Accounting implications of the war in Ukraine

Considerations for 31 December 2021 financial statements prepared in accordance with IFRS, Swiss GAAP FER and Swiss CO

In the following sections, some of the key accounting questions are answered with reference to IFRS, Swiss GAAP FER (FER) and Swiss CO (CO). The impact on financial statements for the year ended 31 December 2021 will depend on entity-specific facts and circumstances, including the degree to which an entity's operations are exposed to the impacts of this war and the related events and market conditions.

Background

On 24 February 2022, Russian troops started invading Ukraine. The ongoing military attack has led, and continues to lead, to significant casualties, dislocation of the population, damage to infrastructure and disruption to economic activity in Ukraine.

In response, multiple jurisdictions, including the EU, Switzerland, the UK, the US, Canada, Japan and Australia have imposed initial tranches of economic sanctions on Russia (and in certain cases Belarus). In addition to the imposition of sanctions, a growing number of large public and private companies (including KPMG) have announced voluntary actions to curtail business activities with Russia and Belarus. These actions include plans to dispose of assets or discontinue operations in Russia/Belarus, curtailing exports to, or imports from, these countries and discontinuing the provision of services.

Further, a number of Russian publicly listed entities have had their listings suspended on certain stock exchanges and been excluded from market indices. The Russian central bank has temporarily suspended stocks and derivatives trading, and local authorities have also temporarily barred foreign investors from selling Russian assets and placed significant limitations on any payments to foreign entities, e.g. to settle financial liabilities.

The war in Ukraine and related events take place at a time of significant global economic uncertainty and volatility, and the effects are likely to interact with and exacerbate the effects of current market conditions. Many sectors/jurisdictions are already facing the impacts of rising commodity prices and increased raw materials costs, as a result of surging consumer demand as the COVID-19 pandemic eases. Supply-chain bottlenecks, arising from the effects of the pandemic, continue to persist, and are heightened by labor shortages and trade friction. These conditions may be significantly exacerbated by the wider effects of the war in Ukraine, increasing inflationary pressures and weakening the global post-pandemic recovery.

Are the implications of the war and the related events adjusting or non-adjusting events?

IFRS, FER, CO
Events occurring between the reporting date and the date when the financial statements are authorized for issue have to be classified into adjusting and non-adjusting events. *Adjusting events* are those providing evidence of conditions existing at the end of the reporting period and therefore need to be considered when preparing the financial statements (which may lead to adjustments of assets/liabilities). In contrast, *non-adjusting events* are indicative of conditions that arose after the reporting period and therefore are accounted for in the following reporting period.

For 31 December 2021 financial statements, the financial statement impacts of the events and market conditions arising from the war in Ukraine will generally be non-adjusting events (with the exception of going concern, see below). This is because the significant adverse changes in economic conditions and the political/business environment developed as a direct consequence of events occurring after the reporting date – i.e. the Russian invasion of Ukraine and the resulting implementation of economic sanctions by the international community. Although certain events did occur prior to 31 December 2021 (in particular, the fact that Russian troops were mobilized around the Ukrainian border and certain sanctions had previously been imposed), the invasion of Ukraine was a specific, defined event which occurred on 24 February 2022, i.e. after the end of the reporting period, and the significant sanctions imposed, as a coordinated package by the international community, were a direct response to that invasion. Therefore, based on the information that was reasonably available as of 31 December 2021, whilst market participants may have reflected the risks as a result of the uncertainty arising from the escalating tensions in the region in their assumptions, they would not have reflected the impacts of the invasion and the significant response from the international community that followed.

What disclosures might be required?

IFRS, FER, CO
As the impacts of the war in Ukraine and related events are generally considered to be non-adjusting events, they do not affect amounts recognized as of 31 December 2021. If the (potential) financial impacts in 2022 and beyond are material, entities are required to provide appropriate disclosures that reflect the nature of these events or changes in conditions after the reporting date, including an estimate of their financial effect if that can be determined, or a statement that such an estimate cannot be made.

For example, the following non-adjusting subsequent events may warrant disclosure in the 31 December 2021 financial statements:

- Impacts on personnel and related support initiatives;
- Significant business interruption arising from supply chain disruption, closure/abandonment of operations/manufacturing or commercial facilities, travel restrictions and logistics disruption;
- Damage/destruction of non-financial assets e.g., buildings and inventory;
- Seizure/expropriation of assets by government authorities or nationalization events after 31 December 2021;
- Restrictions on cash balances;
- Impairments of financial and non-financial assets (considering events and new information arising after the reporting date);
- Breaches of loan covenants, triggering of subjective covenants (e.g., material adverse change clauses), amendments, or waivers in lending agreements, and/or debt default;
- Significant declines in sales, earnings and/or operating cash flows;
- Volatility/abnormally large changes in equity or debt security prices, commodity prices, foreign currency exchange rates, and/or interest rates after 31 December 2021 that will significantly impact the measurement of assets and liabilities and/or income and expenses in the next 12 months; and
- Announcing plans of discontinuance or major asset disposals.

Relevant information may include respective carrying amounts, size of the local operations (e.g., number of employees, proportion of group's total revenue/profit) and dependence of the entity on the respective operations/relationships.

Is it possible to use hindsight when preparing the 2021 financial statements?

IFRS, FER, CO
No, the use of hindsight is generally not permitted. The financial statements should be based on the information that was reasonably available as of the reporting date. As such, only information that provides evidence of the conditions that existed at the end of the reporting period can be considered.

In particular, assumptions used in impairment calculations and fair value measurements for financial and non-financial assets at the reporting date need to reflect reasonable and supportable information available as of 31 December 2021. As such, caution should be exercised to avoid inappropriately using hindsight or developing valuation inputs that are not consistent with the conditions or reasonable expectations as of 31 December 2021.

Does the concept of adjusting vs. non-adjusting event apply for the going concern assumption as well?

IFRS, FER, CO
No, the concept of adjusting vs. non-adjusting event does not apply to the going concern assumption. The assessment as to whether the going concern basis is appropriate takes into account events and conditions after the end of the reporting period, i.e. 31 December 2021. Management assesses all available information about the future, considering the possible outcomes of events and changes in conditions and the realistically possible responses that are available to such events and conditions. Those considerations include, among others, the current economic uncertainty and market conditions, which are exacerbated by the consequences of the war in Ukraine.

As these events that occurred after the reporting date may have caused significant disruption to the business activities of certain entities, a significant deterioration in market conditions for some entities, and an increase in economic uncertainty for others, management may need to assess whether these events, individually or collectively, may cast significant doubt on the entity's ability to continue as a going concern, or in severe cases, whether the going concern assumption is still appropriate as a basis for the preparation of the entity's financial statements.

An entity is no longer a going concern if management either intends to liquidate the entity or cease trading, or has no realistic alternative but to do so.

What are the implications if there is significant doubt on the entity's ability to continue as a going concern?

IFRS
There are two scenarios in which specific disclosures are required in an entity's financial statements with regards to events or conditions that may cast significant doubt on an entity's ability to continue as a going concern:

- Material uncertainties exist, i.e. after consideration of all available evidence, management expects to be able to continue as a going concern, but cannot exclude the possibility that the entity might not have sufficient liquidity or enough reserves to absorb future losses; or
- Management concludes that there are no material uncertainties but reaching that conclusion involves significant judgement (a "close call").

FER, CO
If, after consideration of all available evidence, management expects to be able to continue as a going concern, but there is significant doubt about the entity's ability to do so (e.g., because it might not have sufficient liquidity or enough reserves to absorb future losses), specific disclosures must be provided in the entity's financial statements.

IFRS, FER, CO
Given the significance and widespread impacts of these recent events and market conditions, particularly for entities operating in Ukraine and Russia/Belarus or with significant exposure to these markets, these types of disclosures are more likely to be considered necessary. The level of detail of disclosures will depend on the entity's specific facts and circumstances, including the nature and extent of impacts on the entity. In our view, if there are such material uncertainties then an entity should, at a minimum, disclose the following information:

- details of events or conditions that may cast significant doubt on the entity's ability to continue as a going concern and management's evaluation of their significance in relation to the going concern assessment;
- management's plans to mitigate the effects of these events or conditions;
- significant judgements made by management in their going concern assessment, including their determination of whether there are material uncertainties; and
- an explicit statement that there is a material uncertainty related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern, and therefore that it may be unable to realize its assets and discharge its liabilities in the normal course of business.

IFRS only: For "close call" situations, similar disclosure requirements apply (as outlined in the first three bullet points above).

Explicit disclosures are not required in cases where management can conclude without significant judgement that no material uncertainties exist.

What are the implications if the going concern basis of preparation is no longer considered appropriate?

IFRS
If, after consideration of all available evidence, management concludes that there is no realistic alternative but to liquidate the entity or cease trading, the basis of preparation of the entity's financial statements must be adjusted and appropriately explained. This requires application of the general measurement, recognition and disclosure requirements, with particular attention paid to the requirements for assets that are being held for sale, the classification of the entity's debt and equity instruments, impairment testing and recognition and measurement of provisions.

FER, CO
If, after consideration of all available evidence, management concludes that there is no realistic alternative but to liquidate the entity or cease trading, the entity's financial statements must be prepared based on liquidation values. Appropriate explanations must be provided in the notes to these financial statements.

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