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ESMA emphasises need for transparency in preparation of 2020 half-yearly report

The importance of the information provided on the impact of the COVID-19 pandemic will be highlighted when listed companies prepare their 2020 half-yearly reports. For this reason, ESMA published on 20 May 2020 a [public statement](#) in order to promote transparency and consistent application of European requirements under the exceptional circumstances arising from the pandemic.

The importance of transparency in financial reporting increases as uncertainty grows. Companies should provide information on the actual and potential impact of the pandemic on their operations and financial position. The statement emphasises the importance of relevant and reliable information, even if this would require companies to delay the usual and planned publication of the half-yearly report.

Audit committee's oversight role highlighted

ESMA calls on audit committees to play an active role in overseeing financial reporting. In connection with the Financial Supervisory Authority's (FIN-FSA's) task of monitoring and assessing the performance of audit committees, the FIN-FSA also draws attention to the important role of audit committees as the highest level to monitor the quality and reliability of financial reporting.

In addition to risk areas, it would be important for audit committees to pay due attention to the judgments, estimates and forecasts used by management. Market uncertainty and the difficulty of forecasting increase the importance of management judgment. The need to use an external expert during the year may also be relevant, as the audit committee's independent view and expertise will play a key role. Controls on reporting processes will also be increasingly important.

The FIN-FSA encourages audit committees to engage in proactive and close dialogue with the auditor in addition to management and the board of directors. Dialogue with the auditor may assist audit committees in their own oversight role, but it will also assist the auditors in their challenging assurance role in the prevailing uncertainty. The auditor must state in the audit report for the full financial year if, in the opinion of the auditor, the company's half-yearly report has not been prepared in accordance with the provisions thereon.

Management report's description of COVID-19 impact, company measures and expected effects should be entity-specific

ESMA expects companies to provide detailed and entity-specific information in the management report of the half-yearly report about the impact that the COVID-19 pandemic has had on their strategic orientation and targets, operations, financial performance, financial position and cash-flows. Information on liquidity and financial position and the impact of the pandemic on supply chains and production is important information for investors to understand the effects. Measures taken by the companies to minimise the negative effects should also be described.

ESMA considers forward-looking information to be important for investors at this stage of the year. ESMA recommends that, where possible, estimates of the future impact of the pandemic be provided. Providing such information may be difficult, however, in the absence of reliable information in an uncertain market environment. In that case, the FIN-FSA considers that it is advisable to present a description of the estimated future development on the basis of the best information and insofar as such information is available at the time of preparation.

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COVID-19 pandemic might require more detailed and extensive disclosures in the half-yearly report

For many companies, it is expected that the pandemic constitutes a significant event under paragraph 15 of IAS 34, which will require the information presented in the last annual financial statements to be updated with information concerning the pandemic. This may mean providing more detailed information and more extensive disclosures. *IAS 1 Presentation of Financial Statements* requires additional disclosures if giving a true and fair view so requires (IAS 1.17, IAS 1.31). The FIN-FSA also wishes to draw the attention of preparers of half-yearly reports to the list in paragraph 15B of IAS 34 of significant events and transactions for which updated information is required in the half-yearly report.

ESMA emphasises that companies should also assess the significance of material events after the reporting date and present information on them in the half-yearly report, as appropriate.

Increased management judgment should be reflected in half-yearly reports

Uncertainty about future development has increased significantly due to the COVID-19 pandemic, and this in turn will result in management exercising increased judgment in the preparation of interim reports. Such situations may relate to, for example, forecasts and impairments as well as the impact of new factors that were not current and did not require consideration at the balance sheet date or in the previous interim report. For some companies, the impact has been so severe that management will have to assess the existence of uncertainties related to the company's ability to continue as a going concern. It is to be expected that increased management judgment will be described in sufficient detail in the half-yearly reports to enable investors to understand which items have required such new management judgment and how management has exercised that judgment.

COVID-19 pandemic may increase financial risks – financial risk disclosures should be reassessed

The impact of the pandemic may cause or increase financial risks that did not affect the company or were not significant for the company in the financial statements for 2019. Paragraphs 15-15C of IAS 34 require additional information about significant changes and events related to the company's financing, such as new financial arrangements, breaches of covenants or significant impairments of financial assets, such as investments and loan and trade receivables. With regard to financial risks, the FSA recommends that companies consider providing additional disclosures based on the requirements of *IFRS 7 Financial Instruments: Disclosures* such as, for example, analyses and descriptions of liquidity risk and its management in accordance with IFRS 7.39.

Critical assessment of carrying amounts and assessment of the need for impairment

In many companies, increasing uncertainty and possible new sources of uncertainty will result in a critical assessment of the carrying amounts of assets and liabilities and in an increased risk of asset impairment. ESMA urges companies to update their assessments and forecasts made at year-end about the carrying amounts of assets and liabilities and to take into account in accordance with paragraph 125 of IAS 1 the requirement to provide information on major sources of estimation uncertainty arising from a significant risk of material adjustment to the carrying amounts of assets and liabilities. If there has been a change in the estimates, disclosures on their nature and amount should be made (IAS 34.16Ad).

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In its statement, ESMA reminds companies they should assess on an ongoing basis whether there are any internal or external factors indicating impairment of non-financial assets (IAS 36.9 and IAS 36.12). In ESMA's view, the effects of the COVID-19 pandemic might for many companies constitute a strong basis to conclude that impairment indicators exist and that impairment testing should be carried out. Cash-flow uncertainty can be modelled using scenario analyses and related probability weightings.

The FIN-FSA recommends that companies assess carefully the assumptions used in the preparation of the sensitivity analysis of goodwill impairment testing and to disclose information on management judgment and the uncertainties associated with estimates. The uncertain economic situation and the difficulty of forecasting may suggest that the scale of reasonably possible changes in the key assumptions used in half-year report impairment testing will be larger than usual. The FIN-FSA reminds companies that when a reasonably possible change in a key assumption would cause the carrying amount of a cash-generating unit to exceed its recoverable amount, the disclosures should include all information in accordance with IAS 36.134 (f) (i)-(iii). Companies are urged to pay attention to sensitivity analyses' conformity with standards also when they disclose so-called voluntary sensitivity analysis data.

ESMA statement on the application of IFRS 9 Financial instruments particularly in credit institutions

In the preparation of half-yearly reports, companies should also take into account the ESMA [public statement](#) of 25 March 2020 on the application of IFRS 9 in the exceptional circumstances caused by the pandemic. ESMA's position concerns the calculation of expected credit losses. The statement's guidance also applies to companies other than credit institutions. In any assessment of a significant increase in credit risk and the assessment of expected credit losses, companies should pay attention to the exceptional temporary circumstances in which forward-looking information may not be reliable or available.

In preparing the half-yearly report, credit institutions are faced with a number of implementation issues that require significant judgment, to which it is also necessary to apply the principles of ESMA's new statement.

ESMA expects more disclosures on assessment of ability to continue as a going concern

When financial statements are prepared on a going concern basis, management may be aware of material uncertainties that might cast significant doubt upon the company's ability to continue as a going concern. In that case, the company must present these uncertainties in its financial statements in accordance with paragraph 25 of IAS 1. If management has had to exercise significant judgment in determining that the company has no material uncertainties regarding ability to continue as a going concern, the company must disclose this judgment in accordance with paragraph 122 of IAS 1. In addition, ESMA expects companies most significantly impacted by COVID-19 to provide disclosures on the assessment of their ability to continue as a going concern as well as the related underlying judgments. An example of this could be significant additional financing required by the company due to the pandemic.

One of the FIN-FSA's areas of focus in previous years has been the financial reporting of companies in a weak financial situation. Currently, a number of companies may find themselves in such a situation, so the FIN-FSA's earlier recommendations may be useful, even though they do not contain the special characteristics brought about by the exceptional situation. In the view of the FIN-FSA, information disclosed on ability to continue as a going concern should be presented together under its own heading, and the information should be sufficiently detailed. The FIN-FSA

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also considers it important that the company presents a justified conclusion as to why compliance with the principle of ability to continue as a going concern is appropriate, despite the threats. The company should also remember to document any analysis and conclusions it makes for the auditor's assurance work and possibly also for the supervisor. Further communications and recommendations of FIN-FSA are also available, for example in

- article [Epävarmuus toiminnan jatkuvuudesta – tärkeää sijoittajainformaatiota](#) in Market newsletter 2/2012 (in Finnish)
- article [Laadukas tilinpäätösinformaatio tukee yhtiötä sen heikossa taloudellisessa tilanteessa](#) Market newsletter 3/2014 (in Finnish)
- presentation for 2014 event for listed companies [Tilinpäätösinformaatio yhtiön heikossa taloudellisessa tilanteessa](#) (in Finnish), and in
- [ESMA's Database of Enforcement Decision \(EECS/0215-04\)](#) on information to be disclosed in interim reports.

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