Markets Brief

COVID - 19 disclosures in Annual Financial Statements of Reporting Entities

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Introduction

In March 2020, the DFSA issued Markets Brief No. 19, Update on Coronavirus (COVID -19), reminding Reporting Entities of disclosure obligations that may arise as a result of the impact of the COVID-19 pandemic.

In this edition of Markets Brief, the DFSA sets out information to assist Reporting Entities and their advisors in identifying the International Financial Reporting Standards (IFRS) relevant to COVID-19 coronavirus pandemic disclosures in their annual financial statements and understanding what we consider to be good practice in applying them. The Markets Brief highlights key financial reporting disclosure considerations relating to COVID-19. However, Reporting Entities should note that these are not exhaustive and are not a substitute for the authoritative IFRS as issued by the International Accounting Standards Board (IASB)[1], as at the date of this Markets Brief.

Regulatory framework

Article 44 of the DIFC Markets Law[2] states that a Reporting Entity shall prepare and file with the DFSA an annual financial report in accordance with the requirements prescribed in the Markets Module (MKT) of the DFSA Rulebook. Pursuant to Chapter 5 of MKT a Reporting Entity must prepare financial statements for each financial year of the Reporting Entity. MKT 5.1.2 specifies that the Reporting Entity must prepare and maintain all financial statements in accordance with the IFRS (or other financial reporting standards acceptable to the DFSA).

Rule 6.2.1 of the Auditor Module (AUD) of the DFSA Rulebook states that an Auditor must conduct an audit, and prepare the contents of any relevant audit report, for a Public Listed Company Auditor's Report, in accordance with AUD. AUD A6.1.1 prescribes that, in producing a Public Listed Company Auditor's Report, an Auditor must state whether the financial statements have been properly prepared in accordance with the Rules in MKT.

Guidance

Please note that the contents of this communication are not intended to be Guidance as contemplated by the Regulatory Law 2004 and the contents should neither be interpreted, nor relied upon, as Guidance. You should refer to the DFSA Rulebook for Guidance or contact the DFSA if you require individual guidance.

Technical explanations given in this brief are for

[1] https://www.ifrs.org/issued-standards/list-of-standards/

[2] Markets Law, DIFC Law No. 1 of 2012 (August 2014)

illustrative purposes and should not be considered or relied upon as legal advice. We recommend that if you are unsure about any aspect of the DFSA Markets regime which may apply to you then you obtain appropriate independent advice.

Defined terms are identified in this Brief by the capitalisation of the initial letter of a word or each word in a phrase and are defined in the Glossary (GLO) Module of the DFSA Rulebook.

COVID-19 coronavirus pandemic disclosures in Annual Financial Statements

The impact of COVID-19 was generally a "non-adjusting event" (IAS 10)[3] with little or no change in financial statements with a year-end date of 31 December 2019, other than post-balance sheet date event disclosures. However, Reporting Entities should incorporate the effects of COVID-19 into their 2020 annual financial statements. Users of the annual financial statements will want to understand not only the historical performance of Reporting Entities, but also their future prospects.

Presentation of primary statements – IAS 1 Presentation of Financial Statements requires certain material items to be disclosed separately, either in the statement of comprehensive income or in the notes, if this aids a user's understanding of the Reporting Entity's financial performance. Reporting Entities will need to consider whether certain COVID-19 related items of income or expenditure, such as material restructuring costs and impairment charges, should be disclosed separately in accordance with existing policies for "exceptional" or similar items.

Going concern disclosures – IAS 1 Presentation of Financial Statements requires directors of Reporting Entities to assess the company's ability to continue as a going concern for at least 12 months from the Reporting Entity's reporting date. If information is available beyond 12 months that is relevant in management's assessment, then it must be included as well.

As a result of the economic uncertainties caused by COVID-19, management of Reporting Entities should assess whether these events or conditions cast significant doubt on the Reporting Entity's going concern status. If there is a material uncertainty over going concern, Reporting Entities should disclose the material uncertainty and any significant assumptions and judgements applied in making going concern assessments. It is imperative that these disclosures are clear and robust. The level of detail will depend on the specific circumstances of the Reporting Entity.

Where the Registered Auditor disagrees with management over its going concern assessments, or if there are inadequate disclosures about the material uncertainty in the financial statements, the auditor may modify its report.

Significant judgements and estimates – IAS 1, paragraph 125 requires disclosure of key sources of estimation uncertainty that have a significant risk of causing a material adjustment to assets and liabilities within the next financial year. Additional disclosure should also be made of other estimates, such as those that may affect carrying amounts in the longer-term.

In addition, disclosure of sensitivities and ranges of possible outcomes, including where management's view sits within the range of possible outcomes, will be of benefit to users. Reporting Entities should consider whether they could enhance users' understanding of assumptions underlying estimates by quantifying information.

Where there has been a change in past assumptions as a result of the impact of COVID-19, which results in a significant change in an accounting estimate, IAS 8 requires a disclosure of the nature and amount of the change.

Finally, Reporting Entities are reminded to make company-specific disclosures that highlight areas of estimation uncertainty and should avoid the use of boilerplate

[3] IAS: International Accounting Standards

disclosures.

Fair Value Measurements – As a result of the increased economic uncertainty of cashflow forecasting and other unobservable inputs used in valuation techniques, disclosure of valuation techniques, of inputs used to develop fair value measurements and of the sensitivity of the valuation to changes in assumptions will be required under IFRS 13. The disclosures should be clear and transparent to enable users to understand the impact of COVID-19. We anticipate the impact of COVID-19will be greater for fair value measurements classified as level 2 and 3 in the fair value hierarchy.

Impairment of Financial Assets (IFRS 9) – In March 2020, the IASB published an educational material reiterating the requirements of IFRS 9 on the Expected Credit Loss (ECL) model[4]. The publication highlights the need for ECL models to be based on reasonable and supportable information based on current circumstances rather than a mechanistic approach. Past models and historical data may no longer be relevant predictors of current expectations hence a probability weighting of different scenarios may be required. This would involve a high degree of judgement and estimation uncertainty.

Accordingly, Reporting Entities should disclose their significant judgements, assumptions and sensitivities as well as key sources of estimation uncertainties, the impact of COVID-19 on their credit risk exposures, concentration of credit risks and how forward-looking information has been incorporated into ECL measurement.

Impairment of Non-Financial Assets – The economic uncertainties introduced by COVID-19 are likely to constitute a triggering event under IAS 36 Impairment of Assets.

Where an asset is impaired and the recoverable amount is based on fair value less costs of disposal, the disclosure requirements of IAS 36 include disclosure of:

i. the level of the fair value hierarchy within which the fair value measurement is categorised;

ii. the valuation techniques used to measure fair value less costs of disposal; and

iii. the key assumptions used, categorised within 'Level 2' and 'Level 3' of the fair value hierarchy.

Where the recoverable amount has been determined on the basis of value in use, or on the basis of fair value less costs of disposal using a present value technique, disclosure of the discount rates and growth rates used to extrapolate cash flow projections is required. How Reporting Entities have incorporated the impacts of COVID-19 into their cashflow projections, discount rates and long-term growth rates should also be disclosed.

The assumptions made during impairment assessments should be consistent with the going concern assumptions disclosed by the Reporting Entity.

IFRS 15, Revenue from Contracts with Customers – A slowdown in economic activity as a result of COVID-19 may have led to a reduction in sales and revenue for Reporting Entities in certain industries, as well as revisions or changes to contractual terms which may result in significantly different reporting outcomes. For instance, assumptions made by management when recognising revenue from contracts with a variable consideration element may be different for the 2020 annual reports. IFRS 15 Revenue from contracts with customers requires recognition of variable consideration only when it is highly probable that amounts recognised will not be reversed when the uncertainty is resolved. Management may need to re-evaluate their estimates of variable considerations considering the current levels of economic uncertainty.

IFRS 15 requires Reporting Entities to disclose information such as the significant

[4] IFRS 9 and covid-19 - accounting for expected credit losses

judgements applied and significant estimates made. The disclosures should be detailed enough to allow users to understand the nature, amount, timing and uncertainty of cash flows arising from revenue.

We encourage Reporting Entities to consider the above when preparing their disclosures for their 2020 year-end reporting. A number of areas not highlighted in this Markets Brief may still be relevant, so we expect Reporting Entities to apply professional judgement and comply with the disclosure requirements of the IFRS.

Contact us

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- other editions of Markets Brief; and
- access to DFSA-administered legislation and DFSA Rulebook modules, including a full text of the Markets Law 2012, the Markets Rules, the Auditor and Glossary Modules of the DFSA Rulebook.

For Markets related enquiries:

- Telephone: +971 4 362 1500
- Email: markets@dfsa.ae

The DFSA will not advise a particular course of action or provide (legal) advice, but it is prudent to keep the DFSA informed of ongoing developments in relation to the Reporting Entity.

Arabic edition

Every Markets Brief is produced in both English and Arabic and is available on the DFSA website.

Feedback

We appreciate your feedback and welcome any suggestions that you may have. Please email us at markets@dfsa.ae