Telling the COVID-19 story

Making IFRS financial statements an effective communication tool

Accounting

Tax

Global

‘ Telling the COVID-19 story is not only about reflecting what the financial reporting standards require disclosure on.’

Contents

Summary of best practice	2
Comply but communicate	4
Omit the immaterial	10
Re-think the notes	16
Prioritise the policies	22

Foreword

Annual financial statements will always be a critical communication to investors and other stakeholders ('users'). But how effective will they be in explaining to your stakeholders how the global COVID-19 pandemic has affected your organisation?

While the focus over the last three years has been on explaining the introduction of new International Financial Reporting Standards (IFRS) dealing with revenue, financial instruments and leasing, readers of the financial statements will want to know how the global pandemic changed the business.

No matter what situation exists, preparers of financial statements need to get the content right. When drafting the financial statements that will be issued, management should be mindful of what others have done – particularly businesses in the same industry sector – when they tell their own COVID-19 story and they should never lose sight of what makes their business unique. This will take time and effort because the recognition, measurement and disclosure requirements set out in IFRS issued by the International Accounting Standards Board (IASB) can be complex and demanding.

Unfortunately, many users complain that IFRS generates financial statements that are cluttered, and important information is often hard to find.

Telling the COVID-19 story is not only about reflecting what the financial reporting standards require disclosure on. It is also about correctly applying the materiality concept to disclosure and not being fearful of regulatory and stakeholder challenge. A reluctance to deviate from well-established practices by adopting a 'safety first' mindset often results in duplication, irrelevance and many 'boilerplate' disclosures which is not what users, including many securities and audit regulators, want to see.

In light of COVID-19, those charged with the governance of reporting entities, particularly those that are listed, have another opportunity to reflect on how they want to tell their story of their business activities throughout 2020 and how they are responding to the pandemic. The art, rather than the science, of issuing high-quality financial statements in 2021 is to prepare those that will not only comply with all the technical requirements set out in IFRS, but also effectively communicate how the entity has adapted and reacted to the environment it has been operating in.

This publication describes and illustrates how entities can better tell their COVID-19 story using four key tools we believe can help explain what has happened over the last 12 months.

Mark Hucklesby
Global Head IFRS Reporting
Grant Thornton International Ltd

Summary of best practices

With encouragement from regulators and from the IASB itself, entities around the world continue to innovate and introduce new perspectives and insight into their financial statements. Every entity, be it a company or not, should be looking to tell a unique story of operations and activities.

Given this, we have identified four themes – or best practices – we believe will prove helpful when reporting the consequences of the COVID-19 pandemic throughout the financial statements. The four best practices are interdependent. Each is a 'tool' that should be used to a greater or lesser extent depending on the circumstances.

1 Comply but communicate

Telling the COVID-19 story effectively not only requires entities to comply with applicable accounting standards and regulations, their financial statements should also become an effective part of the wider communication to their stakeholders.

Be mindful that the financial statements are just one 'piece of the puzzle' when communicating with stakeholders. Make them more effective by considering the following:

- **Holistic approach** – ensure the overall communication is effective by having a holistic approach. This means the annual report, which includes the financial statements, read as a whole, should deliver a consistent and coherent message throughout.
- **Be transparent with APMs** – if using alternative performance measures (APMs), do so transparently, making sure users do not misinterpret them. Do this by providing useful additional information which supports and explains how COVID-19 has impacted the entity.

2 Omit the immaterial

Make effective use of materiality to enhance the clarity and conciseness of the financial statements.

Incorrectly applying the concept of materiality is perceived to be one of the main drivers for overloaded financial statements. Information should only be disclosed if it is material. It is material if it could influence users' decisions which are based on the financial statements.

The materiality assessment is the 'filter' in deciding what information to disclose and what to omit. Once it has been determined which specific line items require disclosure, entities should assess what to disclose about these items, including how much detail to provide and how best to organise the information in the financial statements. This can be done using a two-stage filtering process as follows:

- firstly, filter #1 is to consider if the underlying item (ie the amount recognised or the unrecognised event or risk) is itself material because of its **size** or its **nature**, and
- if it is, filter #2 then applies to determine which specific disclosures (and level of detail) need to be provided for each item.

3 Re-think the notes

Re-evaluate how the notes to the financial statements are organised to improve their effectiveness as a communication tool.

Being the largest section of the financial statements, the notes can have the greatest impact on the effectiveness of the financial statements as a communication tool. Improve the effectiveness of the notes by:

- **Re-organising the notes** – move away from the traditional order of the notes. Group the notes into various categories, placing the most critical information upfront. COVID-19 has placed a renewed emphasis on various elements within the financial statements such as going concern, impairment and how revenue is being recognised. Be mindful of the importance of these topics to the readers of the financial statements by making these some of the first topics that are included in the notes to the financial statements.
- **Signposting** – assist users in navigating their way through the financial statements through the effective use of signposting, cross-referencing and indexing.

Getting it right

In making these changes, one thing does not change. Financial reporting is a regulated activity and compliance with these requirements is essential. Getting the content of the financial statements right, particularly in light of the COVID-19 pandemic will require the application of professional judgement, care and attention to detail, proper planning and project management, and making sure fit-for-purpose systems and controls support the amounts included in the financial statements.

4 Prioritise the policies

The financial statements need only disclose the most significant accounting policies. The disclosures made should be relevant, specific to the reporting entity and in light of COVID-19 explain how the accounting policies have been applied throughout the reporting period.

The aim of accounting policy disclosures is to help users properly understand how the amounts included the financial statements were determined. To make accounting policy disclosures effective preparers should:

- **Make them significant** – remove non-significant disclosures that do not add any value, and make sure that new accounting policies are included if, for example, government grants have been received and the amounts involved are material. Use judgement to determine whether the accounting policies are significant and do not fall into the trap of automatically including what was reported last year. Consider not only the materiality of the balances or transactions affected by the policy but also other factors including the nature of the entity's operations in light of the pandemic.
- **Be clear and specific** – reduce generic disclosures (for example those that summarise the recognition and measurement requirements in the accounting standards) and develop disclosures that explain in detail how the entity has applied the policies (eg revenues that are recognised over time as opposed to at a point in time).
- **Articulate key estimates and judgements** – effective disclosures about the most important estimates and judgements provide investors with a useful understanding of the amount included in the financial statements. So:
  - for **estimates**, focus on the most difficult, subjective and complex estimates. Include details of how the estimate was derived, key assumptions involved, the process for reviewing the amounts disclosed and a sensitivity analysis, and
  - for **judgements**, provide sufficient background information on each judgement, and explain how they were made.

Comply but communicate

Telling the COVID-19 story effectively not only requires entities to comply with applicable accounting standards and regulations, their financial statements should also become an effective part of the wider communication to their stakeholders.

Holistic approach

It is important that the content of the annual report is assessed holistically to ensure it delivers a consistent and coherent message to the users.

There are many powerful social media channels available to entities to corroborate disclosures in the financial statements, so preparers of the financial statements should be mindful of this when drafting their financial statements. Depending on jurisdictional requirements, the annual report will typically include financial statements, together with management commentary providing further insight into the entity's governance, strategy and business developments (often including corporate, environmental and social responsibility). It might also report on how the organisation is managing various forms of capital that are part of its operations and activities, such as financial, manufactured, intellectual, human, social and relationship, and natural capital.

As defined in the recently updated Reporting Framework issued by the International Integrated Reporting Council (IIRC), an integrated report should be a concise communication about how an organisation's strategy, governance, performance and prospects, in the context of its external environment, lead to the creation of value over the short, medium and long term. The IIRC have produced an interesting article on '**Integrated reporting post COVID-19**' (issued in May 2020), linking the pandemic to the six forms of capital.

IFRS guidance

IAS 1 'Presentation of Financial Statements' acknowledges that any entity may present, outside the financial statements, a financial review that describes and explains the main features of an entity's financial performance, its cash flows and its financial position, and the operation uncertainties and risks it faces. In light of COVID-19, every reader of the financial statements will be interested in this.

Although reports and statements presented outside financial statements are beyond the scope of IFRS, reports and statements on sustainability are becoming essential, particularly in industries in which environmental factors are significant and when employees are regarded as an important user group.

The IASB issued in 2010 a Practice Statement called 'Management Commentary' which provides a broad, non-binding framework for the presentation of commentary that relates to financial statements that have been prepared in accordance with IFRS Standards. It is currently being updated and an exposure draft is due to be issued in Q2 2021.

Even though reports and statements outside financial statements are excluded from the scope of IFRS, very often they will not be beyond the scope of other types of regulation. Telling users what they need to know in a digestible manner about the significance of non-financial information (eg climate related matters such as those set out by the Task Force for Climate-related Financial Disclosures (TCFD) click **here**), and how COVID-19 may or may not have impacted it, will be of great interest to users and will likely go a long way to help satisfy any regulatory requirements.

Remember it is still important that certain information set out in IFRS is included either in the financial statements or in the notes. Be careful not to place information outside the financial statements that should be included within them.

Are the messages consistent and coherent?

Although information presented outside the financial statements is not governed by IFRS, it is important to provide a consistent and clear message throughout an annual report. In preparing the annual report containing financial statements the following matters should be considered:

- what is important to the business, what are its main objectives, and did they change as a result of the COVID-19 pandemic? If yes, then explain, to an appropriate extent, what has happened
- are the messages consistent throughout the annual report and within the financial statements? If significant changes have been made during the last annual reporting period, either dealing with unforeseen positive or negative outcomes from the pandemic, has sufficient attention been given to this throughout the entire annual report?
- are you emphasising the right things, and does your latest reporting period compare with what you may have previously reported?
- are you using the same terminology between the financial statements and the management commentary? For example, if you refer to the statement of financial position as the balance sheet, is this done throughout the entire annual report – rather than switching between the two titles?
- if you are disclosing APMs, either in your financial statements or elsewhere, can they be reconciled to IFRS-based amounts. Refer to our section on APMs for more details.
- does information about key business developments leave out information that can be found elsewhere (for example, on the company's website)?

Example – providing a consistent and coherent message

A company's key objective is to maximise growth. One of its key indicators in achieving this is their reported revenue. In the annual report they discuss in the management commentary how COVID-19 has impacted their revenue, comparing their targeted revenue amounts to their actual. They also discuss their intentions for the future to maintain their growth targets. This story links to the financial statements which have key disclosures on business combinations (including disclosures about the impact on the new business to future revenue), revenue and operating segments and subsequent events. They also link these disclosures to the overall COVID-19 disclosure note where a similar overview to management commentary is provided.

Be transparent with APMs

APMs are performance metrics that are either not defined in IFRS, or are calculated differently from the requirements in IFRS. Many companies disclose APMs in the financial statements or elsewhere in the annual report. Examples include:

- revenue including share of joint ventures and associates
- EBITDA
- measures of profit or loss that exclude certain items.

IFRS guidance

Although APMs are not defined in IFRS, there is some limited guidance in this area.

IAS 1 requires entities to disclose additional 'headings and subtotals' in the statement of profit or loss and other comprehensive income when relevant to understanding its financial performance. IAS 1 as it currently stands requires these amounts to be:

- made up of amounts recognised and measured in accordance with IFRS
- presented and labelled clearly and understandably
- consistent from period to period
- be displayed with no more prominence than the required subtotals and totals.

The Basis for Conclusions to IAS 1 discusses operating profit (which is not defined in IFRS, however there is currently an exposure draft on issue that proposes a definition – refer to 'Watch this space' on page 9 for more details).

When an entity includes such a subtotal for results of operations, it should include all expenses and income that are of an 'operating nature' – even if some items occur irregularly or infrequently or are unusual in amount. For example, it would be inappropriate to exclude items clearly related to operations such as inventory write-downs and restructuring and relocation expenses. Similarly, it would be inappropriate to exclude items on the grounds that they do not involve cash flows, such as depreciation and amortisation expenses.

There is also guidance in IAS 33 'Earnings per Share' regarding alternative earnings per share calculations. Alternative EPS amounts should use the same denominator and are required to be disclosed in the notes to the financial statements (however disclosing on the face of the statement of financial performance is not prohibited) with basic and diluted amounts having equal prominence.

Why are they an issue?

- The use of APMs has been increasing over recent years, and it is now quite rare for an entity not to include them when reporting on their operations and activities.
- APMs can certainly help in telling the story of how COVID-19 has impacted operations when they are used appropriately. But by contrast, non-transparent, inconsistent or selective use causes confusion. Therefore, securities regulators around the world have warned entities to use APMs with caution and not to create new measures to explain the impact of the pandemic on their operations and activities.
- APMs can be good if they are used by management to monitor the business and make decisions over time. In light of COVID-19, there could well be an insightful story to be shared with the readers of the annual report and the financial statements that can be told using APMs appropriately.
- APMs can be bad when they are used to mask underlying performance or show the reporting entity in an inappropriately flattering light. COVID-19 has brought attention to going concern issues, and potentially overly optimistic management assumptions underlying the carrying amounts of assets.

If using APMs, what should you do?

When preparers are using APMs they should:

Carefully define the APMs they have used and explain how they have been calculated. While some APMs may be self-evident (eg EBITDA), others might be calculated in a number of different ways.

Explain why they are using particular APMs and why they are useful.

Label the APMs clearly and distinguish them from IFRS disclosures.

Ensure the measures are unbiased, (eg non-recurring gains should be treated in the same way as non-recurring losses and there is transparency with the definition of 'non-recurring').

Reconcile the APM amounts to the IFRS disclosures made if it is not immediately clear where the numbers come from.

Use measures consistently each year and explain any changes to the disclosures. If changes are made then comparatives, and any accompanying reconciliations, should be adjusted accordingly.

Avoid presenting the APMs with more prominence than the IFRS disclosures.

These best practice principles are consistent with those issued by the European Securities Markets Authority (ESMA) in June 2015. ESMA regulates EU financial markets. Recently ESMA issued a publication reminding entities of the main principles of the APM guidelines. Their publication, **'Questions and Answers, Guidelines on APMs'** (issued in April 2020), recommends entities to use caution when adjusting APMs and when including new APMs to address the impact of COVID-19.

Example – reconciliation to an IFRS disclosure

In an entity's management accounts they include an adjusted EBITDA calculation. As this is not required by IFRS, they use APMs to add this in. As it is not directly reconcilable to an IFRS line item, they provide a reconciliation as follows:

Non-IFRS measures: adjusted EBITDA

	2020	2019
Profit before tax	X	X
Add back:	X	X
Net interest expense		
Depreciation	X	X
Amortisation	X	X
EBITDA	**X**	**X**
Cost adjustments:		
– impairment of other intangibles	X	–
Income adjustments:		
– profit on disposal of investment property	X	–
Adjusted EBITDA	**X**	**X**

Watch this space – a new disclosure standard is coming

The IASB for the last few years has been working on a project to enhance the 'principles of disclosure'. The objective of this project is to improve existing guidance in IFRS that helps entities to determine the basic structure and content of a complete set of financial statements.

The aim is to develop a disclosure standard that improves and brings together the principles for determining the basic structure and content of the financial statements, in particular the notes.

In December 2019, the IASB issued an Exposure Draft 'General Presentation and Disclosures'. The Exposure Draft proposes to replace IAS 1 with a new IFRS and amend several other IFRS Standards.

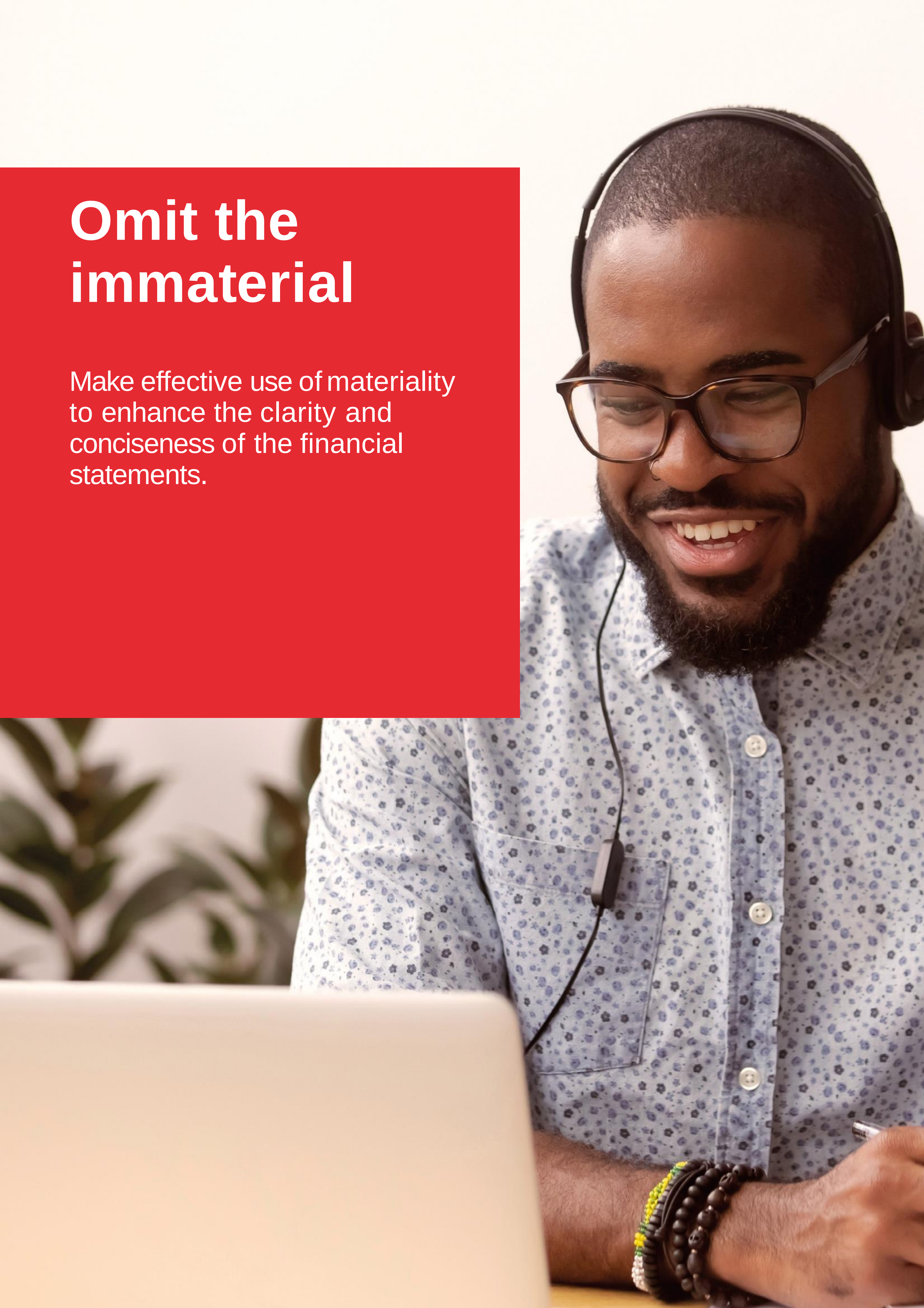
The impact of the proposals would include:

- changes to the structure of the statement of profit or loss
- more minimum subtotals, including a subtotal for operating profit
- new requirements on disaggregating information in the financial statements
- new disclosures about unusual items, management performance measures and the analysis of expenses
- limited changes to the statement of cash flows and statement of financial position.

For more information on this Exposure Draft refer to our **IFRS Alert 2020-01**.

Omit the immaterial

Make effective use of materiality to enhance the clarity and conciseness of the financial statements.



The concept of materiality is used throughout financial reporting and auditing. Put simply, information is material if it could reasonably be expected to influence the decisions made by users which are based on the financial statements.

Using materiality when deciding how to account for transactions is familiar. For example, some entities use a 'capitalisation threshold' below which purchases of property, plant and equipment are expensed immediately. But materiality also acts as a 'filter' in deciding what information to disclose – and what to omit. This filtering process is the focus of this section.

IFRS guidance – materiality definition

Information is material if omitting, misstating or obscuring it could reasonably be expected to influence decisions that the primary users of general purpose financial statements make on the basis of those financial statements, which provide financial information about a specific reporting entity.

Why is materiality an issue?

The disclosures in IFRS are voluminous. Some are labelled as 'minimum' requirements. Some IFRS standards include a disclosure objective along with examples of the types of information that might meet the objective. In all cases, however, entities don't need to disclose information if it's immaterial.

Traditionally, however, many entities have taken a checklist approach. Why is this? It can seem easier to simply include a disclosure than to make a difficult judgement about whether it is material or not. The incentives – such as the risk of regulatory challenge – have traditionally been slanted towards a 'safety-first' approach. But the tide is now turning. The new consensus is that including immaterial information is not only unnecessary – it actually reduces the usefulness of the financial statements, and therefore preparers, together with their auditor need to be bold and no longer include information that falls into this category.

IFRS guidance – materiality practice statement

The IASB has issued a practice statement '**Application of materiality to financial statements**'. The aim is to help management apply the concept of materiality. The scope of the statement is the financial statements as a whole, not only the notes. The statement provides guidance in the following three main areas:

- characteristics of materiality
- how to apply the concept of materiality when making decisions about presenting and disclosing information in the financial statements
- how to assess whether omissions and misstatements of information are material to the financial statements.

The key messages in the statement are in line with this publication. However, the practice statement gives some useful further guidance.

What information about COVID-19 should be disclosed?

In deciding what information to disclose, it can be useful to think about the broad types of disclosure that IFRS requires – and this does not change for COVID-19 reporting. Most IFRS disclosures can be classified into four types:

Analysis of amounts in the primary statements

Event-driven disclosures

Unrecognised items

Risks and uncertainties.

The table shows examples of the types of disclosure under each category:

Analysis of amounts in the primary statements

- Components of line items
- Reconciliations and roll-forwards
- Explanations of balances
- Assumptions and valuation methods

Event-driven disclosures

- Business combinations
- Discontinued operations
- Materiality definition
- Impact of COVID-19
- Related party transactions

Unrecognised items

- Capital commitments
- Contingent liabilities
- Deferred tax not recognised
- Post-reporting date events

Risks and uncertainties

- Risk disclosures
- Sensitivity analysis
- Going concern

COVID-19 reporting could fall into all types of disclosures under each category noted above as it is highly dependent on an entity's own circumstances and operations and how they have been impacted by the pandemic.

Entities should also think about removing some other types of disclosure even though they may be considered useful by a very small group of investors. Remember that IFRS is all about the provision of general purpose financial statements, not financial statements for a specific purpose or certain users.

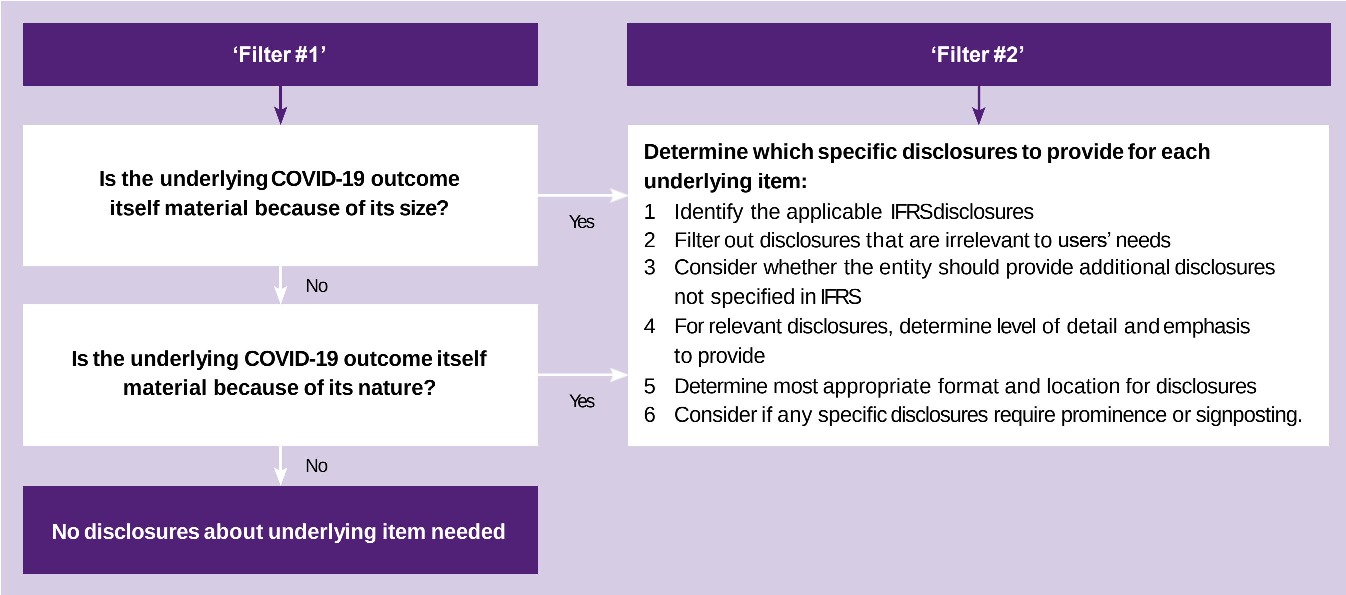
There are a few disclosures that are almost always considered material in practice, and if there is any impact from COVID-19 on these areas it should be disclosed.

Disclosures that are almost always material:

- significant uncertainties about going concern
- related party transactions
- key management personnel compensation.

The challenge lies in deciding what to disclose about an underlying transaction or line item that is itself material. This is not just an 'in or out' decision. It might be appropriate to provide only some of the disclosures in the applicable IFRS. Decisions also need to be taken about how much detail to provide and how best to organise the information.

The flowchart below outlines a high-level decision-making process. Consider it a process of applying two 'filters' – the first one assessing the underlying item itself, and the second the specific disclosure relating to that item:



How do the two filters apply when opting what to disclose regarding COVID-19?

Filter #1 – material because of the size of the underlying item

Most disclosures provide more information about an 'underlying item' (eg a line item, unrecognised amount, risk or event). The size-based materiality assessment therefore looks to the underlying item, not the disclosure itself. In respect to COVID-19, the underlying item is not the pandemic itself, it could be say 'impairment to intangible fixed assets as a result of COVID-19'.

In practice some entities might use quantitative 'benchmarks' as a starting point for their assessment, but there are no 'hard and fast' rules. A simple benchmark, such as a percentage of profits or total assets/liabilities, may not always tell the full story.

Example – contingent consideration

A company has purchased a business (which was sold as a consequence of COVID-19) and some of the consideration is an 'earn-out' arrangement. The acquirer measures the liability for the earn-out at fair value as required by IFRS 3 'Business Combinations'. The valuation uses both observable and unobservable inputs. The fair value of the liability at year-end is only 2% of total liabilities and is not considered material. However, the total amount that might be payable to the vendor could be up five times higher, depending on future results. Therefore, the company should provide information about management's fair value estimate in accordance with IFRS 13 'Fair Value Estimates'.

It is equally important to consider materiality on both an individual and a collective basis. The impact to COVID-19 on one area may be immaterial in isolation, but when combined with all the areas impacted by COVID-19 the overall effect might be material.

Example – impairment write-downs

An entity impacted by COVID-19 has made impairment write downs to all of its intangible fixed assets. Individually these write downs are immaterial but in aggregate they are material to the entity's loss for the year and therefore detailed disclosure has been provided in the financial statements.

Filter #1 – material because of the nature of the underlying item

In making this judgement the key considerations include:

The entity's 'primary' users and their needs

An inside and outside view

What's material?

Primary users and their needs

Financial statements that are included in annual reports are frequently accessed by a wide range of users. 'Users' can include institutional (current and potential) investors, private investors, lenders, other creditors, customers, employees and regulators. But it is sometimes possible to identify a 'primary' class of users and the type of information that is most important to them.

This task is not always simple and it will often not yield clear-cut conclusions because users are a diverse group and most disclosures could potentially be relevant to all of them. However, when deciding on the level of detail, emphasis and prominence of the disclosures, be mindful of the entity's primary users' needs and the insights they are seeking, such as the positive and negative impacts of COVID-19.

Example – smaller quoted company

A small, quoted company has analysed who the users of its financial statements are. It concludes its primary users are institutional investors that specialise in 'small cap' investments across a range of industries in Euroland. These investors' stated objective is to identify early-stage investments with strong growth prospects and invest for the longer-term.

As a result, management decides to put greater emphasis on forward-looking disclosures. These include event-driven items (eg business combinations and discontinued operations that will likely occur as a result of COVID-19) and information about risks and uncertainties arising from the pandemic.

Inside and outside view

If a transaction, event or risk is significant to management it's probably also important to the entity's users. Financial statements prepared using IFRS provide insights into how the business is being assessed and evaluated through management's eyes. This is what we mean by an inside view:

Example – new revenue stream

A company in the software sector has communicated to its stakeholders a strategic intention to focus its new development efforts in cloud-based solutions in light of COVID-19. In the previous financial year cloud-based revenues were less than 5% of the total but have grown rapidly. The company therefore decides to provide separate disclosure about this revenue stream in accordance with IFRS 8 'Operating Segments' even though other revenue streams of similar size are typically combined into 'other revenue.'

Equally, users of financial statements will want to understand whether and how significant outside developments affect the business even if the current period financial impact is minor. Given the economic consequences of COVID-19 around the world we think this outside view is particularly important. Outside developments can include industry/market trends and events as well the impact of events in the local or national economy that are directly affecting the entity.

Example – employee remuneration

A company working in the retail sector had to close its stores for six months of 2020. Normally employee remuneration is a large expense in the statement of profit or loss, however the government put in place a wage subsidy scheme whereby they paid 80% of the employee salary and the company paid none during the closure of the stores. This is considered material to the company in 2020 and as such is disclosed.

An unusual or new type of transaction is more likely to be material than a routine or regularly occurring transaction of the same size. The global pandemic is likely to bring about new types of transactions and disclosure and these should be considered carefully.

IFRS guidance – 'unusual' items

IAS 1 provides some examples of items considered 'unusual' that could warrant disclosure that may otherwise fall below materiality thresholds:

- write-downs of inventories to net realisable value or of property, plant and equipment to recoverable amount, as well as reversals of such write-downs
- restructurings of the activities of an entity and reversals of any provisions for the costs of these restructurings
- disposals of items of property, plant and equipment
- disposals of investments
- discontinued operations
- litigation settlements
- other reversals of provisions.

In our view, all these examples could be relevant when reporting the COVID-19 pandemic. For further insight on IAS 1, refer to 'Watch this space' on page 9.

Example – litigation settlement

An entity has a litigation issue with one of its suppliers. They have agreed a settlement amount which means they do not need to take the issue further.

Whilst the amount is not material, the expense is unusual. In addition, as the settlement relates to a supplier of the entity, it is likely this information would also interest the users. Therefore, the entity should disclose the amount of the litigation.

Filter #2 – specific disclosures to provide

It is not always necessary to disclose all the information specified in IFRS just because the underlying item is material. Deciding which specific disclosures to provide is the second 'filter' referred to in the flowchart.

Disclosure requirements for some underlying items are straight forward, an entity will either disclose the event or amount or it will not. For example, if there is a significant event after the reporting date, if it meets the criteria set out in IAS 10 'Events after the Reporting Date' then it is required to be disclosed.

Other disclosures will require more consideration, and this is where the items noted in filter #2 will apply.

Re-think the notes

Re-evaluate how the notes to the financial statements are organised to improve their effectiveness as a communication tool.

The disclosures (or notes) are a significant component of any financial statements. As such they can have a great impact on the effectiveness of the financial statements as a communication tool. Many entities have been experimenting with the traditional way of organising the notes in order to better tell their story and emphasise the most important information. This section considers some of the emerging practices and some recommendations for the COVID-19 disclosure notes.

IFRS guidance

IAS 1 explains that the overall objectives of the notes to the financial statements are to:

- present information about the basis of preparation of the financial statements and the specific accounting policies used (refer to separate accounting policies section)
- disclose the information required by IFRS that is not presented elsewhere in the financial statements
- provide information that is not presented elsewhere in the financial statements but is relevant to an understanding of them.

IAS 1 requires that the notes are presented in a 'systematic manner', as far as practicable. Following the amendments made as part of the IASB's disclosure initiative, however, IAS 1 is more flexible on how to achieve this.

It gives examples of the possible alternatives to the 'traditional' ordering:

a. by giving prominence to the areas of activities that are considered to be most relevant to understanding its results and position, for example by grouping together information on the same operating activities
b. by grouping together information about items measured similarly such as assets measured at fair value.

In deciding how to approach this, IAS 1 reminds preparers to consider the effect on the understandability and comparability of the financial statements with other entities as well as the approach taken in prior periods. For further insight on IAS 1, refer to 'Watch this space' on page 9.

Re-organising the notes

Traditionally many reporting entities have organised their notes starting with accounting policies (including information about key judgements and estimates), then they have notes linked to each primary statement in the order of the line items appearing in those statements, and finally other notes such as post-reporting date events. This approach has its merits. However, alternative structures can tell an entity's story more effectively, and emphasise the information management considers most important to its users. As noted, IFRS also offers scope to present notes in the order that best suits the business and the readers of its financial statements.

Re-organising the notes

The basis for re-ordering is normally to:

Group notes into categories that cover related areas

Place the most critical information more prominently

A combination of both.

Categorising the notes

There are several categories entities could consider when grouping related notes. In some instances, notes may fall into more than one category, so preparers will need to pick the category that is most appropriate given the circumstances of the business.

Examples of categories:

Category	Examples of notes that could fall into these categories	
COVID-19 reporting	• going concern • plus other notes that have been impacted by the global pandemic	
Significant transactions and events	• assets classified as held for sale and discontinued operations • business combinations • related party transactions	
Group structure	• subsidiaries • associates and joint ventures	
Risk management	• financial instruments risk • financial assets and liabilities	• fair value measurement
Group performance	• revenue • expenses • dividends	• earnings per share • income tax
Operating assets and liabilities	• receivables • payables	• inventories • provisions
Unrecognised items	• capital commitments • post-reporting date events	• contingent liabilities • contingent assets

Combining the notes

Some entities have also taken this a step further and combined their notes to achieve more effective communication. For example, a note that sub-analyses a line item in the statement of financial position, its accounting policy and any critical key estimates and judgements affecting that item.

Another aspect of combining the notes is to combine all information about a specific type of transaction, or group of related transactions, in a single note. This is a possible way to approach the COVID-19 disclosures.

Example – goodwill and intangible assets impaired as a result of COVID-19

Agroup has significant goodwill and intangible assets from several past business acquisitions. During the year one of these business acquisitions made significant losses because of COVID-19 and as a result an impairment was recorded in the goodwill balance. The group decided to place its goodwill, intangible assets and impairment notes together so this event (which is a significant part of their COVID-19 story) could be easily explained all in the same place.

Signposting

Signposting enables the information to be more accessible to investors and users. When producing the first annual set of IFRS-based financial statements dealing with the consequences of the COVID-19 pandemic, signposting will be important, particularly if the entity adopts a non-traditional approach to compiling the notes (eg bringing together accounting policies, significant estimates and judgements and reported amount together all in a single note) or if the financial statements are very large.

Providing cross-references from the primary statements to related notes is required by IAS 1 and, of course, is well-established. Since the global pandemic was officially recognised in February 2020, some organisations have included immediately after their basis of preparation note (ie Note 1), a note that addresses COVID-19 (ie Note 2), before their accounting policies. This note acts as a hub to other notes that contain more specific details on the economic consequences of the pandemic. This approach has several advantages, and when COVID-19 is no longer the entity's central focus of decision making, it can either be repositioned further back in the notes to the financial statements or removed completely.

Additional cross-referencing can help considerably when information from prior accounting periods has been re-ordered or relocated:

Example – areas impacted by COVID-19

Information about areas impacted by COVID-19 is included in the related notes as follows:

- **revenue** – see note 8
- **goodwill** – see note 10
- **other intangible assets** – see note 11
- **impairment** – see note 12
- **leases** – see note 14
- **inventories** – see note 15
- **provisions** – see note 17

Cross-referencing selected details to external sources of information is a very effective way preparers of financial statements can refer readers to complementary and/or additional data on COVID-19 outside of its annual report.

Signposting to outside the financial statements can include:

- standing data (eg share option terms and conditions of issuance)
- additional information amplifying what been summarised in financial statement disclosures
- other connected non-financial data, such as metrics reporting on the achievement of sustainability goals and objectives or the non-financial impact of COVID-19.

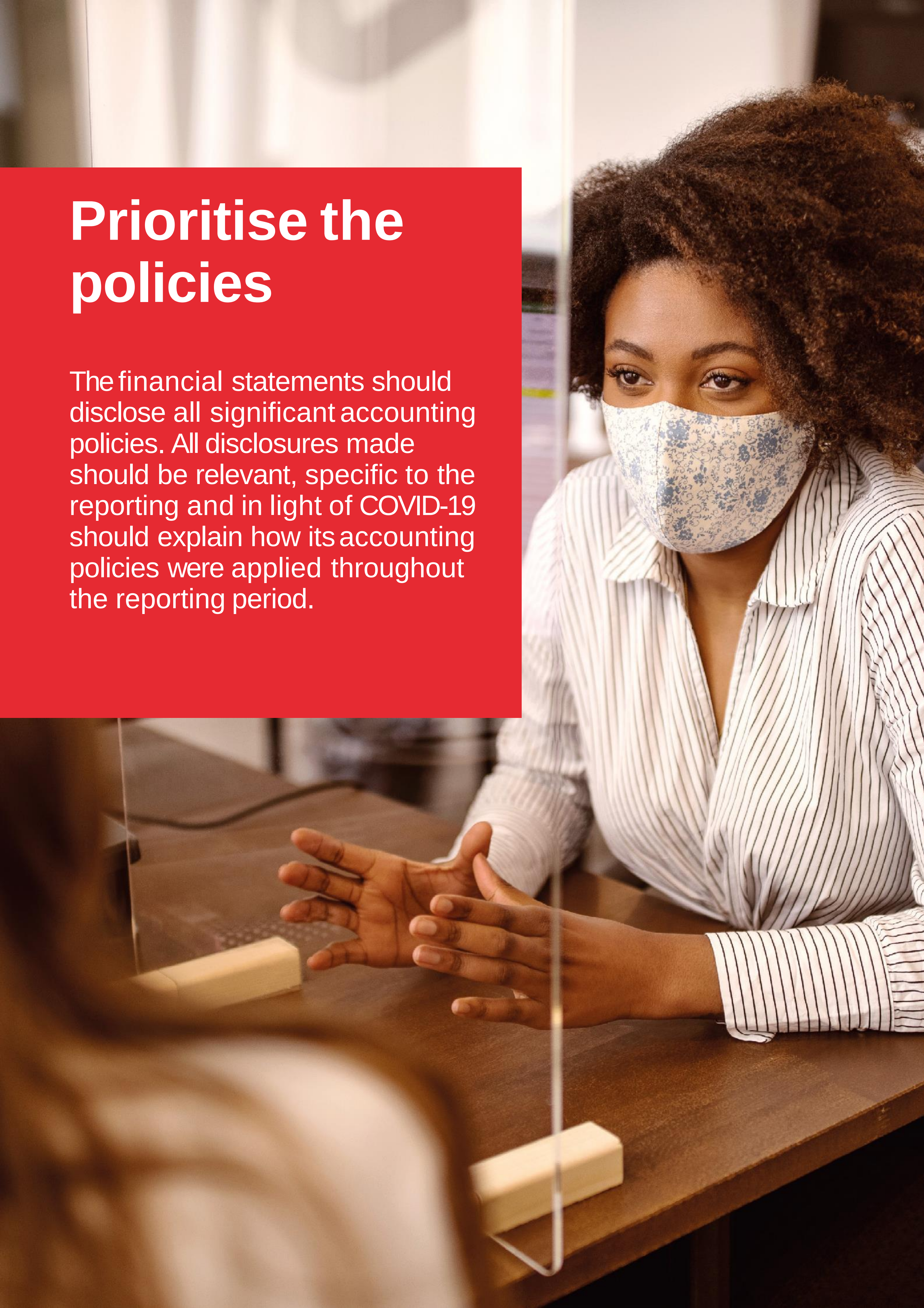
IFRS guidance

Most standards do not allow material disclosures to be placed outside the financial statements. However, IFRS 7 allows descriptions of risks to be placed outside the financial statements. IFRS 7.21B explains that entities should present the required disclosures in a single note or separate section in its financial statements. However, an entity need not duplicate information that is already presented elsewhere, provided the information is incorporated by cross-reference from the financial statements to the other statement. For example, a management commentary or risk report, and this should be available to users of the financial statements on the same terms and at the same time as the financial statements. Without the information incorporated by cross-reference, the financial statements would be incomplete.

Example – events after the reporting date

On 1 February 2021 the Group acquired 100% of the equity instruments of Goodtech GmbH (Goodtech), a Hamburg (Euroland) based business, thereby obtaining control. The acquisition was made because the vendor would have failed to comply with its period end bank covenants had it not disposed of this subsidiary and it was keenly priced. This resulted in it being accounted for as bargain purchase arrangement and a profit of CU1,1 million was immediately recognised. Goodtech is a significant business in Euroland in the Group's targeted market. For a company profile of Goodtech GmbH and more details of the company's activities, please refer to our website **www.illustrative corp.com/goodtech**.

Finally, entities can direct users to where the elements of financial statements can be found using an index to the notes to the financial statements. The use of hyperlinks, particularly when the financial statements are large, are commonly found when the financial statements are accessed via websites.



Prioritise the policies

The financial statements should disclose all significant accounting policies. All disclosures made should be relevant, specific to the reporting and in light of COVID-19 should explain how its accounting policies were applied throughout the reporting period.

The disclosure of significant accounting policies is often the longest note in the financial statements and reporting on the impact of COVID-19 will not change this. Done well, accounting policy notes will help investors and users to properly understand the entity's financial statements. Done badly, it contributes to clutter without adding value.

Key attributes of accounting policies

In light of the global pandemic, the accounting policy disclosures should::

- **Cover all the transactions and balances that are significant to the entity**
- **Remain relevant**
- **Be specific to the entity**
- **Are positioned in the financial statements in a way that best meets its users' needs**
- **Report on all the key judgements made in applying the entity's accounting policies and all the major sources of estimation uncertainty.**

Make them significant

Putting aside COVID-19 reporting for a moment, judgement will always be required in deciding which accounting policies are significant, and those that are not. It is not just about whether the numbers being reported on are large.

In assessing significance management needs to consider not only the materiality of the balances or transactions affected by the policy, but also:

- the nature of the entity's operations – even if amounts involved are not material
- whether the entity has selected a policy among alternatives provided by the relevant standard (for example, the revaluation model for property, plant and equipment or investment property)
- the extent of judgement, estimation uncertainty or complexity involved in applying the policy
- whether any policy was developed for a type of transaction not specifically covered by IFRS
- whether the users' needs and expectations on seeing the balance being reported have changed.

Reporting the COVID-19 pandemic could impact the significance assessment of accounting policies. In addition, new policies may need to be included, eg accounting for governments grants if they are being provided and used for the first time.

IFRS guidance

IAS 1 explains that a complete set of financial statements includes notes, which comprise significant accounting policies and other explanatory information. However, the Standard gives only limited guidance about what a significant accounting policy could be:

- the measurement basis(es) used in preparing the financial statements, and
- the other accounting policies used that are relevant to an understanding of the financial statements.

When the IASB amended IAS 1 as part of its 'Disclosure Initiative' project, the IASB said an entity should consider:

- the nature of its operations, and
- the policies that its users of the financial statements expect to see.

Helpfully, the IASB also removed some previous wording that had been interpreted to mean that policies on income tax and foreign currency translation would always be significant.

Watch this space – changing 'significant' to 'material'

The IASB are in the process of finalising guidance to assist entities in applying materiality judgements to their accounting policy disclosures. The IASB are planning to amend IAS 1 so entities are required to disclose their material accounting policies rather than their significant accounting policies. To support this, the IASB will also amend 'IFRS Practice Statement 2: Making Materiality Judgements' to provide more explanation and practical guidance. The IASB are planning to issue these amendments in February 2021.

Be clear and specific

We are seeing an evolution in this area – and it is continuing to accelerate. Traditionally, many accounting policy disclosures simply summarise the relevant accounting standard. Some regulators and commentators describe this as an example of 'boilerplate' reporting, and some have noted this has already emerged on aspects of COVID-19 reporting. While it is not necessary to remove every generic disclosure, we do believe the real value and insight comes from explaining how the reporting entity has applied its significant policies – particularly since the onset of the global pandemic.

Should accounting policies be grouped?

While there is no requirement to do this, grouping accounting policies does assist users in identifying those accounting policies and notes they particularly want to read.

Ways on which accounting policies can be grouped:
- those that have changed, if any, from the prior reporting period
- those that are "new" accounting policies for the entity in the sense they have never had to previously account for this type of transaction before (eg government wage subsidy grants)
- those relating to new accounting standards
- those that are key to the reporting entity's activities
- those where an accounting policy choice exists under IFRS
- those that relate to the different primary statements (ie group all accounting policies associated with matters disclosed in the statement of profit or loss and other comprehensive income first, then those that relate to amounts disclosed in the statement of financial position and finally those that relate to the statement of cash flows).

In terms of reporting the COVID-19 story, accounting policies that are either new or amended as a result of the pandemic could be grouped together. In addition, those policies that are key to understanding the impact of COVID-19 can be placed together.

Articulate key estimates and judgements

Making estimates and judgements is an integral part of preparing financial statements. Effective disclosures about the most important estimates and judgements enable investors to understand the financial statements. However, given the pervasiveness of estimates and judgements, deciding which to disclose – and what to say about them – can be challenging. This area is going to be particularly important when estimating the impact of COVID-19 for certain areas such as impairment and provisions, so providing the right level of detail is key.

How should entities disclose key estimates?

Most of the numbers included in financial statements are based on estimates to some degree – even relatively simple amounts such as depreciation and the cost of inventories. Several of these estimates involve predictions about the future. Many estimates are routine, and the range of reasonably possible alternative outcomes is narrow. However, investors and users need to know more about the major sources of estimation uncertainty to properly understand the financial statements.

IFRS guidance

IAS 1 explains the overall requirements for disclosures about estimates. The requirements focus on assumptions that have been made about the future, and other major sources of estimation uncertainty at the end of the reporting period, when there is a significant risk of a material adjustment within the next financial year/reporting period.

IAS 1 requires disclosure about the assumptions made and the nature and carrying amounts of the assets and liabilities affected. It does not prescribe the exact information to disclose about these assumptions but gives examples of the types of information:

- the nature of the assumptions
- sensitivity of carrying amounts
- expected resolution/range of reasonably possible outcomes
- changes made to past assumptions.

Some standards also include disclosure requirements about particular estimates. For example:

- IAS 36 'Impairment of Assets' specifies disclosures about impairment testing
- IAS 37 'Provisions, Contingent Liabilities and Contingent Assets' requires disclosures about uncertainties and major assumptions affecting provisions
- IFRS 13 'Fair Value Measurement' requires information about how fair values have been estimated.

One of the most common pitfalls is to describe several balances or amounts that are based on estimates but provide little or no information about the estimates themselves and how they were made. In addition, disclosures about the underlying assumptions, how actual outcomes compare to past assumptions and sensitivity analysis of reasonably possible changes, are often frequently omitted.

Example – weak disclosure about estimation uncertainty

Key estimate: net realisable value of inventory

The Group reviews net realisable value (NRV) of its inventory regularly to provide assurance it is stated at the lower of cost and NRV. Factors that could affect NRV include technological changes, competitor actions and market trends. Changes in the net realisable value of inventory could affect profit in a future period.

Our view is financial statements can be improved by focusing on the estimates that are genuinely key and providing better information about them. The focus should always be on the most difficult, subjective and complex estimates with a significant risk of material adjustment in the next 12 months. Taking COVID-19 into consideration, illustrated below is a disclosure that we believe would be helpful to decision makers because it includes key assumptions, the process for reviewing, key numbers and sensitivity. In our view, key estimates in relation to COVID-19 are going to be scrutinised carefully by investors and users and so providing good disclosure on this area is essential.

Example – better disclosure

Key estimate: net realisable value of inventory

The key assumptions, which require the use of management judgement, are estimated costs to sell and the expected selling price. These key assumptions are reviewed annually. The total expense relating to inventory write-downs during the year was CU69m (2019: CU51m). The write down was higher than broadly historical levels, after the third biggest stock item became obsolete in 2020 due to technological advances and not being able to ship goods offshore as a result of COVID-19 lockdown. If the average selling prices were to decline by 5% an additional write-down of CU2.5m would be required. Based on the last 5 years of trading activity, and considering the current economic environment in Euroloand over the next 12 months, expected selling prices have been reduced on average 1.5% but costs to sell remain unchanged.

- **Key assumptions**
- **Review Process**
- **Relevant figures**
- **Explain trends**
- **Sensitivity analysis**

Should key judgements made in relation to COVID-19 be treated differently from any other key judgements that have been made?

Our view is they should not be treated differently.

IFRS is a principle-based set of accounting standards and applying principles will always require preparers to exercise their professional judgement. The outcome of any judgements made can have a major effect on reported results and financial position. But judgement, however soundly made, is inherently subjective. It is therefore inevitable that different people – acting diligently and in good faith – sometimes make different judgements on similar fact patterns. Accordingly, investors and users need to understand the critical judgements in order to understand the financial statements.

IFRS guidance

IAS 1 provides general guidance on disclosures about judgements. Other standards, such as IFRS 12 'Disclosure of Interests in Other Entities', supplements IAS 1 by requiring disclosure about particular judgements.

Entities should disclose the judgements management has made in the process of applying its accounting policies and those that have the most significant effect on the amounts recognised in the financial statements. These can be disclosed in either the accounting policies or the notes to the financial statements.

Practical tip – judgements versus estimates

IAS 1 distinguishes between judgements and sources of estimation uncertainty. In practice, however, we observe that some entities' disclosures blur the line.

A judgement refers to a conclusion being made by management as to the correct accounting treatment when applying accounting principles and policies to the entity's transactions. For example, whether:

- an acquisition meets the definition of a business
- the entity has control or significant influence over an investee in a borderline situation.

An estimate refers to how the actual numbers are determined, once management has concluded on the correct accounting treatment. Commonplace examples of estimates involving a high degree of uncertainty include provisions and impairment losses.

In practice, of course, this distinction is not always clear cut. For example, making estimates also requires judgement. There is also no need to segregate disclosures about judgements and those about estimates. Nonetheless, in order to ensure an entity is making the correct disclosures it is important to first make the distinction and then to decide how best to organise the information.

Example

When looking at impairment, the judgement is whether there is any impairment in the relevant underlying item; the estimate is the calculation of the impaired losses incurred.

Below are two examples relating to the control assessment in IFRS 10 'Consolidated Financial Statements'. One is considered weak and the other improved.

Example – weak judgement disclosure

Key judgement: control or significant influence over an investee

The Group enforcing its rights under an arrangement with creditors, now holds 45% (2019: 42%) of the ordinary shares and voting rights in Equipe Consultants S.A (Equipe).

Management has assessed its involvement in Equipe in accordance with IFRS 10's control definition and guidance and has concluded that it has significant influence but not outright control.

Why is it weak disclose? It is weak because it does not:

- provide background information on the required judgement
- explain how the judgement was actually made and how the conclusion was reached.

Example – better judgement disclosure

Key judgement: control or significant influence over an investee

The Group enforcing its rights under an arrangement with creditors now holds 45% (2019: 42%) of the ordinary shares and voting rights in Equipe Consultants S.A (Equipe). Two other investors each hold 15%. The remaining 25% is held by several other unrelated investors, none of whom own more than 2% individually. There are no arrangements for the other shareholders to consult one another or act collectively and past experience indicates that few of the other owners actually exercise their voting rights at all.

The Group has not increased its representation on the Board of Directors. Consistent with the prior year, the Group can only appoint four of Equipe's Board of Directors out of a total of eleven. Management has assessed its involvement in Equipe in accordance with IFRS 10's control definition and guidance and has concluded that it has significant influence but not outright control. In making its judgement, management considered the Group's voting rights, the relative size and dispersion of the voting rights held by other shareholders and the extent of recent participation by those shareholders in general meetings. Recent experience demonstrates that a sufficient number of the smaller shareholders participate such that they, along with the two other main shareholders, prevent the Group from having the practical ability to direct the relevant activities of Equipe unilaterally.

This is an example of a judgement about the correct accounting treatment (whether the company has control of the investee and should consolidate it, or whether the investee is an associate and should be accounted for using the equity method). This is a key judgement because these two accounting methods have very different effects on the financial statements.

Our Team

Our team of IFRS experts have supported the IFRS 17 implementation programme for a wider range of our clients across the Gulf. To navigate the complexities of the standard and to ensure you are fully compliant by the deadline of January 2023 contact us.

Jatin Karia

Senior Partner

T +973 39575562
E jatin.karia@bh.gt.com

Jatin, the Senior Partner of Grant Thornton Abdulaal, has over 15 years of experience in the field of internal audit, business assurance, and special advisory for local and multinational clients. Prior to joining Grant Thornton, he was associated with Lovelock & Lewes, India (a member firm of Price Waterhouse Coopers - India) & Chartered Accountants firm M/s Kalyaniwalla & Mistry (a member firm of Ernst & Young). Jatin is actively involved in each assignment from its business development phase up to the final deliverables for ensuring all deliverables comply with Grant Thornton International quality standards. His qualifications are: CA (ICAI India), MBA Finance (India), CFC (USA), and CRMA, (IIA USA).

Shahnawaz Khan

Partner

T +973 35640273
E shahnawaz.khan@bh.gt.com

Shahnawaz Khan is a Partner at Grant Thornton Abdulaal. He leads the IFRS Advisory and Insurance & Energy practice. He has worked numbers of years in London financial services market serving life and general insurance clients, Lloyds syndicates and US and Bermuda listed Companies. In GCC, he has led the audit of a broad range of large corporations and public interest entities across various industry sectors, including insurance and Takaful entities. He has lead and performed due diligence assignments on Basel and Solvency II compliance. Some of his key clients are Capital Market Authority, Qatar National Bank, Muscat Securities Market, Dhofar Insurance, Prudential Plc, Citi Bank, Al Ahleia Insurance, Medgulf Insurance, , LIC, Solidarity Insurance and Gulf Finance House. He has been responsible for various cross-border assurance services to leading clients in the region reporting on IFRS, UK and US GAAPs. He has been part of learning and development teams in the GCC region and Europe, facilitating internal and external trainings on IFRS, insurance, industry trends and best practices. He is a brand ambassador of ICAEW in Bahrain. Shahnawaz is also member of IFRS 17 drafting group at AAOIFI and member of insurance working group at GT International. In past he worked with big fours firms in KSA, UAE, Kuwait, Bahrain and UK. Prior to joining GT Bahrain, he worked with GT Oman as Partner.

Yaser Abbas Salman

Partner

T +973 39402188
E yaser.abbas@bh.gt.com

Yaser, a Partner at Grant Thornton Abdulaal, has over 13 years of experience in audit and assurance, internal audit, risk assessment, corporate governance, process analysis and documentation, and policies and procedures development. Prior to joining Grant Thornton, he was associated with Gulf International Bank and Ernst and Young in Bahrain. He joined GIB's internal audit department at a critical stage in the bank's strategy implementation, which allowed him a very unique opportunity to participate in the launch of the new Retail Bank in KSA. Yaser was involved in the overhaul of existing policies and procedures which were replaced with newly developed process flow maps, policies and procedure manuals. At Ernst and Young, he led assurance service delivery to a portfolio of investment and retail banks. He is an ACCA, CIA, CFSA, and CIPA. He is also a member of IIA.

Chris Noguera

Partner

T +973 36549696
E chris.noguera@bh.gt.com

Chris, a Partner at Grant Thornton Abdulaal, has over 14 years of post qualification experience in the field of audit and assurance services. Prior to joining Grant Thornton, he was a Senior Associate in SyCip, Gorres, Velayo & Co. (SGV & Co.), a member firm of Ernst & Young in the Philippines. Chris is currently the head of Audit Quality at Grant Thornton Abdulaal. He is a Certified Public Accountant (CPA-Philippines) and finished his degree (BS Accountancy) in the Philippines.

Ali Abbas Salman

Partner

T +973 36444838
E ali.abbas@bh.gt.com

Ali has been associated with the firm since 2005. He has over 14 years of experience in engagement management, assurance services, risk advisory services and business process solutions. As a part of Grant Thornton's audit and assurance services division, he is responsible for coordination and supervision of projects. His key responsibilities on assignments include managing teams responsible for risk assessment, engagement planning, execution, delivery and engagement closure. Ali has conducted and managed projects and services offered to entities across different sectors and industries. His geographical experience spans across Bahrain and Saudi Arabia. He is a qualified CPA (USA), CGMA and holds a Certificate in Financial Reporting Standards (IFRS).

Sameer Shafiq

Senior Manager

T +973 34496356
E sameer.shafiq@bh.gt.com

Sameer, Senior Manager - Audit at Grant Thornton – Abdulaal, has over 12 years of experience in auditing a range of listed, multinational and local clients in several industries including manufacturing, real estate, trading, services, commercial and investment banking, leasing, insurance and mutual funds. Prior to joining Grant Thornton Abdulaal, Sameer was associated with Grant Thornton Dubai and Grant Thornton Pakistan. He is responsible for managing and monitoring audit engagements. He is an ACA – Associate member of Institute of Chartered Accountants of Pakistan (ICAP), APFA – Associate member of Pakistan Institute of Public Finance Accountants (PIPFA), and ACPA – Associate member of Institute of Certified Public Accountants of Pakistan (ICPAP).

Technical support and assistance

Grant Thornton works to support dynamic organisations to address financial reporting issues in today's complex world.

We can help you get up to date with current trends in financial reporting by providing:

- thought leadership insights
- examples of best practice disclosures
- commentary on emerging practices
- support you to enhance the content and impacts of your annual reports.

Whatever stage you are at in making improvements to the content and presentation of your annual reports, our specialists offer pragmatic solutions, whilst still complying with IFRS.

The requirements set out in IFRS are often very detailed and technical. To the untrained eye, they can appear hard to navigate. But at Grant Thornton, we have people who are well versed in their intricacies and can translate them into language that you can understand and apply to your financial statements.

We hope you found this publication useful when thinking about how to tell your COVID-19 story. If you would like to discuss any of the points raised, talk to your Grant Thornton contact now, or visit **www.grantthornton.bh** to find out more and to connect to a specialist in your country.

About Grant Thornton

We are a network of independent assurance, tax and advisory firms, made up of 58,000+ people in 138 countries. For more than 100 years, we have helped dynamic organisations realise their strategic ambitions. Whether you are looking to finance growth, manage risk and regulation, optimise your operations or realise stakeholder value, we can help you.

Grant Thornton

grantthornton.bh