COVID-19

Impact on the Balance Sheet

April 2020
1. **Introduction** – Reto Brunner

2. **Key topics – what our experts are saying**
   a. Valuation & Impairment Testing – Marc Schmidli, Pascal Ziegler
   b. Accounting & Financial Reporting – Christophe Bourgoin, Amanda Waddill
      - Accounting complexities
      - Debt & liquidity considerations
      - Capital market considerations

3. **Q&A** – Marc Schmidli

4. **Wrap-up** – Reto Brunner
Valuation & Impairment Testing: Capital markets response

Does the observed decline in stock prices imply a comparable decline in the company values?

**Observations**

“…drop of ~30% in global equity markets between 31.12.2019 and today…”

“…impact across all sectors with airlines and energy being most severely hit …”

“…more than doubling in the number of companies in S&P Global 1200 with equity book value > market capitalization…”

No. of companies in S&P Global 1200 with equity book value higher than market capitalization…”
Valuation & Impairment Testing: Key valuation considerations

Two key considerations to adjust for COVID-19 with adjustment of business plan as preferred solution

1. Adjust business plan (incl. WACC update)
   - Pre-COVID-19 financial projections not applicable for valuations
   - Critical review and adjustment of business plan required
   - Development of reasonable and supported financial projections to account for high degree of uncertainty is major challenge for clients
   - Sensitivity and scenario analysis necessary to reflect increased market volatility
   - Wide valuation ranges due to the increased volatility and uncertainty expected
   - WACC update as of the valuation date based on Capital Asset Pricing Model required even in cases where business plan has been adjusted

2. Add COVID-19 risk premium only in exceptional cases
   - COVID-19 risk premium (CVRP) adjustment on WACC only appropriate if company is unable to adjust cash flow projections
Valuation & Impairment Testing: Business plan considerations

Business plan is to be adjusted in three steps to derive reasonable value ranges

Assess key business plan items

- Full revenues in the short-term regarded as lost or can catch-up effects be justified?
- How do additional costs incurred or possible countermeasures (e.g. short-time work) influence future cost structure?
- Impact of government support?

Extend business plan period

- Is going concern assumption still valid?
- How is recovery anticipated to happen (V-, U- or L-shape)?
- What is a reasonable extension of discrete business plan period?
- When are revenues expected to be back at pre-crisis levels?

Conduct scenario analysis

- Which assumptions are reasonable to define best- and worst case scenarios?
- Are potential credit and liquidity risks taken into account?
- Are increased market volatility and different economic scenarios considered?

Illustrative Post-COVID19 Business Plan

- Largest impact on revenues in years 1 - 3
- Pre-crisis revenue level

Initial Projection Period

Extended Projection Period

Terminal Value
Valuation & Impairment Testing: WACC considerations

COVID-19 risk premium on WACC only a fallback solution

- **Capital Asset Pricing Model** for WACC still valid and therefore should continue to be used

- Additional WACC adjustment with CVRP **only indicative fallback solution** in case financial projections cannot be adjusted

- Different **methods and tools available from PwC territories** to derive CVRP

- **Country-**, **industry-** and **company**-specific factors to be considered

- CVRP adjusted WACC to be applied on **full business plan period incl. terminal value**

Based on Swiss Performance Index
Valuation & Impairment Testing: Impacts in Q1/2020

PwC to support clients in assessment of COVID-19 effects on impairment tests

Is the COVID-19-crisis a triggering event in Q1 2020?

- Yes
  - **Impairment test must be performed!**
    - Effects of COVID-19 crisis to be considered in **revised financial projections** (incl. WACC update)
  - **Validation & documentation** of management’s assessment
  - **Audit / review the revised financial projections**
    - **Financial projections reasonable?** (Analysis of specific COVID-19 effects on CGUs/groups of CGUs)
  - **Impairment-Test result robust!**
  - **Impairment-Test result acceptable!**
  - **Correction of non-existent or inadequate consideration of the effects of COVID-19 crisis in financial projections by adjusting WACC with CVRP:**
    - Validation of client's impairment test results by means of adjusting WACC with CVRP: **indication of impairment?**
    - **No**
      - Client to include COVID-19 impact into financial projections!
    - **Yes**
      - **Impairment-Test result acceptable!**

- No
  - **Yes**
    - **Impairment test must be performed!**
      - Effects of COVID-19 crisis to be considered in **revised financial projections** (incl. WACC update)
    - **Validation & documentation** of management’s assessment
    - **Audit / review the revised financial projections**
      - **Financial projections reasonable?** (Analysis of specific COVID-19 effects on CGUs/groups of CGUs)
    - **Impairment-Test result robust!**
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    - **Correction of non-existent or inadequate consideration of the effects of COVID-19 crisis in financial projections by adjusting WACC with CVRP:**
      - Validation of client's impairment test results by means of adjusting WACC with CVRP: **indication of impairment?**
      - **No**
        - Client to include COVID-19 impact into financial projections!
      - **Yes**
        - **Impairment-Test result acceptable!**
  - **No**
    - **Recommendation:** Analysis of the CGUs/groups of CGUs (with and without goodwill) with regard to potential impairment risks (e.g. conduct headroom analysis)
    - (generally unacceptable)

- ✔️
- ☐
# Accounting & financial reporting

## Accounting complexities

<table>
<thead>
<tr>
<th>Challenges</th>
<th>Key topics</th>
<th>What companies are doing</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Value of intangible and tangible assets</td>
<td>• Impairment (goodwill, other intangible and</td>
<td>• Disclosures</td>
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<td></td>
<td>tangible assets)</td>
<td>• Consistency of assumptions used and</td>
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<td>sensitivity analysis</td>
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<tr>
<td>• Value of inventories</td>
<td>• Net realizable value</td>
<td>• Modelling of scenario</td>
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<td></td>
<td>• Idle capacity</td>
<td>• Impact assessment</td>
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<tr>
<td>• Accounting for government assistance</td>
<td>• Grants or not</td>
<td>• Overview for completeness</td>
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<td></td>
<td>• Timing for recognition</td>
<td>• Assess details of country specific</td>
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<td>• Presentation</td>
<td>schemes (e.g. “Kurzarbeit” in CH,</td>
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<td>rent-free periods)</td>
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<td>• Options in presentation</td>
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</tbody>
</table>
## Accounting & financial reporting

### Accounting complexities (continued)

<table>
<thead>
<tr>
<th>Challenges</th>
<th>Key topics</th>
<th>What companies are doing</th>
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</thead>
</table>
| • Additional liabilities to be recognized | • Restructuring provision  
• Onerous contracts  
• Future operating losses | • Modelling of scenario  
• Impact assessment |
| **• Uncertainty about revenue and related recognition** | • Transactions in scope of IFRS 15 or not  
• Variable consideration and constraint on recognition (“only to the extent that it is highly probable that a significant reversal of revenue recognized will not occur in the future”) | • Scrutiny on customers monitoring  
• Increased awareness and coordination for consistent judgment to be applied |
| • Employee benefits and share-based compensation | • Pension assets  
• Discount rate  
• Modifications / new plans | • Anticipation of pension valuation  
• Impact assessment of modifications as well as new plans being introduced |
Accounting & financial reporting

Debt and liquidity considerations

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<th>Key topics</th>
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</thead>
<tbody>
<tr>
<td>Valuation of financial assets and expected</td>
<td>• Financial assets in scope</td>
<td>• Determination of forward looking information</td>
</tr>
<tr>
<td>credit loss (ECL) model</td>
<td>• 12-month or lifetime ECL</td>
<td>• Update models and assess impact</td>
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<td></td>
<td>• Estimate of ECL (risk, exposure, loss)</td>
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<tr>
<td>Considerations for debt modifications</td>
<td>• Application of IFRS 9 guidance</td>
<td>• Consider classification and impact</td>
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<td></td>
<td>• Derecognition / modification gain or loss</td>
<td>• Identify all cross-default clauses</td>
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<td>• Discontinuation of hedge accounting</td>
<td>• Plan ahead (e.g. treatment of waivers as subsequent events)</td>
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<tr>
<td>Government assistance</td>
<td>• Scope</td>
<td>• Assess details of country specific schemes</td>
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<td></td>
<td>• Interest free loan</td>
<td>• Options in presentation</td>
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<tr>
<td>Breach of covenants</td>
<td>• Impact</td>
<td>• Checking contracts</td>
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<td>• Disclosures</td>
<td>• Sensitivity analysis</td>
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## Accounting & financial reporting

### Capital market considerations

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<tr>
<td>• Ad'hoc publicity</td>
<td>• Suspended 2020 guidance</td>
<td>Across all topics:</td>
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<td></td>
<td>• Profit warning</td>
<td>• Benchmarking</td>
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<td></td>
<td></td>
<td>• Finalization of impact assessment</td>
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<tr>
<td></td>
<td></td>
<td>• Discuss communication strategy</td>
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<tr>
<td>• Alternative performance measures (APMs or non-GAAP measures)</td>
<td>• Impact of Covid-19</td>
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<td>• Recent SIX directive</td>
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<tr>
<td>• Other means of communication</td>
<td>• Disclosure outside the financial statements</td>
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Summary

Second priority is to stabilise your organisation

Assess your situation

• Where is your organisation now, focus on critical points (impairment, other impacts on financial statements, communication)
• Use our published guidance, it is there to help you get an overview and ideas to set up your approach

What you can do now

• Ensure all critical topics impacting your financial reporting are on your radar
• Gather all relevant facts
• Match facts and guidance to determine recommended options

Other things to consider

• Stay informed: situation is constantly changing
• Focus your effort on transparency and external communication
• Align with other functions to streamline the process (e.g. Investor Relations, etc.)

PwC tools & links that can help you:

Checklist (DE, EN, FR)
COVID-19 Navigator
Beekeeper App
Cyber Attack and Readiness Evaluation

Publicly available information:

Easy gov
SECO
Short-time work
Cantons
Thank you

**One Point of Contact:**
Via [our crisis helpline](#) and PwC Switzerland website ([EN](#) | [DE](#) | [FR](#))

**Our experts:**

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Director
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