In the Spotlight

A Utility Industry Focus on COVID-19 Accounting Considerations

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COVID-19: Top 5 Accounting Issues for Utility Companies

At a glance:

The COVID-19 outbreak has developed rapidly in 2020, with a significant global impact. Measures taken to contain the virus have affected economic activity, which in turn has implications for financial reporting.

Measures to prevent transmission of the virus include limiting the movement of people, restricting flights and other travel, temporarily closing businesses and schools, and cancelling events. This will have an immediate impact on businesses such as tourism, transport, retail and entertainment. It will also begin to affect supply chains and the production of goods throughout the world, and lower economic activity is likely to result in reduced demand for many goods and services.

COVID-19 will impact many areas of accounting and reporting for all industries, as outlined in our publication: https://inform.pwc.com/s/Accounting_implications_of_the_effects_of_coronavirus_PwC_In_depth_INT2020_02/informContent/2033163303178016#ic_2033163303178016.

While not yet severely impacted from a financial reporting perspective, utility entities provide an essential service and have been required to keep their doors open.

In this Spotlight we provide our insights into the top issues that utility entities might face. While this Spotlight focuses on issues that are likely to be the most frequently encountered, many others are certain to arise. As the situation continues to evolve, so too will the consequential accounting issues. For these reasons, the following is not an exhaustive list of all relevant accounting considerations.

We believe that management should carefully consider the impact on each line item in the financial statements for both interim and annual reporting purposes. Several key issues that we expect to see impacting utility entities are:

1. Estimates of expected credit losses under IFRS 9

Utility entities are often required to provide services to both commercial and industrial customers across industries and retail customers who might be impacted to varying degrees by the pandemic. IFRS 9 requires entities to use an expected credit loss model for most financial assets, including trade receivables. The expected credit loss model requires consideration of historical and current information, as well as reasonable and supportable forecasts of future conditions (including macroeconomic information).

Expected credit losses are likely to increase as a result of the pandemic. However, utilities should also consider the impact of any collateral (such as deposits) and government programmes designed to support customers (for example, unemployment assistance) in developing their provision.

More information on the accounting for government programmes is included in item 5 below. See In Depth 2020-021: Accounting implications of the effects of the Coronavirus for further details on the impairment requirements of IFRS 9.

2. Impact on employee compensation arrangements

Utility entities typically have a large workforce and significant defined benefit pension obligations.

Management should consider whether any of the assumptions used to measure the employee benefits and share-based payments have been impacted by the current global economic situation.

For example, one of the inputs into the measurement of the defined benefit obligation is either the yield on high-quality corporate bonds or government bonds; this might have changed as a result of the current situation. Furthermore, IAS 19 requires plan assets of defined benefit plans to be measured at fair value in accordance with IFRS 13.

Downward pressure on financial markets might have had a significant impact on the values of pension assets and the funded position of such plans.

Further information on the impacts to employee benefits and share-based payments can be found in In Depth 2020-021: Accounting implications of the effects of the Coronavirus.

3. Revenue and regulated operations

Utility entities, in economies where businesses have curtailed or ceased operations, might experience a decline in the demand for their services.

Additionally, there could be an impact on assumptions used in measuring revenue, including any expected price concessions or deferred payment plans which create a significant financing component.

Further, for a contract to exist, it must be probable (under IFRS 15) that the entity will collect the consideration to which it is entitled for transferring the goods and services to the customer. If a utility entity is required or chooses to continue providing goods and services to a customer that is experiencing cash flow problems and there is significant doubt as to whether consideration will be collectible, it might not be appropriate to recognise revenue when the related goods or services are transferred to that customer.

The actions of regulators can have a pervasive impact on a utility's results of operations, financial position and cash flows. Regulated utilities should consider whether COVID-19 measures will be imposed by a regulator for rate-making purposes and how this might impact the utility's revenues. For example, regulators might order temporary rate relief for customers that causes rates to fall below the cost of services. Utilities will need to consider the accounting impact of these actions. The impact might differ for those utilities applying IFRS 14 versus those that have not applied rate-regulated accounting.

Furthermore, utilities might incur costs as a result of the pandemic which are not recoverable in current rates. Where such costs are expected to be included in future rates, the implications under IFRS 14 will need to be considered.

Assessing these and other revenue considerations might require significant judgement.

4. 'Own use' and onerous contracts

Many commodity contracts under long-term, non-cancellable agreements are inputs into utility services, such as coal, natural gas and electricity. To the extent that the entity is purchasing volumes that are no longer required due to declines in customer demand, these contracts might become onerous or they might no longer be held for the utility's 'own use'.

Where purchase or sales contracts are net settleable in accordance with IFRS 9 (for example, because the underlying is readily convertible to cash or because the contract permits cash settlement) and the entity is no longer holding such contracts for 'own use', they might need to be accounted for as derivatives measured at fair value through profit or loss in accordance with IFRS 9.

However, to the extent that such contracts continue to fall outside the scope of IFRS 9, they would need to be evaluated to determine whether they are onerous contracts within the scope of IAS 37.

These considerations can be complex, and we encourage entities to discuss these matters with their professional advisors.

5. Government relief programmes

Many governments are developing programmes to provide economic support. Where this intervention is made through the utility (for example, by providing funding to utilities in order to compensate for deferred payment plans), a key accounting consideration is whether an element of the transaction is a government grant. This can impact the timing of recognition of the effects of the relief, the presentation of those effects and what disclosures might be required.

In order to determine the appropriate accounting treatment, it will be important to understand the exact details of each particular support arrangement. Some of the factors to consider when assessing the treatment are:

- Whether the programme is on arm's length terms, based on past transactions or market pricing, or can be considered to be 'on market' for transactions of this kind in the current environment.
- If a programme does contain a government grant, whether there is 'reasonable assurance' that the grant will be received, as required by paragraph 7 of IAS 20.

If the recognition of a government grant is determined to be appropriate, the timing of recognition of the benefit in profit and loss, and its presentation and disclosure.

Conclusion

COVID-19 has given rise to unprecedented challenges that have affected virtually every aspect of modern life. The economic implications of the virus will have a consequent impact on many aspects of accounting and financial reporting. We hope that this Spotlight will help you and your advisors as you navigate the key issues.