხები კომპანია პიარსონის (Pearson) მაგალითზე; ასევე ბასს 36 აქტივების გაუფასურების ზარალის გაანგარიშების პრაქტიკული ასპექტები; პანდემიის ზეგავლენის შესაფასებლად დიდი ყურადღება ეთმობა ასევე ბუღალტრული აღრიცხვის საერთაშორისო სტანდარტის (ბასს) 1-ის, ასს 570 (შესწორებული) მოთხოვნებს; საწარმომ რა ღონისძიებები უნდა გაატაროს, რომ რეალურად შეფასდეს კომპანიას შეუძლია თუ არა, პანდემიის დროს ან მის შემდეგ, ჩვეულებრივ შეუზღუდავად, ლიკვიდაციის გარეშე ფუნქციონირების გაგრძელება. ამრიგად, კომპანიის დონეზე აღწერილია ფინანსური აღრიცხვის საერთაშორისო სტანდარტების მოთხოვნები და მათი შესრულების/შეფასების პრაქტიკული ასპექტები განსაკუთრებით პანდემიის დროს წარმოშობილ რთულ ვითარებაში;

საკვანძო სიტყვები: ფინანსური ანგარიშგების(IFRS), აუდიტის საერთაშორისო სტანდარტები(ISA); კოვიდ-19-ის ზეგავლენა, მარაგების გაუფასურება, მოსალოდნელი საკრედიტო ზარალი (ECL), წმინდა სარეალიზაციო ღირებულება(NRV), ფუნქციონირებადობა.