

IFRS in Focus

The Greek debt crisis: Financial reporting implications for 30 June



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Introduction

On 13 July 2015 Europe's leaders agreed in principle that they are ready to start negotiations on a European Stability Mechanism (ESM) financial assistance programme for Greece, which means the EU intends to continue to provide financial support to Greece by means of a third bailout. That agreement does not, however, signal the end of the Greek debt crisis. It is only an agreement in principle and has several preconditions.

Before formal negotiations on an ESM programme can even begin several national parliaments, as the creditors, must approve the plan. For its part, the Greek Parliament must endorse all of the commitments included in the text of the Euro Summit on Greece. Additionally, Greece must legally implement several economic reforms within a defined timetable and formally request the IMF to provide support beyond March 2016. On 15 July, the Greek Parliament approved the plan and passed legislation to reform pensions, increase taxes and establish a debt repayment fund.

A positive outcome of the agreement reached is that it will reduce the uncertainty in the markets about the ability of the Greek Government and Greek businesses to continue to operate, and to meet their ongoing commitments.

For more information please see the following websites:

www.iasplus.com

www.deloitte.com

Nevertheless, risks remain and there will still be some uncertainty about how the package of reforms will affect individual businesses. The costs of the reforms will be borne by many parties, including tourists and consumers.

Many entities will be preparing financial reports for the period to 30 June 2015 – for most entities these will be interim reports, but some will be preparing annual reports. The on-going financial reporting implications of the Greek debt crisis will need to be considered when those reports are prepared, including that Greece leaving the Eurozone still remains a possibility.

Following previous publications on the consequences of the Eurozone crisis, including a Greek exit from the euro¹, many of the financial reporting implications will already have been factored into financial reports.

The purpose of this publication is to remind preparers of the main issues that they will need to think about as entities prepare their IFRS financial statements as at 30 June 2015.

Financial reporting consequences at a glance

General disclosures

For 30 June reporting periods, the 13 July decision, and its consequences, will be a non-adjusting event after the reporting period. The Greek referendum on 5 July, the revised proposal from Greece on 9 July and the agreement on 13 July and its endorsement by the Greek parliament on 15 July were all conditions arising after 30 June. Entities will need to consider whether there are any matters about the agreement relevant to them that should be disclosed.

How the on-going Greek crisis affects a particular entity will depend on its facts and circumstances. It remains important that an entity's financial report includes information to help investors assess how the crisis is affecting the entity. For annual reports this will include:

- information about credit risk, liquidity risk, market risk and concentrations of risk (IFRS 7);
- restrictions on the use of assets within a group (IFRS 12);
- restrictions on the use (for example, on repatriation) of cash (IAS 7); and
- other specific requirements on impairment (IAS 36), temporarily idle property, plant and equipment (IAS 16), etc.

Depending on the extent of an entity's exposure to the Greek economy it could be particularly important to ensure that related disclosures are presented together, rather than distributed throughout the report.

The disclosures should be specific to the entity, rather than boiler-plate statements about the current state of Greece, and proportionate to the exposure of an entity to the Greek economy. Greater exposure to Greece is likely to warrant more extensive explanations of how the entity is affected.

For interim financial statements, the disclosures are likely to be less extensive, because the notes should focus on highlighting changes that are significant to an understanding of the changes in financial position and performance of the entity since the end of the last *annual* reporting period, but should still be sufficient to provide users with an understanding of the effect of recent developments on the entity. Again, these need to be specific to the entity and proportionate.

In addition to the requirements of IFRSs, many local laws or regulations require disclosure of the risks facing an entity.

Entities with an exposure to the Greek economy that are subject to such requirements should consider whether recent developments have led to new risks or in previously disclosed risks becoming more significant.

Impairment

Given the ongoing crisis in Greece, it should be assumed that an impairment review will be required of the assets of Greek businesses and balances due from Greek entities at 30 June 2015. That impairment assessment for 30 June must reflect the facts and circumstances that existed at that date and not be influenced by subsequent non-adjusting events such as the decisions made by the Greek government and its creditors in July 2015.

The likelihood that assets in Greece are impaired beyond the assessment made at 30 June should be reduced by the agreement. However, it does not eliminate this risk and preparers should continue to monitor the assets affected. It is also unlikely that the agreement would provide any basis for reversing any impairments already recognised.

1 Turbulent Times
<http://www.iasplus.com/en/publications/global/other/turbulent-times-2014-financial-reporting-considerations-arising-from-the-eurozone-crisis>

Exiting the Euro
<http://www.iasplus.com/en/publications/global/other/exiting-the-euro-2014-financial-reporting-implications-of-a-countrys-exit-from-the-eurozone>

Depending on the asset being assessed, impairment issues might arise in different ways. For example:

- impairment of a receivable reflects the current condition of the counterparty. The likelihood of recovery of any amounts due from the Greek government will need to be considered carefully;
- impairment of goodwill or of deferred tax assets results from a deterioration in expected future trading performance; and
- impairment of inventory reflects the current estimated selling price that can be achieved.

Impairment of other financial assets is governed by the specific rules of IAS 39 (or, when applied, IFRS 9).

Going concern

Entities that have significant exposure to the Greek economy will need to assess whether they can continue to prepare their financial statements on a going concern basis. Although the agreement should reduce that risk in the immediate term, the question remains one that needs to be asked. Also, it is not just for entities with direct dealings in Greece as, for example, suppliers to businesses trading in Greece might also be adversely affected.

The outlook



Even though the danger of an immediate exit from the Eurozone appears to have been averted, it is not completely off the table. The Greek Government must still implement the reforms, which will require a lot of political will. The sentiment expressed by voters in the referendum on 5 July against many of the measures set out in the text of the Euro Summit on Greece, and a coalition Government with a slim majority, mean that implementation of the commitments will not be straightforward. In any case, this is just the first step towards a third bailout – a formal Memorandum of Understanding still needs to be negotiated. It is possible that once that process begins further decisions on continuation of the bailout plan will need to be made by Greece's creditors.

The financial situation can change quickly. Entities will need to continue to monitor developments, including continuing to consider the consequences of Greece leaving the Eurozone

The Greek Government must still implement the reforms, which will require a lot of political will.

Exiting the Eurozone – keeping the consequences in mind

The discussion that follows is intended to be indicative as the mechanism by which a Greek exit from the Eurozone would be enacted is currently unclear. If such an event becomes more likely we will issue more comprehensive and specific advice.

Direct consequences

An exit from the Eurozone would require Greece to introduce a new currency. That step would likely to be accompanied by legislation specifying that contracts that are governed by Greek law be redenominated from the euro to the new currency. The redenomination of contracts from the euro to a new currency will inevitably come with some legal uncertainties about enforceability. Although the courts will resolve these uncertainties over time, until they do financial reports will need to capture or convey those uncertainties.

The imposition of exchange and other controls is also expected, to manage the currency and limit capital flight.

Among the main financial reporting matters we would need to consider are:

- Determination of an entity's functional currency as a new currency could affect that assessment.
- Changing the currency of a financial instrument raises questions about whether it becomes a new instrument as a consequence of changes to the rights or risks changing. If this is the case the replaced instrument would be derecognised, with a potential gain or loss. In a similar manner, changing the currency could change the classification of the instrument as a liability or as equity.
- Hedge relationships could be upset by a change in currency, with the consequence that a hedging relationship becomes ineffective.
- Exchange controls and the possibility of grey markets developing could mean that identification of the rates required by IAS 21 *The Effects of Changes in Foreign Exchange Rates* to retranslate Greek activities requires the use of judgement and warrants additional explanation and disclosure.
- Government action following an exit from the Eurozone might affect control and joint control assessments.
- The reference point for assessing high quality corporate bonds for measuring pension liabilities could change.
- A new currency could change the assessment of operating segments.

Broader economic considerations

The economic consequences of a new currency are broad and potentially far reaching. A Eurozone exit might coincide with Greece defaulting on its sovereign debt obligations – the direct consequences for businesses are not likely to be as significant as the Greek Sovereign Debt problems experienced in 2012, because most Greek Sovereign Debt is now held by governments rather than in the private sector.

If a new Greek currency was severely discounted relative to the euro and other currencies, the ability of the Government, corporations and individuals in Greece to meet financial obligations denominated in foreign currencies (including the euro) would be severely hampered.

Most of the broader consequences relate to impairment issues, which would put a greater spotlight on going concern and the other matters highlighted in the first part of this publication. It would also carry the risk of contagion, whereby other economies within the Eurozone could be at greater risk of experiencing economic difficulties.

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