October 2022

Financial Reporting Supervision

Observations on Selected Financial Reporting Issues – Years ending on or after 31 December 2022

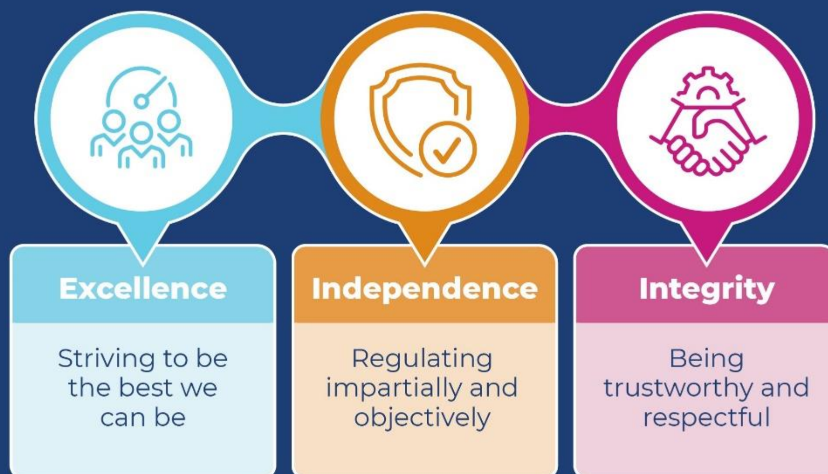
IAASA

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

Our Values



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1. Financial reporting environment

1.1 Introduction

In its role as Ireland's accounting enforcer, IAASA examines the annual financial statements and half-yearly financial reports of certain[1] issuers to ensure that their financial reports comply with the relevant reporting framework.

In publishing this *Observations* Paper, IAASA hopes to assist issuers in preparing high quality financial reports by offering observations on selected financial reporting topics.

The matters set out in this Paper may be subject to detailed scrutiny by IAASA in its 2023 cycle of financial report examinations.

1.2 Uncertain economic outlook

Globally, across Europe and domestically, the economic outlook is uncertain with several adverse geo-political issues facing businesses.

"The global economy has lost momentum in the wake of Russia's war of aggression in Ukraine, which is dragging down growth and putting additional upward pressure on inflation worldwide, according to the OECD's latest Interim Economic Outlook.

The Outlook projects global growth at a modest 3% this year before slowing further to just 2.2% in 2023. This is well below the pace of economic growth projected prior to the war and represents around USD 2.8 trillion in foregone global output in 2023.

The war has further pushed up energy prices, especially in Europe, aggravating inflationary pressures at a time when the cost of living was already rising rapidly around the world due to lingering impacts of the Covid-19 pandemic. With businesses across many economies passing through higher energy, transportation and labour costs, inflation is reaching levels not seen since the 1980s, forcing central banks to rapidly tighten monetary policy settings faster than anticipated."

OECD Press Release "OECD Interim Economic Outlook warns of pervasive global economic slowdown", 26 September 2022

[1] The Authority's financial statement review remit derives from Directive 2004/109/EC of the European Parliament and of the Council of 15 December 2004 on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market and amending Directive 2001/34/EC (the EU Transparency Directive), as transposed into Irish law

"As the reality of a protracted Russian invasion of Ukraine sinks in, the assessment of its economic consequences for the global economy is turning grimmer. The shocks unleashed by the war are hitting the EU economy both directly and indirectly, setting it on a path of lower growth and higher inflation. The rapid increase in energy and food commodity prices is feeding global inflationary pressures, eroding the purchasing power of households, and triggering a faster monetary policy response than previously assumed. Furthermore, the deceleration of growth in the US is adding to the negative economic impact of China's strict zero-COVID policy"

European Commission "European Economic Forecast – Summer 2022", 14 July 2022

Uncertainties facing businesses include:

Interest rate increases with the first European Central Bank ('ECB') rate rise in 10 years and the expectation of further rate increases later in the year

"High inflation is a major challenge for all of us. The Governing Council [of the ECB] will make sure that inflation returns to its 2% target over the medium term.

In May inflation again rose significantly, mainly because of surging energy and food prices, including due to the impact of the war. But inflation pressures have broadened and intensified, with prices for many goods and services increasing strongly. Eurosystem staff have revised their baseline inflation projections up significantly. These projections indicate that inflation will remain undesirably elevated for some time."

ECB Press Statement "Monetary policy decisions", 9 June 2022

Inflation with domestic price increases at their highest level in 38 years

"… prices for consumer goods and services in June 2022 increased by 9.1% on average compared with June 2021. This follows an increase of 7.8% in the year to May 2022. Prices have been rising on an annual basis since April 2021, with an annual inflation of 5.0% or more recorded each month since October 2021. The annual increase in the CPI to June 2022 is the largest observed in 38 years, when annual inflation stood at 9.7% in Q_2 1984.

The most significant increases in the year to June 2022 were seen in Housing, Water, Electricity, Gas & Other Fuels which was up 22.5%, and Transport, up 20.4%. Increased energy costs are reflected in the yearly increase of Housing, Water, Electricity, Gas & Other Fuels driven by rises in electricity (+40.9%), gas (+57.2%), liquid fuels/home heating oil (+115.4%) and solid fuels (+26.2%) in the year. The annual change in Transport costs reflects a rise in the cost of diesel (+50.7%), petrol (+43.8%), purchase of motor cars (+13.0%) and airfares (+38.4%) compared to June 2021."

Central Statistics Office, Press Statement Consumer Price Index June 2022, 14 July 2022

A slowdown in economic growth forecasts and some talk of recessionary risks in some economies

"… the demand recovery from the pandemic has been tempered by the effects of the Russian invasion of Ukraine and persistent supply chain challenges. Whilst positive economic growth is still expected in 2022, higher prices and costs are already impacting negatively on households and firms. Households' real incomes and purchasing power are expected to fall in 2022, before recovering over the following years. Relatedly, domestic consumption and investment are expected to grow at a slower pace this year and next than previously expected. Uncertainty around the medium-term outlook remains high …"

Central Bank of Ireland – Press Release on publication of "Quarterly Bulletin 2022", 7 July 2022

Meanwhile, the COVID-19 recovery path remains unclear and sporadic resurgence in cases continues to be a source of concern.

Such developments will particularly impact on areas such as:

- going concern assessments and the reliability of budgets
- fair value measurements generally, and
- the measurement of pension assets and liabilities.

1.3 Some general financial reporting pointers

In preparing periodic financial statements, management, Directors, and Audit Committees should:

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

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

consider the impact of climate change on the issuer's operations and on the measurement of assets and liabilities, and

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

And should not:

misuse alternative performance measurements (APMs')

misuse exceptional item presentation, and

"greenwash" when it comes to disclosing the impact of climate change.

2. Observations on selected financial reporting issues

2.1 War in Ukraine

The impact of the war in Ukraine may warrant consideration from a financial reporting perspective for entities with activities in Russia, Belarus and Ukraine.

2.1.1 Consolidation and loss of control

One area that is likely to impact certain issuers is that of IFRS 10 *Consolidated Financial Statements*. Given the situation in the region, the question will arise under paragraph 5 of IFRS 10 as to whether the investor has control over the investee. IFRS 10.10 deals with power and it says that an investor has power over an investee when the investor has existing rights that give it the current ability to direct the relevant activities.

A key consideration here is the **current** ability to direct relevant activities; while the investor may continue to have 100% interest in the investee in Russia, Belarus and Ukraine, an assessment must be made as to whether or not the investor has the current ability to direct the relevant activities. IFRS 10.25 deals with the loss of control and how to account for the loss of control.

2.1.2 Loss of control – re-measurement

Under IFRS 10, if there is loss of control then the investment in the investee is re-measured to fair value. There may be difficulties in determining what that fair value might be, and there may be much uncertainty surrounding that fair value measurement. However, simply assuming that the fair value is zero is not necessarily the appropriate approach. Fair value needs to be measured and there may be a requirement for disclosures under paragraph 122, significant judgments, and paragraph 125, estimation uncertainty, of IAS 1 *Presentation of Financial Statements*.

2.1.3 Expected credit losses

Against the backdrop of the war, measurement of expected credit losses ('ECLs') under IFRS 9 *Financial Instruments* may be challenging for affected issuers. Simply assuming that Russian, Belarusian, and Ukrainian assets are going to be 100% provided against and that the asset is measured at zero may not be the appropriate measure to apply.

Paragraph 5.5.17 of IFRS 9 regarding measurement requires the use of reasonable and supportable information in the determination of ECLs. In the circumstances, management judgement may be necessary in determining what is reasonable and supportable. Again, the disclosures required under paragraph 122, significant judgments, and paragraph 125, estimation uncertainty, of IAS 1 will warrant careful consideration.

2.1.4 Presentation of impact – exceptional items

In addition, there is a need to distinguish between the direct impact of the war from other geo-political disruptions. Consideration should be given to paragraphs 17(b) and 98 of IAS 1 where the financial reporting treatments and associated disclosures, including their presentation as exceptional in nature, may differ and may require separate disclosure.

Matters for consideration by management, Directors, and Audit Committees

Management, Directors, and Audit Committees should, in instances where the issuer has significant activities in in Russia, Belarus and Ukraine, consider the recognition, measurement, presentation and disclosure of assets, liabilities, income, expenses and cash flows impacted by the war.

2.2 Geo-political developments

The uncertain geo-political environment merits consideration in preparing financial statements in the upcoming reporting season.

Developments such as interest rate increases, inflation, a slowdown in economic growth forecasts and recessionary risks in some economies may impact on areas such as:

- going concern assessments and the reliability of budgets,
- fair value measurements generally, and
- the measurement of pension assets and liabilities.

Each of these will require careful consideration in preparing and auditing financial statements at year end 2022 stage.

In presenting the impact of the war in Ukraine there is a need to distinguish the impact of that war from other geo-political factors. There are two distinct events here: one is the war itself, the impact of direct war itself and the other end is a broader impact on of geo-political events, the indirect impacts. IAASA views these two aspects as separate events. Consequently, aggregating both into a single item may not be an appropriate presentation or disclosure; they are considered distinct and should be presented and explained separately.

Some issuers may provide modified APMs (or KPIs) to reflect the impact of the war in Ukraine; such treatment is permissible under the *ESMA Guidelines on Alternative Performance Measures*. But each of the disclosures in the ESMA APM Guidelines must be met. Aggregating the direct Ukraine impact and the impact of other geo-political impacts into a single APM may not be appropriate.

In addition, should an issuer present some of these geo-political or Ukrainian items as exceptional, it may be inappropriate to aggregate direct Ukraine impacts and broader geo-political developments into a single line item. The treatment applied must be in line with the issuer's accounting policy for exceptional items. However, aggregating all the impacts into a single measure may not be an appropriate presentation.

Matters for consideration by management, Directors, and Audit Committees

Management, Directors, and Audit Committees should carefully consider the impact of broader geo-political events and expectations on amounts included in the financial statements including the going concern assessment, fair value measurement and pensions assets and liabilities.

In addition, the presentation of the impact of geo-political developments and the Ukrainian war should be carefully considered; particularly, the use of APMs should fully comply with the ESMA APM Guidelines.

2.3 Impairment testing

Against the background of global developments and uncertainties, the recognition and measurement of impairments under IAS 36 *Impairment of Assets* will likely be a key consideration in 2022 financial statements. Preparers and auditors need to ensure that assumptions used for impairment testing are reasonable and supportable [IAS 36.33(a)].

There is much uncertainty to capture in impairment tests:

- the trajectory of the COVID-19 recovery,
- the fallout from the Russian invasion of Ukraine,
- reflecting the impact of inflation and interest rate increases,
- uncertainty over energy supplies,
- supply chain bottlenecks, and
- climate risks.

Issuers are reminded that, where there is any indication than an asset may be impaired, the issuer must estimate the recoverable amount of the asset [IAS 36.9].

Issuers' attention is drawn to the disclosure requirements of IAS 36 [IAS 36.126 *et seq*] including, in certain instances, the key assumptions used by management in estimating its cash flow projections [IAS 36.134-135].

In assessing whether or not issuers have based their cash flow projections on reasonable and supportable assumptions that represent management's best estimate of the range of economic conditions [IAS 36.33(a), IAASA has:

(a) requested and examined assumptions that were used in cash flow projections to assess whether or not, these assumptions are reasonable,

(b) examined the growth assumptions for revenue and EBITDA in cash flow projection calculations to ensure that these assumptions are consistent with past actual outcomes,

(c) examined the accuracy of budgets by reviewing actual outcomes to budgeted amounts,

(d) assessed management's explanations as to whether or not, subsequent events or circumstances that did not exist when actual cash flows were generated are consistent with budgetary assumptions [IAS 36.34], and

(e) examined calculations of discount rates to assess whether each element in the calculation is reasonable e.g., has an appropriate country risk premium being applied in determining discount rates [IAS 36.55 and IAS 36.A18].

IAASA has received undertakings from certain issuers that they will disclose the assumptions used in the cash flow projections on which the recoverable amount was calculated [IAS 36.134(d)(i)(ii) and (iv)].

Matters for consideration by management, Directors, and Audit Committees

Management, Directors, and Audit Committees should:

(a) carefully consider the recognition and measurement of impairments under IAS 36,

(b) ensure that assumptions used for impairment testing are reasonable and supportable, and

(c) comply with each of the disclosure requirements in IAS 36.

2.4 Climate commitments

Some climate commitments may meet the definition of a provision under IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* in that they may create a constructive obligation resulting in a probable outflow of economic resources and be reliably estimated. If so, the climate commitment may need to be recognised and measured as a provision [IAS 37.14] or a contingent liability may need to be disclosed in the financial statements.

A constructive obligation might arise where an issuer has published, for example, environmental policies, targets, or goals, even though no legal obligation exits. In this context, attention is drawn to the definitions of 'constructive obligation' and 'contingent liability' [IAS 37.10].

IAS 37.85 sets out the disclosure requirements for each class of provision (nature, amounts, uncertainties) and IAS 37.86 provides the disclosure requirements for contingent liabilities (nature, amounts, uncertainties).

Other climate commitments may be achieved through planned future capital expenditure, where a promise made by an issuer to stakeholders results from legal or contractual requirements. In this context, attention is drawn to paragraph 74(c) of IAS 16 *Property, Plant and Equipment*.

Issuers operate within constraints which typically derive from legal obligations. Constraints can also be constructive where obligations are derived from the actions of the issuer that create valid expectations in other parties that the entity will behave in a particular way.

IAASA reminds issuers that at its June 2022 meeting, the IFRS Interpretations Committee ['IFRS IC'] decided to finalise its Agenda Decision *Negative Low Emission Vehicle Credits (IAS 37 Provisions, Contingent Liabilities and Contingent Assets)*. The following is noted in relation to possible constructive obligation arising:

'The possibility of a constructive obligation

The Committee concluded that, if an entity determines that it has no legal obligation to eliminate its negative credits, it would then need to consider whether it has a constructive obligation to do so. It would have a constructive obligation if it has both:

(a) in a calendar year, produced or imported vehicles with average fuel emissions higher than the government target; and

(b) taken an action that creates valid expectations in other parties that it will eliminate the resulting negative credits—for example, made a sufficiently specific current statement that it will do so'

IFRS Interpretation Commission decision 'Negative low emissions vehicle credits'

IAASA has engaged with issuers to assess whether or not they, as a result of their public announcements on climate targets, have created constructive obligations warranting recognition as a provision or a disclosure of a contingent liability or a contractual commitment for future capital expenditure.

Given the importance of this mater to a wide range of stakeholders, IAASA continues to engage with issuers on this topic.

Greenwashing – key risk

IAASA considers that greenwashing is risk indicator impacting certain issuers and, consequently, it is engaging with and will continue to engage with issuers. IAASA, together with other EU accounting enforcers are engaging with issuers to minimise the risk of greenwashing. IAASA has noted that certain issuers have made public announcements regarding, for example, their CO_2 emission reduction targets by specific dates in their management commentary. However, the financial impact from these climate announcements is not readily apparent from the disclosures in the financial statements. IAASA encourages issuers to ensure that there is an appropriate balance between the disclosures in the management commentary [see Section 2.5 below] and the disclosures in the financial statements.

IAASA has challenged issuers' climate targets and has required some issuers to provide further explanations on their decarbonisation and nature-based projects which issuers undertake or commit to undertake to achieve climate targets.

IAASA is requesting explanations from issuers to identify any potential greenwashing matters. For example, the type of information IAASA has requested from issuers include:

(a) clarification as to whether or not the climate change risks and/or any expenditure related to the issuer's climate strategy and commitment to achieving net zero on Scope 1 and Scope 2 emissions by a specific date are included or factored into its value-in-use calculations [IAS 36.33(a) to (c)],

(b) provision of an analysis of the costs for decarbonisation and nature-based initiatives that were recognised in the financial statements where such information is not apparent from the disclosures in the financial statements,

(c) an explanation as to why sensitivity analysis does not include sensitivities on the issuer's own commitment of achieving net zero scope 1 and scope 2 emissions by a specific date [IAS 1.125 and IAS 1.129], and

(d) an explanation as to why the issuer's public announcement, that it will achieve a net zero on Scope 1 and Scope 2 emissions by a specific date, is not considered to be a constructive obligation and disclosed as a contingent liability [IAS 37.10 and IAS 37.86].

Matters for consideration by management, Directors, and Audit Committees

Management, Directors, and Audit Committees should:

(a) consider whether or not entities' climate commitments require recognition as a provision or disclosure as a contingent liability,

(b) consider the broader impact of the IFRS IC agenda decision titled *Negative Low Emission Vehicle Credits (IAS 37 Provisions, Contingent Liabilities and Contingent Assets,* and

(c) ensure that there is a balance and consistency between the disclosures in the management commentary and the disclosures in the financial statements to minimise greenwashing risks. For example, if the costs of the decarbonisation and nature-based projects are not known and not incorporated into the issuer's financial statements (e.g., impairment model), then this information should be clearly disclosed for users of the financial statements.

2.5 Transparency Directive Regulations

Regulation 5(4)(c)(ii) of the Regulations requires that '*the management report includes a fair review of the **development*** [bold emphasis added] *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.'*

IAASA engaged with issuers on disclosures in the management report regarding climate related matters. IAASA has noted that issuers have disclosed climate reduction targets and explanations as to how these targets will be met through either decarbonisation or nature-based carbon capture projects in the management report. However, the practical difficulties in implementing the projects are not discussed or referenced in the management reports.

IAASA notes that information that was provided to IAASA during financial statement examinations had not always been disclosed in the management reports. Set out below are examples of information provided to IAASA which was not disclosed in issuers' management reports:

(a) an issuer disclosed in its report that it will achieve its climate targets through a combination of decarbonisation projects and nature-based initiatives. The issuer indicated to IAASA that it could not estimate how much the nature-based initiatives would cost. It is not apparent as to whether or not the nature-based initiatives will be sufficient to allow the issuer to achieve its climate goals; this fact was not disclosed in the management report; and

(b) an issuer disclosed three climate goals in its 2021 annual report with one target scheduled for completion by 2025 and one scheduled for completion by 2030. The issuer indicated to IAASA that its 2025 target represented a goal set by the issuer and was not driven by any external bodies or legislative requirements; no specific actions towards achieving the target have been committed to by the issuer. This fact was not disclosed in the management report.

IAASA has noted that issuers disclose or publicly announce information regarding their climate goals in publications other than the management report and the financial statements, e.g., in investor presentations and press releases. It is not readily apparent to IAASA as to why this information is not included as part of the fair review of the development of the issuer's business. It is IAASA's expectation that information which is sufficiently significant to warrant inclusion in an investor presentation or a press release is also relevant for disclosure in the management report as part of the fair review of the development of the issuer's business.

Matters for consideration by management, Directors, and Audit Committees

In relation to the climate related disclosures in the management report, Management, Directors, and Audit Committees should ensure that the management report contains a fair review of the development and performance of the business by:

(a) expanding the management report to include:

   (i) additional explanatory information to provide details as to the evidence used to set these targets and the actions the issuer intends to take to ensure these targets are achieved, and

   (ii) any practical difficulties in implementing the decarbonisation or nature-based initiatives that the issuer will use to achieve its targets, and

(b) information that is included in investor presentations/press releases and obviously relevant in the context of the fair review of the business.

2.6 Alternative Performance Measures (APMs)

ESMA's APM 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 ESMA APM Guidelines and ensure compliance, to the fullest extent possible, with each of the requirements of those guidelines.

IAASA notes that issuers may disclose new climate related APMs, e.g., APMs related to 'green' revenue in their annual reports. IAASA reminds issuers of ESMA Questions and Answers on the ESMA Guidelines on Alternative Performance Measures[2] and specifically to questions 19 and 20 which indicate that the APM guidelines apply to the financial measures related to Environmental Social Governance matters (e.g., green revenue or sustainable capital expenditure).

IAASA received undertakings from issuers that the principles of the ESMA APM Guidelines will be applied to environmental, social and governance (ESG) financial measures in future periodic financial reports.

IAASA continues to examine the use of APMs and continues to identify shortcomings in the application of the requirements of the guidelines.

IAASA reminds issuers of the following matters on which IAASA continues to identify non-compliance:

(a) APMs were presented with more prominence and emphasis or authority than measures directly stemming from the IFRS-based financial statements. The ESMA APM 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) reconciliations of APMs were provided to amounts of pre-exceptional items as opposed to reconciling APMs to full IFRS amounts [Guideline 26],

(c) reconciliations were not provided 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 [Guideline 26 *et seq*],

(d) incorrect labels were used 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) all APMs were not defined, or the basis of the calculation applied was not set out, 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) the use of APMs were not explained. Explanation of the use of APMs is required by the ESMA APM Guidelines as it allows users of the financial statements to understand the APM relevance and reliability [Guideline 33], and

(g) prior period comparative amounts for APMs were not presented. APMs should be accompanied by comparatives for the corresponding previous periods [Guidelines 37 and 38].

[2] Microsoft Word - esma32-51-370 qas on esma guidelines on apms (europa.eu)

Matters for consideration by management, Directors, and Audit Committees

Management, Directors, and Audit Committees should carefully consider each of the requirements of the ESMA APM Guidelines 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 and, in particular, those relating to the disclosure of ESG financial measures [Questions 19 and 20].

2.7 IFRS 8 *Operating Segments*

IFRS 8.5 states that '*an operating segment is a component of an entity:*

(a) that engages in business activities from which it may earn revenues and incur expenses (including revenues and expenses relating to transactions with other components of the same entity),

(b) whose operating results are regularly reviewed by the entity's chief operating decision maker to make decisions about resources to be allocated to the segment and assess its performance, and

(c) for which discrete financial information is available …'

The identification of operating segments has implications on the recognition and measurement of impairments as operating segments are used to determine the level at which impairment testing is performed. For example, goodwill acquired in a business combination must be allocated to each of the acquirer's cash-generating units (CGUs) or group of CGUs. Each CGU to which the goodwill is allocated shall:

(a) represent the lowest level within the entity at which the goodwill is monitored for internal management purposes, and

(b) not be larger than an operating segment as defined by IFRS 8.5 before aggregation.

This requirement – which is set out in paragraph 80 of IAS 36 *Impairment of Assets* – results in goodwill being tested for impairment at a level that reflects the way an issuer manages its operations and with which the goodwill would naturally be associated [IAS 36.82].

IFRS 8 outlines the use of the '*management approach'* [IFRS 8.5(b)]. IFRS 8.BC9 states that '*entities will report segments that correspond to internal management reports …*'.

IAASA has examined issuers' disclosures of their operating segments and, in particular, has reviewed the Chief Operating Decision Maker ('CODM') reporting pack to ensure that these issuers are reporting the segments that correspond to their internal management reports.

COVID-19, the Ukrainian war and other geo-political disruptions may have a direct impact on the composition of internal structures or geographical markets in which an entity operates.

In this context, issuers should consider the impact of such changes in the context of IFRS 8 reporting requirements as well as paragraphs 29 and 30 with regard to the re-statement of previously reported information.

Matters for consideration by management, Directors, and Audit Committees

Management, Directors, and Audit Committees should:

(a) consider any changes in management reporting and the structure of the internal organisation in terms of IFRS 8 Operating Segments,

(b) comply with the requirements of IFRS 8.29 and 30 where such changes occur, and

(c) consider the interaction of IFRS 8 and IAS 36 when performing impairment testing.

2.8 European single electronic format (ESEF)

2022 was the first year that the annual financial reports of issuers were required to be prepared in accordance with ESEF requirements.

Europe-wide, enforcers' observations from their review of the ESEF files in during the year included:

Use of extensions/custom tags

An issuer can create an extension/custom tag to tag issuer specific information. When extensions/custom tags are used, the issuer shall ensure that it is (i) correctly anchored to the closest core taxonomy element(s), and (ii) appropriately marked up using XBRL markup language.

Consistent tagging of the same fact

Where a fact is reported in more than one financial statement, the issuer shall ensure that the fact is consistently tagged. E.g., profit/(loss) for the year after tax is stated in the income statement, statement of comprehensive income, statement of changes in equity, and statement of cash flows.

Dashes that represent zeros

Dashes are often used to represent nil amounts in financial statements. The issuer shall ensure that the dashes are appropriately tagged and marked up.

Footnotes to the primary statements

Where footnotes are included in the primary statements and include a monetary amount, the issuer shall ensure that the monetary amount is appropriately tagged and marked up.

ESMA has recently published an updated ESEF Reporting Manual applicable to the 2022 financial year. This manual includes the requirement to mark up the notes to and the accounting policies of the IFRS consolidated financial statements, following the "block tagging" approach.

Matters for consideration by management, Directors, and Audit Committees

Management, Directors and Audit Committees should ensure that the matters noted above are addressed in the ESEF compliant annual financial reports.

Issuers are expected to follow the guidance provided in the updated ESEF reporting manual when preparing their 2022 annual financial reports.

2.9 Digital security disclosures and cybersecurity risks

Digital security risks are increasing as the economy, systems, processes, and data continue to become more digitised. Stakeholders need to understand these risks to evaluate an issuer's ability to remain sustainable and resilient.

In this context, attention is drawn to disclosure requirements in terms of strategy, governance, risk, and events. Where specific risks impact judgements made, issuers are reminded of the disclosures required under paragraph 122 of IAS 1. Consideration should also be given to disclosing sufficient information about geo-political and cyber events.

Issuers should ensure that information regarding any cybersecurity breaches that are included in other locations e.g., investor presentations, press releases etc., be considered for inclusion as part of the fair review of the development of the issuer's business [Regulation 5(4)(c)(ii) of the Transparency (Directive 2004/109/EC) Regulations 2007 (as amended)].

Matters for consideration by management, Directors, and Audit Committees

Management, Directors, and Audit Committees should carefully consider the impact of cyber risks and events and ensure related disclosures connect to the wider strategic direction of the business.

2.10 Supply chain financing

Some issuers rely on financial solutions to navigate the changing landscape within the supply chain. Such arrangements may include supply chain financing (SCF), enabling suppliers to receive funding earlier than the invoice due date, at their discretion and at their own cost.

Issuers must ensure that where changes in processes have been implemented, and as they are being removed, that the accounting policies disclosed reflect current processes.

Paragraphs 33 and 34 of IFRS 7 *Financial Instruments: Disclosures* list the qualitative and quantitative disclosures required for each type of risk arising from financial instruments. IFRS 7.35 requires the disclosure of credit risk. Issuers must assess if the SCF activity has impacted on liquidity or liquidity risks.

Where such transactions are material to the issuer, consideration must be given to disclosing how they have been reflected in the financial statements by assessing if the liability has the characteristics of a trade payable or if it should be classified as borrowings.

Matters for consideration by management, Directors, and Audit Committees

Management, Directors, and Audit Committees should ensure accounting policies and risk disclosures reflect current supply chain processes.

2.11 Bank covenants and collateral pledged or held

Bank covenants set minimum standards for a borrower's future conduct and performance and can accelerate the maturity of a loan or result in higher interest rates in the event of a breach.

For many issuers, bank covenants are being restored to pre-COVID-19 limits and terms.

Impacted issuers should review the disclosure of financial covenants ensuring they reflect the covenants agreed with lenders over the full term of the facilities. In this context, issuers should also consider the requirements of paragraphs 17 and 18 of IFRS 7 and paragraph 135(a)(ii) of IAS 1.

Separately, the financial environment through and post COVID-19 may have resulted in lenders seeking additional protection against the risk of loss. Borrowers may have been required to provide additional security in terms of assets, property held or intangibles. In such instances, issuers are reminded of the provisions of paragraph 14 of IFRS 7 which requires disclosure of the carrying amount of asset(s) pledged as well as the related terms and conditions. Where the issuer is the lender and holds collateral the requirements of paragraph 15 of IFRS 7 must be considered.

Matters for consideration by management, Directors, and Audit Committees

Management, Directors, and Audit Committees should consider the level of disclosures surrounding bank covenants to ensure they reflect the covenants agreed with lenders over the full term of the facilities, the carrying amount of asset(s) pledged ,and the related terms and conditions.

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:

Observations documents	Observations on selected financial reporting issues issuers' financial years ending on or after 31 December 2021
	Observations on selected financial reporting issues issuers' financial years ending on or after 31 December 2020
Financial reporting decisions	Financial Reporting Decisions (February 2022)
	Financial Reporting Decisions (January 2021)
	Financial Reporting Decisions (June 2020)
	Financial Reporting Decisions (February 2020)
Surveys and commentaries	Information Note: *Reporting Climate Change* (January 2022)
	Information Note: *Applying IFRS 9* Financial Instruments – *expected credit losses* (January 2022)
	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)
Annual Reports	2021 Annual Report
	2020 Annual Report

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