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Financial Reporting Webinar Series: Sailing through the storm with clarity

Friday 15 May 2020

Agenda

Setting the stormy scene

Weathering the COVID-19 storm on the P&L and balance sheet

Increasing visibility under adverse conditions

With you today

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Setting the stormy scene

On the overcast economic front…

[Source: *OECD Economic Outlook, Interim Report March 2020*, https://doi.org/10.1787/7969896b-en]

Coronavirus: Carrie Lam unveils Hong Kong's biggest Covid-19 relief package yet, worth HK$138 billion, to ensure 1.5 million workers still get paid

- Hong Kong leader sets out six-month income guarantee to save jobs and firms amid 'disastrous' impact of Covid-19

[Source: https://www.scmp.com/news/hong-kong/politics/article/3078969/coronavirus-hong-kong-set-hk100-billion-covid-19-relief]

Hundreds of Earnings Calls Show Companies More Scared than 2008

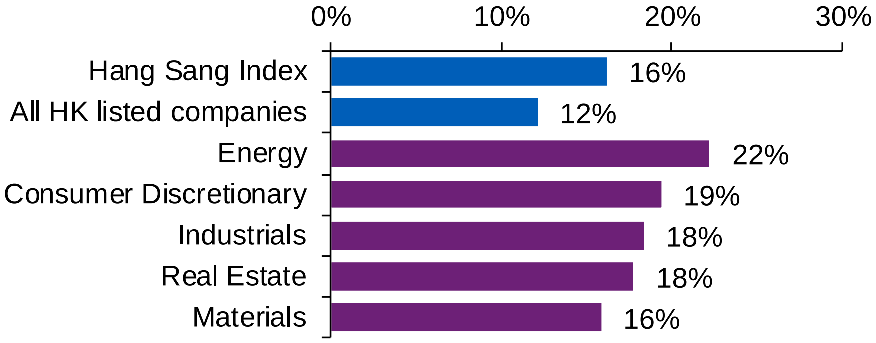
[Source: http://www.Bloomberg.com]

China Considers Dropping Numerical GDP Growth Target for 2020

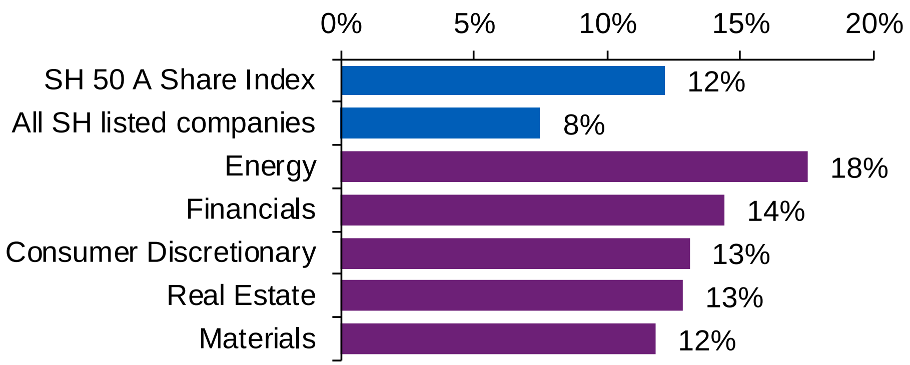
[Source: http://www.Bloomberg.com]

Some sectors are bearing the brunt of the storm harder

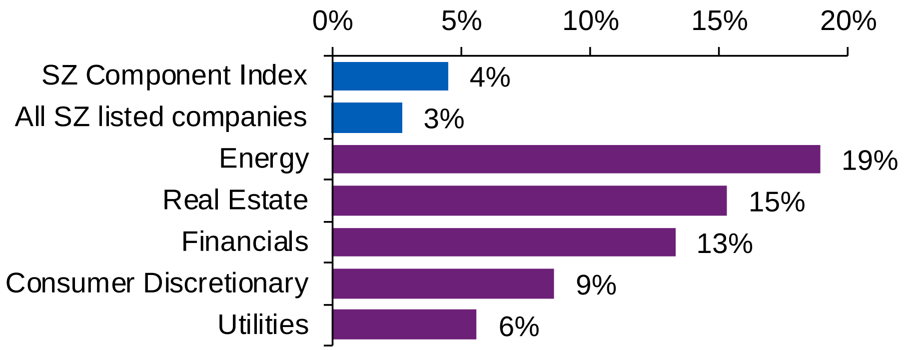
Hong Kong Stock Exchange



Shanghai Stock Exchange



Shenzhen Stock Exchange



Source: S&P Capital IQ

Companies are in the same rocky boat…

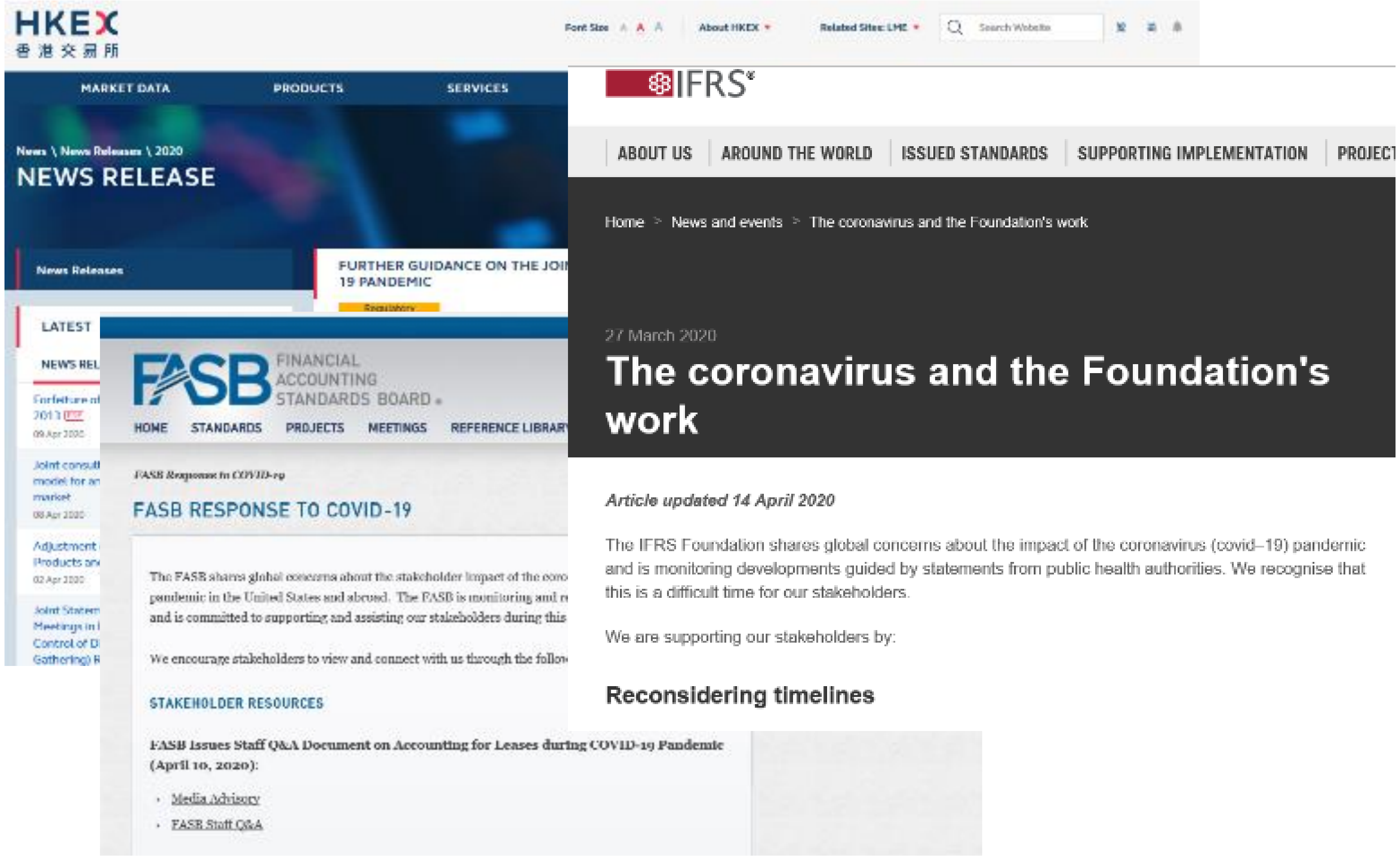
"…COVID-19 does cast uncertainty over the macro-economic worldwide. Given slowdown in the economic activities due to the worldwide partial lockdown, demands for crude oil, aluminium, coal and steel had been inevitably be affected. Shrinking in demand for crude oil, uncertainty in crude oil supply and turbulent in global financial market, led to plunge in crude oil prices and abnormal volatility in commodity prices in the first quarter of 2020…
The scale and duration of those remain uncertain. Prolong of such might adversely affect the Group's earnings, cash flow and financial position."

[Source: Citic Resources Holdings Limited 2019 Annual Report Financial Statements Note 45]

The outbreak of COVID-19 since January 2020 has resulted in a challenging operational environment, and will adversely impact the Group's financial performance and liquidity position. Travel demand has dropped substantially and the Group has taken a number of short-term measures in response, including aggressive reduction of passenger capacity ... passenger load factor had declined to approximately 50% and year-on-year yield had also fallen significantly. It is difficult to predict when these conditions will improve. However, the Group is expected to incur a substantial loss for the first half of 2020 ... The Directors believe that with the cost saving measures being taken … as well as the Group's liquidity position and availability of sources of funds, the Group will remain a going concern.

[Source: Cathay Pacific 2019 Annual Report Financial Statements Note 36]

Regulators and standard-setters provide some relief…



Estimated number of COVID-19 related guidance from Hong Kong regulators* alone: 24

*includes HKEX, HKMA, IA and SFC

Weathering the COVID-19 storm on the P&L and balance sheet

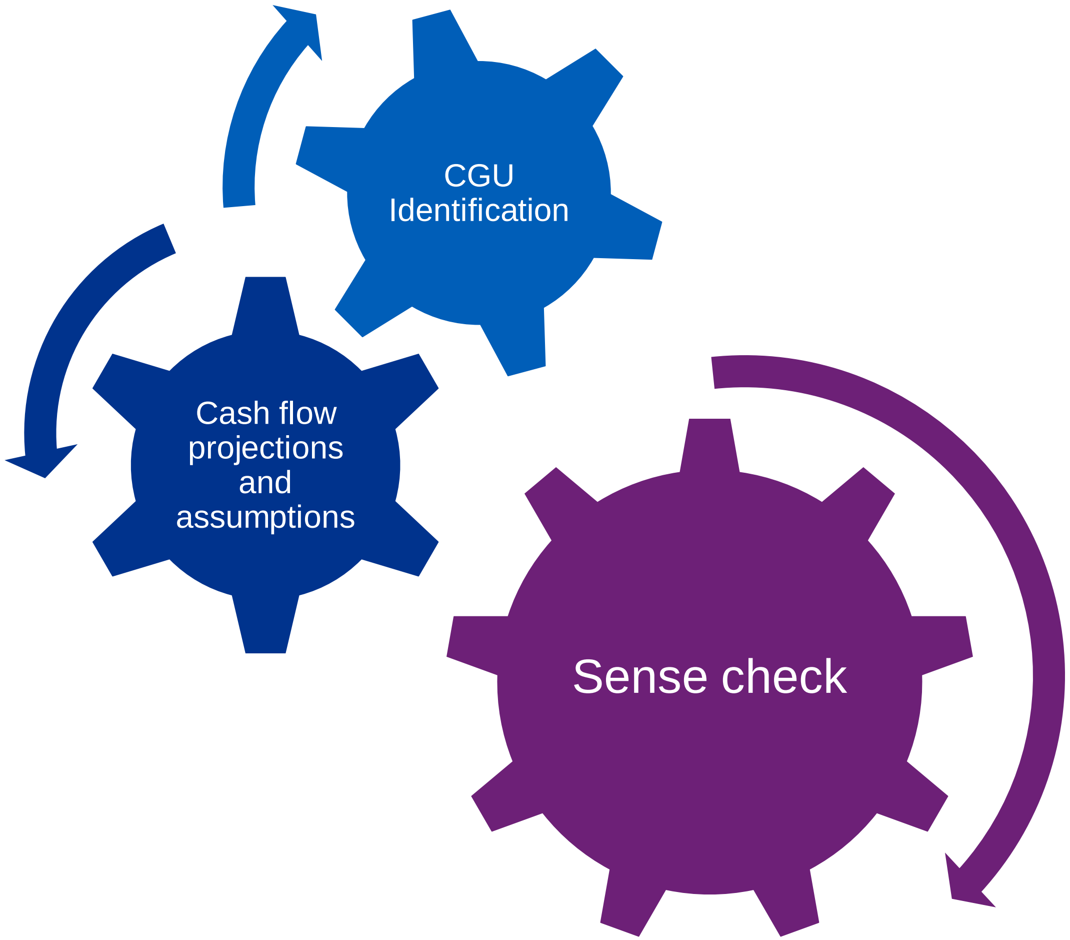
Polling question 1

Which of the following areas do you expect will require increased consideration for your organisation in this current climate? Select the top 3 issues.

A. Impairment of non-financial assets
B. Fair value measurement
C. Lessee accounting
D. Lessor accounting
E. Government grant
F. Revenue recognition
G. Inventory valuation
H. Valuation of financial assets
I. Modification of financial instruments
J. Classification of financial liabilities

Financial statement impact - overview

Non-financial asset impairment - What could be the weakest link?



Could that be…?

✓ **CGU identification**

- Has the identification robustly tested – should it be tested again?
- Are there management plans suggesting past grouping no longer appropriate?

✓ **Reflection of uncertainties**

- Single cash flow projection – still appropriate?
- Assumptions – consistent with assumptions made elsewhere?
- Sense check on VIU – corroboration with observation information and the sector the entity is in? Sensitivity?

Not 'business as usual' - FVM

Fair value

- Exit price
- Market-based measurement
- Orderly transaction
- At measurement date

1. Impact of Covid-19

a. Using quoted market price
- Decreased liquidity: has market become inactive?
- Increased volatility: adjust for aftermarket info?

b. Using valuation techniques
- Challenges associated with developing appropriate inputs

2. A closer look: FV of unlisted equities

a. Income approach

Cash flows
- Short-term cash flows (CFs) ↓
- Longer term CFs: depend on speed and shape (i.e. V, U or L) of recovery
- Single most likely CF vs probability-weighted CFs

Discount rate
- Unlikely to drop
- Equity risk premium ↑
- Incorporate other specific risk premiums

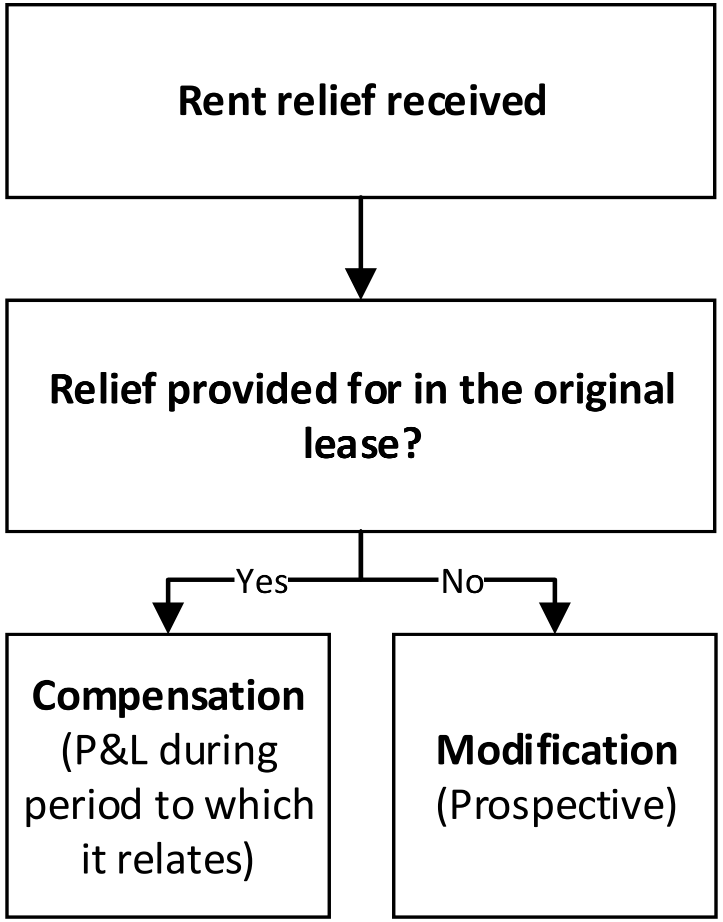
b. Market approach

e.g. Market multiple × Company's value driver = Company's FV
- Appropriate identification of comparable companies?
- Multiple incorporating impact of Covid-19 available?
- Financial basis of the multiple and that of the company consistent?
- Effect of discount for lack of marketability?

3. Cautions

a. Inappropriate use of 'cost ≈ FV'
b. Caveats and limitations in the valuer's report
c. Appropriateness of management's assumptions
d. Inconsistent or incomplete documentation

Lessees - if modification assessment is tricky…



How should companies account for rent concessions?

26 March 2020

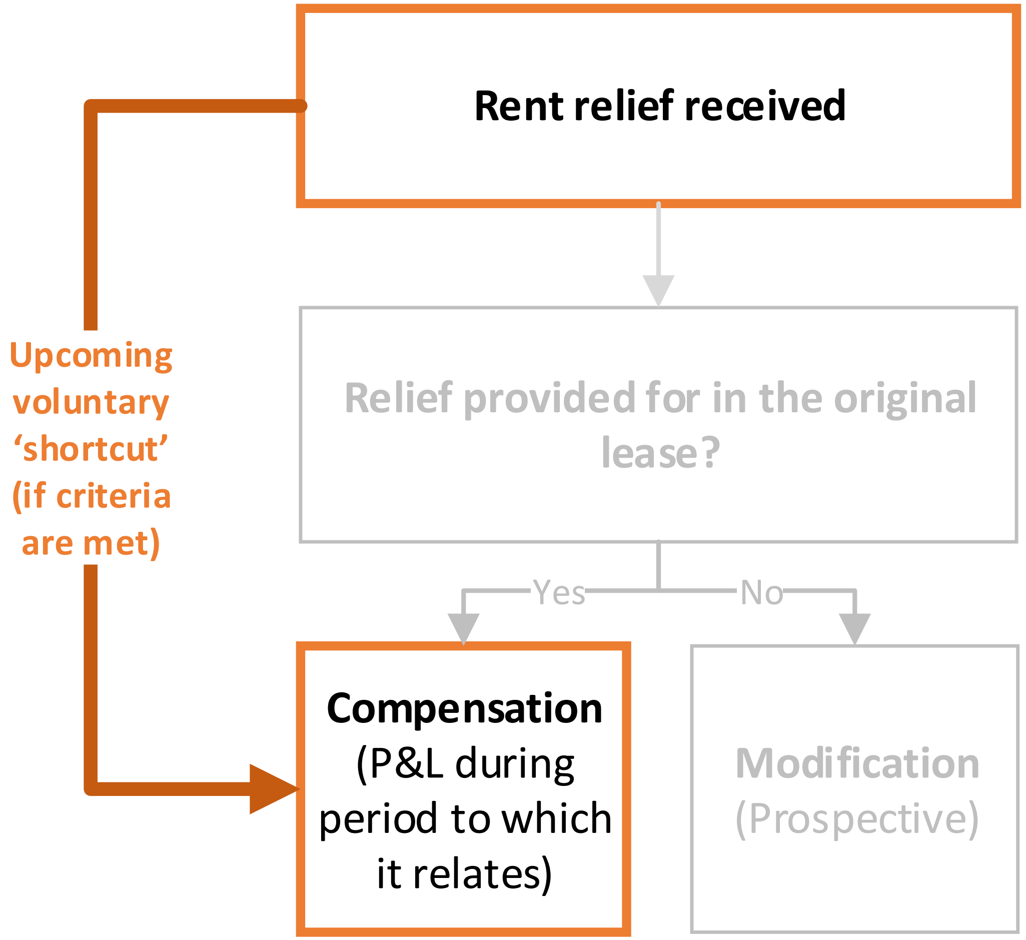
Issue | Details | Actions | Home

26 March 2020

What's the issue?

Due to the impact of the COVID-19 coronavirus outbreak on trading conditions, many lessees are seeking rent concessions from lessors. Rent concessions may take the form of a one-off reduction in rent, a reduction for a defined period of time or a change in the nature of rent – e.g. fixed rent payments becoming variable. For example, a number of retailers are seeking reductions in real estate rents – though similar issues may arise in other leases.

Lessee – … then forthcoming relief isn't without a catch



Criteria:

- change in lease payments results in revised consideration that is substantially the same as, or less than before
- any reduction in lease payments affects only payments originally due in 2020
- there is no substantive change to other terms and conditions of the lease.

Polling question 2

Do you expect to adopt the lessee's modification exemption on COVID-19 related rent concession?

A. Yes
B. No
C. Not applicable – as we are mainly acting as lessors
D. Not applicable – other reasons (e.g. no concessions given)

Not 'business as usual' - ECLs

1. Scope

a. IFRS 9 or equity method?
- e.g. loans to joint ventures/associates

b. Subject to ECL assessment?
- Measured at amortised cost or FVOCI (recycling) – SPPI met
- Contract assets
- Lease receivables
- Most FGCs and some loan commitments issued

2. Simplified approach: always lifetime ECL

a. Applicable to:
- Trade receivables and contract assets from IFRS 15
- Lease receivables

b. Provision matrix for trade receivables
- Revisit customer segmentation
- Adjust historical loss rates for current and forward-looking info

- Stage 3 accounting
- Modification

ECLs:
- Probability-weighted amount
- Time value of money
- Reasonable & supportable info

3. General approach: 12m or lifetime ECL depending on SICR

a. SICR
- Incorporate forward-looking info
- Individual vs collective assessment
- Reasonable & supportable info required to rebut 30 DPD presumption

b. Measurement of ECLs
- Include additional economic scenarios?
- Parameters updated to reflect changing conditions?

5. Credit insurance / financial guarantees held

Integral

Part of financial asset's
- Initial carrying amount
- ECL measurement

Not Integral
- Separately recognised

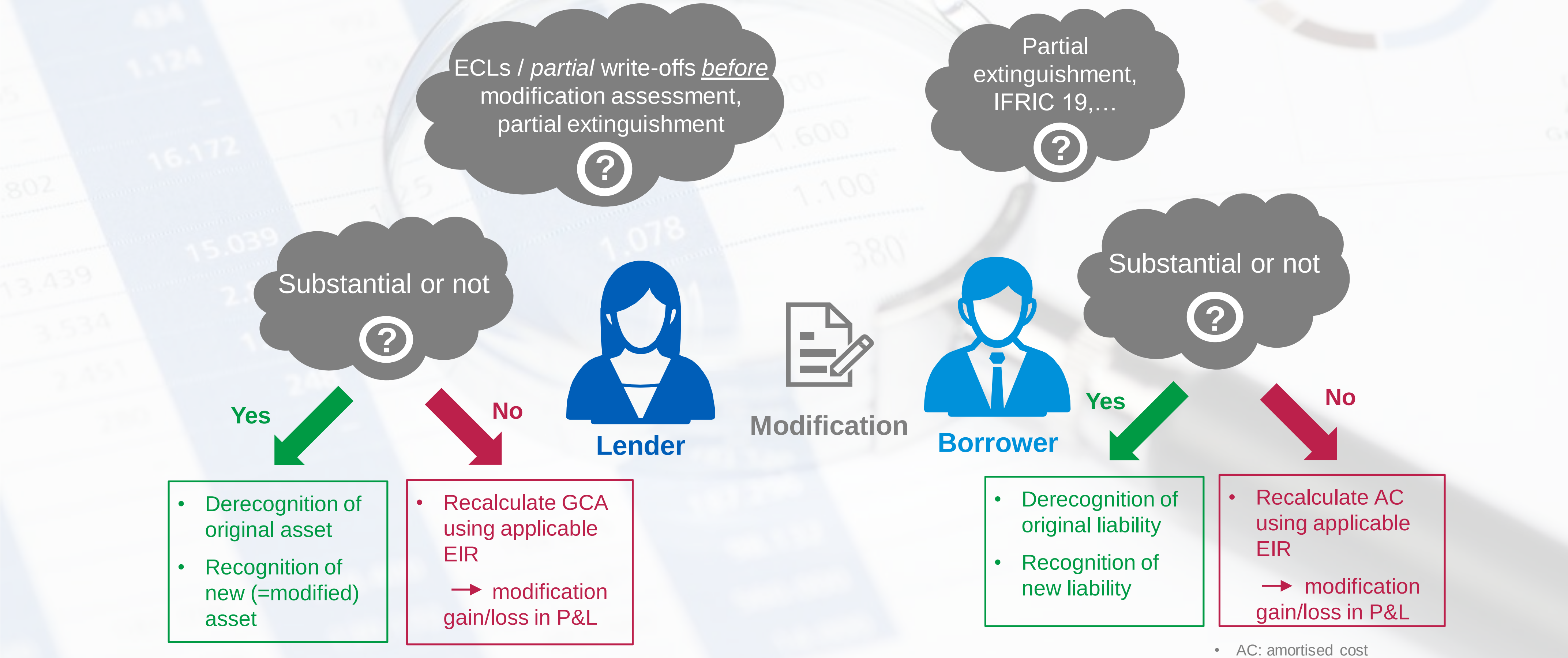
4. POCI financial assets

a. Credit-adjusted EIR

b. Δ Lifetime ECL $\longrightarrow$ P&L

- DPD: day past due
- EIR: effective interest rate
- FGC: financial guarantee contract
- FVOCI: fair value through other comprehensive income
- POCI financial assets: purchased or originated credit-impaired financial assets
- SPPI: solely payments of principal and interest
- SICR: significant increase in credit risk

Watch out for - Modification



- AC: amortised cost
- EIR: effective interest rate
- GCA: gross carrying amount

Watch out for - 'Morphing' of business model

Market volatility

Liquidity management

- To improve liquidity by selling financial assets that are held to collect contractual cash flows
- Incentive to reclassify financial assets measured at fair value to amortised cost

'Big bang' change in business model ?

RARE

VS

'Morphing' of business model ?

Reclassification of financial assets ?

- No reclassification
- Affects business model of *new* assets

Polling question 3

Which aspect(s) of the asset (financial and non-financial) impairment assessment is (are) likely to take up more time and effort for your organisation?

A. **Data collection**
B. **Developing appropriate inputs**
C. **Scenario analysis and modelling**

And frequently slipping below the radar…

Hedge accounting

Existing hedging relationships

- Do forecast transactions continue to be highly probable?
- Credit risk dominating?
- Losses accumulated in CFHR expected to be recovered?

New hedging relationships

- Dry-run before start
- No backdating of hedge documentation

Disclosures

Check need to update or add to key judgements, assumptions and estimates

Update/add risk disclosures

- Liquidity management

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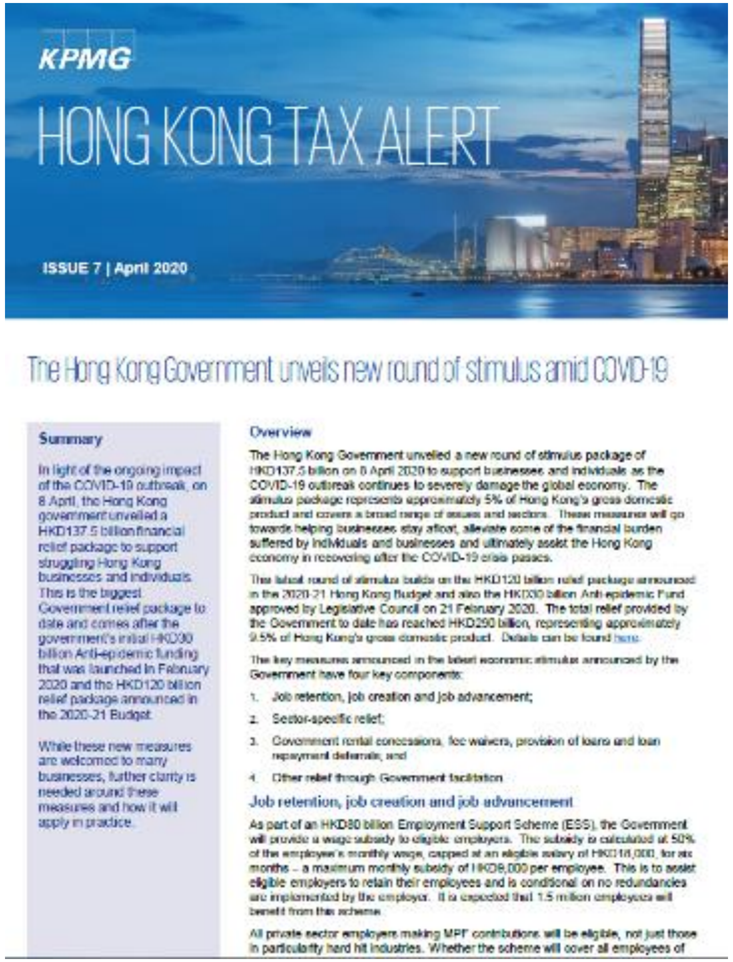
Revenue - one key metric, many moving parts

Should revenue still be **recognised?**	- Is legal enforceability in question, e.g. customers claiming 'force majeure'? - Are there indications of significant increase in customers' credit risk?
How and when **renegotiations** should be reflected in revenue?	- Since when have changes become enforceable? - Which type of modifications is it – IFRS 15.20, 21(a) or 21(b)?
Should old **'point-in-time'** be re-assessed?	- Are there new practices adopted to accommodate changing customer expectations and trends?
How are revenue **estimates** affected?	- How has customers' behavior changed (discounts, returns, amortisation of capitalized contract costs)? - How has cost estimate changed (measure of progress)?
Has the contract become **onerous**?	- Have costs increased because of closures and supply chain disruptions? - Have prices decreased because of reduction in demand or market volatility?

Government grants - New and different programmes on offer



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HONG KONG TAX ALERT

ISSUE 7 | April 2020

The Hong Kong Government unveils new round of stimulus amid COVID-19

Summary

In light of the ongoing impact of the COVID-19 outbreak, on 8 April, the Hong Kong government unveiled a HKD137.5 billion financial relief package to support struggling Hong Kong businesses and individuals. This is the biggest Government relief package to date and comes after the government's initial HKD30 billion Anti-epidemic funding that was launched in February 2020 and the HKD120 billion relief package announced in the 2020-21 Budget.

While these new measures are welcomed to many businesses, further clarity is needed around these measures and how it will apply in practice.

Overview

The Hong Kong Government unveiled a new round of stimulus package of HKD137.5 billion on 8 April 2020 to support businesses and individuals as the COVID-19 outbreak continues to severely damage the global economy. The stimulus package represents approximately 5% of Hong Kong's gross domestic product and covers a broad range of issues and sectors. These measures will go towards helping businesses stay afloat, alleviate some of the financial burden suffered by individuals and businesses and ultimately assist the Hong Kong economy in recovering after the COVID-19 crisis passes.

This latest round of stimulus builds on the HKD120 billion relief package announced in the 2020-21 Hong Kong Budget and also the HKD30 billion Anti-epidemic Fund approved by Legislative Council on 21 February 2020. The total relief provided by the Government to date has reached HKD290 billion, representing approximately 9.5% of Hong Kong's gross domestic product. Details can be found here.

The key measures announced in the latest economic stimulus announced by the Government have four key components:

1. Job retention, job creation and job advancement;
2. Sector-specific relief;
3. Government rental concessions, fee waivers, provision of loans and loan repayment deferrals; and
4. Other relief through Government facilitation

Job retention, job creation and job advancement

As part of an HKD80 billion Employment Support Scheme (ESS), the Government will provide a wage subsidy to eligible employers. The subsidy is calculated at 50% of the employee's monthly wage, capped at an eligible salary of HKD18,000, for six months – a maximum monthly subsidy of HKD9,000 per employee. This is to assist eligible employers to retain their employees and is conditional on no redundancies are implemented by the employer. It is expected that 1.5 million employees will benefit from this scheme.

All private sector employers making MPF contributions will be eligible, not just those in particularly hard hit industries. Whether the scheme will cover all employees of

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China Tax Alert

Issue 15, February 2020

Updates on China Social Security Policies during the Coronavirus Outbreak

Regulations discussed in this issue:

- The Announcement issued by the Ministry of Human Resources and Social Security on Administration of Chinese Social Security Contributions during the Period of Prevention and Containment of the Spread of Coronavirus Disease 2019 (Renshetingmingdian [2020] No. 7, hereinafter referred to as "Announcement No. 7").
- Related announcements issued by the local Social Security Bureau.

Since the start of 2020, people across China have been working together to fight against outbreak of Coronavirus Disease 2019 (COVID-19). On 30 January 2020, the Ministry of Human Resources and Social Security ("MHRSS") issued an announcement regarding the administration of Chinese social security contributions during the period of prevention and containment of the spread of COVID-19 (Renshetingmingdian [2020] No. 7, hereinafter referred to as "Announcement No. 7"), to ensure appropriate measures are stipulated by local Social Security Bureau ("SSB"). Several local SSBs also released their respective local practices for the administration of social security contributions in response to Announcement No. 7. In addition to Announcement No. 7, the Standing Committee of the State Council met on 18 February 2020 and decided to reduce or waive employer obligations on social security contributions for a specified period of time to ease the burden of enterprises during this difficult time.

Salient points

Announcement No. 7 is instrumental in providing local SSBs with a framework on administering social security contributions during the outbreak of COVID-19. In particular, allowing enterprises to make catch-up employer social security contributions within a period of 3 months following containment of COVID-19 outbreak without adversely impact the employee's rights to social security benefits.

The Standing Committee of the State Council also determined that it was appropriate to reduce or waive employer contributions to pension, unemployment and work-related injury insurance schemes for enterprises in the following areas:

- Hubei Province

  Between February and June 2020: All enterprises enrolled in China Social Security Schemes are exempt from making employer contributions to pension, unemployment and work-related injury insurance schemes.

- Other Provinces & Cities (except Hubei)

  Between February and June 2020: Micro, small and medium size enterprises are exempt from making employer contributions to pension, unemployment and work-related injury insurance schemes.

Government grants - New and different programmes on offer

Which standard applies? Eg. some assistance in the form of tax relief falls within IAS 12

Judgment on when to recognise new government assistance programmes

Understanding the conditions is crucial in identifying the right period to recognise

Be aware of the interaction with other standards, e.g. with IFRS 9 for below-market interest loans

Inefficiencies - Unprecedented pandemic; unprecedented accounting?

Production overheads during closures or operation under-capacity	• Nature or function of expense does not change
	  • Unallocated production overheads -> "Cost of sales" (IAS 2.38)
	  • Material amounts may warrant separate presentation within "cost of sales" on the face (IAS 1.97)
	  • Total impact of an event may be analysed in notes if material

Depreciation during closures	• Depreciation begins when a PPE is available for use, and does not cease when it becomes idle (IAS 16.55) • Exception when the PPE depreciated under usage methods
Capitalisation of borrowing costs during suspension	• Capitalisation should be suspended during extended period of suspended development (IAS 23.20)

Increasing visibility under adverse conditions

Polling question 4

Is goodwill impairment assessment expected to be a significant issue for your organisation this coming reporting period?

A. **Yes**
B. **No**
C. **Not applicable for our organisation**

Impairment test - interim reporting considerations

If goodwill impaired at interim

Cannot be reversed at year end

IAS 34.15-15C:

When an entity recognises significant amount of impairment losses in interim report, it shall:

- provide an explanation of and an update to the relevant information included in the financial statements of the last annual reporting period
- disclose the nature and amount of changes in estimates of amounts reported in prior financial years
- IAS 36 provides relevant disclosures to be considered in this regard

Interim disclosures – these are weeks where decades happen

IAS 34.15: '… explanation of events and transactions that are significant to an understanding of the changes… since the end of the last annual reporting period'

IAS 34.15C: '… interim financial report should provide an explanation of and an update to the relevant information included in the financial statements of the last annual reporting period'

1. Check the need to update **or add** disclosures including key judgements, assumptions, estimates and risk disclosures including liquidity management

2. Similar going concern assessments required at interim

3. IAS 34.15B: Disclosures around 'significant events and transactions'

   -> IAS 34.15C: 'Individual IFRSs provide guidance regarding disclosure requirements for many of the items listed in paragraph 15B'

Useful disclosures from the investors' perspective

Reporting during times of uncertainty

Financial Reporting LAB

Five current questions investors seek information on...

Resources		Action		The future
1	2	3	4	5
How much cash does the company have?	What cash and liquidity could the company obtain in the short-term?	What can the company do to manage expenditure in the short-term?	What other actions can the company take to ensure its viability?	How is the company protecting its key assets and value drivers?

1. How much cash does the company have?

Helpful disclosure might include:

- The amount and nature of cash and liquid resources.
- Where the cash is located within the group (legal entities, countries, currencies etc).
- Whether there are any barriers to accessing the cash (capital controls, regulatory issues).
- Whether there is an impact from accessing the cash, such as tax or other liabilities.

2. What cash and liquidity could the company obtain in the short-term?

Helpful disclosure might include:

- Information about the company's short-term financing arrangements, facilities and other obligations and likely changes.
- Information about the credit lines (committed and uncommitted, drawn and undrawn) the company has access to.
- Whether the company has additional support e.g. from related businesses, shareholders, suppliers.
- Whether there are any covenants that are being imposed or waived.

3. What can the company do to manage expenditure in the short-term?

Helpful disclosure might include:

- Whether the company is changing its dividend policy or cancelling a dividend.
- Information on the extent to which supplier financing schemes are being used, and what commitment the provider has given to maintain access to these schemes.
- Information about the nature and timing of capital expenditure commitments, and whether there is any flexibility.
- Information about any payments that may be deferred e.g. tax payments.
- Information about the company's approach to its pension funding.

4. What other actions can the company take to ensure its viability?

Helpful disclosure might include:

- Information of the nature of any government-backed support, by country and any conditions that attach to this.
- Information about any stress testing/reverse stress testing carried out and how the viability of different parts of the group are being affected.
- Whether there are any intergroup guarantees and commitments.
- Details of how the board is monitoring the situation.

5. How is the company protecting its key assets and value drivers?

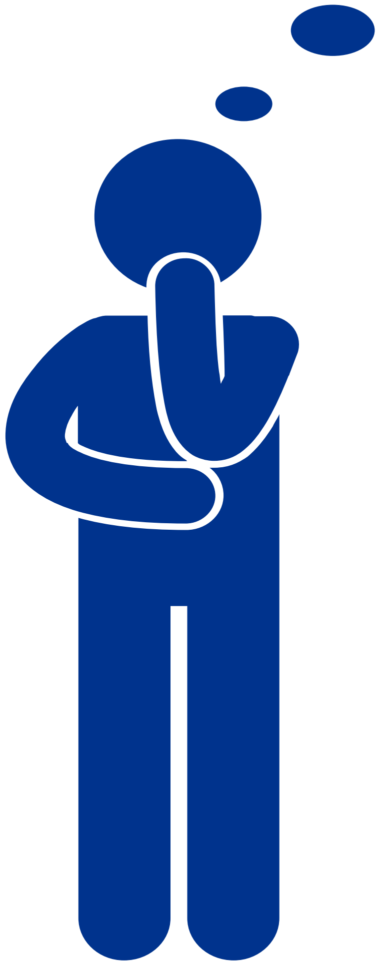
Helpful disclosure might include:

- Plausible scenarios on revenue and costs over the short-term and into a longer transition period.
- Details of the likely impact of shorter-term decisions on the company's key assets and longer-term drivers of value, e.g. people, brands, licences.
- Approach to support for employees.
- Information about how the company is managing commitments with customers where services are delayed.
- Information about how the company might adapt its business model and strategy in the short/medium term.

More guidance is available on the FRC website - https://www.frc.org.uk/about-the-frc/covid-19

Q&A and takeaways

Questions?



Takeaways

Check the status quo

- Understanding the financial statement impact of contracts (leases, sales, loans) renegotiations and changes in business models; communicating the impact to other parts of the business will also be critical

Exercise caution and realism

- Current economic situation is still evolving with high levels of uncertainty, judgements can and should be made with care
- Ensure assumptions are realistic and consistent with the general economic environment and appropriate consideration given to severe but plausible downside scenarios

Communicate effectively

- Clear and relevant disclosures are important to provide users with useful information

Resources and publications

Home > Services > Audit and Assurance > IFRS news

IFRS news

The latest need-to-know information on IFRS.

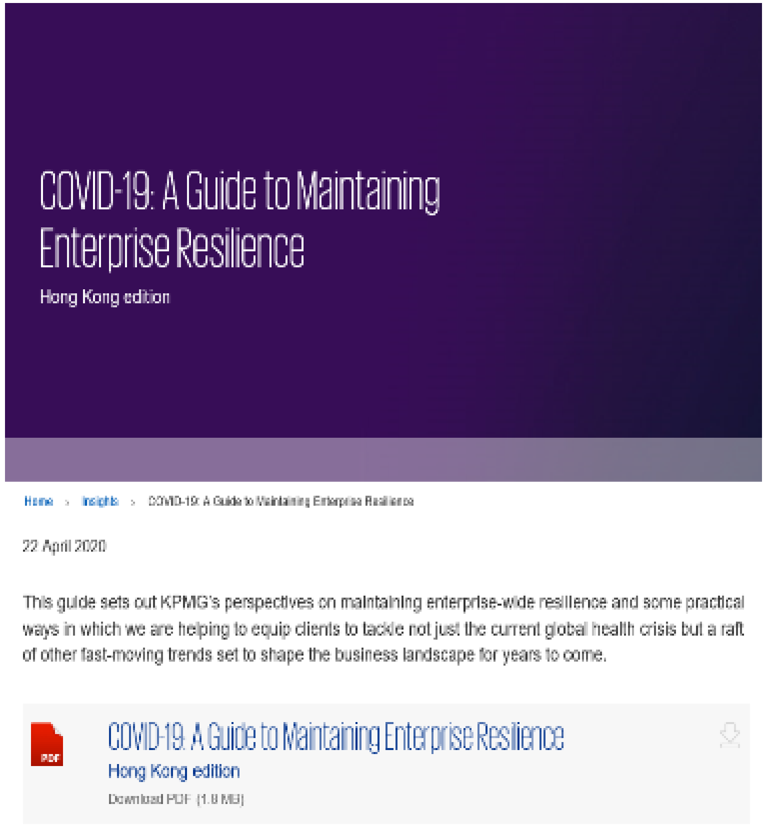
Financial Reporting Hot Topics: Coronavirus

Our newsletters provide insights on financial reporting impact of the novel coronavirus (COVID-19) outbreak.

Your source for breaking news on IFRS

IFRS News features KPMG's insights on the international accounting standards and the latest global financial reporting developments. Our topic pages provide comprehensive information and resources to help you stay up to date and to guide you through the changing financial reporting framework.

- **Financial Reporting Hot Topic: Coronavirus**
- **IFRS - Revenue** (see also **for sectors**)
- **IFRS - Leases**
- **IFRS - Financial Instruments**
- **IFRS - Insurance**



COVID-19: A Guide to Maintaining Enterprise Resilience

Hong Kong edition

Home > Insights > COVID-19: A Guide to Maintaining Enterprise Resilience

22 April 2020

This guide sets out KPMG's perspectives on maintaining enterprise-wide resilience and some practical ways in which we are helping to equip clients to tackle not just the current global health crisis but a raft of other fast-moving trends set to shape the business landscape for years to come.

PDF

COVID-19: A Guide to Maintaining Enterprise Resilience

Hong Kong edition

Download PDF (1.8 MB)

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HONG KONG TAX ALERT

ISSUE 6 | April 2020

OECD COVID-19 analysis

Summary

On 3 April, the OECD issued an analysis examining tax treaties and the impact of the COVID-19 crisis on cross border workers. A number of key tax issues are addressed including the risk of a company creating a permanent establishment or taxable presence in a new jurisdiction and changes to the tax residence status of an individual as a result of key staff being forced to work in a location other than their normal place of work.

The OECD's guidance provides a pragmatic approach designed to prevent

Background

The OECD issued an analysis on 3 April examining tax treaties and the impact of the COVID-19 crisis. A number of potentially significant tax concerns may arise as a result of key staff being forced to work in a location other than their normal place of work. These include accidently causing a company to be resident in a location other than intended, accidently creating a permanent establishment or other taxable presence in a new jurisdiction and changes to the tax residence status of the individual concerned. The OECD analysis is helpful in this regard, setting out the view that COVID-19 measures are generally exceptional and should not normally impact on a company or individual's tax status under tax treaties in a particular jurisdiction. We note however that construction projects appear to be an exception where delays as a result of the virus may result in a permanent establishment being created.

The OECD's guidance will be helpful for many taxpayers who have been concerned about the impact staff dislocation may have on their tax position. However, it is worth noting that this only guidance, and is not binding, especially on the many jurisdictions in this region that are not OECD members. Further, the paper primarily deals with the position under OECD-model treaties rather than liabilities that might arise under domestic law. We note that a number of jurisdictions, such as the UK and Australia, have also issued their own guidance setting out the domestic law position and trust that other jurisdictions will take a similar approach, although taxpayers will need to monitor this on a case-by-case basis. Finally it is worth noting that, while the OECD generally encourages a position of maintaining the

Tentative dates and topics for 2020

- **12 June – Developments on sustainability reporting**
- **17 July – IASB’s major projects**
- **18 September – IASB and IFRIC update**
- **13 November – Year-end reporting considerations**

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ACCA Think Ahead

KPMG & ACCA Joint Survey

Are Hong Kong companies adopting a technology-enabled operating model?

As more organisations have invested in technology in recent years, the objective of this survey is to understand how organisations have changed or will change the way they operate and manage their talent to fully utilise the technology solutions implemented.

We would greatly appreciate it if you could provide us your thoughts on what this new normal will be by scanning the QR code.

Thank you