2020

Financial Reporting Supervision

Observations on selected financial reporting issues – years ending on or after 31 December 2020

IAASA
Irish Auditing & Accounting Supervisory Authority

MISSION

To contribute to Ireland having a strong regulatory environment in which to do business by supervising and promoting high quality financial reporting, auditing and effective regulation of the accounting profession in the public interest

IAASA publications referred to in this *Observations* document are available on the publications section of IAASA's website

COVID-19 related pronouncements are available on the COVID-19 hub on IAASA's website

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1. FINANCIAL REPORTING ENVIRONMENT

1.1 Introduction

Ireland's accounting enforcer, IAASA, examines the annual financial statements and half-yearly financial reports of certain equity issuers, debt issuers and closed-end fund issuers (collectively 'issuers') to ensure that the reports are compliant with the relevant financial reporting framework.

In publishing this *Observations* document, IAASA hopes to assist issuers' management and those charged with governance in the preparation of high quality financial reports by offering observations on selected financial reporting topics to coincide with the preparation of issuers' 2020 financial statements. Issuers can expect that some of the matters set out in this document will be subject to detailed scrutiny as IAASA conducts its programme of examinations of issuers' financial reports during 2021.

Globally, Europe-wide and domestically the economic environment is uncertain. Issuers are grappling with significant uncertainties such as COVID-19 and Brexit.

1.2 COVID-19

COVID-19 has had a significant impact on individuals, society and financial markets; it has accounting implications for many entities. As the progress of the pandemic is unknown in both depth and duration, entities are exposed to conditions more often seen only in a severe and widespread economic downturn. The pandemic could result in an even broader economic downturn, which could have a prolonged and negative impact on an entity's financial performance and position.

Issuers are faced with the challenge of reflecting short, medium and longer-term forecasts into their financial statements in a climate of weak economic signals. A major challenge is the uncertainty brought about by COVID-19 in terms of its depth and duration.

> '*Given the scale of uncertainty surrounding the economic outlook, two different scenarios are outlined in the Quarterly Bulletin. In the "baseline" scenario, the gradual reopening of the economy would allow for an initial rebound in economic activity over the near term … In the "severe" scenario, the strict lockdown period is assumed to have a more damaging impact on economic activity … In this scenario, there is a subdued economic recovery with a larger permanent loss of output.*'
>
> Press Release accompanying publication of Quarterly Bulletin QB3 – July 2020, Central Bank of Ireland

> '*Economic growth is set to slow over the coming decades.*'
>
> Long-term Sustainability Report - Fiscal challenges and risks 2025-2050, Irish Fiscal Advisory Council, July 2020

> '*Global growth is projected at -4.9 percent in 2020, 1.9 percentage points below the April 2020 World Economic Outlook (WEO) forecast. The COVID-19 pandemic has had a more negative impact on activity in the first half of 2020 than anticipated, and the recovery is projected to be more gradual than previously forecast.*'
>
> *A Crisis Like No Other, An Uncertain Recovery* World Economic Outlook Update, June 2020, International Monetary Fund

1.3 Brexit

Brexit continues to pose uncertainties for issuers. Negotiations on the post-Brexit relationship between the United Kingdom and the European Union continue. However, without some kind of free trade agreement, trade between the UK and the EU will be based on World Trade Organisation (WTO) rules. Put simply, this means import duties and various controls would be imposed on trade between them.

Given the disruption to trade and supply chains that could result from a ‘no-deal’ or ‘hard’ Brexit, issuers need to remain mindful of the uncertainties any arrangements will bring.

2. OBSERVATIONS ON SELECTED FINANCIAL REPORTING ISSUES

IAASA expects issuers to provide entity specific and comprehensive disclosures that enable users of financial reports to understand:

(a) the impact that the COVID-19 pandemic has had on issuers – on their financial performance, financial position, cash flows and risks;

(b) the sources of estimation uncertainty and changes in the key assumptions underpinning assets, liabilities, income, expenses and cash flows;

(c) the mitigating actions taken to respond to the pandemic; and

(d) the expected impact on the future financial performance, financial position, cash flows, and risks.

2.1 Management report – COVID-19

Regulation 5(4)(c)(ii) of the Transparency (Directive 2004/109/EC) Regulations 2007 (S.I. 277 of 2007) ('Regulations') states that for each person making a responsibility statement, a statement shall set out to the best of his or her knowledge '*the management report includes a fair review of the development and performance of the business and the position of the issuer and the undertakings included in the consolidation taken as a whole, together with a description of the principal risks and uncertainties that they face …*'

COVID-19 is having a different impact on each issuer. Therefore, it is important for issuers to clearly explain in the management report the impact COVID-19 has had on the development and performance of its business and the position of the issuer.

Again, depending on the specific circumstances of the issuer, some of the matters that IAASA expects to be disclosed in annual reports in the context of COVID-19 are:

(a) a clear indication that the issuer has negotiated waivers of loan covenant conditions with its lenders, including an explanation of the terms of the waiver;

(b) an explanation of the impact of any non-compliance with the loan covenant waiver terms;

(c) a discussion of any likelihood of a potential failing of the loan covenant waiver terms and the possibility of obtaining another waiver in the future;

(d) a discussion of the impact of the new economic reality following COVID-19 on the issuer's liquidity position. Depending on the issuer's specific circumstances, IAASA expects to see discussion on the generation and utilisation of cash resources (cash burn) and, possibly, some discussion on financial support received from Government;

(e) in the event that the market capitalisation of the issuer is below the carrying amount of its net assets, IAASA expects detailed disclosures regarding impairment charges or detailed explanations as to why the decline in market value has not triggered an impairment charge;

(f) a discussion of the impact of COVID-19 on the economies or markets where the issuer operates (e.g. travel restrictions, physical distancing, work from home requirements) which may have resulted in a reduction in revenue and delayed cash collection. IAASA expects to see explanations from issuers of the impact of COVID-19 on its wider financial performance (i.e. cost increases, margin reduction) together with a discussion on how each of the operating segments were affected by the new economic situation. IAASA also expects issuers to provide commentary as to how the future financial performance, financial position and cash flows will likely be impacted by the economic situation;

(g) a discussion setting out how the issuer has changed its strategy in light of the new economic situation as a result of COVID-19;

(h) a discussion of the impact of any operations of the issuer being closed due to COVID-19 or if there was supply chain disruption. Issuers should indicate how long any of its premises/operations were closed or how their supply chains were disrupted;

(i) a discussion of the health and safety of its employees;

(j) to aid user's understanding of the issuer's business, management should also provide insights into any future trends that they have observed, for example, any changes in their customers behaviour patterns, increase in on-line sales, staff contracting COVID-19 and unable to work, etc.

Matters for consideration by management, Directors and Audit Committees
Management, Directors and Audit Committees should ensure that their COVID-19 disclosures in the management report are entity specific, and provide sufficient detail to allow users to understand the impact that the COVID-19 restrictions have on the issuer's current and future financial performance, financial position, cash flows and risks.

2.2 Changes in liquidity and funding

IAASA has previously commented about the poor quality – both qualitatively and quantitatively – of liquidity risk disclosures and of liquidity maturity tables by certain issuers. Our 2019 *Observations* document highlighted some of the more common deficiencies identified in this area.

Issuers are reminded that paragraph 39 of IFRS 7 *Financial Instruments: Disclosures* requires the disclosure of:

(a) a maturity analysis for non-derivative financial liabilities showing the remaining contractual maturities [IFRS 7.39(a) and IFRS 7.BC11];

(b) a maturity analysis for derivative financial liabilities [IFRS 7.39(b)]; and

(c) a description of the entity's approach to risk management.

The onset of the COVID-19 pandemic has prompted IAASA to consider and examine more broadly the quality of issuers' reporting of liquidity risk and their description of their approach to the management of liquidity risk and changes therein. Disclosures that are considered relevant in this context include the following:

Paragraph 44A of IAS 7 *Statement of Cash Flows* requires entities to provide disclosures that '*… enable users of financial statements to evaluate changes in liabilities arising from financing activities, including both changes arising from cash flows and non-cash changes.*'

Issuers should note that IFRS 7.18 – 19 require issuers to disclose information about the details of loan defaults and covenant breaches, the carrying amount of loans in default or in breach of terms and whether the default or breach was remedied and the terms of such remediation.

Paragraph 135(e) of IAS 1 *Presentation of Financial Statements* requires an issuer to disclose when it has not complied with externally imposed capital requirements and the consequences of such non-compliance.

In addition, when an issuer is at an increased risk of breaching or defaulting on borrowing covenants (e.g. because it is close to key covenant limits), IAASA expects the issuer to disclose how it has complied with key covenant metrics in both quantitative and qualitative terms and to describe any actions taken to mitigate the increased risk [IFRS 7.33 to 35 and IAS 1.17(c)] .

Matters for consideration by management, Directors and Audit Committees
IAASA reminds management, Directors and Audit Committees to:

(a) reassess their reporting of changes in liquidity risk and funding arising from the impacts of COVID-19;

(b) provide liquidity and funding information that is issuer specific and describes the issuer's approach to liquidity risk management and changes therein; and

(c) enhance the transparency of its disclosure of liquidity risk and its sources, availability and use of funds.

2.3 Compliance with bank covenants

A significant deterioration in an entity's financial performance and financial position because of the COVID-19 pandemic could result in breaches of debt covenants or trigger subjective covenant clauses. These could mean the borrowings become repayable on demand and in advance of the otherwise contractual maturity date. As a result borrowings may be reclassified as current liabilities rather than non-current liabilities at the reporting date.

When loan agreements include subjective covenant clauses (e.g. 'material adverse change' clauses) the entity will need to exercise judgement in determining whether or not those subjective clauses are breached or are in default as defined by agreements.

When an entity breaches a provision of a long-term loan arrangement on or before the reporting date such that the borrowings become repayable on demand, it must classify the liability as current. This is because the entity does not have an unconditional right to defer its settlement for at least 12 months after that date. [IAS 1.74].

However, if by the reporting date the entity obtains from the lender an agreement to provide a grace period ending at least 12 months after the reporting date, then the liability is classified as non-current [IAS 1.75].

If the entity obtains this agreement after the reporting date, then this is treated as a non-adjusting event in accordance with IAS 10 *Events after the Reporting Period* meaning that the entity is required to classify the liability, which is now repayable on demand as a result of the breach, as current at the reporting date [IAS 1.76].

IFRS 7 requires that for loans payable recognised at the end of the reporting period, an issuer shall disclose the following [IFRS 7.18]:

(a) details of any defaults during the period of principal, interest, sinking fund, or redemption terms of those loans payable;

(b) the carrying amount of the loans payable in default at the end of the reporting period; and

(c) whether the default was remedied, or the terms of the loans payable were renegotiated, before the financial statements were authorised for issue.

The extent to which an issuer complies or otherwise with its borrowing covenants and its liquidity are factors in assessing whether or not it is a going concern. IAS 1 25 – 26 require that management assess the issuer's ability to continue as a going concern. In assessing whether the going concern assumption is appropriate, management takes into account all available information about the future including, in this context, debt repayment schedules and potential sources of replacement financing.

In the event that issuers proactively negotiate modifications of the terms of its borrowings with lenders, issuers are reminded that the requirements of paragraph 3.3 of IFRS 9 *Financial Instruments* may apply. This requires an assessment as to whether or not there is a substantial modification of the terms of an existing financial liability or a part of it. Where there is a substantial modification of the financial liability this shall be accounted for as an extinguishment of the original financial liability and the recognition of a new financial liability.

In 2020, IAASA sought more detailed disclosures in periodic financial statements regarding modifications of borrowing covenants and, specifically, more precise details as to the dates on which covenant terms were modified and subsequently rectified.

Matters for consideration by management, Directors and Audit Committees
Management, Directors and Audit Committees should carefully consider the extent to which the issuer complies with covenant requirements. In instances of breaches and rectifications, the disclosures under IAS 1, IAS 10 and IFRS 7 should be carefully prepared and reviewed so that useful information is provided to users of these financial reports.

2.4 IFRS 13 *Fair Value Measurement*

The COVID-19 pandemic has had a significant impact on financial markets since it first emerged in Q1 2020. Some stock markets have declined sharply, volatility has increased, for some asset classes the volume of transactions has reduced in frequency, treasury bond yields have reached record lows (some negative) and credit-default-swap indices have been increasing, reflecting possible increased corporate defaults.

For financial reporting periods ending on or after March 2020 the fair value measurements of both financial and non-financial assets (e.g. investment property, and property, plant and equipment) will need to be re-assessed and, where necessary, updated to ensure the fair values reflect the impact of the COVID-19 pandemic. This is important for all issuers and, in particular, for issuers active in sectors most impacted by COVID-19 (e.g. airlines, retail and leisure).

The following observations are highlighted by IAASA in the context of issuers' approach to determining a fair value in a COVID-19 environment.

2.4.1 Changes in valuation techniques

A material reduction in market transactions may result in independent valuation reports (or issuers' own fair valuations) having to apply a combination of different valuation methodologies and new valuation techniques to address fair value price volatility and uncertainty. For example, in the absence of a sufficient level market transactions, valuation methodologies may have moved from a market transaction model to a single likely cash flow valuation model or to a multiple cash flow scenarios valuation model. The latter utilise probability weighted scenarios to reflect greater risk and uncertainty in valuations. If there has been a change in the valuation techniques (or the use of additional valuation techniques) issuers shall disclose those changes and the reasons for same [IFRS 13.93(d)].

2.4.2 Link between cash flows, discount rates, and valuation techniques

The discount rate used in a fair valuation is often a combination of the risk-free rate and other components such as credit spreads or risk premiums [IFRS 13.B16]. To avoid double accounting (or omitting) the effects of risk factors, a change to the valuation technique may require a change to the calculation of discount rate used to discount cash flows. For example, a change from a single contractual or most likely cash flow valuation model to a model that applies probability weightings to multiple cash flows scenarios will merit a change to the discount rate [IFRS 13.B14 and B17].

Even in instances where the valuation technique remains unchanged, risk free rates may have decreased (e.g. treasury yields) and other factors such as credit spreads (as measured by CDS spreads) may have increased. Pre-COVID-19 discount rates may be out-of-date and issuers should consider updating.

2.4.3 Use of independent valuation reports

Independent valuation reports used by issuers will need to be assessed to determine whether or not they are based upon pre- or post-COVID-19 market transactions and assumptions. Fair valuation adjustments may be required in order to comply with IFRS 13.9 [definition of fair value] and IFRS 13.B2 [the fair value measurement approach]. Where independent valuation reports include qualifications such as material uncertainty clauses, valuation assumptions and caveats need to be clearly understood by issuers in order to consider whether or not the fair value adjustments comply, in full, with the requirements of IFRS 13 and whether or not fair value reflects what market participants would use in making fair value judgements at the measurement date.

2.4.4 Own credit risk and liquidity risk

The uncertain economic environment has resulted in increases in the credit risk and liquidity risk for many issuers. Own credit risk and counterparty credit risk that are used as inputs into valuation techniques may therefore increase. Significant judgment may be needed to quantify risk premiums and other adjustments for these risks. The number of fair value measurements classified as Level 3 in the fair value hierarchy may increase (e.g. due to unobservable inputs such as the credit risk becoming significant in the current environment).

2.4.5 COVID-19 expanded fair value disclosures – sensitivity

COVID-19 will increase the use of unobservable inputs (e.g. risk-adjusted discount rates) in fair valuation for many issuers. Issuers should consider whether, in accordance with their individual circumstances and the requirements of IFRSs, they require additional sensitivity disclosures to address the increased uncertainty in fair values. Additional disclosures, including the sensitivity of fair values, may be required by IFRSs to enable users to understand how fair value has been determined together with material changes (and the reasons for changes) in the fair valuations.

Issuers need to be mindful that additional fair value disclosures may be required by IFRS 13 to address increased uncertainty in fair valuations caused by COVID-19 such as:

(a) IFRS 13.93(d) [significant unobservable inputs];

(b) IFRS 13.93(h) [sensitivity of the fair value measurement to changes].

In addition, IAS 1.125 and IAS 1.129 require disclosures about major sources of estimation uncertainty – including fair values – that have a significant risk of resulting in a material adjustment to the carrying amounts of assets or liabilities within the next financial year. IAS 1.129 sets out examples of the types of disclosures an entity makes to achieve compliance with IAS 1.125.

Fair value disclosures required by other Standards include IAS 36 *Impairment of Assets*, [fair value less cost of disposal], IAS 40 *Investment Property*, IAS 16 *Property, Plant and Equipment* and IFRS 3 *Business Combinations*.

Matters for consideration by management, Directors and Audit Committees
Management, Directors and Audit Committees will need to monitor whether or not:

(a) fair values are based upon pre- or post-COVID-19 market transactions and assumptions;

(b) changes in the valuations techniques and assumptions have been applied in order to maximise the use of observable inputs and minimise the use of unobservable inputs [IFRS 13.67];

(c) fair valuations (e.g. independent valuation reports) contain material uncertainty clauses and, if so, what are the implications for the compliance with IFRS 13;

(d) changes in discount rates, own credit risk, liquidity risk and other risk premium are required in fair valuations; and

(e) enhanced fair value disclosures and additional fair value sensitivity disclosures are required to be disclosed in accordance with IFRS 13 and IAS 1 that reflect COVID-19 transactions and assumptions.

2.5 IAS 36 – Impairment

2.5.1 Indicators of impairment

Market uncertainty about issuers' future cash flows and future prospects arising from the COVID-19 pandemic has resulted in significant volatility and reductions in the market capitalisation of many issuers.

IAS 36.9 states that '*An entity shall assess at the end of each reporting period whether there is any indication that an asset may be impaired. If any such indication exists, the entity shall estimate the recoverable amount of the asset.*'

Goodwill and intangible assets with an indefinite useful life are tested annually for impairment irrespective of any indication of impairment. However, the impact of the COVID-19 pandemic may indicate that impairment of other non-financial assets (e.g. property plant and equipment, right-of-use assets and other non-financial assets) has arisen. For other assets, IAS 36 describes indicators of impairment that issuers shall consider in assessing whether or not there is any indication that an asset may be impaired. External information that issuers consider include:

(a) the carrying amount of the net assets of the entity is more than its market capitalisation;

(b) there are observable indications that the assets value has declined during the period significantly more than would be expected as a result of the passage of time; and

(c) significant changes with an adverse effect on the entity have taken place during the period, or will take place in the near future.

IAASA have observed a number of half-yearly financial reports where:

(a) it is unclear whether or not an impairment test has been performed; and

(b) no impairment test has been performed, notwithstanding evidence of indications of impairment, including market capitalisation is below the carrying value of the net assets of the issuer, material decreases in revenue, closure of some operations, and changes in customer behaviour).

While it is noted that there is uncertainty amongst issuers as to the depth and duration of the impacts of COVID-19 restrictions, we expect many issuers will have an indication of impairment present in their 2020 financial statements. Issuers should critically assess whether or not there are any indications of impairment and, if so, an impairment test is required by IAS 36 (which may or may not result in an impairment charge).

Matters for consideration by management, Directors and Audit Committees
We expect many issuers will have an indication of impairment present in their 2020 financial statements thus necessitating an impairment test. In the context of the uncertainties posed by COVID-19, issuers' management, Directors and Audit Committees need to critically assess whether or not there are any indicators of impairment that an asset may be impaired and, if so, perform an impairment test in accordance with IAS 36.

2.5.2 Incorporating uncertainty into impairment testing

Given the economic uncertainty caused by COVID-19, IAASA expects that issuers will incorporate the higher levels of uncertainty into their impairment testing. In such instances, issuers should consider the importance of high quality disclosures in relation to this uncertainty, including but not limited to:

(a) providing clear disclosures as to how the issuer has incorporated COVID-19 related risks and uncertainties into their cash flow projections, discount rates and long-term growth rates. Determining the recoverable amount of assets in the current environment requires a thorough assessment of the cash flow projections over a period of time. Because of the increased level of uncertainty, the cash flow projections may require the use of the "expected cash flow approach". IAS 36.A7 outlines this approach, which includes multiple probability weighted scenarios of expected cash flows, as opposed to a single most likely cash flow allowing for the incorporation of different potential outlooks for the future economic recovery.

Where this approach is applied, IAASA expects issuers to disclose the number of scenarios used, their weightings and how the main assumptions used in the downside scenarios differ from the other scenarios. IAASA highlights the importance of providing high quality and transparent disclosures regarding the assumptions that underline the measurement and recognition of the impairment assessment.

When determining the discount rate, IAASA highlights that care should be taken when deciding on the discount rate to be used. IAS 36.56 states that the discount rate used to measure an asset's value-in-use shall not reflect risks for which the future cash flow estimates have themselves been adjusted.

(b) disclosures relating to the significant judgements, assumptions used and estimation uncertainty underlying these assessments. Due to the uncertainty surrounding COVID - 19, the range of possible assumptions and judgments used by issuers in developing their assessments may vary widely.

Irrespective as to whether management has based its determination of the recoverable amount of an asset on value-in-use or fair value less costs of disposal, IAASA highlights to issuers the requirements in IAS 36(d)(i) and IAS 36(e)(i), respectively, in relation to the need to disclosure each key assumption used.

IAASA calls on issuers to evaluate and, if required, update and clearly identify the areas of the impairment assessments which they consider to be significant judgements (critical accounting judgements) and to clearly distinguish them from sources of estimation uncertainty.

(c) disclosures that provide users of the financial statements with an understanding as to how sensitive measurements are to changes in assumptions. Given the increased levels of uncertainty in the current environment, such sensitivity disclosures are increasingly of significance to users. IAASA draws issuers' attention to IAS 36.134(f) which states that if a reasonably possible change in a key assumption on which management has based its determination of the CGUs recoverable amount would cause the unit's carrying amount to exceed its recoverable amount, a detailed sensitivity analysis is required to be disclosed.

Matters for consideration by management, Directors and Audit Committees
Management, Directors and Audit Committees should carefully consider the key judgements made in preparing impairment tests and the disclosure requirements of IAS 36.

They should carefully assess whether or not there are indications of impairment, especially in relation to the impact and uncertainty associated with the COVID-19 pandemic, and whether or not an impairment review is required. If so, they should ensure that the uncertainty of the current environment is incorporated into the testing and that the recognition, measurement and disclosure requirements of IAS 36 and IAS 1 are met in full.

2.6 Expected credit losses (ECLs) – IFRS 9

2.6.1 Financial institutions

IAASA notes that the IFRS 9 disclosures of financial institutions falling within its remit have, in general, been of good quality; however, there remains room for improvement in selected areas. In our more recent examinations, IAASA has examined and raised questions in the following IFRS 9 topics including:

(a) management adjustments to modelled ECLs;

(b) staging and determining a significant increase in credit risk (SICR);

(c) incorporating forward looking information into ECL models;

(d) ECL disclosures including ECL sensitivity analysis; and

(e) ECL impairment loss allowance reconciliations (qualitative and quantitative information).

It is noted that in light of the spread of COVID-19, a range of measures have been taken by governments, regulators and financial institutions. Relief measures offered to customers include moratoria on repayment of borrowings, loan guarantees, and other forms of business support targeted at individual entities or specific industries (e.g. for liquidity purposes).

IAASA reminds issuers to consider ESMA's Public Statement "Accounting implications of the COVID-19 outbreak on the calculation of expected credit losses in accordance with IFRS 9". Financial institutions are reminded by ESMA that they must distinguish between measures and reliefs that have an impact on the credit risk of financial instruments over the expected life of financial assets and those which address temporary liquidity constraints of borrowers and apply IFRS 9 accordingly.

Matters for consideration by management, Directors and Audit Committees
It is IAASA's expectation that management, Directors and Audit Committees of financial institutions will ensure that their IFRS 9 disclosures:

(a) explain their judgements as to how, and the extent to which, the effect of COVID-19 and related support measures have been factored into the assessment of SICR and ECL, as well as the use of forward-looking information;

(b) enable users of financial statements to understand the changes assumptions and judgements made in their ECL estimates and the reasons for those changes; and

(c) enhance the disclosure of ECL management adjustments and ECL sensitivity, given the scarcity of available and reliable information related to COVID-19.

2.6.2 Corporates

IAASA has examined the determination of the ECL allowance by some corporate issuers using the simplified approach for trade and other receivables [IFRS 9.5.5.15]. IAASA identified some instances of non-compliance with the recognition and measurement of expected credit losses on overdue trade receivables under the simplified approach [IFRS 9.5.5.17 – 18].

Given the expected increase in ECLs arising from the COVID-19 pandemic, IAASA reminds issuers to reassess the recognition and measurement of ECLs on trade receivables and contract assets. The use of historic loss rates may no longer be valid because of the effects of

COVID-19. Issuers are reminded that IFRS 9.5.5.17 requires the measurement of ECLs of a financial instrument in a manner that:

(a) reflects an unbiased and probability weighted amount that is determined by evaluating a range of possible outcomes; and

(b) uses reasonable and supportable information that is available without undue cost or effort at the reporting date about past events, current conditions and forecasts of future economic conditions.

Furthermore, issuers are reminded that IFRS 9.B5.5.44 requires that:

> '*Expected credit losses shall be discounted to the reporting date, not to the expected default or some other date, using the effective interest rate determined at initial recognition or an approximation thereof.*'

Discounting trade receivable cash flows at the rate that reflects counterparty credit risk or another rate may be inconsistent with IFRS 9.B5.5.44.

Matters for consideration by management, Directors and Audit Committees
Management, Directors and Audit Committees of corporate issuers should reassess their recognition and measurement of ECL on trade receivables and contract assets. The use of historic loss rates may no longer be valid in the current economic climate.

2.7 IFRS 15 *Revenue from Contracts with Customers*

IFRS 15 establishes principles that entities shall report useful information to users of financial statements about the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers.

Examinations undertaken by IAASA during 2020 noted some areas of concern in the application of IFRS 15 by issuers:

(a) Disaggregation of revenue [IFRS 15.114 – 115 and IFRS 15.B87 – B89 refer]. IAASA continues to challenge issuers on their disclosures regarding disaggregation of revenue. IAASA again notes that certain issuers disclose more detailed information outside of the financial statements regarding their revenues (e.g. issuer's website, management reports and investor presentations).

IAASA reiterates the point made in our 2019 *Observations* document that if issuers are providing revenue information for major product lines and geographic areas in locations outside of the financial statements then management need to consider whether or not additional categories for the disaggregation of revenue should be presented within the financial statements themselves. Management need to consider the economic factors that affect the issuer's contracts with customers when assessing whether additional categories of revenue need to be disclosed in the financial statements. Issuers are reminded that segment revenue disclosures may not always provide users of financial statements with enough information to help them understand the composition of revenue recognised [IFRS 15.BC340].

(b) Contract balances. IFRS 15.116 states that an entity shall disclose information regarding the opening and closing balances of receivables, contract assets and contract liabilities from contracts with customers:

'*An entity shall disclose all of the following:*

(i) the opening and closing balances of receivables, contract assets and contract liabilities from contracts with customers, if not otherwise separately presented or disclosed;

(ii) *revenue recognised in the reporting period that was included in the contract liability balance at the beginning of the period; and*

(iii) *revenue recognised in the reporting period from performance obligations satisfied (or partly satisfied) in previous periods (for example, changes in transaction price).*'

IFRS 15.118 states that:

'*An entity shall provide an explanation of the significant changes in the contract asset and the contract liability balances during the reporting period. The explanation shall include qualitative and quantitative information.*'

IAASA examinations have detected instances where issuers had not disclosed the movements on contract assets and contract liabilities and instances where the explanations of the significant changes in contract assets and contract liabilities balances during the reporting period were not provided.

Matters for consideration by management, Directors and Audit Committees
Management, Directors and Audit Committees should ensure that they continue to assess whether the recognition, measurement, presentation and disclosure of revenue from contracts complies, in full, with all the requirements of IFRS 15.

Particular attention should be directed by management, Directors and Audit Committees towards the level of disclosure of disaggregated revenues in the financial statements and to the required contract asset and liability disclosures.

2.8 IFRS 16 *Leases*

IFRS 16 topics examined by IAASA in its 2020 financial statement examinations include:

(a) determination of the incremental borrowing rate;

(b) determination of the lease term and how the issuer has determined that it is reasonably certain to exercise an option to extend a lease, or not to exercise an option to terminate a lease, (including property leases having renewal rights and escalation clauses); and

(c) application of the portfolio approach to accounting for leases [IFRS 16.B1].

IAASA has examined the implementation of IFRS 16 by a number of issuers during the current reporting season. IAASA has not identified significant levels of non-compliance with IFRS 16 based on examinations completed to date. Some examinations of issuers' implementation of IFRS 16 are ongoing at this time and IAASA will highlight areas where IFRS 16 (and IAS 1) judgements and disclosures can be improved, in due course.

Matters for consideration by management, Directors and Audit Committees
Where the impact of IFRS 16 is material, management, Directors and Audit Committees are reminded to disclose the key judgements applied in implementing IFRS 16 including the determination of the incremental borrowing rate and the lease term in a transparent manner.

In instances where issuers apply the IFRS 16 amendment, IAASA expects issuers to disclose compliance with this amendment as issued by the IASB in the notes to the financial statements.

2.9 Alternative performance measures (APMs)

ESMA's Guidelines on Alternative Performance Measures (the Guidelines) have been applicable since 2016. These Guidelines are supplemented by a series of questions and answers providing specific on questions posed by stakeholders in relation to the practical application of the Guidelines.

In April 2020, ESMA published an updated Q&A in the context of Covid-19. This updated Q&A:

(a) highlighted the main principles of the Guidelines;

(b) encouraged issuers to use caution when adjusting APMs and when including new APMs to address the impact of COVID-19; and

(c) recommended issuers provide narrative information regarding the modifications made, the assumptions used and the impact of COVID-19 in APMs.

IAASA continues to examine issuers' use of APMs and has identified a number of instances of non-compliance:

(a) issuers presenting APMs with more prominence and emphasis or authority than measures directly stemming from the IFRS-based financial statements (prominence principle). The Guidelines require that APMs should not be displayed with more prominence, emphasis or authority than measures directly stemming from IFRS-based financial statements;

(b) issuers ceasing to use an APM. If an issuer stops using an APM it should explain the reason why that APM is no longer presented. When an APM is replaced by another APM, the issuer should explain why the new APM provides more reliable and more relevant information;

(c) issuers failing to define an APM or failing to set out the basis of calculation applied including details of any material hypotheses or assumptions used. Issuers are required to define all APMs used and their components as well as the basis of calculation adopted, including details of any material hypotheses or assumptions used;

(d) issuers failing to present prior period comparative amounts for APMs. APMs should be accompanied by comparatives for the corresponding previous periods; and

(e) issuers not providing reconciliations for all of the APMs presented. Issuers have to include reconciliations of the APM to the most directly reconcilable line item, sub-total or total presented in the IFRS-based financial statements.

Matters for consideration by management, Directors and Audit Committees
Management, Directors and Audit Committees should continue to carefully consider the requirements of the ESMA's Guidelines on Alternative Performance Measures and ensure compliance to the fullest extent possible with each of the requirements of those Guidelines.

Management, Directors and Audit Committees should also consider the guidance that is provided in the ESMA Questions and Answers for the ESMA APM Guidelines

2.10 Other matters

2.10.1 Exceptional items

Issuers may decide to present items within the income statement in a particular way to highlight the impact of COVID-19 on their performance.

IAS 1 requires entities to present information in a manner that provides relevant, reliable, comparable and understandable information [IAS1.17 refers]. IAS 1.85 states that an entity shall present additional line items, headings and subtotals in the income statement when such presentation is relevant to an understanding of the entity's performance. IAS 1.97 states that '*When items of income or expense are material, an entity shall disclose their nature and amount separately*.'

The inclusion of additional line items, subtotals or headings highlighting costs as a result of COVID-19 is permitted provided that they provide more understandable information and do not obscure other material information.

Some issuers may elect to disclose specific COVID-19 information only in the notes to the financial statements [IAS 1.112(c) refers].

Issuers should disclose the accounting policy setting out how expenses, including material items, are presented in the income statement.

However, issuers should exercise caution in presenting the financial impact of COVID-19. Points to consider include:

- consumption of resources that were not able to generate income as a result of COVID-19 would generally not be included within COVID-19 costs. This is because it is the lost revenue rather than the incurrence of these costs themselves that is the exceptional item as a result of COVID-19. For example, payroll costs of those employees whose productivity has been impacted as a result of COVID-19 would have been incurred irrespective of COVID-19; therefore, such costs are incurred as a result of employment contracts and not as a result of COVID-19;

- a major impact of COVID-19 was the loss of revenues. The presentation in IFRS financial statements of notional revenues foregone due to the pandemic is not permitted;

- additional line items, headings and subtotals in the income statement are presented only when such presentation is relevant to an understanding of an issuer's performance. Flooding the income statement with separate non-COVID -19 items and COVID-19 items may not provide users with understandable information;

ESMA, in its *Questions and Answers – ESMA Guidelines on Alternative Performance Measures* [item 18], recognises that, due to the impact of COVID-19 on their operations, issuers may decide to disclose new, or to adjust existing, APMs presented in management reports or IFRS financial statements. The definition and calculation of an APM should be consistent over time. ESMA recommends that issuers use caution when making adjustments to APMs used and when including new APMs solely with the objective of depicting the impact of COVID-19 on performance and cashflows.

2.10.2 IFRS 8 Operating Segments – Chief Operating Decision Maker (CODM)

IFRS 8.7 states that the term 'chief operating decision maker' identifies a function, not necessarily a manager with a specific title. That function is to allocate resources to and assess the performance of the operating segments of an entity. Often the CODM of an entity is its chief executive officer but, for example it may be a group of executive directors or others.

During the course of its financial statement examinations IAASA has noted that a number of issuers have determined that the CODM is the chief executive officer alone. IAASA has examined the basis on which issuers have identified the CODM. Some of the areas that IAASA has examined are:

- the role of the complete Board of Directors, including the non-executive directors in allocating resources to and assessing the performance of the operating segments of the issuer;

- how and at what level the performance of the issuer's operating segments are evaluated; and

- the nature of the financial information that the CODM reviews to make decisions on the allocation of resources and the assessment of the performance of the issuer's operating segments.

2.10.3 Government supports

In response to the fallout from restrictions imposed to combat the spread of COVID-19, the Irish Government has offered a suite of supports to business and individuals including:

- income supports (e.g. COVID-19 Wage Subsidy Scheme (TWSS), Pandemic Unemployment Payment (PUP) and Short-time Work Support);

- loans, grants, vouchers and schemes (including schemes such as Credit Guarantee Scheme, COVID-19 Working Capital Scheme, Future Growth Loan Scheme, Sustaining Enterprise Fund, Pandemic Stabilisation and Recovery Fund, and general grant supports); and

- rates waiver, warehousing of tax debts and VAT reduction (i.e. commercial rates waiver, 'warehousing' of deferred tax debts, and reduction in the standard rate of VAT).

Similar supports have been provided in other jurisdictions.

To the extent that issuers avail of these supports, issuers should apply the provisions of IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance*. IAS 20 applies to all government grants and other forms of government assistance. The benefit of a government loan at a below-market rate of interest is treated as a government grant.

Issuers should carefully assess whether or not there may be a contingent repayment element attaching to Government assistance and, if so, to consider the nature of that contingency and the related disclosures of that contingency.

The provision of guarantees is an example of Government assistance that cannot reasonably have a value placed upon it and, accordingly, does not fall within the definition of “Government grants” under IAS 20 [IAS 20.3]. However, the significance of the benefit in this instance may be such that disclosure of the nature, extent and duration of the guarantee is necessary in order that the financial statements do not mislead.

2.10.4 Parent company individual accounts – impairment

IAASA has examined the impairment assumptions and judgements made by a number of issuers in determining the impairment provision for:

(a) the parent company investment in subsidiaries; and

(b) inter-company loans, receivables and guarantees within the scope of IFRS 9 in the parent company individual accounts.

COVID-19 will likely increase the credit risk that inter-company loans, receivables and guarantees falling under the scope of IFRS 9 may not be repaid on time or in full.

IAASA will continue to monitor issuers’ determination of the recoverable amount of the investment in the subsidiary and impairment of inter-group loans, receivables and guarantees in future parent company financial statements.

2.10.5 European Single Electronic Format (ESEF)

ESEF is the electronic reporting format in which issuers on EU regulated markets shall prepare their annual consolidated financial reports for financial years beginning on or after 1 January 2020.

In 2013 the EU Transparency Directive, which sets rules on harmonisation of transparency requirements of issuers, was amended to include a requirement for issuers to prepare their annual financial reports in a single electronic reporting format. ESMA was assigned the responsibility to develop regulatory technical standards to specify this electronic reporting format.

The objectives of the provision are to make reporting easier for issuers and to facilitate accessibility, analysis and comparability of annual financial reports.

The ESEF requires that:

(a) issuers' annual financial reports shall be prepared in XHMTL, which is human readable and can be opened with any standard web browsers;

(b) where annual financial reports contain IFRS consolidated financial statements, these shall be labelled the XBRL 'tags', which make the labelled disclosures structured and machine-readable;

(c) the XBRL 'tags' shall be embedded in the XHTML document using the Inline XBRL technology; and

(d) the taxonomy to be used for ESEF is an extension of the IFRS taxonomy.

Detailed guidance on the application of ESEF in financial reports is available in ESMA's *ESEF Reporting Manual Preparation of Annual Financial Reports in Inline XBRL*.

APPENDIX

IAASA'S FINANCIAL REPORTING RELATED PUBLICATIONS

Readers may find it helpful to refer to other IAASA financial reporting related publications, available on the IAASA website, including:

Category	Document
Observations documents	Observations on selected financial reporting issues issuers' financial years ending on or after 31 December 2019
	Observations on selected financial reporting issues issuers' financial years ending on or after 31 December 2018
Financial reporting decisions	Financial Reporting Decisions (June 2020)
	Financial Reporting Decisions (February 2020)
	Financial Reporting Decisions (September 2019)
	Financial Reporting Decisions (November 2018)
	Financial Reporting Decisions (June 2018)
	Financial Reporting Decisions (February 2018)
Surveys and commentaries	Information Note: Transition to IFRS 16 *Leases* – review of 2019 half-yearly disclosures (October 2019)
	Information Note: Liquidity analysis in annual and half-yearly financial reports (September 2019)
	Information Note: Some key areas of focus for 2019 half-yearly reports (June 2019)
	Information Note: Requirement to disclose disaggregated revenue (April 2019)
	Information Note: Requirement to disclose dividends proposed (April 2019)
	Thematic review of companies' revenues disclosures (December 2018)
	Desk-top review on Companies' Business Combinations Disclosures (November 2018)
	Desk-top review on Companies' Bank Covenants Disclosures (October 2018)
	Information Note: Corporate Income Tax Reporting by Irish Issuers (October 2018)
Annual Reports	2019 Annual Report
	2018 Annual Report

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