BDO

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Listed companies must consider European enforcement priorities

I. Listed companies must apply ESMA guidelines

ESMA - the European Securities and Markets Authority has issued its annual position on European Common Enforcement Priorities for 2021 annual reports (ECEP). This year's priorities include: consideration and disclosure of the impacts of COVID-19, consideration of climate related risks and disclosure of compliance with IFRS 9 "Financial Instruments" with regard to the determination and recognition of expected credit losses. They also stress the requirements to disclose information in accordance with Article 8 of the Taxonomy Regulation. After the guidelines are issued, each national oversight authority confirms whether it applies or intends to apply them. In the case of Poland, the Polish Financial Supervision Authority (KNF) has consistently applied the guidelines relating to financial statements.

II. Pandemic impacts cannot only be considered from one year's perspective

ESMA recommends a careful assessment of the longer-term impacts of COVID-19 on issuers' activities, financial results, financial position and cash flows. Above all, it points out that the period of twelve months from the end of the reporting period referred to in par. 26 of IAS 1 is a minimum period. This is why, as required by paragraph 25 of IAS 1, issuers need to assess and disclose if material uncertainties exist related to events or conditions that may cast significant doubt upon the issuers' ability to continue as a going concern if relevant beyond the twelve-month period after. Issuers should not consider the effects of the pandemic only in the context of what they may lead to in the coming year, but also assess them from a time perspective that will be appropriate to present the full impact of the pandemic for the assessment of the entity's ability to continue as a going concern in the future.

III. Liquidity risk to be assessed in the context of disrupted supply chains

Bearing in mind the pandemic's disruption of supply chains and the resulting changes in methods of trade, it is necessary to provide full transparency of any material arrangements that take the form of supply chain financing (e.g. management judgements in accordance with IAS 1, presentation in the statements of financial position and statements of cash flows, as well as impacts). In particular, annual reports (financial statements) should provide transparent information on liquidity risk. It is important for those disclosures to not be general in nature, but rather to relate directly to the entity (be sufficiently entity-specific). At the same time, issuers, especially those operating in sectors severely impacted by the long-term effects of COVID-19 (e.g. transport, hospitality, retail) are expected to disclose information on the judgements, estimates and assumptions that have been updated as a result of any recent changes in their economic and financial situation.

ESMA has published its public position on European Common Enforcement Priorities for 2021 annual reports (ECEP), which the KNF takes into account when performing its supervisory activities. The document's portion that applies to financial reporting contains priorities relating to: consideration and disclosure of the impacts of COVID-19, consideration of climate related risks, disclosure of information on the determination and recognition of expected credit losses.

IV. It may be necessary to reverse impairments

At the end of each reporting period issuers should assess whether there is any indication that an impairment loss recognized in prior periods for an asset other than goodwill may no longer exist or may have decreased. In making the assessment issuers should at a minimum consider the indications specified in par. 111 of IAS 36 and that an impairment loss recognized in prior periods for an asset other than goodwill is subject to reversal only if there has been a change in the estimates used to determine the asset's recoverable amount since the period in which the last impairment loss was recognized (see par. 114 of IAS 36).

V. Pandemic related public assistance must be disclosed

Also required is the disclosure of information related to government assistance including, among other information, the accounting policy adopted for government grants, as well as the methods of presentation adopted in the financial statements and the nature and extent of government grants. This is consistent with par. 39 of IAS 20 Accounting for Government Grants and Disclosure of Government Assistance. Issuers are expected to include in their financial statements a description of the nature and extent of any significant public support measures received by category (e.g. loans, tax relief, compensation schemes). They are also expected to provide information on the main characteristics of the support measures (e.g. expected duration, reimbursement and main conditions), as well as on the effects of their termination. In addition, ESMA expects issuers to make a link with the assumptions relating to going concern or other planned actions.

VI. Issuers must disclose climate related risks

In their 2021 annual reports issuers must consider climate related risks insofar as they are material to those reports, even if IFRS do not explicitly refer to climate related mattes. The same applies to auditors who should consider these matters when auditing financial statements. It is of key importance for all issuers to consider these matters holistically in their communications to the market by ensuring consistency of the information disclosed in management reports, non-financial statements, financial statements, and where relevant, issue prospectuses. ESMA encourages issuers to provide all climate related information in a single note, or alternatively to prepare a list of places where such information is provided. It also notes that identification and assessment of climate related risks usually requires a longer time horizon than that taken into account for financial risks.

VII. Risk of impairment of non-financial assets must be assessed

Where relevant, issuers should: firstly, assess whether indications exist that non-financial assets are impaired as a result of climate risk or implementation of the Paris agreement; secondly, use assumptions reflecting climate risks; thirdly, adapt the sensitivity analysis disclosed to consider climate risks and commitments in the assumptions used. External information about significant changes with an adverse effect on the company, such as significant changes in the environment in which the company operates, is an indication that an asset may be impaired. Issuers should also carefully consider the requirements of IAS 37 Provisions, Contingent Liabilities and Contingent Assets, for example, with regard to contingent liabilities for potential litigation, regulatory requirements to remediate environmental damage, additional levies or penalties related to environmental requirements, contracts that may become onerous, or restructurings to achieve climate-related targets.

VIII. Sustainable development reporting needs to be considered

In the context of climate in financial reporting, irrespective of the ESMA guidelines, attention should also be drawn to the draft directive on Corporate Sustainability Reporting. It covers three areas: the environment, social matters and management matters. With respect to the environment (climate), the new regulations are to cover the disclosure of such information as: preventing climate change; adapting to climate change; water and marine resources; use of resources and circular economy; pollution; biodiversity and ecosystems. The reporting itself is to include: a description of the business model and strategy; description of sustainable development goals and progress in their achievement; the role and composition of the company's bodies in sustainable development matters; the company's sustainable development policies, as well as a description of: due diligence procedures, major actual and potential negative impacts on supply chains, products and services and trading partner relationships, as well as the measures taken to prevent or remedy such impacts. It will also be necessary to report all the factors relevant to those descriptions.

IX. Material credit risk adjustments have to be explained

Where significant adjustments are made in the estimation of expected credit losses (also referred to as "management overlays"), issuers should ensure higher transparency to achieve the overarching objectives and principles set out in par. 35B of IFRS 7 Financial Instruments: Disclosures. Such adjustments take the form of ECL model revisions, including updates of the model inputs ("in-model adjustments"), or are applied outside the primary models ("post-model adjustments"). To meet the requirements of IFRS 7, issuers are expected to disclose – for each material adjustment – specific and detailed information on its impact on the expected credit loss estimate, the rationale and the methodology applied. These disclosures should be provided at an appropriate level of detail, for example by explaining to which specific type of products, exposures, sectors or geographic areas the adjustments relate, if relevant. Issuers should also explain any significant changes in the methods and assumptions from the previous reporting period.

X. Issuers must explain all credit risk estimation components

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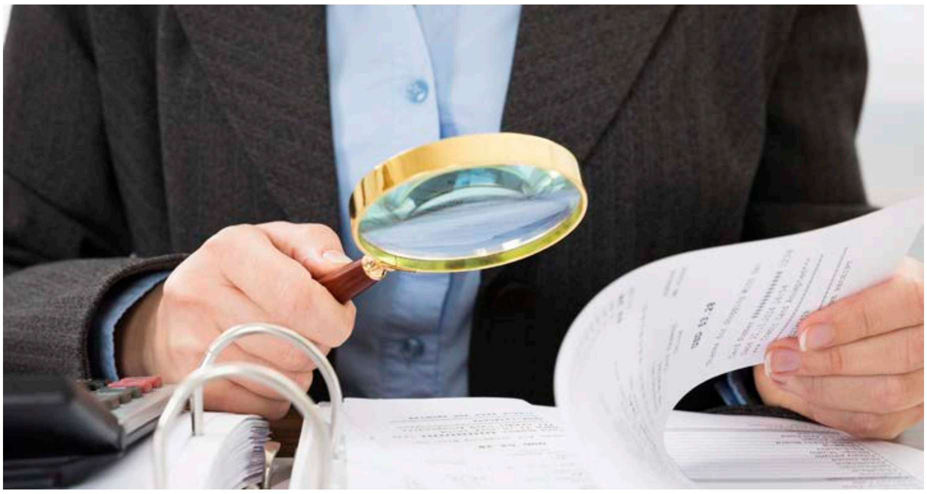
Issuers are required to disclose the basis for the inputs and assumptions and the estimation techniques used to determine whether a significant increase in credit risk has occurred for financial instruments since their initial recognition or whether an asset is impaired. Issuers should explain the quantitative and qualitative factors applied, including the length of the “cure” period, and any material differences in the application of the factors across portfolios. It is recommended that issuers disclose any quantitative significant increase in credit risk thresholds applied, such as indications of deterioration in the probability of default. If there are significant differences in thresholds depending on portfolio type, additional explanations are required. If, during the reporting period, any significant relief measures were provided to borrowers by issuers, issuers are expected to explain how these measures have impacted the assessment of significant increase in credit risk.

XI. Issuers must explain the impact of relief to borrowers on credit risk

Issuers are reminded of the need to disclose the basis for the inputs and assumptions and the estimation techniques used to determine whether a significant increase in credit risk (SICR) has occurred for financial instruments since their initial recognition or whether a financial asset is credit impaired. Issuers should explain the quantitative and qualitative factors applied, including the length of the “cure” period, and any material differences in the application of the factors across portfolios. It is recommended that issuers disclose any quantitative SICR thresholds applied, such as probability of default (PD) deterioration thresholds. If there are significant differences in thresholds depending on portfolio type, additional explanations are required. If, during the reporting period, any significant relief measures were provided to borrowers by issuers, ESMA expects the issuers to explain how these measures have impacted the assessment of SICR.



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