Intergovernmental Working Group of Experts on International Standards of Accounting and Reporting
(ISAR)

UNCTAD-ISAR – IAAER Workshop
Impact of COVID 19 on company financial and sustainability reporting

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Presented by

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Effects of COVID-19 on Financial Reporting, Nonfinancial Reporting and Assurance

Early Findings from Research and Information Provided by Securities Regulators, Standard Setters and Professional Accountancy Organizations

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INTERNATIONAL ASSOCIATION FOR ACCOUNTING EDUCATION & RESEARCH

Starting point, objective and limitation

- *Starting point*:
  - Effects of COVID-19 on all forms of commerce around the world placed substantial pressure on financial reporting, nonfinancial reporting and assurance
- *Objective*:
  - Summarize early findings of effects using several information sources
    - Securities regulators
    - Standard setters
    - Professional accountancy firms and organizations
    - Practice-oriented research
    - Academic research
- *Important limitation:*
  - Research, especially academic research, is sparse and tends to use small nonrandom samples
  - We expect the breadth and depth of research to increase as more data become available

Standard setters: IOSCO

- Early awareness of likely difficulties with financial reporting: IOSCO (May 2020)
  - Investors need timely entity-specific information about effects of COVID-19 on operations, financial position, liquidity and future prospects
  - Preparers should use the best available (imperfect) information in an evolving and uncertain environment
  - Disclosures and management commentary should discuss both effects of COVID-19 and measures taken to mitigate those effects
  - Areas of concern
    - Going concern assessments
    - Asset impairments and credit losses
    - Effects of government relief such as debt repayment moratoriums
    - Subsequent events
    - Non-GAAP (alternative) performance measures
  - Special accommodation: some securities regulators extended 2019 annual and 2020 interim reporting deadlines

Standard setters: IASB

- Targeted IASB actions (examples)
  - IFRS 9: Assessments of expected credit losses (ECLs) may require adjustments (overlays) to results from models
  - IFRS 16: Practical expedient to account for rent concessions as if they are not lease modifications
  - IAS 1 and IAS 10: Going concern assessments and events after the reporting period (subsequent events)
- Certain other standard setters modified local standards and/or provided resources for preparers

The profession: accountancy firms, IFAC, PAOs

- The profession provided non-authoritative guidance and resources to assist financial statement preparers and auditors
- Links to relevant websites are in the discussion paper
- Examples
  - Going concern assessments
  - Asset impairments including goodwill
  - Realizability of deferred tax assets
  - Contract modifications and breaches
  - Subsequent events/events after the reporting period
  - Alternative performance measures
  - Restructurings
  - Leases
  - Compensation and employee benefits (including termination benefits)
  - Government assistance

Non-academic research on effects of COVID-19

- Features of this research
  - Primarily from large (multinational) accountancy firms
  - Focuses on descriptive analysis of financial reporting issues and outcomes in reports covering 2019 and the first half of 2020
  - Sample sizes range from less than 20 to over 300
  - Industry focus on financial services (banks), aviation and tourism
  - Geographical focus on Europe, Oceania and the US
- Examples of findings
  - Some (but not all banks) reported declines in credit quality of loans
  - Substantial variation in the degree of detail of COVID-19-related disclosures
    - Liquidity and actions taken to increase liquidity
      - Suspend or reduce dividends
      - Defer or cancel capital expenditures
      - Renegotiate lending agreements
      - Issue equity
    - Supply chain issues and mitigation activities

Non-academic research on effects of COVID-19

- Some research reports included “best practices” examples and recommendations
  - Dedicated summary of COVID-19 impacts and mitigating actions
    - *Example:* Adidas AG
  - Management’s outlook and underlying financial reporting assumptions
    - *Example*: Continental AG’s quantitative disclosure of assumptions
    - *Example:* Kuehne+Nagel’s outlook beyond the current year
  - Quantitative sensitivity analyses
    - *Example:* SGS AG’s sensitivity analysis related to assumptions/inputs underlying impairment charges
  - Going concern assessment
    - *Example:* IAG’s scenario modeling
  - Discussion of actions taken to mitigate effects of COVID-19
    - *Example:* Continental AG’s discussion of cost reductions to preserve liquidity
    - *Example:* Adidas AG’s schematic presentation of progress on measures to manage inventories
    - *Example:* Glencore’s explanation of change in dividend policy

Academic research on effects of COVID-19

- Research is sparse, tends to be country-specific and based on small samples covering at most fiscal 2020
  - Data availability, including in machine-readable commercial databases
  - Lengthy peer review processes
- Tends to document effects on reporting outcomes and disclosures
  - Subsequent events/events after the balance sheet date
  - Asset impairments
  - Declines in revenues and/or profitability
  - Declines in investing activity
  - Discussions of COVID-19 effects

COVID-19’s impact on nonfinancial/sustainability reporting

- Advice from regulators, accountancy firms and sustainability advocacy and consulting firms
  - Nonfinancial reporting is, generally, less strictly regulated than financial reporting. Exceptions include Directive 2014/95/EU (Nonfinancial Reporting Directive) which requires disclosure of specified nonfinancial information by certain large companies (EU 2014).
  - Regulatory reviews of nonfinancial information to focus on COVID-19’s effects on, in particular, **social/employee matters, value creation, risks related to climate change**
    - e.g., ESMA (2021)
  - Some securities regulators encourage disclosures to **assist investors in evaluating COVID-19’s effects “through management’s eyes”**
    - Guidance from the US SEC Division of Corporate Finance (2020)
      - Effects on employees, for example, job security and telework/ “work from home” arrangements
      - Effects on suppliers and supply chains
      - Efforts to support local communities

Advice from regulators (continued)

- SGX RegCo (2020) - COVID-19 exposed the importance of **managing material social risks and opportunities among key stakeholders**. A company's response should be included in, and may serve as the basis of, the social aspect of sustainability reporting, e.g.,
  - Responses to government calls for safe distancing and 'work from home' arrangements
  - Job security, training and reskilling of staff leveraging on training grants
  - Consideration of supply chains and assessments of potential future lockdowns impact

SGX RegCo expects issuers to articulate **recovery plans and strategies** in their annual or sustainability reports for the relevant period, **emphasizing social aspects in the latter.**

Advice from sustainability advocacy/consulting firms

- Fishman, Hatch, and Allison-Hope (2020) of BSR
  - In 2019, some companies delayed or downsized sustainability reports
  - Reiterate **importance of engagement on long-term ESG issues**
    - e.g., BlackRock indicating 2021 proxy season would focus on **board composition and quality, environmental risks and opportunities, corporate strategy and capital allocation, compensation promoting long-termism, and human capital management**
  - COVID enhances **importance of, and scrutiny on, addressing the "S" in ESG**. For sustainability reporting during COVID recommend, e.g.,
    - Over-time consistency and completeness, performance on key social issues may be more thoroughly examined than usual
    - Sustainability reports should become a primary venue for accountability around a company's actions during COVID
    - Numbers should be backed by narrative
    - Stakeholders' information needs outside the annual reporting cycle should be addressed, e.g., a COVID-19 webpage.

Research on COVID-19's impact on nonfinancial reporting

- Practice-oriented research from accountancy firms, sustainability advocates, consultancy firms and academics
  - Research is sparse, and tends to report descriptive analyses of small nonrandom samples including corporate responses to COVID-19 in terms of safety, logistics, maintaining continuity of operations and, human rights
    - *Examples of findings in some (not all) research reports/papers*
      - 2020 declines in meeting sustainability goals and in sustainability reporting performance as compared to 2018/2019
      - Financial constraints associated with COVID-19 result in re-allocations of resources away from sustainability efforts and sustainability reporting
      - A few 2020 integrated reports analyze COVID-19 effects as a source of uncertainty

An example - CSRone’s 2020 *Taiwan and Asia Pacific Sustainability Reports Analysis*

- Examines the sustainability reporting performance of 99 large listed companies in 10 Asia Pacific countries
  - The findings indicate **sustainability reporting improved in 2018 and 2019 and declined in 2020.**
    - Disclosure decline strongest in India
    - Performance also declined in Thailand, Singapore, South Korea, Hong Kong, and China
  - Large Asia Pacific companies perform best in reporting energy savings and carbon emissions reductions, social investments, and waste management, although performance declined in 2020.
  - Reporting for human rights improved, from a low base.
    - Only Taiwanese, Australian, and Korean countries received above-average disclosure scores for both human rights and alignment with the UN’s Sustainable Development Goals.

Academic research on COVID-19's impact on nonfinancial reporting

- We identified three academic research papers related to COVID-19's effect on nonfinancial reporting.
  - These include Humphreys and Trotman (2021) who posit that high levels of unemployment, an increase in company failures, negative impacts on executive bonuses and increased difficulty of forecasting and achieving targets associated with COVID-19 may affect demand for and use of nonfinancial information.
  - Managers of financially constrained organizations may find their decisions about allocation of discretionary resources to sustainability efforts, including reporting, to be negatively affected.
  - Humphreys and Trotman make several recommendations for future research on COVID-19's impact on nonfinancial reporting and assurance

COVID-19's impact on assurance (1)

- Advice from IOSCO, IFAC, IAASB and accountancy firms to assurance professionals
  - Regulators and others acknowledge challenges/difficulties with performing audits ***but*** **professional responsibilities are unchanged**
    - *Examples*
      - Reporting on key audit matters and how they were addressed
      - Communications with management and audit committees/governing boards
      - Assessing management's judgment with respect to the entity's ability to continue as a going concern
      - Difficulty (or inability) to obtain sufficient appropriate audit evidence because of travel restrictions, lockdowns and distancing requirements
        - » *Example:* EY audit of Target Corporation (NYSE) included steps to address suspension of physical inventory counts

COVID-19’s impact on assurance (2)

- Practice-oriented and academic research
  - Discussions of features of the COVID-19 audit environment (applicable to both financial reporting and non-financial reporting)
    - Geographically dispersed audit teams all working remotely (not in offices)
      - Quality control, supervision and the review process
      - Remote work could be persistent feature of audits
    - Operating and financial pressures on management might increase misstatement risk
    - Ways to address difficulties in obtaining audit evidence
  - Descriptive analyses of audit reports
    - Frequency of COVID-19-related critical audit matters by area (for example, intangible assets including goodwill)
    - Cross-sectional analyses by industry and firm size

Concluding comments

- We found no systematic evidence that existing financial reporting and auditing standards are insufficiently robust to pressures from effects of COVID-19
  - *However:* the pressures are far from over and the evidence available to us is based on small nonrandom samples
- Some evidence suggests COVID-19 related changes to the conduct of assurance engagements might be durable
  - Use of technology to co-ordinate dispersed audit teams and to communicate with audit committees/governing boards
- We found examples of thoughtful suggestions for future research (as more archival data become available and as researchers develop experimental instruments to analyze COVID-19-related changes in judgments and decisions)
  - Did standards to account for credit losses promulgated in response to the financial crisis of 2007-2009 perform well under COVID-19-related pressure?
  - How did the high uncertainty caused by COVD-19 affect nonfinancial reporting and assurance and the willingness to pursue sustainability efforts?
  - How does a reduction in face-to-face work (in financial reporting and auditing) affect outcomes?

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Questions and Discussion