2020

Financial Reporting Supervision

Information Note

Reporting the Impact of COVID-19

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

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

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INFORMATION NOTE

REPORTING THE IMPACT OF COVID-19

Key message

IAASA expects that issuers' 2020 annual and future half-yearly financial reports will provide enhanced disclosures of the impact of the COVID-19 pandemic. In doing so, issuers should ensure that the following disclosures are clearly provided to aid users' understanding of the financial statements:

(a) the effects of the pandemic on the financial performance, financial position, cash flows and risks;

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

(c) the actions taken to mitigate the impact of the pandemic; and

(d) the future prospects for the issuer and changes, if any, to the issuer's strategy for dealing with the pandemic.

1. Purpose of this Information Note

The purpose of this Information Note is to highlight for management, Audit Committees and those charged with governance, the expectation that high quality disclosures of the impact of COVID-19 are disclosed in annual financial statements and half-yearly financial reports and, thereby, provide useful information to the users of those reports.

2. Introduction

IAASA conducted a desktop examination of the half-yearly financial reports of twenty equity issuers and the annual financial statements of one equity issuer – all listed on the main market of Euronext Dublin and all with 2020 reporting dates (the issuers).

This Information Note builds on the Public Statement *Implications of the COVID-19 outbreak on the half-yearly financial reports* (May 2020) from the European Securities and Markets Authority (ESMA) and shares insights from IAASA's recent enforcement experiences and IAASA's engagement with other European accounting enforcers.

3. Evaluation of the quality of issuers' reporting of the impacts of COVID-19

The impact of the pandemic has been severe with many of the issuers activating business continuity protocols, furloughing employees and/or closing plants or branches or significantly scaling back activity. Many of the issuers have prioritised the preservation of cash and have taken steps to strengthen liquidity and restrict discretionary spending until there is a clearer understanding of the likely depth and duration of the pandemic.

IAASA observed diversity in the quality of reporting by issuers of the impact of the pandemic.

- Higher quality disclosures were those that clearly explained to users, in issuer specific terms, the critical judgements and sources of estimation uncertainty and any sensitivities associated with those judgements.
- Lower quality disclosures were characterised by boilerplate references to the pandemic and instances where entities remain silent or vague in explaining some of the key judgements and an absence of issuer specific information.

3.1. Areas of higher quality disclosure

Areas in which a majority of issuers presented higher quality disclosures included:

(a) presentation in the primary financial statements;

(b) description of the effects of the pandemic on the financial performance in the management report; and

(c) presentation of alternative performance measures (APMs).

3.2. Areas of lower quality disclosure

However, instances where the disclosures in the 2020 half-yearly financial statements were of a lower quality and/or which may be indicative of increased risk of non-compliance with IFRSs included:

(a) explanation of critical judgements and material uncertainties;

(b) non-financial assets: indications of impairment, key assumptions and sensitivities; and

(c) aspects of management reports – describing the entity's prospects and the expected impact of mitigating actions.

3.3. Other areas meriting closer scrutiny

Based on the results of this desktop examination, IAASA will closely monitor whether or not there are improvements in issuers' disclosures of, particularly, the following topics in upcoming 2020 annual financial statements:

(a) expected credit loss (ECL) recognition and measurement (i.e. for both corporate entities and financial institutions);

(b) disclosure of government assistance (in accordance with IAS 20.39);

(c) liquidity, financial liabilities maturity tables and credit risk management disclosures; and

(d) hedge ineffectiveness.

4. Judgements, estimation uncertainty and material uncertainties

The impact of the pandemic for most issuers constitutes a significant event. In this context significant judgements made by issuers may include matters such as:

(a) estimation of the depth and duration of the impacts of the pandemic and its impact on revenue, profits, carrying amount of assets, liabilities and cash flows;

(b) the sensitivities of the carrying amounts of assets, liabilities, income, expenses and cash flows to plausible variations in assumptions identified through stress testing and scenario planning; and

(c) issuers' ability to source additional financing and/or renegotiate existing covenant terms.

It is IAASA's expectation that issuers' will enhance their disclosures in their 2020 annual financial statements and future half-yearly financial reports for:

(a) material uncertainties related to events or conditions that may cast significant doubt upon the issuer's ability to continue as a going concern (IAS 1.25); and

(b) the judgements applied in concluding that there are no material uncertainties referred to in (a).

IAASA expects that issuers' enhanced disclosure of the impact of the pandemic in future financial reports will include:

(a) an explanation of the nature of material uncertainties;

(b) summary quantitative data of the key assumptions and an explanation of changes made to past assumptions;

(c) mitigating actions taken; and

(d) sensitivities of key judgements (i.e. scenarios considered).

IAASA will monitor issuers' explanations of the nature and amounts of estimates used in multiple scenarios where this information is relevant to an understanding of the key judgements and material uncertainties.

5. Impairment of non-financial assets

COVID-19 has introduced uncertainty to the operations of many issuers and, as a result, a significant risk of material adjustment to the carrying amounts of assets (e.g. goodwill, intangible assets, property, plant & equipment, inventory, and investment property) may have arisen.

Careful assessment of all facts and circumstances is necessary in determining whether or not business disruption attributed to the pandemic is temporary in nature (and, therefore, less likely to be regarded as an indication of impairment) or whether, on balance, facts such as business restructuring, reduced cash flows and revenues or changes in customer behavior may be regarded as an indication of impairment that warrants an impairment assessment.

IAASA will closely monitor issuers' 2020 annual and future half-yearly financial reports for:

(a) judgements as to whether or not there are indications of impairment of assets (or cash generating units (CGUs)) present;

(b) instances where there was limited headroom reported in the recoverable amount of assets (or CGUs) in the most recent annual report;

(c) impairment judgements in the event of the re-introduction of COVID-19 restrictions during H2 2020;

(d) other indications of impairment of assets being present (e.g. changes in customer behaviour, simplifying product range or re-organisation of operations);

(e) the key assumptions underpinning the recoverable amount of assets (or CGUs) and whether or not these are consistent with data elsewhere in the financial statements (e.g. going concern assumptions, liquidity and cash flow forecasts); and

(f) disclosure of the estimates of the recoverable amount of assets (or CGUs) in the 2020 annual financial statements and whether or not these reflect a wider range of sensitivities than disclosed previously.

6. Management reports

Regulation 5(4)(c)(ii) of the Transparency (Directive 2004/109/EC) Regulations 2007 (S.I. 277 of 2007)(as amended) and Schedule A of the Central Bank (Investment Market Conduct) Rules 2019 (S.I. 366/2019) require that the annual management report contains:

(a) a fair review of the development and performance of the issuer's business and of its position; and

(b) a description of the principal risks and uncertainties that they face.

Uncertainty as to the depth and duration of the COVID-19 pandemic is expected to require enhanced disclosure by issuers of the principal risks and uncertainties facing the issuer and the issuer's likely future development in future annual and half-yearly management reports.

IAASA will monitor whether issuers' future management reports disclose enhanced details of:

(a) the future outlook (including quantitative information) and describe the principal risks and reasons for material uncertainties linked to that outlook;

(b) actions taken to mitigate the impacts of the pandemic on the issuer's operations (i.e. to provide issuer specific information and more granular details to enable users to understand the actions taken by management); and

(c) the expected impact of the actions taken to mitigate the effects of the pandemic.

7. Liquidity

The cash flows of many of the issuers have been significantly disrupted due to the impact of the pandemic. Liquidity risk has increased. Issuers' disclosure of changes to liquidity risk (e.g. the negotiation of extended maturity and changes to the terms of debt, debt covenant reliefs or the issuing of new debt in response to the pandemic) is important information for users of the financial statements.

IAASA will monitor issuers' 2020 annual and future half-yearly financial reports for enhanced qualitative disclosure of liquidity risk and quantitative disclosure of financial liabilities maturity tables (IFRS 7.39) and, in particular, where issuers show evidence of increased liquidity risk.

IAASA expects issuers to enhance their discloses in the 2020 annual and future half-yearly financial reports of the following, where material:

(a) additional narrative description of the management of liquidity risk and, in particular, where there are changes to liquidity risk;

(b) the judgements and estimation uncertainty applied in calculating bank covenants;

(c) the accounting policy applied to substantial modifications of debt (IFRS 9.3.3.2) and judgements and major sources of estimation uncertainty made in accounting for debt modifications;

(d) the policies for any new financial arrangements that impact liquidity risk (e.g. bespoke supplier financing arrangements, supply chain financing/reverse factoring, or bespoke recourse/non-recourse sales arrangements that enhance cash flows); and

(e) unexplained increases in overdue trade receivables or other receivables.

8. Expected credit losses and credit risk management policy

The pandemic has had no discernable effect to-date on the issuers' disclosure of their credit risk management policies or their measurement of ECLs on trade receivables, based on disclosures in 2020 half-yearly financial reports. Since the start of the pandemic, counterparty risk has increased and the settlement dates for trade receivables have been extended for many issuers. However, there were no disclosures of changes to the issuers' measurement of ECLs on trade receivables (i.e. revising upwards default rates or other metrics in response to the pandemic).

IAASA will monitor issuers' 2020 annual and future half-yearly financial reports for enhanced disclosures of:

(a) changes to issuers' credit risk management policies arising from the pandemic and explanations thereof (e.g. extended payment terms and actions to deal with rising credit risk);

(b) how forward-looking information has been reflected in ECL measurement (e.g. trade receivables) and key sources of estimation uncertainty; and

(c) disclosure of a table of the gross carrying amount of financial assets analysed by credit risk rating (IFRS 7.35M);

IAASA will also monitor issuers' ECL judgements for:

(a) material inter-company receivables and loans (e.g. to subsidiaries) that are within the scope of IFRS 9, and recognised in the separate parent company financial statements; and

(b) loans, commitments and guarantees (e.g. investments in Associates and Joint Ventures) that are within the scope of IFRS 9 and recognised in the consolidated financial statements or unrecognised and within the scope of IFRS 9.

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