REQUIREMENTS FOR THE RECOGNITION AND ACCOUNTING MEASUREMENT OF EXPECTED CREDIT LOSSES IN LIGHT OF THE CORONA CRISIS

Lecturer. Ahmed Mahdi Sahi¹
¹College of Administration & Economics
Department of Accounting
Thi-Qar University, Iraq

*Corresponding Author: Ahmed Mahdi Sahi
Corresponding Author Email: ahmed-mahde@utq.edu.iq

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ABSTRACT

The COVID-19 pandemic crisis and its economic implications mean that investors and other stakeholders need high-quality financial information more than ever before. To this end, accounting firms, regulators, members of the International Federation of Accountants and others are rapidly providing advice and guidance on accounting and reporting requirements. Financials to be taken into account in addressing the financial implications of COVID-19 when preparing financial statements. There will be problems to consider in reporting this year as well as in the coming years. Some companies may first report financial implications in interim financial statements (in accordance with IAS 34 - Interim Financial Reporting), which is likely to include a greater use of accounting estimates. However, the information must be reliable and all financial information relevant to an understanding of the financial position or performance of the company must be disclosed. There may also be differences as to whether the financial statements are prepared using IFRSs or generally accepted accounting principles. Therefore, the aim of the current study is to identify the accounting measurement of expected credit losses in light of the Corona crisis.

Keywords: IFRS, COVID-19, ECLs, Hedge Accounting.
INTRODUCTION

IAS 10 - Subsequent events after the reporting period includes requirements when events are modified that provide evidence that was in place at the end of the reporting period. Unadjusted events that arose after the reporting period need to be reflected in the financial statements. Amounts recognized in the financial statements are adjusted to reflect revised events, but disclosures are only required for unadjusted events. Management may need to review and update assessments on a regular basis up to the date of issuance of the financial statements given the volatile nature of the crisis and the uncertainty associated with it (Al-Masoodi, et al., 2020).

With regard to reporting periods ending on or before December 31, 2019, there is general consensus that the effects of the COVID-19 outbreak are the result of events that have arisen after the date of reporting (for example, in the United Kingdom, the Financial Reporting Council stated that COVID-19 is in general. 2020 was a non-adjustable event for the vast majority of UK companies preparing financial statements for the periods ending December 31, 2019). For subsequent reporting dates (for example, end of February or March 2020), it is likely an event in the current period that will require ongoing evaluation to determine the extent to which developments after the reporting date in the reporting period are recognized (Coibion, & Weber, 2020).

If management concludes that the impact of unadjusted events is material, the company must disclose the nature of the event and estimate its financial impact. If it cannot be quantified reliably, then qualitative disclosure is still required including a statement that the impact cannot be estimated.

Examples of unadjusted events that will be disclosed generally in the financial statements include breaches of loan covenants, management plans to discontinue the operation, carry out major restructuring, or significant drops in fair value of investments and abnormally large changes in asset prices after the preparation period. Reports (Günther, & Walkshäusl, 2020).

Due to the rapid changes in economic conditions, the degree of exposure to risks (credit, liquidity, market) and the concentration of risks may change, which requires additional disclosures from management. Also, when disclosing sensitivity analyzes, management may need to use a greater range of potential changes in indicators and the trend of indicators.

Corporate Assessment of Continuity

International Accounting Standard No. 1 - Presentation of Financial Statements requires management to evaluate the company's ability to continue as an entity. An assessment of the entity's continuity must be performed until the date of issuance of the financial statements. The evaluation relates to at least the first twelve months after the balance sheet date, or after the date the financial statements are signed, but this time frame may need to be extended (Wymeersch, & Stability, 2020).

Material doubts about the company's ability to operate on a going concern basis must be disclosed in the financial statements. It is likely that many companies large and small, especially in certain sectors, will have issues related to the current situation which should be considered by management. There will be a wide range of factors to consider in ongoing judgments and financial projections including travel bans, restrictions, government assistance and potential sources of alternative financing, financial health of suppliers and customers and their impact on expected profitability and other key financial factors including information
that clarifies whether there was sufficient liquidity to continue fulfilling the obligations as they fall due (Steinert, 2020).

Management should assess the current and projected impacts of COVID-19 on the company's activities and the appropriateness of using the continuity basis. If it was decided either to liquidate or to stop trading, and the company has no alternative, then this no longer represents the principle of continuity and the financial statements must be prepared on another basis, such as the liquidation basis (Rashwan, 2020).

**The Important Implications for the Accounting and Reporting of the Corona pandemic**

Throughout 2020, companies will need to review all areas of accounts that are subject to judgment and estimation of uncertainty (Günther, & Walkshäusl, 2020).

**Fair Value Measurements (IFRS 13 Fair Value Measurement)**

In accordance with the standard, the change in the fair value measurement affects the disclosures. This requires companies to disclose the valuation techniques and inputs used in the FVM as well as the valuation's sensitivity to changes in assumptions. Disclosures are needed to enable users to understand whether virus spread has been taken into account when measuring fair value (Feschiyan, & Andasarova, 2017).

For 2020, fair value measurements, particularly financial instruments and investments, should be reviewed to ensure that values reflect conditions at the balance sheet date. This will include measurement based on unobservable inputs that reflect how market participants will take into account the impact of COVID-19 in their expectations of future cash flows related to the asset or liability at the reporting date (Fegert, et al., 2020).

During the current environment, price volatility has increased in different markets and this affects the FVM either directly - if the fair value is determined based on market prices or indirectly - for example, if the valuation technique relies on inputs derived from volatile markets. Consequently, special attention will be required in the commodity price forecasting used in developing fair value conclusions.

International Accounting Standard 36 guarantees that the assets of the company are maintained at no more than their recoverable value. Firms are required to perform impairment tests when there is an indication that an asset is impaired at the reporting date. Indicators of impairment include significant changes that have a negative impact on the company that occurred during the reporting period or will occur soon in the market or economic environment in which the company operates (Coibion, & Weber, 2020).

**The Impact of COVID-19 on Impairment of Asset Value.**

In accordance with IAS 2 - Inventories, inventories are measured on the basis of cost or net realizable value, whichever is the lower. In the current environment, it is likely that the calculation of NPV will require more detailed methods or assumptions for example companies may need to reduce inventory due to reduced sales. Impairment losses of temporary inventory should be reflected in the transition period in which they occur while recognizing subsequent recoveries as gains in Future periods (Coibion, & Weber, 2020).

**Measuring Estimates of Expected Credit Losses (ECLs)**

The impact of COVID-19 on credit risk will be more severe in various sectors. The International Accounting Standards Board has published a document that answers questions related to the application of IFRS 9 which requires companies to incorporate reasonable and supportive information about past events, current conditions and expectations of future
economic conditions in assessing expected credit losses of financial assets that are not measured at FVTPL or loss. Such evaluation should be based on the information at the reporting date and adjusted to obtain subsequent available information.

The increased credit risk faced by banks and lenders is associated with exposure to borrowers in highly vulnerable sectors. Provisions should be estimated based on expected credit losses over the remaining life of the financial instrument (Corona,& Zhang,2013).

**Hedge Accounting**

Hedge effectiveness should be evaluated initially and on an ongoing basis in the history of the financial position or in the event of significant changes in conditions. Currently volatile market conditions may require the entity to re-arrange the hedge or discontinue hedge accounting if the economic relationship no longer exists or the credit risk is overcome. Likewise, if there is no longer a high probability of the anticipated hedging transaction occurring in existence (eg inventory purchase or sales) then future hedge accounting is discontinued (Coibion,& Weber ,2020).

**Disclosures about the Risks of Financial Instruments**

Due to the rapid changes in economic conditions, the degree of exposure to risks (credit, liquidity, market) and the concentration of risks may change, which requires additional disclosures from management. Also, when disclosing sensitivity analyzes, management may need to use a greater range of potential changes in indicators and the trend of indicators.

**Paying and Classifying Debts**

As a result of the difficult economic conditions, many lenders have postponed repayment installments and other financing conditions, including interest rates, which may affect the value of the financing provided and may result in profits or losses as well as the classification of the debt as a current or non-current item. Under the financing pledges stipulated in the agreements, which may lead to the entire debt becoming due in the event that the lender does not tolerate cases of non-compliance, and some lenders may exempt completely from the debt, which requires the management to determine the appropriate timing to cancel the recognition of the debt in the financial position and the accounting treatment Appropriate for that (Günther,& Walkshäusl,2020).

**Safeguards**

The enterprise that provided guarantees to other parties must look into the impact of the crisis on those parties. Depending on the circumstances, the entity may need to record additional obligations related to those guarantees.

**Impairment**

IFRSs require entities to test for impairment of their assets when there are indications of impairment. This is in addition to the necessity of testing with respect to goodwill and intangible assets of indefinite life at least annually. Value in use may need to be recalculated as a result of changes in expected cash flows and interest rates.

All assumptions and expectations that the entity previously used to estimate impairment must be reviewed in light of changes in circumstances resulting from COVID-19 and their impact on the entity’s performance, expected cash flows and applicable discount rates. The measures in place to contain the effects of the crisis must also be taken into consideration. Also, the fair value of the asset minus the disposal costs may decrease and the active markets for some assets may disappear (Fegert,et al.,2020).
Indicators of Decline Due to COVID-19: -

A. Investments accounted for using the equity method
   • Significant financial difficulties for the investee company.
   • Non-compliance or failure to implement contracts and agreements (for example, loan agreements).
   • The investee company becomes bankrupt or undergoing restructuring
   • A major negative change in the economic or regulatory environment in which the investee company operates

B. Property machinery and equipment and intangible assets (other than goodwill)
   • Changes in the extent or manner in which the asset is used
   • Significant negative changes in the work environment or regulations that may affect the value of the asset
   • Low interest rates in the market, which results in a decrease in the value in use

Reducing or stopping the demand for services from the beginning.

In addition to the above, the existence of doubt about the sustainability is an indicator of decline in most assets. Goodwill must be tested for impairment on an annual basis. COVID-19 may affect fame as follows:
   • Major negative changes in the work environment, laws and instructions.
   • Loss of senior staff
   • Significant decline in the value of a group of assets
   • Reducing goodwill in an investee company
   • A significant decrease in the company's share price, which makes its market value less than its book value.

CONCLUSION

The COVID-19 pandemic crisis and its economic implications mean that investors and other stakeholders need high-quality financial information more than ever. COVID-19 may reduce the likelihood of forecasting and taking precautions and may affect timing. Consequently, the hedge accounting standards in the financial reporting standards may not be met. Additional disclosures may also be required. For example, IFRS 7 Financial Instruments: Disclosures, may be disclosures of default and breach of outstanding loans. Disclosures also include quantitative data, for example about liquidity risk, and narrative disclosures, for example how risks are managed.

References


