September 2021

Financial Reporting Supervision

Observations on selected financial reporting issues – years ending on or after 31 December 2021

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

Related publications

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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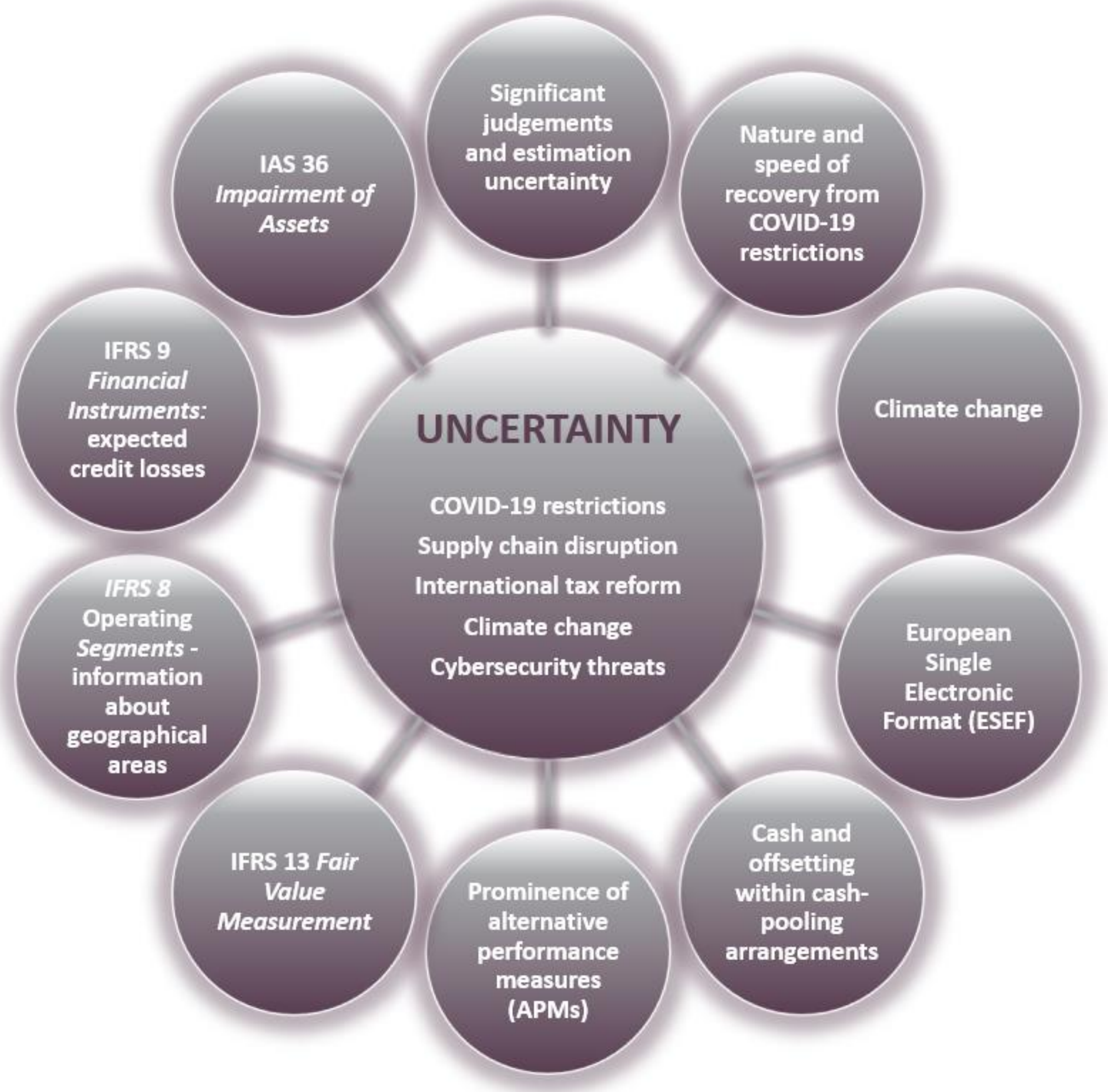
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1. FINANCIAL REPORTING ENVIRONMENT

1.1 Introduction

As 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 their reports are compliant with the relevant financial reporting framework.

In publishing this *Observation*s document, IAASA hopes to assist issuers in preparing high quality financial reports by offering observations on selected financial reporting topics. Some of the matters set out in this document will be subject to detailed scrutiny by IAASA in its 2022 its cycle of examining financial reports.

1.2 Uncertain outlook

Globally, across Europe and domestically, the economic outlook remains uncertain. Issuers are grappling with significant uncertainties such as the nature and speed of recovery from COVID-19 restrictions, disruption to supply chains, proposals on international tax reform, the impact of climate change and cybersecurity risks.

'*As the COVID-19 restrictions have relaxed, we are seeing that domestic economic activity is rebounding. While the possibility of a more protracted recovery in certain sectors cannot be discounted, the prospects for the economy as a whole appear to be more favourable, and risks to the growth outlook appear to be relatively balanced.*

… strict public health restrictions … dampened economic activity in the first quarter of the year, as modified domestic demand contracted by 5% in year-on-year terms.

GDP figures in Q1 2021 highlight the difference between the externally focussed and the domestic economy, with net exports of predominantly foreign-owned multinationals engaged in contract manufacturing driving headline growth of 11.8% …

Supply shortages and bottlenecks are evident across many sectors and raw material inputs, leading to higher inflation in many countries …

The strengthening of economic activity over the coming months is expected to lead to lower levels of people receiving pandemic-related income supports. A consistent pickup in employment will see the COVID-adjusted unemployment rate fall from 21.9% in May 2021 to around 8% by mid-2022 …

Households in aggregate have accumulated excess savings since the onset of the pandemic, reflected in the sharp rise in deposits … How households use any excess savings over the coming years will likely influence consumer demand, housing demand and individual financial investment decisions …

… different challenges emerge as trading conditions normalise, and government supports are removed. The viability of individual businesses and jobs will become clearer, as we see changes in consumer and investor preferences and behaviour, alternative work, supply chain and migration patterns, increased digitalisation, and ongoing adjustment to the new trading arrangements between the EU and the UK …'

Press Release accompanying publication of Quarterly Bulletin QB3 – July 2021, Central Bank of Ireland

The nature and speed of any recovery from **COVID-19 restrictions** is uncertain. It is possible that changes in consumer, investor and employee preferences and behaviours will impact businesses in the short-, medium- and long-term. It is also possible that these impacts will vary according to region and industry sector.

Disruption to supply chains have been brought about by the pandemic, disruption to shipping in the Suez Canal in early 2021 and Brexit and have resulted in some raw material shortages and increased inflationary pressures. Such disruptions increase uncertainty in a globalised world.

Issuers are facing uncertainty arising from proposals on **international tax reform** and minimum global corporate tax rates. Any such reformed arrangements may impact issuers' financing and investment decisions.

Climate change and measures taken and to be taken to mitigate the impact of climate change will undoubtedly impact business models and consumer behaviours. Users of financial reports are demanding more and more entity specific climate impact information. Business models and investment decisions will likely change as a result of emissions targets. Government measures such as levies on polluters and outright bans on activities may be an increasingly frequent feature of business. Certain industries may face partial or complete restrictions on activities due to Government actions or consumer demands. Climate change uncertainty may impact on the recognition, measurement and disclosure of assets and liabilities in issuers' financial statements.

Cybersecurity threats, if they materialise, can have a significant impact on issuers. In extreme cases, a significant cybersecurity breach could threaten the very existence of an entity. The extent of disclosure of cyber risks and their impact on the financial reporting – such as potential disruption of business activities and operations, data loss, reputational damage, penalties arising from regulatory non-compliance and other legal consequences (e.g. contractual damages or inability to meet contractual obligations) – warrants careful consideration.

2. OBSERVATIONS ON SELECTED FINANCIAL REPORTING ISSUES

IAASA expects that annual and half-yearly financial reports of issuers will:

(a) provide entity specific disclosures on the significant judgements and the sources of estimation uncertainty and changes in the key assumptions underpinning assets, liabilities, income, expenses and cash flows;

(b) disclose the impact that COVID-19 restrictions have had on the entity's financial performance, financial position, cash flows and risks, and the mitigating actions taken to respond to the pandemic;

(c) consider the impact of climate change on the issuer's operations and on the measurement of assets and liabilities; and

(d) apply the specific recognition, measurement, presentation and disclosure requirements of financial reporting standards so as to provide users with financial information that is comparable, relevant, verifiable, timely and understandable.

2.1 Significant judgements and estimation uncertainty: entity specific disclosures

Paragraph 9 of IAS 1 *Presentation of Financial Statements* sets out the purpose of financial statements.

The objective of general purpose financial statements is to provide information about the financial position, financial performance and cash flows of an entity that is useful to a wide range of users in making economic decisions. To meet that objective, financial statements provide information about an entity's assets, liabilities, equity, income and expenses, including gains and losses, contributions by and distributions to owners in their capacity as owners and cash flows. That information, along with other information in the notes, assists users of financial statements in predicting the entity's future cash flows and, in particular, their timing and certainty.

IAS 1.122 requires that an entity must disclose the judgements – apart from those involving estimations – that management has made in the process of applying the entity's accounting policies that have the most significant effect on the amounts recognised in the financial statements.

IAS 1.125 requires that an entity must disclose information about the key assumptions concerning the future, and other key sources of estimation uncertainty at the end of the reporting period, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year.

IAS 1.129 states that an entity presents the disclosures required by IAS 1.125 in a manner that will help users of the entity's financial statements to understand the judgements made by management about the future and about other sources of estimation uncertainty. The nature and extent of the information provided will vary according to the nature of the assumption and other circumstances. Examples of the types of disclosures an entity makes include:

(a) the nature of the assumption or other estimation uncertainty;

(b) the sensitivity of carrying amounts to the methods, assumptions and estimates underlying their calculation, including the reasons for the sensitivity;

(c) the expected resolution of an uncertainty and the range of reasonably possible outcomes within the next financial year in respect of the carrying amounts of the assets and liabilities affected; and

(d) an explanation of changes made to past assumptions concerning those assets and liabilities, if the uncertainty remains unresolved.

Inherent within these requirements and paramount to achieving the objective of providing information about the financial position, financial performance, and cash flows of an issuer that is useful to a wide range of users, is the tailoring of the disclosures to the issuer's specific circumstances and the avoidance of boiler-plated discourses. The observations provided in this Paper should be read with this over-riding consideration in mind.

These IAS 1 requirements carry additional significance against the backdrop of the current uncertain economic and climatic environment. Issuers should carefully consider how to report on the specific impacts of matters such as:

- the sources of significant judgements and sources estimation uncertainty associated with COVID-19 restrictions and the recovery from those pandemic restrictions;
- the basis for assumptions and judgements – and changes thereto – made in applying IFRSs such as IFRS 13 *Fair Value Measurement*, IAS 16 *Property, Plant and Equipment*, IAS 36 *Impairment of Assets*, IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*, and IAS 38 *Intangible Assets*;
- the assumptions made regarding the removal of temporary Government COVID-19 supports and their impact on future cash flows; and
- the timing and duration of any COVID-19 recovery and the impact on impairments and going concern.

Other areas that may warrant careful consideration by issuers include the basis underpinning the recognition of deferred tax assets given disrupted business activity levels, inflation trends driving an uptick in input prices and the prospect of negative interest rates impacting discount rates and finance income and expense.

Matters for consideration by management, Directors and Audit Committees

Management, Directors and Audit Committees should:

(a) critically assess the disclosures made in periodic financial statements regarding sources of significant judgements and sources of estimation uncertainty;

(b) assess whether, taken as a whole, the financial statements provide information about the issuer's financial position, financial performance, and cash flows that is useful to a wide range of users in making economic decisions;

(c) ensure that disclosures are appropriately tailored to the specific circumstances of the issuers; and

(d) avoid boiler-plate disclosures that do not aid users' understanding of the financial statements.

2.2 Management Report

2.2.1 Nature and speed of recovery from COVID-19 restrictions

Regulation 5(4)(c)(ii) of the Transparency (Directive 2004/109/EC) Regulations 2007 (S.I. 277 of 2007) (the 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 …*'

Just as COVID-19 and the public health measures that were put in place to contain its spread had different impacts on different sectors of the economy, so too will the speed and duration of any recovery impact various sectors differently.

Therefore, it is important for issuers to clearly explain in the management report both:

- the impact COVID-19 has had on the development and performance of its business and the position of the issuer; and
- management's views as to the path to recovery.

IAASA expects disclosure of the impact of COVID-19 with reference to the specific circumstances of the issuer in annual reports:

(a) annual reports should include a discussion of the continued impact of **COVID-19 restrictions** on the economies or markets in which the issuer operates. IAASA expects discussion of any impacts on revenue and cash collection. Where Government restrictions have eased, IAASA expects discussion of the resulting impact on financial performance.

IAASA expects to see explanations from issuers regarding:

- the continued impact of COVID-19 restrictions on issuers' broader financial performance such as raw material price increases, margin reduction, supply chain constraints; and
- how the financial performance, financial position and cash flows will likely be impacted by the pandemic and/or the economic recovery.

(b) annual reports should provide an indication of **future developments** consequent on an easing of restrictions such as changes in customer behaviours, increased revenue from on-line channels and the impact of working from home for extended periods.

(c) the impact on **loan covenants** should be explained in annual reports with disclosure of:

- re-negotiation of waivers of loan covenant conditions with lenders, including an explanation of the terms of the waiver;
- explanation of the impact of any non-compliance with the loan covenant waiver terms; and
- potential failure of the loan covenant waiver terms and the possibility of obtaining another waiver in the future.

(d) annual reports should explain the impact of the **new economic reality** following COVID-19 on the issuer's liquidity position.

(e) where an entity places reliance on **financial supports** received from Government, the annual report should disclose this matter and the impact of weaning off such supports.

(f) in instances where the **market capitalisation** of an issuer is below the carrying amount of its net assets, annual reports should ensure disclosures regarding either the impairment provision recognised or an explanation as to why an impairment charge is not recognised.

Matters for consideration by management, Directors and Audit Committees

Management, Directors and Audit Committees should ensure that the 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.

2.2.2 Other matters

Regulation 5(4)(c)(ii) is also relevant in this regard.

IAASA's examinations of issuers' management reports have detected cases where the management report:

(a) included in the fair review of the business a discussion of the issuer's financial performance with reference to notional full year amounts from subsidiaries acquired during the year and notional amounts for the preceding year. Therefore, the fair review of the business focussed on amounts that were not '*included in the consolidation taken as a whole'*;

(b) did not include a fair review of the financial position of the issuer;

(c) did not include, in the case of certain fund and debt issuers, a discussion on the following topics as part of the fair review of the development and performance of the businesses:

- an overview of the performance of the loan notes supported by key performance indicators;
- a discussion on any new products developed during the year;
- a discussion on the sales environment; or
- a discussion on the economic environment and its impact on the loan notes issued.

(d) did not include a narrative on the following risks which could be considered principal risks and uncertainties given the specific profile of the issuer:

- the macro-economic environment;
- identfied risks in the markets in which the issuer operates;
- risks related to the business environment; and
- regulatory risks.

(e) did not include, in the case of certain debt issuers, a discussion of the following topics as part of the fair review of the development and performance of the business:

- a general discussion on the markets and how market conditions would impact on the loan notes issued;

- the activity of the issuer during the year or the performance of the issuer, including the basis for the notes redeemed during the period; and
- explanations for the use of and definitions of specified key performance indicators.

IAASA continues to focus on and engage with issuers in relation to their disclosures in the management reports.

Matters for consideration by management, Directors and Audit Committees

Management, Directors and Audit Committees should carefully assess:

(a) the disclosures in the management report for the fair review of the development and performance of the business, the position of the issuer and the undertakings included in the consolidation taken as a whole; and

(b) disclosures in the management report for the description of the principal risks and uncertainties that they face;

and should ensure compliance in full with the provisions of the Regulations.

2.3 Climate change

2.3.1 IFRS requirements

The International Accounting Standards Board (IASB) published educational material *Effects of climate-related matters on financial statements* highlighting how IFRSs require entities to consider climate-related matters when the impact is material to their financial statements. This educational material complements an article that a member of the IASB, Nick Anderson, wrote on this subject in November 2019.

The educational material contains a list of examples of when entities may need to consider climate-related matters in their reporting and is aimed at supporting the consistent application of IFRS. It does not add to or change the requirements in the Standards.

The list of examples provides guidance on how issuers might consider the effects of climate-related matters when applying IFRS including IAS 1, IAS 2, IAS 12, IAS 16, IAS 38, IAS 36, IAS 37, IFRS 7, IFRS 9, IFRS 13 and IFRS 17.

IAASA expects issuers to take this educational material into account when assessing the impacts of climate change and risks in their financial statements.

2.3.2 Significant judgements

Issuers, and in particular those in the most affected sectors such as extractive industries, aviation and transport, should disclose how they have assessed climate risks when applying paragraphs 122 to 124 of IAS 1 *Presentation of Financial Statements* (significant judgements) and paragraphs 125 to 133 (major sources of estimation uncertainty).

Specifically, issuers should disclose how the forward-looking assumptions and judgements they have applied are consistent with information included elsewhere in the annual report such as in the management report and any non-financial information statement. Issuers should also explain, to the fullest extent possible, why apparently significant risks have not had a material impact on the financial statements where users might expect them to do so.

2.3.3 Non-current assets

Climate change impacts should be considered in assessing whether the expected useful lives of non-current assets and the estimated residual values in IAS 16 *Property, Plant and Equipment* and IAS 38 *Intangible Assets* should be revised. Furthermore, issuers should use assumptions reflecting climate risks and adapt the sensitivity analysis disclosed to consider climate risks in accordance with IAS 36 *Impairment of Assets*.

2.3.4 Provisions

Issuers should also carefully consider the requirements in IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*, for example, regulatory requirements to remediate environmental damage, contracts that may become onerous or restructurings to redesign products or services to achieve climate-related targets.

Matters for consideration by management, Directors and Audit Committees

Management, Directors and Audit Committees should consider climate-related matters in preparing, reviewing and approving the financial statements and ensure that appropriate estimates and judgements have been made and are adequately disclosed.

2.4 IAS 36 *Impairment of Assets*

2.4.1 Indicators of impairment

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.'*

IAS 36.12 states that:

> '*In assessing whether there is any indication that an asset may be impaired, an entity shall consider, as a minimum, the following indications:*
>
> *External sources of information*
>
> *(a) there are observable indications that the asset's value has declined during the period significantly more than would be expected as a result of the passage of time or normal use.*
>
> *(b) significant changes with an adverse effect on the entity have taken place during the period, or will take place in the near future, in the technological, market, economic or legal environment in which the entity operates or in the market to which an asset is dedicated.*
>
> *(c) market interest rates or other market rates of return on investments have increased during the period, and those increases are likely to affect the discount rate used in the calculating an assets value in use and decrease the asset's recoverable amount materiality.*
>
> *(d) …*
>
> *Internal sources of information*
>
> *(e) …*
>
> *(f) significant changes with an adverse effect on the entity have taken place during the period, or are expected to take place in the near future, in the extent to which, or manner in which, an asset is used or is expected to be used. These changes include the asset becoming idle ...*

(g) *evidence is available from internal reporting that indicates that the economic performance of an asset is, or will be, worse than expected.'*

During its 2021 cycle of examinations, IAASA examined the financial reporting treatment of impairment in a number of issuers' annual financial statements. IAASA noted that certain issuers disclosed that they had not performed an impairment review as no internal or external indicators of impairment had been identified.

IAASA challenged issuers' rationale regarding the lack of impairment indicators during 2020 in the context of:

(a) COVID-19 restictions that were in place during 2020;

(b) the decline in certain issuers' revenues, profits and operational activities during 2020; and

(c) issuers operating at less than normal capacity.

IAASA concluded that the events in 2020, including travel restrictions and the impact on certain issuers' activities, were indicators of impairment and these issuers should have carried out an impairment review.

IAASA required the issuers to perform an impairment review in accordance with IAS 36.

Matters for consideration by management, Directors and Audit Committees

Management, Directors and Audit Committees must ensure that impairment reviews are performed, when indicators of impairment are identified, to ensure that an asset or cash generating unit (CGU) is carried at not more than its recoverable amount.

2.4.2 General comments on impairment testing

IAS 36.1 states that:

'*The objective of this Standard is to prescribe the procedures that an entity applies to ensure that its assets are carried at no more than their recoverable amount …*'

IAASA continues to challenge issuers on IAS 36 related topics – some of which were identified and communicated in previous years' *Observations* documents – including:

(a) whether or not CGUs have been tested for impairment at an appropriate level;

(b) the discount rate used to measure recoverable amount and whether or not that rate has been appropriately set, including country risk premium [IAS 36.55 and Appendix A: A15 to A21];

(c) the determination of the key assumptions used, the long-term growth rates used and the disclosure of sensitivities; and

(d) whether or not all key assumptions are realistic and consistent with other information in the financial statements.

Matters for consideration by management, Directors and Audit Committees

Management, Directors and Audit Committees should carefully consider all the key judgements in preparing impairment tests and the disclosure requirements of IAS 36.

2.5 IFRS 9 *Financial Instruments*: expected credit losses

2.5.1 Expected credit losses (ECLs) – financial institutions

Economic support and relief measures continue to be taken by European authorities to counteract the impact of COVID-19 restrictions. Such relief measures included moratoria on repayment of loans, overdraft facilities and mortgages, loan guarantees, as well as other forms of business supports targeted at specific regions or industries.

While the depth and duration of the impact of COVID-19 restrictions and the trajectory of any recovery remain uncertain, there are signs that restrictions are being eased and the Irish vaccination programme is enabling a phased re-opening of society. Consequently, relief and supports will be unwound over time and the longer-term impacts on ECLs will become apparent.

IAASA reminds issuers to continue 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*.

IAASA expects that financial institutions will 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 in preparing their financial statements.

2.5.2 Post model adjustments

The sudden and severe impact of the COVID-19 restrictions has resulted in the recognition of material post model adjustments (or 'management overlays') to supplement model-based ECL calculations.

IAASA expects that post-model adjustments will comply with the requirement of IFRS 9.5.5.17(a) to measure ECLs in a way that reflects an unbiased and probability-weighted amount that is determined by evaluating a range of possible outcomes.

Financial institutions are expected to disclose the following entity specific information for each material post-model adjustment in a clear and transparent manner:

(a) the absolute amount of the management overlay;

(b) the reasons for the management overlays such as recent updates to the macro-economic outlook, particular model limitations, or new information;

(c) the impact on the ECLs estimate – preferably by sub-class of loan category – if material and necessary for an understanding of financial performance;

(d) significant changes in management overlays from the previous reporting period;

(e) the methodology applied; and

(f) the governance in place.

IAASA expects that financial institutions will ensure that management overlays will comply with the requirements of IFRS 9.5.5.17(a) and (c) and are directionally consistent with changes in observable data [IFRS 9.B5.5.52, IFRS 7.35B(b), IFRS 7.35G(c)].

2.5.3 Macro-economic scenarios and changes therein

IAASA reminds issuers, particularly financial institutions, that paragraph 35G(b) of IFRS 7 *Financial Instruments: Disclosures* requires disclosures about the macro-economic information used when determining the ECL.

Macro-economic assumptions used in estimating the ECLs are likely to include, but are not limited to:

- significant macro-economic variables used in the calculation of ECLs;
- a description as to how the macro-economic scenarios were determined;
- scenario weightings and how they have been determined; and
- significant differences in the application of the scenarios to individually and collectively assessed exposures and to different types of portfolios.

It is likely that there may be significant changes to macro-economic assumptions due to COVID-19 restrictions and the subsequent recovery. IAASA expects that issuers, particularly financial institutions, will disclose and clearly explain any significant changes in macro-economic assumptions used in ECL measurement during the reporting period and the reasons for changes that are significant to the measurement of ECLs.

2.5.4 Significant increase in credit risk (SICR)

IFRS 7.7.35F and IFRS 7.7.35G require issuers to disclose the basis for the inputs and assumptions and the estimation techniques used to determine whether there is a SICR of financial instruments since initial recognition.

IAASA notes that most financial institutions have provided a range of relief measures (i.e. forbearance) to borrowers. It is IAASA's expectation that issuers, particularly financial institutions, will explain how these measures have impacted the assessment of SICR.

IAASA recommends that issuers disclose how they have applied operational simplifications when assessing SICR, such as using 12-month risk as an approximation for change in lifetime risk [IFRS 9.B5.5.13] or assessing SICR at the counterparty level rather than at the level of the individual financial instrument.

2.5.5 ECL sensitivity disclosures

IAASA expects that financial institutions will make every effort to:

(a) consider how ECL sensitivity disclosures incorporate material post-model adjustments;

(b) disclose ECL sensitivities at a disaggregated level such as by class of loan, by geographic region or by some other meaningful loan categorisation where the sensitivities are relevant to an understanding of the financial statements; and

(c) describe, in entity specific terms, any limitations of the disclosure of ECL sensitivities including, but not limited to, the nature of the limitation(s) and the class of financial instruments to which each limitation applies.

2.5.6 Disclosure of the effects of climate-related risk on the ECL measurement

IAASA expects financial institutions to disclose clearly how material climate-related and environmental risks are incorporated into the ECL calculations and how those risks impact the amounts recognised in the financial statements. IAASA will closely monitor the financial reporting impacts of climate risks in future financial statements.

Matters for consideration by management, Directors and Audit Committees

Management, Directors and Audit Committees should ensure that the IFRS 9 disclosures explain the judgements as to how, and the extent to which, the ongoing effects of COVID-19 and related support measures (or reversal of same) have been factored into the assessment of ECLs, SICR and the use of forward-looking information.

2.6 IFRS 8 *Operating Segments* – information about geographical areas

IFRS 8.33 states that:

> '*An entity shall report the following geographical information, unless the necessary information is not available and the cost to develop it would be excessive:*
>
> *(a) revenues from external customers (i) attributed to the entity's country of domicile and (ii) attributed to all foreign countries in total from which the entity derives revenues. If revenues from external customers attributed to an individual foreign country are material, those revenues shall be disclosed separately. An entity shall disclose the basis for attributing revenues from external customers to individual countries.*
>
> *(b) …*
>
> *… An entity may provide, in addition to the information required by this paragraph, subtotals of geographical information about groups of countries.*'

IAASA has examined a number of issuers' disclosures of revenue by geographic area under IFRS 8 *Operating Segments* as part of its 2021 activities.

IAASA has noted that issuers disclosed revenue amounts for Ireland (their country of domicile) and revenues for individual countries that are above a specified threshold (e.g. 10% of total revenue).

IAASA further noted that the remaining amount of revenue for countries below the specified threshold were frequently aggregated in a 'Rest of World' (RoW) category. Amounts of revenue included in the RoW category were material in total but the revenue attributable to individual foreign countries amounted in each case to less than 10% of total revenue. The 10% threshold appears reasonable as IFRS 8 uses a threshold of 10% when determining whether an operating segment is a reportable segment [IFRS 8.13(a)] and for determining when information about major customers is to be provided [IFRS 8.34].

However, some issuers did not specify the threshold applied in providing the revenue by geographic area disclosures.

In order to better aid users' understanding of the nature and financial effects of the business activities in which an issuer engages and the economic environments in which it operates, IAASA expects that issuers will expand the disclosure of revenues by:

- disclosing the threshold applied in determining when revenues from individual countries are disclosed; and
- disaggregating the RoW revenues from external customers to present revenues attributable to areas, regions or sub-regions.

Matters for consideration by management, Directors and Audit Committees

Management, Directors and Audit Committees should ensure that revenue from external customers that is classified as RoW in the IFRS 8 geographic areas note in the financial statements is, where appropriate, further analysed into revenues that are attributable to areas regions or sub-regions (group of countries).

2.7 IFRS 13 *Fair Value Measurement*

COVID-19 restrictions continue to pose challenges to fair valuation measurement for many issuers (including the fair valuation of non-financial assets and liabilities). The impacts of the pandemic are likely to result in changes to the valuation methodologies used as well as to fair valuation assumptions. Issuers should continue to consider aspects of fair valuation measurement and disclosure that were raised in IAASA's 2020 *Observations* document and which continue to be relevant including:

- changes in valuation techniques;
- the link between cash flows, discount rates and valuation techniques;
- independent valuation reports and pre- or post- COVID-19 fair value assumptions and transactions;
- own credit risk and liquidity risk; and
- COVID-19 expanded fair value disclosures – sensitivity.

IAASA has observed certain issuers recognising deferred contingent liabilities arising from past acquisitions. IAASA notes that there may be volatility in the expected future EBITDA, forecast cash flows and/or risk adjusted discount rate(s) as a result of COVID-19, Brexit and economic disruption and that this may result in volatility in the fair value measurement of deferred contingent liabilities. IAASA expects issuers to ensure that deferred contingent liabilities are measured in accordance with the requirements of IFRS 13 and disclosed in line with requirements of IFRS 13.93(d).

Matters for consideration by management, Directors and Audit Committees

Management, Directors and Audit Committees should ensure that fair valuation methodologies, applied to non-financial assets and liabilities, are based upon or reflect post-COVID-19 market transactions and assumptions and comply, in full, with the measurement and disclosure requirements of IFRS 13.

2.8 Prominence of 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 questions posed by stakeholders in relation to the practical application of the Guidelines.

IAASA reiterates the points made in previous years' *Observations* documents that management, Directors and Audit Committees should carefully consider the requirements of the Guidelines and ensure compliance, to the fullest extent possible, with each of the requirements of those Guidelines.

IAASA continues to examine issuers' use of APMs and continues to identify shortcomings in the application of the requirements of the Guidelines including where issuers:

(a) present APMs with more prominence and emphasis or authority than measures directly stemming from the IFRS-based financial statements. The Guidelines require that APMs should not be displayed with more prominence, emphasis or authority than measures directly stemming from IFRS-based financial statements [Guidelines 35 and 36];

(b) provide reconciliations of APMs to amounts of pre-exceptional items as opposed to reconciling APMs to full IFRS results. The Guidelines define '*applicable financial reporting framework*' as:

> ‘*For the purpose of these guidelines any of the following: (i) International Financial Reporting Standards (IFRS) as adopted in the EU pursuant to Regulation (EC) No 1606/2002 on the application of international accounting standards …’*

[Guideline 26].

(c) fail to provide reconciliations for all APMs presented. Issuers must include a reconciliation of each APM to the most directly reconcilable line item, sub-total or total presented in the IFRS-based financial statements [Guidelines 26 *et seq*];

(d) use incorrect labels to describe APMs (e.g. the expression ‘EBITDA’ is used rather than ‘Adjusted EBITDA’). Issuers are required to give meaningful labels to APMs, reflecting their content and basis of calculation, in order to avoid conveying misleading messages to users [Guideline 22];

(e) fail to define an APM or fail to set out the basis of the 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 [Guidelines 20 and 21];

(f) fail to explain the use of APMs. Explanation of the use of APMs is required by the Guidelines as it allows users of the financial statements to understand the APM relevance and reliability [Guideline 33]; and

(g) fail to present prior period comparative amounts for APMs. APMs should be accompanied by comparatives for the corresponding previous periods [Guidelines 37 and 38].

Matters for consideration by management, Directors and Audit Committees

Management, Directors and Audit Committees should carefully consider each of 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 provided in the Questions and Answers for the ESMA APM Guidelines.

2.9 Cash and offsetting within cash-pooling arrangements

IAASA has examined the recognition, measurement, presentation and disclosure of cash and cash equivalents in the financial statements of several issuers. IAASA has asked issuers to explain:

- the basis on which each of (i) bank overdrafts, and (ii) other loans and short-term borrowings were considered as cash and cash equivalents:
- how cash-pooling arrangements impacted the presentation of cash and cash equivalents in the statement of financial position.

Entities may use either actual cash pooling arrangements or notional cash pooling arrangements (i.e. entity-wide wide set-off arrangement between bank accounts). Paragraph 42 of IAS 32 *Financial Instruments: Presentation* states that a financial asset and a financial liability shall be offset and the net amount presented in the statement of financial position when, and only when, an entity:

(a) currently has a legally enforceable right to set-off the recognised amounts; and

(b) intends either to settle on a net basis, or to realise the asset and settle the liability simultaneously.

IAASA has detected diversity in practice between issuers as to what is meant by '*intends to settle on a net basis*' in IAS 32.42(b) and, consequently, whether or not cash and overdrafts are presented gross or net in the statement of financial position.

IAASA draws issuers' attention to the IFRS Interpretations Committee (IFRS-IC) Agenda Decision where, in considering whether an entity can demonstrate an intention to settle on a net basis in accordance with IAS 32.42(b), the IFRS-IC observed that:

IAS 32.46 states that net presentation more appropriately reflects the amounts and timings of the expected future cash flows only when there is an intention to exercise a legally enforceable right to set off; and

- in accordance with IAS 32.47, when assessing whether there is an intention to settle net, an entity considers normal business practices, the requirements of the financial markets and other circumstances that may limit the ability to settle net.

IFRS-IC added that many different types of cash-pooling arrangements exist in practice. Consequently, the determination as to what constitutes an intention to settle on a net basis depends on the individual facts and circumstances of each specific case.

In the event that an issuer concludes that a net presentation of cash and overdrafts is permitted, it is reminded of the disclosure requirements of IFRS 7.13C.

Matters for consideration by management, Directors and Audit Committees

Management, Directors and Audit Committees should carefully consider the judgements made about the presentation of cash and offsetting within cash-pooling arrangements. The IFRS-IC guidance on this matter should be followed.

2.10 European Single Electronic Format (ESEF)

Commencing with the financial year 2021, all annual financial reports pursuant to Article 4 of the Transparency Directive must be prepared in compliance with the ESEF.

xHTML format
All issuers in scope will be required to prepare the annual financial report in Extensible Hypertext Mark-up Language (xHTML). This single report will include, in particular, the financial statements, the management report and the responsibility statements of the persons responsible within the issuer. This format will make a company's annual financial report machine readable and will replace the current PDF format.

iXBRL
As an additional obligation, if the issuer prepares consolidated financial statements on the basis of IFRS (i.e. in the main, all equity issuers) financial information will also have to be marked up in accordance with the ESEF taxonomy (which is based on the IFRS Taxonomy) using mark-ups (known as inline Extensible Business Reporting Language (iXBRL) tags) and the inline XBRL technology. The mark-ups (also called "tags") embedded in the report will make the financial statements machine-readable.

ESMA has produced an *ESEF Reporting Manual – Preparation of Annual Financial Reports in ESEF Format* to assist in the preparation of ESEF compliant reports.

Matters for consideration by management, Directors and Audit Committees

Management, Directors and Audit Committees should, in consultation with their auditors and, if necessary, software providers, ensure compliance with the ESEF requirements.

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 2020 Observations on selected financial reporting issues issuers' financial years ending on or after 31 December 2019
Financial reporting decisions	Financial Reporting Decisions (January 2021) Financial Reporting Decisions (June 2020) Financial Reporting Decisions (February 2020) Financial Reporting Decisions (September 2019)
Surveys and commentaries	Information Note: IAS 36 *Impairment of Assets* – information requests from IAASA (March 2021) Information Note: IFRS 8 *Operating Segments* – Identification of Chief Operating Decision Maker (November 2020) Information Note – IFRS 16 *Leases* – Review of disclosures on initial application (November 2020) Information Note: Reporting the Impact of COVID-19 (November 2020) 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)
Annual Reports	2020 Annual Report 2019 Annual Report

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