COVID-19 | When is the right time to recognise a restructuring provision?

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What's the issue?

As the COVID-19 coronavirus continues to spread around the world, many companies need to adjust their operations and some may plan longer-term changes. Management may consider downsizing or discontinuing specific operations; conversely, some companies may plan to explore a new business opportunity. All of these may lead to a restructuring.

Management's plans alone do not necessarily result in a restructuring provision in the financial statements. A restructuring provision is recognised only when specific conditions are met, and only for qualifying costs.

Getting into more detail

IFRS® Standards provide specific guidance on when to recognise a restructuring provision and at what amount. A 'restructuring' is a programme planned and controlled by management that materially changes the scope of the business or the manner in which it is conducted. *[IAS 37.10]*

Recognition

Under IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*, a restructuring provision is recognised only when both of the following conditions are met:

- there is a detailed formal plan for the restructuring; and
- a company has raised a valid expectation in those affected that the plan will be implemented – i.e. either by starting to implement the plan or announcing its main features to those affected. *[IAS 37.72]*

For example, suppose a company decides to close down one of its production facilities as a result of COVID-19. If the company announces its plan, specifying the facility to be closed, the estimated timing of the closure and the approximate number of employees it plans to make redundant, then it recognises a restructuring provision. The approval of the restructuring plan by the company's board is not by itself sufficient to recognise a restructuring provision. *[IAS 37.75]*

Termination benefits for employees made redundant as part of the restructuring are recognised in accordance with the specific requirements of IAS 19 *Employee Benefits*.

If an entity plans restructuring to respond to COVID-19, then it recognises a restructuring provision only when specific conditions are met.

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Measurement

Under IAS 37, restructuring provisions include only direct costs arising from the restructuring – e.g. employee termination benefits and consulting fees that relate directly to the restructuring, **onerous contract provisions**, contract termination costs and expected costs from when operations cease until final disposal. *[IAS 37.80]*

Costs associated with ongoing activities are not included in restructuring provisions. For example, the costs of retaining or relocating employees, administration or marketing costs and investment in new systems are not recognised as part of a restructuring provision. *[IAS 37.81]*

Provisions are remeasured at each reporting date to reflect changes in the best estimate of the amount or timing of the outflows or changes in discount rates. *[IAS 37.36, 59]*

Actions for management to take now

- Monitor government actions and consider all available government assistance when determining the need for restructuring.
- Assess whether the plan (or need for a plan) to restructure triggers impairment of assets and perform the **impairment test** if necessary.
- Ensure that a formal detailed restructuring plan is in place, and that those affected by the plan have a valid expectation that it will be carried out, before recognising a restructuring provision.
- Ensure that the restructuring provision does not include costs associated with the company's ongoing activities, unless they relate to an onerous contract.
- Provide clear and transparent disclosures about the nature of the restructuring provision, the expected timing of any resulting outflows of economic benefits and related uncertainties. *[IAS 1.98(b), 125, 37.85(a)–(b)]*

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