Disclosures of COVID-19 Impacts

Extract, IFRS® Discussion Group Report on the Meeting – December 17, 2020

At its meetings in May and September 2020, the Group discussed certain COVID-19 financial reporting considerations and income statement presentation matters. As companies are preparing for their 2020 year-end financial statements, the Group discussed various annual reporting disclosure requirements related to COVID-19.

When preparing their financial statements, entities should consider both the entity-specific and the broad effects of COVID-19 arising from the negative impact on the global economy and major financial markets.

The Canadian Securities Administrators ("CSA") published in May 2020 a presentation titled "COVID-19: Continuous Disclosure Obligations and Considerations for Issuers." Key messages from this publication include the following:

(a) When preparing financial statements in an evolving and uncertain environment with imperfect information, issuers should use the best information available to make well-reasoned judgments.

(b) Issuers with similar circumstances may have different judgments based on the information available, which is why detailed entity-specific disclosure in an entity's financial statements is important.

(c) New information should be considered as it becomes available and judgments and estimates need to be updated. The disclosures of these estimates in the financial statements should be entity specific.

(d) Common areas that may be subject to significant judgment and estimation uncertainty include:

   a. going concern assessments;

   b. impairment assessments;

   c. fair value calculations, government assistance, revenue recognition; and

   d. deferred tax recoverability.

Group members discussed COVID-19 impacts on various disclosure topics in an entity's financial statements. The Group's discussion did not address disclosures outside the financial statements, such as the management discussion and analysis. In addition, the topics the Group discussed are not exhaustive. Entities should consider their own circumstances when analyzing how COVID-19 affects financial reporting.

Topic 1: Significant judgments and estimates

Analysis

- COVID-19 has brought many uncertainties and has affected various aspects of an entity's operations. Depending on an entity's specific circumstances, the application of different IFRS Standards may require material judgments and involve significant uncertainties. Some key areas of judgments and estimates are related to going concern assessment, fair value measurement, impairment assessment, recognition of provisions, and expected credit loss (ECL) measurement. In this uncertain environment, entities should provide insights into the risks and uncertainties they are facing and the judgments they have made in the financial statements.
- The disclosure provided should distinguish between the following:
  a. Significant judgments per paragraph 122 of IAS 1 *Presentation of Financial Statements*. These judgments are those apart from estimates made when applying an entity's accounting policies that have the most significant effect on the amounts recognized in the financial statements; and
  b. Significant sources of estimation uncertainty per paragraph 125 of IAS 1 if the source of estimation uncertainty results in a significant risk of material adjustment to recognized assets or liabilities within the next financial year.

The Group's Discussion

Group members agreed with the analysis.

Some Group members commented that during their review of interim and annual financial statements, they observed that the extent of disclosures of significant judgments and estimates varied from general statements to more robust and entity-specific disclosures. One Group member commented that some companies disclosed all potential judgments that COVID-19 can impact without focusing on those judgments that are significant and providing detailed explanations. A CSA representative also observed that in practice, some disclosures only state that COVID-19 has impacted the entity's judgments and estimates. They noted that a list or general statement of risk does not provide financial statement users with an understanding of the information used by an entity when making the significant judgments and estimates in this uncertain environment. Therefore, to make the disclosure more useful, they encouraged the entity to provide specific disclosure on significant judgments made and assumptions associated with major sources of estimation uncertainty.

One Group member observed that one area of judgment includes whether an asset continues to be classified as held for sale when the sale may not be completed within one year. This Group member noted entities should consider guidance in paragraph 9 and Appendix B of IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations* when there is an extension of the period required to complete a sale.

Some Group members also encouraged entities to consider providing the types of disclosures included in paragraph 129 of IAS 1 to help financial statement users understand the judgments that management makes about the sources of estimation uncertainty. These members thought that disclosure of the sensitivity of carrying amounts to the methods, assumptions and estimates underlying their calculation is particularly important to financial statement users in the COVID-19 environment.

Topic 2: Going concern and liquidity risk disclosures

Analysis

(a) Going concern

- COVID-19 may cause severe deterioration to an entity's economic conditions that could cast doubt on its ability to continue as a going concern. An entity is no longer a going concern if its management either intends to liquidate the entity or to cease trading or has no realistic alternative but to do so.
- Assessing an entity's ability to continue as a going concern requires judgment, especially during this uncertain time. Entities should consider:
  - COVID-19's effects on their operations;
  - the effectiveness of management's mitigation plans; and
  - assistance provided by governments and lenders.
- For some entities, management has applied significant judgment to determine that there are no material uncertainties that may cast significant doubt upon the entity's ability to continue as a going concern. In some of these situations, small changes to management's assumptions may result in the determination that there are material uncertainties that cast significant doubt about the entity's ability to continue as a going concern. In these close call situations, the IFRS Interpretations Committee noted in its July 2014 agenda decision that the disclosure requirements of paragraph 122 of IAS 1 would apply to the judgments made in concluding that there remain no material uncertainties related to events or conditions that may cast significant doubt upon the entity's ability to continue as a going concern. The Group discussed this topic during its May 2016 meeting.
- Events after reporting date may provide further information in making this assessment and are adjusting events under IAS 10 *Events After the Reporting Period*.

(b) Liquidity risk disclosure

- To mitigate liquidity risks caused by COVID-19, management may need to obtain additional financing, amend the terms of existing debt agreements or obtain waivers on debt covenants.
- IFRS 7 *Financial Instruments: Disclosures* requires entities to provide disclosures to reflect any significant changes in the entity's liquidity position and how it is managing the liquidity

risk. These disclosures should be consistent with the assessment of the going concern assumption.

- IAS 1 requires an entity to make qualitative and quantitative disclosures regarding its objectives, policies, and processes for managing capital. When an entity changes its capital management policies in response to COVID-19, such as suspending its dividends, the entity should disclose this fact with the reason and the future plans (per paragraphs 134- 135 of IAS 1).

The Group's Discussion

Group members agreed with the analysis.

A CSA representative emphasized the need for management to consider the disclosure requirements of paragraph 122 of IAS 1 when small changes to assumptions used in their going concern assessment may give rise to the determination that there are material uncertainties that may cast significant doubt about the entity's ability to continue as a going concern. In such close-call situations, entities should disclose judgments made in concluding that there are not material uncertainties related to events or conditions that may cast significant doubt upon the entity's ability to continue as a going concern.

A Group member commented that the factors to consider for government organizations may be different than those in private sectors. For a crown corporation classified as an agent of the Crown[1], the corporation's assets and liabilities are the assets and liabilities of the government. Therefore, factors such as the government's intention to provide cash infusion need to be considered when making the going concern assessment of an agent crown corporation.

Topic 3: Impairment assessment of non-financial assets

Analysis

- At its May 2020 meeting, the Group discussed COVID-19's impact on an entity's impairment assessment of non-financial assets.
- The entity should consider the requirements in IAS 36 on its impairment assessment of non-financial assets and provide detailed disclosures of the assumptions made, the supporting evidence and the impact of a change in the key assumptions. The extent of disclosures made depends on whether the carrying amount of an asset or cash generating unit (CGU) is recoverable and the amount to which that recoverable amount exceeds the carrying amount of the long-lived asset or the CGU. An entity may need to provide more extensive disclosure if the asset or the CGU is not recoverable or if its determination is subject to significant

[1] Crown corporations are government organizations that operate following a private sector model, but usually have a mixture of commercial and public policy objectives. Crown corporations are directly owned by the Government of Canada and are established through legislation, letters patent, or articles of incorporation under the Canada Business Corporations Act.

judgment and uncertainty and if reasonably possible changes to assumptions may result in its carrying amount not being recoverable.

- In addition, the entity may need to consider the level at which it provides these disclosures. For example, an entity with multiple CGUs should consider whether separate disclosure is needed for them. It may not be appropriate to combine CGUs for disclosure purposes and provide an average or a weighted average disclosure of assumptions made.

The Group's Discussion

Group members agreed with the analysis.

Some Group members considered the impairment assessment of non-financial assets to be one of the most significant judgments impacted by COVID-19. One Group member noted that even in cases where an entity concluded that its non-financial assets are not impaired, the disclosures of the assumptions used and the judgments applied are valuable to financial statement users to understand the rationale for not impairing non-financial assets. Another Group member commented that factors such as the extent and the longevity of COVID-19's impact, the degree of uncertainty caused by COVID-19, and whether the potential impact of that uncertainty is material to the financial statements are often considered when assessing the extent of disclosures to provide.

Topic 4: Financial assets and fair value measurement

Analysis

- Estimating the expected credit loss of financial assets is another focus area for many entities. The Group discussed the impact of COVID-19 on an entity's ECL model at its May 2020 meeting. The IASB also published educational material on the "Application of IFRS 9 in the light of the coronavirus uncertainty" in March 2020.
- IFRS 7 requires extensive disclosures around credit risk such as:
    - how the impact of forward-looking information has been incorporated into the ECL estimate; and
    - details of significant changes in assumptions made in the reporting period, and changes in the ECL that result from assets moving from stage 1 to stage 2
- The uncertainties presented by the current environment can also impact fair value measurements. Fair value measurements should reflect market participants' views and market data at the measurement date under the current market conditions. An entity should pay close attention to fair value measurements based on unobservable inputs (i.e. level 3 measurements). The unobservable inputs used should reflect how market participants would reflect the effect of COVID-19 in their expectations of future cash flows related to the asset or liability at the reporting date. In addition, when there is a range of possible fair value estimates, the entity should apply judgment to determine the point within the range that is most representative of the fair value in that circumstance.

- Given these impacts on fair value measurements, it is important for the entity to provide transparency about the techniques, key assumptions and inputs it used to determine the fair value, including the sensitivities by providing disclosures required by IFRS 13 *Fair Value Measurement*.

The Group's Discussion

Group members agreed with the analysis.

One Group member commented that for financial institutions, the ECL estimation process involves significant judgments. Furthermore, this Group member observed that banks have provided detailed disclosures associated with the ECL, such as:

- the impacts to the ECL model from COVID-19 and payment relief programs offered to customers from the government and the banks;
- the need for management overlay adjustments to address any limitation in the ECL model; and
- a sensitivity analysis on the ECL incorporating different levels of forecasts of key macro-economic variables and other inputs

Another Group member noted that entities that received credits for any cancelled tradeshows or corporate events, should assess whether the credit should be classified as a current or a non-current asset and whether any of these credits may be impaired.

Several Group members then observed a lack of disclosures in some financial statements regarding COVID-19's impact on the determination of fair value of financial assets, especially on unobservable inputs. One Group member also noted that the measurement and disclosure requirements in IFRS 13 apply to non-financial assets that are measured at fair value, such as investment properties under the fair value model and biological assets. Therefore, entities should ensure IFRS 13 disclosure requirements are met for these assets as well.

Topic 5: Other considerations

Analysis

- Other areas that may require additional disclosures include:
    - onerous contracts,
    - insurance recoveries,
    - lease modifications,
    - employee termination programs,
    - government assistance,
    - share based compensation performance conditions and modifications,

- variable consideration and revenue recognition,
- supplier based financing arrangements,
- inventory cost allocations, and
- hedging and probability of forecasted transaction occurring.

The Group's Discussion

Several Group members considered other factors that may require additional judgment and disclosures, such as disclosures of COVID-19's impacts on an entity's risk management activities.

One Group member noted that from a financial statement user's perspective, more transparent information helps in understanding the nature and magnitude of the impact COVID-19 on the entity. Better COVID-19 disclosures also help users assess whether the impact of COVID-19 is temporary or more permanent in nature so that they can adjust their financial forecast accordingly.

Overall, the purpose of the Group's discussion is to raise awareness about COVID-19 impacts on various disclosure topics in an entity's financial statements. Group members also noted other helpful COVID-19 resources from regulators[2] and the AcSB are available to help entities through the annual financial reporting process. No further action was recommended to the AcSB.

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[2] CSA Presentation: COVID-19: Continuous Disclosure Obligations and Considerations for Issuers
U.S. Securities and Exchange Commission publication: CF Disclosure Guidance: Topic No. 9
European Securities and Markets Authority public statement: Implications of the COVID-19 outbreak on the half-yearly financial reports