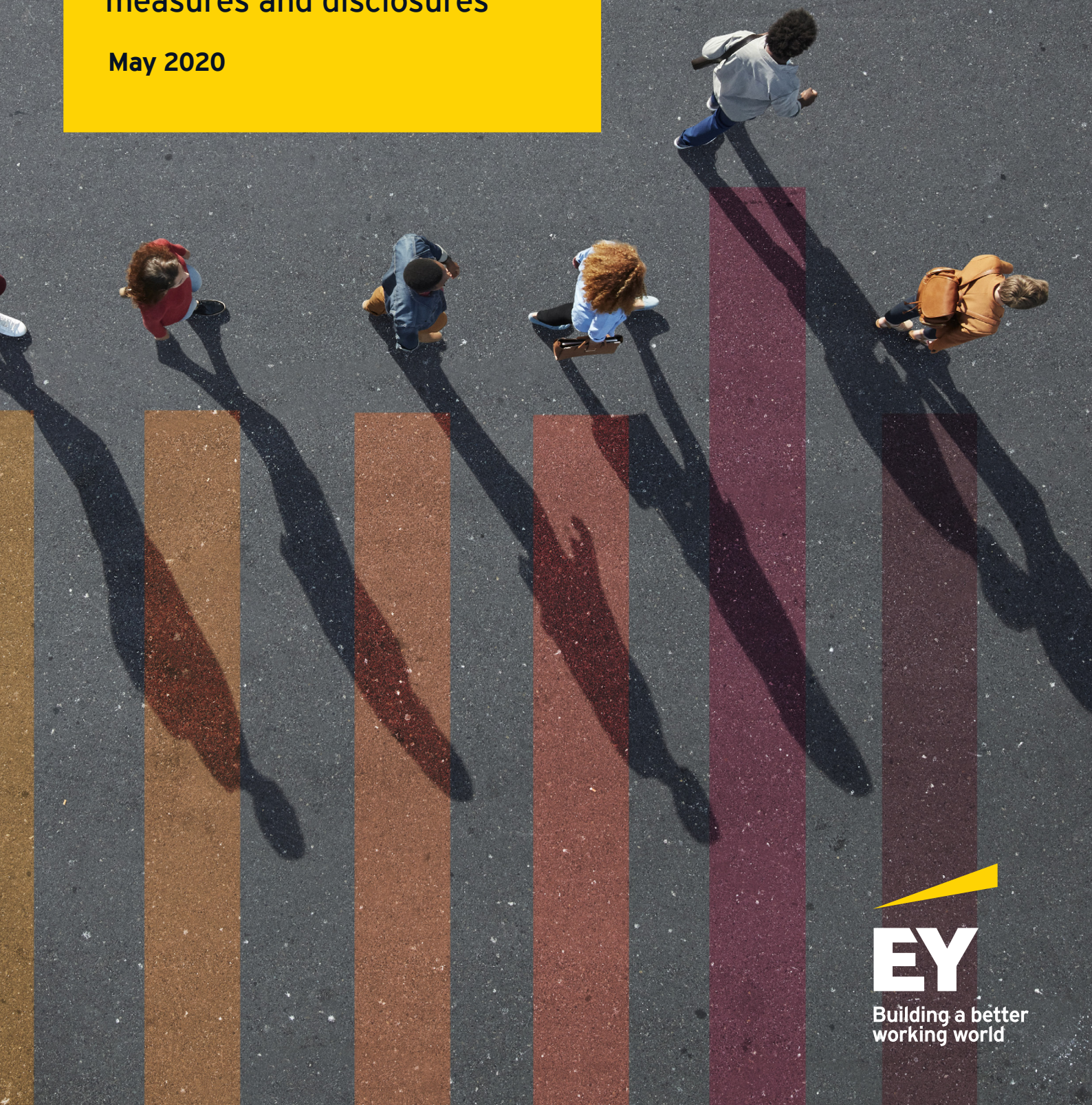


Applying IFRS

Impact of coronavirus on
alternative performance
measures and disclosures

May 2020



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What you need to know

- ▶ The use of APMs in financial communications may offer valuable insights to users of financial statements by highlighting the impact of the coronavirus outbreak on the entity's performance, financial position or cash flows.
- ▶ Certain IFRS requirements apply if APMs are presented or disclosed in financial statements.
- ▶ APM guidelines have been issued by various regulators in many jurisdictions that entities need to consider in their financial information.
- ▶ If entities use new or adjusted APMs to indicate the impact of the coronavirus outbreak, detailed disclosures explaining these APMs are important to understanding them.

1. Background

As the global economic disruption due to the coronavirus outbreak continues, entities are trying to communicate the financial effects of this crisis on their IFRS financial statements for annual or interim reporting periods.

In order to communicate how the coronavirus outbreak has affected financial performance, financial position and cash flows, management of entities may consider using a variety of financial measures, other than the measures required by the application of IFRS, sometimes referred to as, adjusted numbers, non-GAAP measures, Management Performance Measures (MPMs), or Alternative Performance Measures (APMs). In this publication, we refer to such measures as APMs.

Many entities consider APMs to be an important element of their communication of financial information. However, the use of a wide variety of APMs related to the coronavirus outbreak brings with it the risk of confusing or even misleading users of financial information if they are not accompanied by appropriate descriptions and disclosures.

Entities that use APMs to supplement their financial communications, may provide some or all APMs and APM-related disclosures, either outside or inside the financial statements. APMs include financial measures, such as:

- ▶ Subtotals presented or disclosed in the financial statements not defined in IFRS
- ▶ Amounts presented outside the financial statements derived by adjusting measures presented in the financial statements
- ▶ Combinations of measures presented in the financial statements, for example, various ratios, margins and return measures

Refer to our publication, *Applying IFRS: Alternative Performance Measures* (October 2018), for further discussion on APMs.¹

As a result of the coronavirus outbreak, many entities may consider providing new APMs, in addition to those already provided in previous periods, or they may adjust their existing APMs in order to incorporate the impact of the coronavirus outbreak. Other entities may also elect to provide detailed disclosures with explanations of how the pandemic has impacted them, or is expected to impact them in future periods, without introducing new or adjusting existing APMs. There is, in practice, a somewhat fine line between adding disclosures and introducing new or amended APMs. However, providing a stand-alone quantitative estimate of the impact is generally an additional disclosure, while adjusting an IFRS performance measure for the same quantitative estimate is generally considered an APM. This is because, in the first instance, a single impact measure is disclosed, as opposed to a measure presented or disclosed under IFRS with a corresponding alternative performance measure. An example of the latter would be a profit or loss measure presented according to IFRS and a profit or loss measure adjusted for the coronavirus outbreak impact.

¹ Available at ey.com/IFRS.

IAS 1 requires entities to present additional line items and subtotals when relevant to the understanding of the entities' financial position or performance.

2. Accounting and regulatory requirements for APMs

2.1 What is required by IFRS

IFRS provides some flexibility in presenting and disclosing APMs within the financial statements. However, there are some requirements in IFRS that entities need to bear in mind when considering the use of APMs. In particular:

- ▶ IAS 1 *Presentation of Financial Statements* requires entities to clearly identify and distinguish IFRS financial statements from other information in the same published document.²
- ▶ IAS 1 generally requires the presentation of specific line items, but only if these are material.³
- ▶ Entities are required to present additional line items and subtotals, when such presentation is relevant to the understanding of the entity's financial position or financial performance.⁴ If so, IAS 1 sets out certain requirements, including that they are labelled in a manner that makes the line items that constitute a subtotal clear and understandable and that they are not displayed with more prominence than the subtotals and totals required by IFRS.⁵
- ▶ IAS 1 and IAS 34 *Interim Financial Reporting* require separate disclosure of the nature and amount of items of income or expense that are material and this information may be given on the face of the statement of profit or loss and other comprehensive income or in the notes. Although IAS 1 specifically prohibits entities from presenting items of income or expense as "extraordinary items", it is silent on the use of terms such as "exceptional" and "unusual".⁶
- ▶ There is a requirement to disclose in the notes to IFRS financial statements information that is not presented elsewhere in the financial statements which is relevant to an understanding of the financial statements.⁷ If line items or subtotals have been included on the grounds of being relevant to the understanding of the financial performance or position, then definitions and explanations of these items may be relevant to the understanding of the financial statements.

2.2 What is required by regulators

Regulators in various jurisdictions have issued guidelines on the use of APMs in financial communication, outside the financial statements. The objective of these guidelines is to require, or encourage, entities to adopt good practices in the presentation of APMs. The requirements in the guidelines issued by different regulators may be summarised as follows:⁸

² IAS 1.49.

³ IAS 1.54 and IAS 1.82.

⁴ See IAS 1.55 for the statement of financial position, IAS 1.85 for the statement of profit or loss and other comprehensive income.

⁵ IAS 1.55A for the statement of financial position, IAS 1.85A and IAS.85B for the statement of profit or loss and other comprehensive income.

⁶ IAS 1.87, IAS 1.97 and IAS 1.98.

⁷ IAS 1.112(c) and IAS 34.15.

⁸ The summary of guidelines considers the *Statement On Non-GAAP Financial Measures* issued in June 2016 by the International Organisation of Securities Commissions (IOSCO) as the basis. There are other local regulators that have issued similar APM-guidelines, and as such, the high-level summary is not intended to represent a complete list of existing APM guidelines.

The presentation of APMs may be impacted by local regulations as there may be local restrictions on the presentation of APMs in the financial statements.

- ▶ *Unbiased*: APMs must be unbiased and must not, for example, be used to avoid presenting adverse information to the market.
- ▶ *Prominence*: APMs must not be presented with greater prominence than the most directly comparable measure calculated and presented in accordance with IFRS.
- ▶ *Comparatives and consistency*: APMs must be accompanied by comparative information for prior years presented in the financial reports. Their definition should not change year over year and their presentation should be consistent over all periods presented. However, if an APM's composition needs to be changed, an explanation of such change and the reason for making it should be provided. Also, a retrospective adjustment of this APM for prior periods should be made if those periods have been materially affected.
- ▶ *Labels*: In the context of APMs, labels refer to the headings or descriptions used to describe the APM. APMs must be labelled in a way that they are distinguished from IFRS measures. Labels must be meaningful and reflect the composition of the APM.
- ▶ *Definitions*: APMs must be clearly defined with an explanation of their basis of calculation.
- ▶ *Reconciliations*: APMs must be reconciled to the most directly comparable IFRS measure presented in the financial statements, with explanation of the adjustments made.
- ▶ *Explanations*: Entities must explain the reason for presenting the APMs, including an explanation of why the information is useful.
- ▶ *Locations*: In general, the guidelines apply to any APM that an entity discloses outside of the financial statements.
- ▶ *Assurance*: Guidelines issued by regulators addressed in this summary generally do not include any specific requirements with respect to assurance over APM measures.

In the recent European Securities and Markets Authority (ESMA) publication, *'Questions and Answers, Guidelines on APMS'* issued on 17 April 2020, ESMA acknowledges entities' potential decision to disclose new or adjusted APMs in order to communicate the impact of the coronavirus outbreak on their operations. The Q&A publication reminds readers of some of the requirements in the guidelines on APMs mentioned above, such as the 'definitions', 'consistency', 'unbiased', 'prominence' and 'explanations', and recommends the use of caution when adjusting existing APMs and/or when including new APMs directly related to the coronavirus.

ESMA reminds entities to "carefully assess whether the intended adjustments or new APMs would provide transparent and useful information to the market, improve comparability, reliability and/or comprehensibility of APMs and of the financial information disclosed to the market".⁹ ESMA also highlights that entities may fail to achieve this objective if the coronavirus impact is pervasive to their overall financial performance, financial position and/or cash flows. Instead, those entities are urged to provide improved disclosures and information explaining the current or expected impact of the coronavirus outbreak to their operations and performance, the level of uncertainty, the

⁹ See Question 18 in *Questions and answers - ESMA Guidelines on Alternative Performance Measures (APMs)* issued on 17 April 2020.

actions taken or to be taken as well as the impact on assumptions and estimates used in the determination of inputs to APMs (e.g., impairment losses, expected lease payment reductions or grants received).

The United States Securities and Exchange Commission (US SEC) staff, in its Disclosure Guidance: Topic No. 9, Coronavirus (COVID-19) provides some reminders to entities that elect to present non-GAAP measures, adjusted for the impact of the coronavirus outbreak. In particular, entities are reminded to highlight why they find that measure or metric useful, and how it helps investors assess the impact of the coronavirus outbreak on the entity's financial position and results of operations.¹⁰ Furthermore, the guidance provides an accommodation that allows the reconciliation of non-GAAP measures to provisional GAAP amounts, if entities have not yet completed the accounting measurements due to the effects of the coronavirus pandemic.

On application of the US SEC staff's guidance, we believe that entities may make adjustments in non-GAAP measures, but these adjustments should be generally limited to charges incurred or gains recognised that clearly relate to the coronavirus outbreak and are incremental to, and separable from, normal operations. However, non-GAAP measures that include estimates of lost revenue or adjustments to reflect what the performance or condition would have been without those effects are not appropriate.

How we see it

- ▶ The use of APMs in financial communication, either inside or outside financial statements, is pervasive and, therefore, the selection, presentation and composition of APMs can trigger actions from regulators. This point has been reinforced by ESMA and the US SEC in their recently issued guidelines mentioned above.

As with the requirement to include additional line items or subtotals, entities must apply judgement in considering which information in relation to APMs is relevant to an understanding of the financial statements.

3. Ways of reflecting the coronavirus impact on APMs and disclosures

There are various ways that an entity may elect to provide information on the impact of the coronavirus outbreak through APMs, additional line items and additional disclosures. For example, entities may decide to present additional line items or new APMs in their primary financial statements, disclose new or adjusted APMs in the notes to their financial statements or disclose quantitative estimates or qualitative explanations of the impact of the coronavirus outbreak in the notes without using APMs. Moreover, entities may elect to use new or adjusted APMs either inside or outside their financial statements or both.

Identifying appropriate APMs and the appropriate inputs to their calculations requires the application of judgement in order to determine what is relevant to an understanding of the financial statements. Profit measures are typically the most common, but measures based on balance sheet items and cash flows may also provide relevant information. For example, some entities are currently considering APMs based on items affected by a range of accounting measurements (e.g., items affected by asset impairments, including inventory,

¹⁰ US SEC staff Division of Corporation Finance Disclosure Guidance: Topic No. 9, Coronavirus (COVID-19).

goodwill, indefinite-lived intangible assets, etc.) in order to communicate the coronavirus outbreak impact.

Some of the coronavirus-related APMs, additional line items and additional disclosures that entities may be contemplating, could be summarised in the main categories listed below:

- ▶ 'Unabsorbed coronavirus costs': this measure relates to the split of cost of sales presented in the statement of profit or loss into more than one line item. That is, the cost of sales related to the unabsorbed costs attributable to the coronavirus outbreak are presented separately from the rest of cost of sales. If the aggregate of the separate line items of cost of sales is presented as a subtotal, this presentation format is merely about specifying components of a line item. However, if an income measure, such as operating income is presented "before unabsorbed costs", a separate APM is introduced. This measure may, in principle, help users understand the impact of the coronavirus outbreak on the cost of sales. However, entities may need to apply considerable judgement in identifying the unabsorbed coronavirus-related costs, and, thus, may run the risk of excluding recurring costs from their measure of profit and presenting an APM that is quite subjective and lacks comparability. In such a case, an APM will be in conflict with both the requirements of IFRS and certain regulators' guidelines applicable to APMs presented outside the financial statements.
- ▶ 'Incremental coronavirus costs': this measure relates to the presentation of a separate line item that includes all incremental costs incurred due to the coronavirus outbreak. We believe that such costs should be directly attributable to the coronavirus outbreak and should be both: a) incremental to costs incurred prior to the outbreak and not expected to recur once the crisis has subsided and operations return to normal; and b) clearly separable from normal operations. On one hand, for example, temporary premium payments to compensate employees for performing their normal duties at increased personal risk, charges for cleaning and disinfecting facilities more thoroughly and/or more frequently, termination fees or penalties from terminated contracts or compliance with contractual provisions invoked directly due to the events of the pandemic, may be both incrementally incurred as a result of the coronavirus outbreak and separable from normal operations. On the other hand, payments to employees when idle, rent and other recurring expenses (e.g., security, utilities, insurance and maintenance) related to temporarily idle facilities, excess capacity costs expensed in the period due to lower production, paying employees for increased hours required to perform their normal duties and paying more for routine inventory costs (e.g., shipping costs) will generally not be incremental and separable.

Determining what is incremental and what is not, may also require considerable judgement. Therefore, entities should carefully consider whether it is feasible to separate the incremental coronavirus costs without introducing undue subjectivity. For this reason, improved disclosures and information explaining the criteria used in the identification of such incremental costs would be crucial.

- ▶ 'Disaggregation of periods': this measure relates to disclosures that include disaggregated revenue and expense information for each month of the reporting period. The monthly analysis aims to indicate to users the months that were mostly affected by the coronavirus outbreak. It also aims to provide additional information to allow users of financial statements to compare IFRS-based historical information. If disaggregation of periods is

disclosed, the premise is that the entity has access to reliable information on such a disaggregated level, without having to make subjective assumptions that would make the disclosure unreliable and potentially misleading.

- ▶ 'Detailed coronavirus disclosures': entities provide separate disclosure in the notes to the financial statements, or elsewhere, with detailed analysis of the impact of the coronavirus outbreak on their financial position, performance and cash flows. Such disclosures may also include sensitivity analysis on uncertain estimates, as well as management information about measures taken to address the disruption in their operations. In contrast to presenting coronavirus-related APMs in the primary financial statements, this approach may be the less controversial way of identifying coronavirus impacts, as there is a lesser risk of introducing misleading information.
- ▶ 'As if measures': APMs that are 'as if measures' would not be appropriate to communicate the impact of the coronavirus outbreak. These measures relate to adjustments made to APMs in order to normalise operations, such as including estimates of lost revenue to show what results would have been without the effects of the coronavirus outbreak.

How we see it

- ▶ Entities should carefully consider the challenge of not being able to reflect the full effect of the pandemic when contemplating to introduce measures such as 'Unabsorbed coronavirus costs' and 'Incremental coronavirus costs', as well as the risk of including costs not impacted by the pandemic.
- ▶ Entities must carefully consider the requirements in IAS 1, if they are considering introducing coronavirus-related APMs (e.g., the minimum line item requirements (paragraphs 54 and 82 of IAS 1), the use of additional line items when such presentation is relevant to the understanding of an entity's financial position and performance (paragraphs 55 and 85 of IAS 1). Depending on specific facts and circumstances, disaggregating the minimum required line items into additional line items may be acceptable, as long as they aggregate into a single subtotal-line, that would have otherwise been presented had the coronavirus outbreak not occurred.
- ▶ In the current environment, the presentation of additional line items should be accompanied by sufficient disclosures defining them, explaining their composition and providing information that improves their relevance. However, the comparability of coronavirus-related APMs among entities will be a major challenge without a universally-accepted way to objectively structure them. Depending on their specific facts and circumstances, entities may find it less controversial to provide a separate disclosure explaining the impact of the coronavirus, rather than introducing a new APM or adjusting their APMs.

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