KNF | KOMISJA NADZORU FINANSOWEGO

ENFORCEMENT OF THE FINANCIAL REPORTING OF SECURITIES ISSUERS CARRIED OUT IN 2018

POLISH FINANCIAL SUPERVISION AUTHORITY OFFICE

WARSAW, FEBRUARY 2019

PUBLIC COMPANIES DEPARTMENT, THE ACCOUNTING UNIT

KEYWORDS: FINANCIAL STATEMENTS, SECURITY ISSUERS, IFRS, INFORMATION REQUIREMENTS, AUDIT FIRMS, QUALIFICATIONS, ENFORCEMENT ACTIVITIES

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1. INTRODUCTION

1.1. Purpose of the report

This report summarises the activities carried out by the Accounting Unit of the Public Companies Department (DSP/WR) of the Polish Financial Supervision Authority Office (UKNF) in 2018 in the area of enforcement of financial reporting of issuers of securities admitted to trading on a regulated market other than investment funds. Our enforcement activities include the examination of financial statements[1] of selected issuers for their compliance with applicable regulations on financial reporting, in particular IFRS requirements[2], and the adoption of appropriate measures to remove any breach of information requirements.

We have drawn up and published this report on the KNF website in order to provide users of financial statements, issuers and auditors with the results of the periodic review of issuers' financial statements carried out by the DSP/WR, including irregularities identified in the areas of application of accounting policies, and disclosure of information. This should facilitate consistent application of appropriate financial reporting framework and help issuers improve their level of compliance with reporting requirements.

It should be emphasised that provisions on information requirements, including financial reporting, are a part of regulations aimed at safeguarding one of the fundamental principles of the capital market, i.e. the principle of transparency of markets. High-quality transparent financial information is useful to investors and other users of financial statements in their decision-making process. Such information facilitates the assessment of the economic and financial condition, performance and achievements of issuers and their groups of companies, thus increasing investor confidence in financial reporting. Whereas improper performance of information obligations results in a lack of universal and equal access to complete and accurate information, which is of key importance to proper operation of market forces. The lack of transparency of information undermines investor confidence in markets.

Please also note that reports presenting summaries of the review of financial statements of securities issuers other than investment firms for their compliance with applicable regulations on financial reporting, drawn up in the years 2010–2018, are available on KNF website[3], in the 'Publications and reports' section.

1.2. Legal basis for the enforcement of issuers' financial reporting

Below please find the laws and regulations which serve as a basis for our enforcement of issuers' financial reporting.

Under Article 7(1) point 2 of the Act on capital market supervision[4], the KNF is responsible

[1] The term 'financial statements' used in this report includes both separate financial statements and consolidated financial statements.
[2] International Accounting Standards, International Financial Reporting Standards and related interpretations published as European Commission Regulations
[3] https://www.knf.gov.pl
[4] Act of 29 July 2005 on capital market supervision (consolidated text in: Journal of Laws 2017, item 1480, as amended)

for supervising the operations of supervised entities and their compliance with requirements relating to their participation in trading in the capital market, to the extent specified in the legislation.

The Transparency Directive[5] stipulates that a supervisory authority shall be entitled, among other things, to examine whether information referred to in the Directive has been drafted in accordance with appropriate reporting framework, and to adopt appropriate measures if any irregularity is found.

Under recital 16 of the preamble to Regulation 1606/2002[6], Member States are required to take appropriate measures to ensure compliance with international accounting standards.

As part of our supervision, we also take into account regulations issued by the European Securities and Markets Authority (ESMA). In 2014, ESMA guidelines on enforcement entered into force[7]. The document contains guidelines addressed to competent supervisory authorities, issued under the Regulation establishing ESMA[8]. According to the provisions thereof, competent authorities shall make every effort to comply with those guidelines. ESMA guidelines on enforcement state that the objective of enforcement of financial information is to contribute to a consistent application of the financial reporting framework and, thereby, to the transparency of financial information relevant to the decision making process of investors and other users which is subject to publication under the Transparency Directive. As per the Guidelines, the enforcement of financial information includes examination of compliance of financial information with the financial reporting framework, taking appropriate measures where infringements are discovered during the enforcement process, in accordance with the regulations implementing the Transparency Directive, and taking other measures relevant for the purpose of enforcement.

2. PRINCIPLES AND SUBJECT-MATTER OF THE PERIODIC REVIEW

We have reviewed the compliance of issuers' financial reporting with appropriate regulations on reporting, considering Guidelines 5 and 6 of ESMA Guidelines on enforcement, which state that the enforcement should be based on selection, using a mixed model whereby a risk based approach is combined with a sampling and/or a rotation approach, and that as part of its measures, the enforcer may use unlimited scope examination or a combination of unlimited scope and focused examinations. The periodic review comprises both the examination of selected financial statements and review on request, in particular where another organisational unit of the KNF requests an opinion in the course of the ongoing procedure.

[5] Directive 2004/109/EC of the European Parliament and of the Council of 15 December 2004 on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market and amending Directive 2001/34/EC (OJ L 390 of 31.12.2004, p. 38), as amended

[6] Regulation (EC) No 1606/2002 of the European Parliament and of the Council of 19 July 2002 on the application of international accounting standards (OJ L 243, 11.9.2002, p. 1; OJ, Polish Special Edition, Chapter 13, Vol. 29, p. 609), as amended

[7] ESMA Guidelines on enforcement of financial information(ESMA/2014/1293en, 28 October 2014 at: https://https://www.esma.europa.eu/sites/default/files/library/2015/11/2014-esma-1293en.pdf)

[8] Regulation (EU) No 1095/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Securities and Markets Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/77/EC (OJ L 331, 15.12.2010, p. 8), as amended

In 2018, we reviewed annual financial statements for the financial year 2017 and semi-annual financial statements for periods of the financial year 2018, prepared by securities issuers other than investment funds, for their compliance with applicable regulations on financial reporting, in particular IFRS requirements.

When selecting issuers' financial statements for the periodic review in 2018, we maintained, as in previous years, a high priority of the criterion of: occurrence of qualifications in audit reports on financial statements, disclaimers of opinion or adverse opinions. We also considered the occurrence of qualifications in auditor's reports on the review of half-yearly financial statements, disclaimers of report , or negative conclusions.

Therefore, on many occasions we have also reviewed financial statements of issuers whose ability to continue as a going concern was threatened or who have ceased to continue as a going concern. This applied mainly to the issuers who applied, or against whom another person applied, for the restructuring or bankruptcy, as well as the issuers for whom auditor reports on audit or review of financial statements included qualifications or disclaimer of opinion / report resulting from threats to the ability to continue as a going concern.

As part of the evaluation of compliance of issuers' financial statements with applicable regulations on financial reporting, we have taken into account the European Common Enforcement Priorities, defined by ESMA to improve the transparency and proper and consistent application of IFRSs. The topics covered by the European Common Enforcement Priorities relating to financial statements for 2017 included[9]:

- disclosure of the expected impact of implementation of major new standards in the period of their initial application (i.e. IFRS 9 *Financial Instruments,* IFRS 15 *Revenue from Contracts with Customers*, and IFRS 16 *Leases*),
- specific recognition, measurement and disclosure issues of IFRS 3 *Business Combinations,*
- specific issues of IAS 7 *Statement of Cash Flows.*

It should be noted that following the publication by ESMA of the European common enforcement priorities with regard to financial statements for 2018[10], this year's examination will cover, in particular:

- specific issues related to the application of IFRS 15 *Revenue from Contracts with Customers*;
- specific issues related to the application of IFRS 9 *Financial Instruments*; and
- disclosure on the expected impact of implementation of IFRS 16 *Leases.*

Please be informed that ESMA public statements defining European common enforcement priorities with regard to financial statements for specific years are available, together with the Polish translation, on the KNF website[11] (Dla rynku > Regulacje i praktyka > Dokumenty ESMA).

[9] ESMA Public Statement on European common enforcement priorities for 2017 IFRS financial statements (ESMA32-63-340)

[10] ESMA Public Statement on European common enforcement priorities for 2018 IFRS financial statements (ESMA32-63-503)

[11] https://www.knf.gov.pl

3. BASIC FIGURES REGARDING THE REVIEW

In the course of the review of financial statements for their compliance with the financial reporting regulations applicable to issuers, particularly with IFRS requirements, in 2018 we reviewed the financial statements of 96 issuers (for comparison, in 2017 the financial statements of 103 issuers were reviewed and in 2016 of 112 issuers). Unlike in previous years, the number does not include the review of historical financial information of issuers making an initial public offer (10 issuers in 2018).

Table 1. Number of issuers whose financial statements were subject to periodic review in 2016–2018

Year	Number of regulated-market issuers (Warsaw Stock Exchange and BondSpot)* at the year-end	Number of issuers whose financial statements were reviewed	Share in the total number of regulated-market issuers*
2018	441	96	21.8 %
2017	456	103	22.6 %
2016	456	112	24.6 %

* The number does not include closed-end investment funds listed on the regulated market or issuers for whom the Republic of Poland is a host state.

Figure 1. Number of issuers whose annual financial statements / interim financial statements were subject to periodic review in 2016-2018

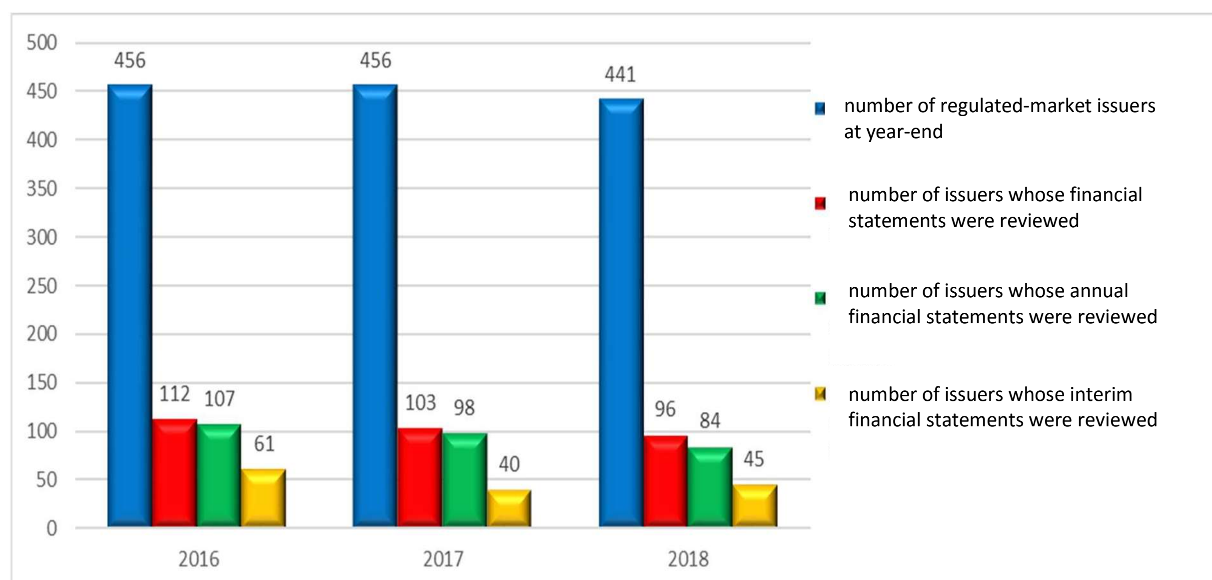


Table 2. Number of issuers whose financial statements were subject to periodic review in 2018, broken down by type of examination

Type of examination	Number of issuers
Unlimited examination	35
Focused examination	42
Follow-up examination	19
Total	**96**

Commentary:
Unlimited scope examination *– examination of the entire financial statements with the goal of identifying any deficiencies or mistakes.*
Focused examination *– examination limited to a scope concerning specific issues, the application of some IFRSs (e.g.*

examination of select items or fragments of the financial statements).
Follow-up examination *– verification of subsequent financial statements exclusively for the necessary improvements and developments, particularly when recommendations were submitted to the issuer. The figure reflects cases where the verification was positive and there was no need for deeper analysis.*

197 sets of financial statements (including consolidated statements) were examined in 2018 in the course of enforcement of issuers' financial reporting.

4. ENFORCEMENT ACTIVIES RELATED TO ENSURING COMPLIANCE OF FINANCIAL STATEMENTS WITH THE FINANCIAL REPORTING FRAMEWORK

As mentioned above, our enforcement activities include the examination of financial statements of selected issuers for their compliance with applicable regulations on financial reporting, in particular IFRS requirements, and the adoption of appropriate measures to remove any breach of information requirements.

As a result of the examination of financial statements, in justified cases, there may arise the need to obtain further clarification due to doubts as to the correctness of the financial statements examined. In such cases, pursuant to Article 68(1) of the Act on public offering[12], the KNF or its authorised representative may request that issuers (management boards and supervisory boards, accordingly) immediately provide information and explanations to enable the supervision of their compliance with information requirements. In justified cases, questions are also asked of the audit firm which audited / reviewed the financial statements (Article 68(2) of the said Act).

As of mid-2016, the KNF gained new supervisory powers. Pursuant to Article 68(5) of the Act on public offering, the KNF or its authorised representative may issue recommendations for an issuer to put an end to any breach of information requirements. The purpose of a recommendation is to allow the issuer to eliminate such non-compliance as soon as possible by amending the relevant financial statements, and to ensure that the users of financial statements have access to fair and complete information. The implementation of recommendations is monitored. 21 recommendations were issued in respect of 21 issuers in

[12] Act of 29 July 2005 on public offering and conditions governing the introduction of financial instruments to organised trading, and public companies (consolidated text: Journal of Laws 2018, item 512, as amended)

2018; in most cases the recommendations addressed irregularities in more than one area. Chapter 6 of this Report lists the topics that we have addressed in the 2018 recommendations.

It should be noted that if an issuer needs to amend their periodic report due to its defects, including non-compliance with IFRSs, the correction procedure is specified in the Regulation on current and periodic information[13]. Under § 15(4) and (5) of the Regulation, where it is necessary to amend an interim report, the issuer must make public both the current report containing information on the subject-matter and nature of the amendment, and the amended periodic report for the period to which the amendment applies. Whereas in the case of an amendment to the financial statements which have already been approved by the approval body, the issuer must only make public the current report containing information on the subject-matter and nature of the amendment.

In justified cases, an appropriate organisational unit of the KNF is notified to initiate administrative proceedings in respect of an alleged breach of laws on financial reporting. Under Article 96(1e) of the Act on public offering, the KNF may decide to impose a fine (of up to PLN 5 000 000 or up to 5% of the total annual turnover as per the last audited annual financial statements for the financial year, provided that it does not exceed PLN 5 000 000), or exclude the issuer's securities from trading on the regulated market, or apply both of those sanctions jointly. When making such decision, the KNF may also, under Article 96(3) of the Act on public offering, require the issuer to publish the necessary information in two nationwide daily newspapers, or to make the information public in another way, or to amend the financial statements already made public.

Following the review of historical financial information of entities seeking approval of their prospectus, the issuers receive comments and are requested to provide explanations or to amend financial information in the prospectus.

We also carry out educational activities. The main outcome of such activities is this Report, published at the beginning of each year; this year for the eleventh time. Some topics of this Report are also presented at the seminar for financial market participants, organised each year by the KNF under the CEDUR project (Education Centre for Market Participants).

5. RESPONSIBILITY OF MANAGEMENT AND SUPERVISORY BOARDS AND THE ROLE OF AUDIT COMMITTEES IN THE AREA OF FINANCIAL REPORTING

We would like to draw attention to the management and supervisory boards' responsibility for ensuring that the financial statements and the management reports on operations meet the legal requirements.

Under Article 4a of the Accounting Act[14], the manager of an entity and members of the supervisory board or another supervisory body are required to ensure that the financial

[13] Regulation of the Minister of Finance of 29 March 2018 on current and periodic information provided by security issuers and on conditions under which information required by the legislation of a non-Member State may be recognised as equivalent (Journal of Laws 2018, item 757)

[14] The Accounting Act of 29 September 1994 (consolidated text: Journal of Laws 2018, item 395, as amended)

statements, consolidated financial statements, the report on operations and the report on the group's operations meet the requirements of that Act (in consequence, also the requirements of IFRSs).

In the case of failure to draw up financial statements, non-compliance with applicable provisions, or unfair information in the financial statements, those persons are liable to a fine, imprisonment for up to 2 years or both penalties jointly (Article 77 point 2 of the Accounting Act).

Likewise, the Act on public offering provides for sanctions for members of management and supervisory boards for non-compliance with reporting requirements. According to Article 96(6) point 2 of the said Act, in the case of non-compliance with the legal requirements regarding periodic reports, the KNF may order a member of a listed company's management board to pay a fine of up to PLN 1 000 000. According to Article 96(6a) point 2 of the said Act, in the case of a serious breach of reporting requirements, a member of supervisory board may be order to pay a fine of up to PLN 100 000. Additionally, Article 100 of that Act establishes criminal liability of persons responsible for providing false data or concealing true data in periodic information that is made public.

Audit committees also play an important role in ensuring high quality of financial statements. The requirement to establish audit committees at Public-Interest Entities[15] (PIEs) in Poland dates back to 2009. However, their role and responsibilities have been significantly enhanced in the Act on statutory auditors[16], implementing Directive 2014/56/EU of 16 April 2014 amending Directive 2006/43/EC on statutory audits of annual accounts and consolidated accounts, and in Regulation on the statutory audit of PIEs[17]. In accordance with the above-mentioned Act, an audit committee consists of at least three members, at least one of whom has the knowledge and skills in the area of accounting or auditing of financial statements. The audit committee members are also required to have the knowledge and skills relevant to the industry in which the PIE operates. The majority of the audit committee members, including the chairman, must be independent of the PIE (independence requirements are defined in statutory law). At minor PIEs, the functions of an audit committee may be entrusted to the supervisory board or any other supervisory body. Audit committees are primarily tasked with monitoring the financial reporting and statutory audit processes, monitoring the quality control and risk management systems and its internal audit, as well as reviewing and monitoring the independence of the statutory auditor and the audit firm.

[15] Public-interest entities are also understood as issuers of securities admitted to trading on a regulated market of a European Union Member State, with their registered office in the territory of the Republic of Poland, whose financial statements are subject to a statutory audit requirement

[16] Act of 11 May 2017 on statutory auditors, audit firms and public oversight (Journal of Laws, item 1089, as amended)

[17] Regulation (EU) No 537/2014 of the European Parliament and of the Council of 16 April 2014 on specific requirements regarding statutory audit of public-interest entities and repealing Commission Decision 2005/909/EC (OJ L 158, 27.5.2014, p. 77)

6. MODIFICATIONS OF OPINIONS AND CONCLUSIONS IN AUDIT REPORTS AND REVIEW REPORTS ISSUED BY AUDIT FIRMS

As regards financial statements for financial year 2017, we noticed a decrease in the total number of issuers whose audit reports contain qualifications or disclaimers of opinion, compared to the previous year. However, in 1 case an adverse opinion was issued. For periodic interim reports, we would like to highlight the decreasing percentage of issuers with qualified reports on review or disclaimers of opinion in the report on the review of their 2018 half-yearly financial statements, compared to the previous year. In this case, the number of issuers with qualified reports on review has increased (from 16 to 21 issuers) and the number of disclaimers of opinion in the report on review remained at the same level as in the previous year (7 issuers). There was 1 case of an issuer whose report contained a negative conclusion.

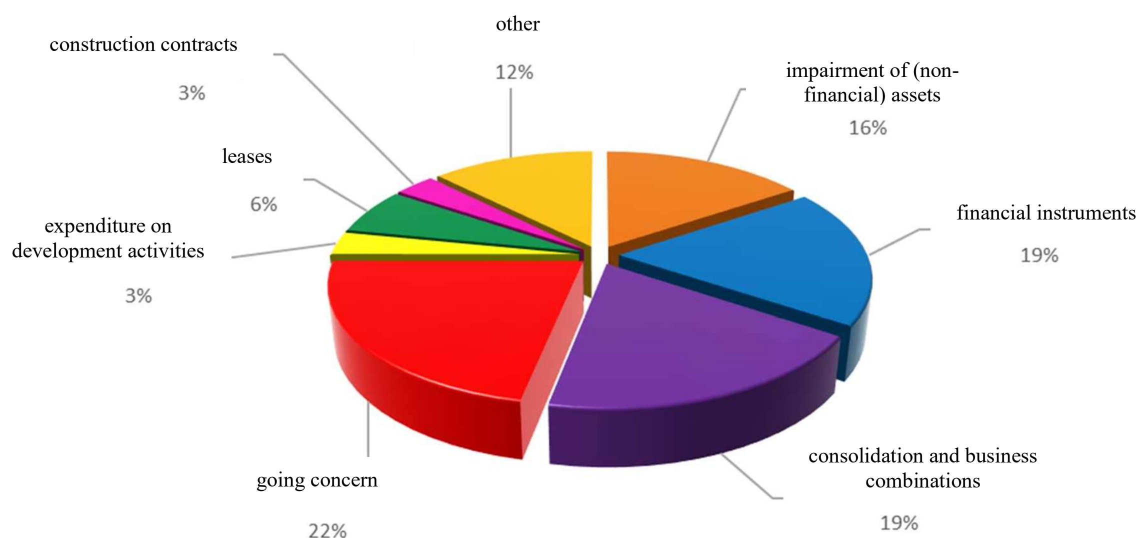
The qualifications in the audit reports on 2017 financial statements and in the reports on the review of 2018 half-yearly financial statements, and disclaimers of opinion/conclusion were most common among issuers in the following sectors: IT systems, construction, investments, transport, and other.

Table 3. Number of issuers with qualifications or disclaimers of opinion concerning their annual financial statements for the years 2015-2017

Number of issuers	2015	2016	2017
Qualified opinions	29	22	20
Disclaimers of opinion	8	11	10
Negative opinions	0	0	1
TOTAL	**37**	**33**	**31**
Number of issuers at year-end*	455	456	456
Share in the number of issuers at year-end	**8%**	**7%**	**7%**

* The number does not include closed-end investment funds listed on the regulated market or issuers for whom the Republic of Poland is a host state

Figure 2. Topics of qualifications in audit reports on 2017 financial statements



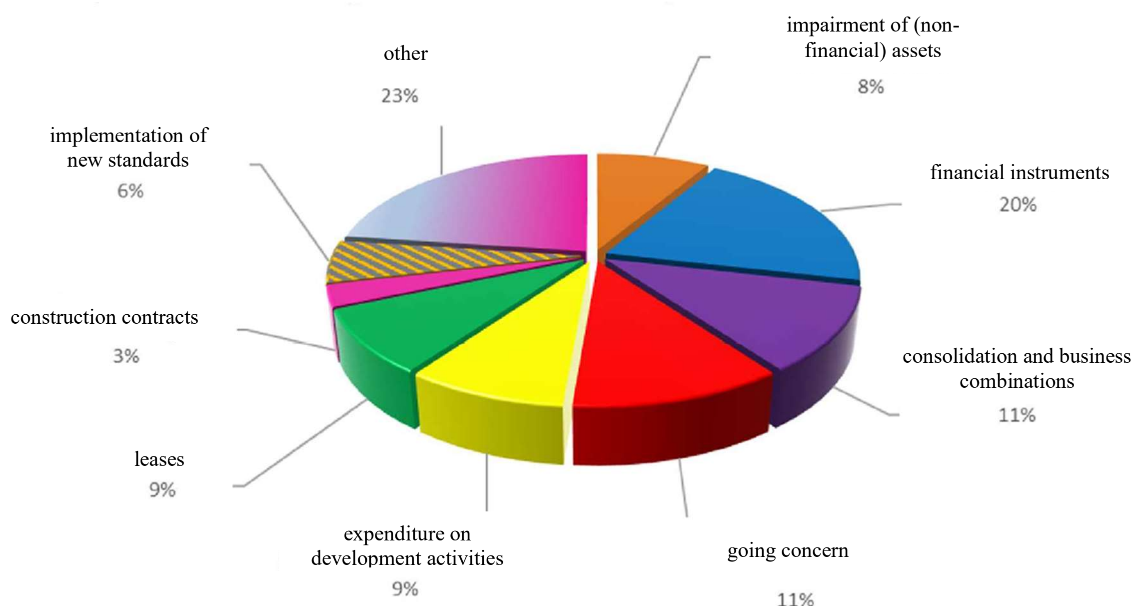
Commentary: If a qualification occurs both in the audit report on the consolidated financial statements and in the audit report on the financial statements of an issuer, the figure reflects such a qualification only once. The figure does not take into account audit reports with disclaimers of opinion. The percentage share depends on the frequency of occurrence of an issue in qualifications, whereas in the following description of issues raised in the qualifications, individual topics are presented only once.

Table 4. Number of issuers with qualifications or disclaimers of conclusions in the report on the review of their half-yearly financial statements in the years 2016–2018

Number of issuers	**First half of 2016**	**First half of 2017**	**First half of 2018**
Qualified reports	24	16	21
Disclaimer of conclusion	7	7	7
Adverse opinions	0	0	1
TOTAL	**31**	**23**	**29**
Number of issuers at the end of the previous financial year*	455	456	456
Share in the number of issuers at the end of the previous financial year	**7%**	**5%**	**6%**

* The number does not include closed-end investment funds listed on the regulated market or issuers for whom the Republic of Poland is a host state

Figure 3. Topics of qualifications in the reports on review of issuer's 2018 half-yearly financial statements



Commentary: If a qualification occurs both in the report on the review of the consolidated financial statements and in report on the review of the financial statements of an issuer, the figure reflects such a qualification only once. The figure does not take into account reports on review with disclaimers of conclusions. The percentage share depends on the frequency of occurrence of an issue in qualifications, whereas in the following description of issues raised in the qualifications, individual topics are presented only once.

The analysis of the topics in qualifications and disclaimers shows that the issues arise in these areas in several consecutive periods. The most common issues include: going concern, financial instruments (including impairment), and the impairment of non-financial assets. It should be noted that those topics are strongly interconnected, as the threats or uncertainties regarding the ability to continue as a going concern cause an increase in the risks associated with financial instruments, and affect the value of the entity's financial and non-financial assets, usually resulting in their impairment. On the other hand, the impairment of significant assets or e.g. an increase in liquidity risk give rise to threats to the entity's ability to continue as a going concern. The link with going concern occurs also in relation to deferred tax assets, which is also featured in qualifications and disclaimers, as in previous years.

To ensure that issuers pay special attention to the need to comply with the applicable financial reporting framework, in particular the IFRS requirements, please find below the issues raised in the qualifications / disclaimers of opinion contained in the audit reports on the issuers' 2017 financial statements, as well as qualifications / disclaimers of conclusion contained in the reports on the review of 2018 half-yearly financial statements. For convenience of reference, those issues have been grouped by topic.

DISCLAIMERS OF OPINION / CONCLUSION AND ADVERSE OPINIONS / CONCLUSIONS

Audit reports containing a disclaimer of opinion or reports on review containing a disclaimer of conclusion were issued due to threats to the issuers' ability to continue as a going concern.

Selected circumstances cited by statutory auditors in such reports are presented below.

- auditor's inability to assess whether the going concern assumption is appropriate;
- no approved restructuring plan was made available;
- auditor's inability to obtain sufficient appropriate audit evidence regarding the significant assumptions underlying the valuation of portfolios of receivables;
- auditor's inability to obtain sufficient appropriate audit evidence regarding liabilities arising from cooperation agreements with certain investment fund management companies;
- auditor's inability to obtain statements from former members of management board and to assess the effect on the financial statements;
- disclosures on liquidity risk and financial difficulties do not reflect those issues and fail to comply with the requirements of IFRS 7 *Financial Instruments: Disclosures*;
- non-compliance with IFRSs at least with regard to the composition of the group, as the parent's condensed consolidated half-yearly financial statements (as at 30 June 2018, and for comparative information as at 31 December 2017) and the consolidated financial statements (as at 31 December 2017, and for comparative information as at 31 December 2016) do not take into account those subsidiaries in the group the control over which was lost; the reason given for this was the absence of management and supervisory bodies of those entities due to the resignation of their members, which, according to IFRS 10 *Consolidated Financial Statements*, is not a reason to conclude that the company has lost control over those entities; the auditor was unable to determine the total impact of exclusion of the subsidiaries from consolidation on the elements of the condensed consolidated half-yearly financial statements;
- auditor's inability to assess the correctness of measurement of investments in joint-ventures;
- uncertainty as to the outcome of a dispute regarding performance of one of construction contracts;
- failure to adjust the provisional amounts of the acquisition price, leading to the auditor's inability to form an opinion on the presented goodwill following take-over of a subsidiary, and on the correctness of the recognised impairment loss on goodwill of that subsidiary;
- auditor's inability to assess the correctness of measurement and presentation of a long-term loan;
- auditor's inability to assess the correctness of reducing the profit/loss by a write-down of investment in a subsidiary;
- issuer's failure to settle liabilities arising from bankruptcy proceedings;
- insufficient audit evidence concerning short-term liabilities;
- insufficient audit evidence concerning measurement of loans and liabilities on bonds, preventing the auditor from assessing whether the evidence is complete and accurate;

- auditor's inability to confirm the possibility of executing the restructuring plan, and to obtain reasonable assurance about whether the issuer will be able to restructure their debt and continue as a going concern in the foreseeable future;
- failure, by the entity manager (receiver), to sign the financial statements under review and statements of the management;
- failure to make available to the auditor the accounting books and documents of a subsidiary in bankruptcy;
- failure to include subsidiaries in the audit;
- no access to documents which could render credible the other receivables disclosed;
- high level of short-term liabilities, including bank loans due and payable, indicating a threat to the ability to continue as a going concern;
- uncertainty regarding pending tax proceedings and tax audits relating to the correctness of VAT payments to which the parent is a party – should the outcome be unfavourable, payment may be required and there is uncertainty whether the company will be able to settle it;
- lack of operating activities, a worsening financial position; negative equity – a threat to continuing as a going concern.

The adverse opinion in the audit report and the adverse conclusion in the report on review were issued as the financial statements failed to give a clear and fair view of all the material aspects, financial position and performance of the company as at the reporting date. The issues raised in the above-mentioned adverse opinion/conclusion include:

- failure to recognise a provision for an expected loss arising from endorsement of bills;
- failure to provide the auditor with information about enforcement proceedings, information on whether the amounts of liabilities subject to enforcement (if any) are included in the company's books, and information on the full history of the company's bank accounts;
- lack of evidence to confirm the actual implementation and application of the new standards IFRS 9 *Financial Instruments* and IFRS 15 *Revenue from Contracts with Customers*.

QUALIFICATIONS

The qualifications in audit reports and reports on review addressed, *inter alia*, the following issues:

Qualifications concerning impairment (non-financial) assets

- failure to conduct impairment tests for fixed assets despite the existence of indications of impairment;
- auditor's inability to assess to what extent a subsidiary will receive the future profits which provided the basis for the tests aimed at confirming the values presented in the assets of investments in subsidiaries;

- auditor's inability to assess the correctness of the amount of impairment loss recognised on fixed assets as an adjustment of the opening balance sheet and the effect of reversal of the impairment loss on the profit/loss;
- adoption of partly different assumptions than the subsidiary when estimating the recoverable amount of assets of the subsidiary, resulting in an overstated value of such assets and overstated fair value of shares held in that subsidiary;
- adoption of partly different assumptions than the subsidiary when estimating the recoverable amount of assets of the subsidiary and when performing the impairment test of the subsidiary' goodwill, resulting in an overstated recoverable amount of the goodwill tested and value of the assets in question;
- lack of audit evidence to confirm the correctness of the carrying amount of a trademark;
- failure to take into account capital expenditure in the impairment test of an intangible asset;
- lack of audit evidence to confirm the correctness of assumptions adopted for the impairment test of goodwill.

Qualifications concerning financial instruments

- failure to recognise impairment losses on receivables for which there are indications of impairment;
- auditor's inability to confirm the value of bonds held, due to the lack of information on the financial standing of debtors;
- lack of audit evidence on the correctness of the amount of receivables arising from the sale of shares and from the assignment of receivables;
- auditor's inability to confirm the recoverability of receivables on bonds from the parent and to assess its effect on the financial statements;
- auditor's inability to confirm the recoverability of receivables due to the lack of information on the counterparty's financial standing and a remote date for repayment;
- lack of audit evidence to confirm the execution of the assignment of claims or to confirm the granting of the loan;
- no reclassification of the liability as current in the case of breaching certain provisions of a loan arrangement.

Qualifications concerning consolidation and business combinations

- application of the acquisition method as of the date of legal combination of an organised part of an enterprise where, in the opinion of the auditor, the issuer controlled the organised part of the enterprise at least from the date of the final contract, which provided for an obligation to sell to the issuer 100% of the enterprise from which the organised part of the enterprise was spun off;
- failure to meet the requirement under Article 44c of the Accounting Act in respect of presentation of comparative information for the previous financial year with regard to

the business combination;

- failure to complete the obligatory review of subsidiaries;
- lack of opinion on the review of the financial statements of subsidiaries;
- failure to review the financial statements of certain subsidiaries;
- failure to present complete consolidation documents for review;
- no confirmation from the auditor on the data of the subsidiary and the associate included in the consolidated financial statements.

Qualifications concerning threats to the ability to continue as a going concern

- material threat to the ability to continue as a going concern due to pending remedial proceedings;
- the company's continuing operations are dependent on the approval of an arrangement with creditors and on the ability to generate surplus cash in order to settle the arrangement liabilities;
- uncertainty as to the company's liabilities arising from objections to the list of claims;
- high level of short-term liabilities, including bank loans due and payable, indicating a threat to the ability to continue as a going concern;
- material risk to the company's ability to continue as a going concern within 12 months of the balance sheet date due to the losses incurred, negative equity and liquidity risk associated with bond redemption in 2018;
- lack of decision on the examination of issuer's application for remedial proceedings;
- failure to provide an exhaustive description of threats to the ability to continue as a going concern in the explanatory note;
- where a planned share issue or merger with an industry entity has not been effected, there may be a substantial threat to the ability to continue as a going concern as well as liquidity risk.

Qualifications concerning development costs

- lack of audit evidence on the correctness of recognition of completed development as intangible assets;
- lack of audit evidence to confirm the method of separating the development phase from the research phase;
- capitalisation of development costs as intangible assets without meeting the requirements laid down in paragraph 57 of IAS 38 *Intangible Assets*;
- it is not possible to establish whether the company will be able to secure future economic benefits following completed development.

Qualifications concerning leases

- in the balance sheet the entity recognised the rights to perpetual usufruct of land, which were obtained free of charge, as property, plant and equipment, investment properties or assets classified as held for sale and not as off-balance-sheet items, as operating

lease under IAS 17 *Leases*;

- recognition of rights to perpetual usufruct of land, which were obtained free of charge, as fixed assets instead as operating leases under IAS 17;
- recognition of excess revenue from the sale of an asset leased back over its carrying amount as revenue from sale following early termination of the agreement with the previous lessor and conclusion of a leaseback agreement with another lessor, without reflecting the purpose of the transactions.

Qualifications concerning construction contracts

- in previous periods, the recognition of claims against customers as revenue, even though the negotiations or legal proceedings have not reached an advanced stage yet;
- failure to update the settlements under a construction contract in the financial statements.

Qualifications concerning implementation of the new standards (IFRS 9 and IFRS 15)

- failure to update the accounting policy with regard to IFRS 15;
- lack of sufficient evidence to confirm the actual implementation and application of the updated standards, in particular IFRS 9 (the implementation of IFRS 9 would involve changes in the measurement of important financial assets and financial liabilities).

Other issues raised in the qualifications

- provisions are not presented by: post-employment benefit, jubilee award, leave not taken, and repair under warranty.
- failure to identify all performance obligations in the contract and incorrect allocation of the transaction price (IFRS 15);
- auditor's inability to assess whether any adjustment to assets or liabilities was necessary due to the disclosure of financial data of a subsidiary which was declared bankrupt as discontinued operations;
- failure to restate comparative information in accordance with paragraph 34 of IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations* when disclosing operations of a subsidiary as discontinued operations;
- lack of possibility of ascertaining, verifying and confirming the economic substance of two transactions: acquisition of tokens by an issuer from a related company and take-up of the issuer's shares by that related company (operations in those transactions occurred alternately and took place on the same day, in a similar amount);
- lack of valuation update on investment property and, in consequence, auditor's inability to confirm its correctness;
- lack of evidence of correct recognition of profit on the sale of trade receivables portfolio in the statement of comprehensive income;
- measurement of shares in consolidated subsidiaries at fair value rather than at cost in accordance with IAS 27 *Separate Financial Statements*;

- lack of estimation of the recoverable amount of shares in an associate despite an indication of impairment;
- lack of audit evidence to confirm the measurement of shares in subsidiaries.

7. RECOMMENDATIONS ISSUED AS A RESULT OF THE REVIEW OF THE FINANCIAL STATEMENTS

As indicated in Chapter 4 hereof, pursuant to Article 68(5) of the Act on public offering, the KNF or its authorised representative may issue recommendations towards an issuer, to put an end to any breach of information requirements. Corrected financial statements or subsequent financial statements of issuers who received such communication are reviewed for compliance with the recommendations. Failure to comply with the recommendations or any doubt as to their implementation may result in the need to demand an issuer to provide explanations and the need to conduct proceedings for an imposition of administrative sanctions, in accordance with the Act on public offering.

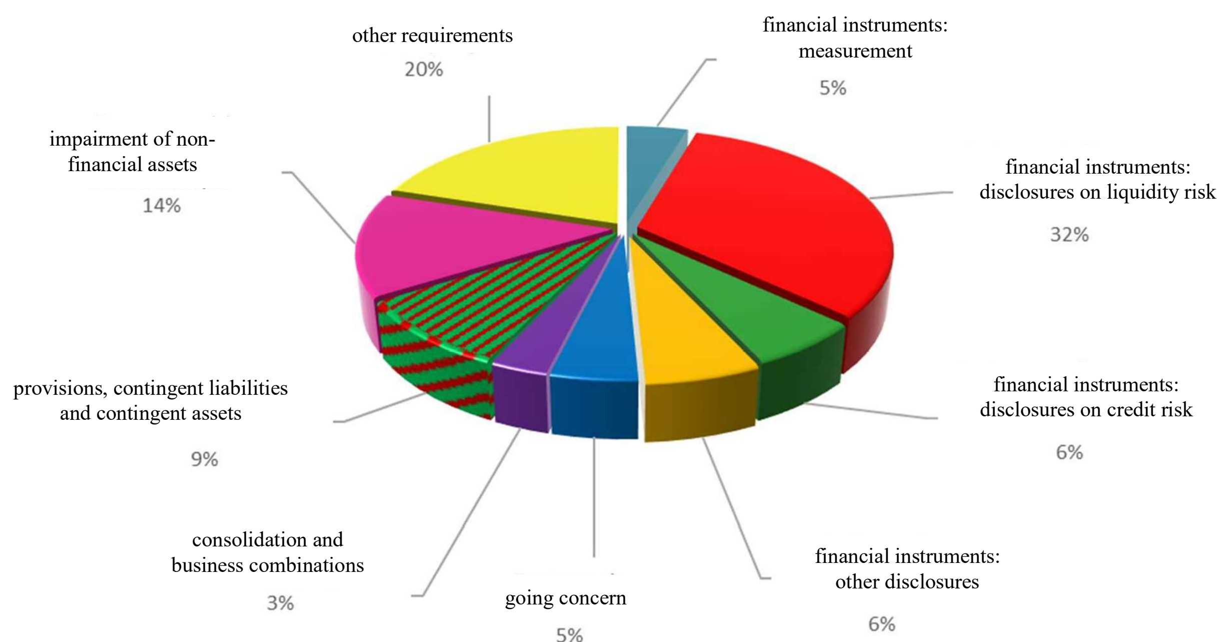
The recommendations issued in 2018 applied to both annual and interim financial statements. The most common recommendations concerning interim financial statements were the highlighting of the obligation to disclose updates on information and data indicated in the recommendation, according to the requirement to include in the interim financial statements an explanation of events which are significant to proper understanding of the financial position and performance of the entity since the end of the last annual reporting period (an update of information in the most recent annual financial statements) (paragraph 15 of IAS 34 *Interim financial reporting*). We would also like to point to the provisions of paragraphs 10, 15B, 15C and 28 of IAS 34, which should be taken into account when drawing up interim financial statements.

It should be noted that each time the issuer should analyse whether applying the recommendations gives rise to inside information within the meaning of the Market Abuse Regulation[18]. If a piece of inside information arises, it should be made public in accordance with Article 17 of the Market Abuse Regulation.

In 2018, recommendations for 21 issuers were issued. Below please find more details on the topics of the most important and common recommendations issued in 2018.

[18] Regulation (EU) No 596/2014 of the European Parliament and of the Council of 16 April 2014 on market abuse (market abuse regulation) and repealing Directive 2003/6/EC of the European Parliament and of the Council and Commission Directives 2003/124/EC, 2003/125/EC and 2004/72/EC (OJ L 173, 12.6.2014, p. 1)

Figure 4. Topics of recommendations issued in 2018



Recommendations concerning measurement of financial instruments

- estimate and recognise impairment loss on receivables resulting from disputed claims, considering the probability of an unfavourable court judgment, uncertainty as to the amount of the potential amount awarded to the entity, uncertainty as to the time limit for obtaining a potential final and binding favourable judgment (paragraph 63 in conjunction with paragraph 59(b) of IAS 39 *Financial Instruments: Recognition and Measurement*);
- estimate and recognise impairment loss on overdue receivables, in particular the receivables which are overdue by more than 1 year, considering that the receivables may be repaid within a long timeframe, repaid in part, or may not be repaid at all (paragraph 63 in conjunction with paragraph 59(b) of IAS 39);
- assess and recognise an impairment loss on loans and receivables in the light of objective evidence of their impairment (paragraphs 58 and 59 of IAS 39);
- recognise interest on due loans that are past due (paragraphs 9 and 47 of IAS 39);
- determine and recognise impairment losses on receivables resulting from claims pursued by the entity in court up to an amount not covered by a guarantee or any other collateral of receivables (Article 35b(1) point 3) of the Accounting Act);
- determine and recognise impairment losses on overdue receivables, in particular the receivables which are overdue by more than 1 year, up to a reliably measured amount of the impairment loss on bad debts (Article 35b(1) point 5) of the Accounting Act).

Recommendations concerning disclosures regarding liquidity risk

- disclose the maturity analysis for financial liabilities (including issued financial guarantee contracts) for which the remaining contractual maturities are shown, using judgement to determine appropriate time bands to assign dates for payment to appropriate periods;

information on expected expenses in periods shorter than 12 months constitutes material information for the purpose of the analysis of the entity's exposure to liquidity risk (paragraph 39(a), paragraphs B11 and B11C of IFRS 7);

- disclose financial liabilities separately, including trade payables for which the parent and the entities in the group are in arrears (paragraph 39(a) and paragraph 31 of IFRS 7);
- disclose a detailed description of how the entity manages the liquidity risk (paragraph 39(c) of IFRS 7);
- disclose information on how the entity manages the liquidity risk, supplementing quantitative information with qualitative information to enable the user to link related information, and hence form an overall picture of the nature and extent of risks arising from financial instruments (lack of detailed and entity-specific information in that regard, limitation to vague statements) (paragraph 39(c) and paragraph 32A of IFRS 7);
- disclose the maturity analysis for financial assets held for managing liquidity risk to allow the users of financial statements to assess the nature and extent of liquidity risk (paragraph B11E of IFRS 7);
- when disclosing the ageing structure analysis for financial assets, as part of disclosures on liquidity risk, the method of presentation of the ageing structure in the maturity analysis for financial liabilities should be taken into account when determining the ageing structure (paragraph B11E of IFRS 7);
- when disclosing data on liquidity risk management, such description should contain concrete and entity-specific disclosures on the activities of the entity and its group in that area, including disclosures on transactions of claim sales, the scope of transactions with related entities and their effect on the level of exposure to liquidity risk (paragraph 39(c) of IFRS 7);
- make a correction consisting in providing additional information on liquidity risk by providing descriptions of the issuer's status, in particular descriptions considering low liquidity rates, to allow for better understanding of quantitative information presented (paragraph 32A of IFRS 7);
- disclose information on liquidity risk (point 1.2.10 of Section B. Additional Explanatory Notes, Appendix No 1 to the Regulation on financial statements according to Polish Accounting Principles[19]);
- disclose information regarding the description of threats in the area of the risk of losing financial liquidity to which the entity is exposed (Article 49(2) point 7 of the Accounting Act);
- when drawing up reports on operations included in annual reports, disclose the assessment (together with justification) of the management of financial resources, with special attention given to the ability to settle incurred liabilities, and identify potential threats and

[19] Regulation of the Minister of Finance of 18 October 2005 on the scope of information disclosed in the financial statements and consolidated financial statements required in a prospectus for issuers with registered office in the territory of the Republic of Poland, which are subject to Polish accounting principles, (Journal of Laws 2017, item 1927)

measures which the issuer has taken or intends to take in order to counteract such threats 70 (Paragraph 70(7) point 11 and Paragraph 71(1) point 4 of the Regulation on current and periodic information);

- disclose information which is essential for the assessment of the ability of the issuer and its group of companies to settle liabilities (Paragraph 66(8) point 11 and Paragraph 69(1) point 3 of the Regulation on current and periodic information).

Recommendations concerning disclosures regarding credit risk

- disclose information about the credit quality of trade receivables and other financial assets with appropriate commentary on the specificity of the entity, including the judgement of management on the quality of receivables from related entities (paragraph 36(c) of IFRS 7);
- disclose information on credit risk for each category of financial instruments (paragraph 36 of IFRS 7);
- provide a description of collateral held in respect of the amount that best reflects the maximum exposure to credit risk and information about the credit quality of financial assets that are neither past due nor impaired (paragraph 36(b) and (c) of IFRS 7);
- disclose an analysis of the age of financial assets that are past due but not impaired (paragraph 37(a) of IFRS 7);
- disclose the analysis of financial assets that are individually determined to be impaired f as at the end of the reporting period, including the factors and criteria considered in determining that they are impaired (paragraph 37 (b) and B5(f) of IFRS 7);
- in relation to receivables on loans (the main items of the entity's assets), disclose information on concentrations of risk (paragraph 34(c) of IFRS 7).

Recommendations concerning other disclosures regarding financial instruments

- disclose information on any default of payments and breach of loan agreement terms (paragraphs 18–19 of IFRS 7);
- disclose, for each type of risk arising from financial instruments, concrete entity-specific and group-specific information on the level of exposures to each risk and how they arise, as well as appropriate related changes as compared to the previous period (paragraphs 33 and 34 of IFRS 7);
- disclose the analysis of financial assets and the factors the entity considered in determining that they are impaired (paragraph 37(b) of IFRS 7).

Recommendations concerning the going concern basis

- assess the ability of companies in the group to continue as a going concern, considering all information available (paragraphs 25–26 of IAS 1 *Presentation of Financial Statements*);
- provide additional information on the going concern basis by including information on the occurrence of material uncertainties related to events or conditions that may cast significant doubt upon the entity's ability to continue as a going concern, and provide

complete and reliable disclosures on such uncertainties, in particular with regard to liquidity issues (paragraphs 25–26 of IAS 1).

Recommendations concerning consolidation and business combinations

- as regards subsidiaries in the entity's group in which subsidiaries the entity recognised a loss of control due to resignation of members of management and supervisory bodies, review the consolidation criteria applied, and appropriate consolidation of the subsidiaries concerned (IFRS 10);
- due to the fact that consolidation applies to certain data of the parent and subsidiaries, not to associates (they are not part of a group of companies), apply in consolidated financial statements, including the description of accounting policies, appropriate disclosures to reflect the foregoing.

Recommendations concerning provisions, contingent liabilities and contingent assets

- recognise and present the provision relating to a decision of a tax authority with regard to a subsidiary (paragraph 14 of IAS 37 *Provisions, contingent liabilities and contingent assets*);
- disclose contingent liabilities and disclose information on contingent liabilities arising from a dispute between the entity and the ordering party (paragraphs 28 and 86 of IAS 37);
- estimate and recognise a provision relating to an identified probability of outflow of cash on account of tax arrears following the receipt by the entity of the results of customs and tax inspection (paragraph 14 of IAS 37);
- as regards material events occurred after the reporting period and disclosed in notes, properly recognise the claims made by counterparties and requests for the execution of bank guarantees in the provisions (paragraph 14 of IAS 37);
- disclose the receivables from the tax authority as a contingent asset, considering unfavourable decision of tax authorities and the judgment of the administrative court, which dismissed the entity's complaints (paragraphs 32, 33 and 89 of IAS 37);
- perform continually assessment of contingent liabilities to determine whether an outflow of resources embodying economic benefits has become probable, and properly recognise a provision in the consolidated financial statements of the period in which the change in probability occurred (paragraph 30 of IAS 37);
- present contingent liabilities arising from a dispute between the entity and the ordering party (Appendix 1 to the Regulation on financial statements according to Polish Accounting Principles).

Recommendations concerning impairment of non-financial assets

- as regards the advance payments recognised in intangible assets and made for a licence for certain products: assess whether there is any indication that an asset may be impaired and in the case such indication exist estimate the recoverable amount of that asset; review at least the indications referred to in the standard (paragraphs 9 and 12–14 of IAS 36 *Impairment of assets*);

- assess whether there is any indication that the shares may be impaired and estimate the recoverable amount of such assets and properly recognise the impairment (the impairment loss) of such assets (paragraph 9 of IAS 36);
- disclose the events and circumstances that led to the recognition of an impairment loss of each asset (paragraph 130(a) of IAS 36);
- disclose the recoverable amount of each asset (paragraph 130(e) of IAS 36);
- disclose the level of fair value hierarchy, and the description of each of the key assumptions underlying the calculation of fair value of each asset (paragraph 130(f) of IAS 36);
- make a formal estimate of recoverable amount of real property owned by a subsidiary on which mortgage has been established to secure the bonds issued by the entity, and properly recognise the impairment loss, where such value is lower than the carrying amount of the asset (paragraphs 8, 13 and 59 of IAS 36);
- write the value of inventories down below cost to net realisable value, if the cost of inventories is not recoverable (paragraphs 28–29 of IAS 2 *Inventories*);
- recognise an impairment loss of property, plant and equipment if it is highly probable that an asset controlled by the entity will not generate any, or any large part of, expected future economic benefits (Article 28(1) point 1 and Article 28(7) of the Accounting Act).

Recommendations concerning other requirements for periodic reports

- in the consolidated profit and loss statement and in the profit and loss statement, exclude from the subtotal 'Operating revenue, including:' those items whose nature is not of revenue and they include a profit/loss related to certain events, and stop marking the item as 'revenue' where the nature of the item is not of revenue (paragraph 15 and paragraph 85A(b) of IAS 1);
- as regards the deferred tax asset, review the carrying amount of that asset and reduce its carrying amount accordingly, to the extent that it is no longer probable that sufficient taxable profit will be available to allow the benefit of part or all of the deferred tax asset to be utilised (paragraph 56 of IAS 12 *Income taxes*);
- properly revise the budgets of construction contracts and properly recognise the items of sales revenue on construction contracts, related receivables, costs of contracts, deferred tax assets and liabilities and provisions for estimated losses on construction contracts in the entity's financial statements (IAS 11 *Construction contracts*);
- take into account, in the description of adopted accounting policies, the accounting policies in relation to advance payments made for licences disclosed as intangible assets (paragraph 117 of IAS 1);
- the parent should take measures regarding the audit and, as appropriate, the review of financial statements of subsidiaries, considering the need to ensure fair presentation of the consolidated financial statements and to disclose reliable data for investors in the consolidated financial statements (paragraph 15 of IAS 1, paragraph 3(1–3) of the Regulation on current and periodic information);

- as regards shares in a subsidiary with regard to which subsidiary the entity has undertaken measures aimed at sale, to ensure appropriate classification and measurement (IFRS 5);
- disclose the substance of the link with the parent and any information regarding transactions and outstanding balances which is necessary to understand the potential effect of that link on the financial statements, in particular disclose the amount due to the entity r loans given to the parent (paragraph 18(b) and paragraph 21(g) of IAS 24 *Related party disclosures*);
- disclose information separately for each class of property, plant and equipment of different nature and use, , in particular in relation to intangible assets in the form of specialist equipment (paragraphs 37 and 73 of IAS 16 *Property, Plant and Equipment*, and paragraph 29 of IAS 1);
- submit the opinion of the management body along with the opinion of the entity's supervisory body, in the form of a separate component of the report (concerning the report on review containing a qualified opinion on the audited financial statements, an adverse opinion or disclaimer of opinion) (paragraph 70(1) point 13 and, as appropriate, paragraph 71(1) point 11of the Regulation on current and periodic information);
- submit the opinion of the management body along with the opinion of the entity's supervisory body, in the form of a separate component of the interim report (concerning the report on half-yearly review of the consolidated financial statements or half-yearly financial statements of the entity containing a conclusion with qualifications or disclaimer of conclusion) (paragraph 68(1) point 7 and, as appropriate, paragraph 69(1) point 6 of the Regulation on current and periodic information).

8. SELECTED AREAS WHERE IMPROVEMENT IS NECESSARY AND ISSUES THAT REQUIRE SPECIAL ATTENTION IN THE PREPARATION OF FINANCIAL STATEMENTS

8.1. The quality of disclosures

The purpose of the financial statements is to provide information on the entity's financial position, financial performance and cash flows that is useful to a wide range of users in making economic decisions. Information presented in financial statements, in particular in the description of accounting policies, is aimed at providing all users with relevant, reliable, comparable and understandable information.

Periodic reports should contain information reflecting the specific nature of a given situation and should be drawn up in an true, fair and complete manner. Where the specific nature of an event described in a given periodic report requires disclosure of additional information to ensure its true, fair and complete view, the issuer is required to include such information in the periodic report. Furthermore, the periodic reports submitted by issuers should be drawn up so as to allow the investors to assess the effect of information on the issuer's economic, property and financial standing (cf. paragraph 3(1–3) of the Regulation on current and periodic information).

When drawing up financial statements, one should take into account the materiality of what

is being disclosed. Pursuant to Article 4(4a) of the Accounting Act, information disclosed in financial statements and consolidated financial statements should be considered material if its omission or misstatement may influence the decisions made on the basis of such information by the users of those financial statements. An item must not be considered immaterial if all immaterial items of similar nature are jointly considered material. Whereas paragraph 5 of IAS 8 *Accounting policies, changes in accounting estimates and errors* stipulates that material omissions or misstatements of items are material if they could, individually or collectively, influence the economic decisions that users make on the basis of the financial statements. Materiality depends on the size and nature of omission or misstatement judged in the surrounding circumstances. The size or nature of the item, or a combination of both, could be the determining factor.

Issuers decide, considering all material facts and circumstances, on the manner of grouping information in the financial statements, including in the notes. Issuers should not limit the understandability of their financial statements by providing immaterial information within material information (cf. also paragraph 30A of IAS 1). For financial statements drawn up in accordance with IFRS, paragraph 31 of IAS 1 also applies. The provision stipulates explicitly that even where an appropriate standard provides for a detailed list of requirements for disclosures, the entity need not provide a specific disclosure required by an IFRS if the information resulting from that disclosure is not material. In particular, your attention is drawn to the requirement to disclose accounting policies which applies to significant accounting policies (paragraph 117 of IAS 1). Therefore, one should not disclose accounting policies regarding the items or transactions which do not occur or are immaterial in the case of the issuer concerned. On the other hand, according to paragraph 17(c) of IAS 1, fair presentation requires additional disclosures to be provided when compliance with the specific requirements in IFRS is insufficient to enable users of the financial statements to understand the impact of particular transactions, other events and conditions on the entity's financial position and financial performance.

Please note the requirement, following from paragraph 122 of IAS 1, to disclose in the financial statements the judgements that management has made in the process of applying the entity's accounting policies and that have the most significant effect on the amounts recognised in the financial statements. Considering that new standards have entered into force, the judgements made by issuers for the purpose of applying IFRS 9 *Financial Instruments* and IFRS 15 *Revenue from Contracts with Customers*, and the judgement made when implementing IFRS 16 *Leases* and IFRS 17 *Insurance Contracts* will also be of particular importance in the nearest future. Moreover, our reviews show that issuers should use due care also with respect to the judgements applied in relation to application of IAS 38 *Intangible Assets* (see Chapter 8.3. of this report). In view of the foregoing, we expect that significant judgements made in accordance with those standards will be disclosed.

Our review shows that sometimes the disclosures made by issuers do not contain sufficiently detailed information on key estimates and assumptions of the management, the measurement methods or significant input data. We would like to point to the need to avoid boilerplate language and needlessly extensive disclosures and to focus on providing information which is useful to users. Disclosures should present information in a possibly short and direct manner, without omitting material information but also without including superfluous or immaterial content.

8.2. Credit risk and liquidity risk

Issuers who draw up financial statements should pay special attention to the scope and quality of disclosures on their financial instruments, chiefly on the risks, including credit risk and liquidity risk. The issues relating to the occurrence of such risks associated with financial instruments are particularly important not only in the case of financial institutions but also in the case of issuers/groups of companies who experience uncertainty as to the ability to continue as a going concern.

The provisions of IFRS 7 *Financial Instruments: Disclosures* (paragraph 31) require that an entity disclose information that enables users of its financial statements to evaluate the nature and extent of risks arising from financial instruments to which the entity is exposed at the end of the reporting period. Both quantitative and qualitative disclosures (descriptions) should be considered in that respect, in accordance with paragraph 32A of IFRS 7.

Therefore, the disclosures on risks arising from financial instruments should include:

- qualitative information, including information on the exposures to risk and how they arise, as well as its objectives, policies and processes for managing the risk (paragraph 33 of IFRS 7);
- quantitative information, including summary of quantitative data about its exposure to that risk at the end of the reporting period; the laws stipulate that such disclosure should be based on the information provided internally to the entity's key management personnel; it may also be appropriate to disclose additional information on risk concentration (paragraph 34 of IFRS 7).

The terms 'financial instrument', ' financial assets' and 'financial liabilities' are defined in IAS 32 *Financial Instruments: Presentation* (paragraph 11 and paragraphs OS3–OS23 of IAS 32).

The definitions of the above-mentioned risks are provided in Appendix A to IFRS 7, which forms an integral part of the standard. According to the definition, credit risk is the risk that one party to a financial instrument, by failing to discharge an obligation, will cause a financial loss for the other party, i.e. for the entity which draws up the financial statements. Liquidity risk is defined as the risk that an entity will encounter difficulties in meeting obligations that are settled by delivering cash or another financial asset.

Credit risk

In addition to the changes in the rules for classification and measurement of financial assets, and introduction of a new model for estimating expected credit losses and recognition of impairment losses (see point 8.5 of this report), the entry into force of IFRS 9 *Financial Instruments* resulted also in changes in disclosure requirements for financial instruments. The new requirements in the area of recognition of impairment losses have resulted in, among other things, the need to ensure additional disclosures on credit risk.

The new disclosure requirements with regard to credit risk apply to several areas:

- credit risk management practices,
- quantitative and qualitative information about the amounts arising from expected credit losses,
- exposure to credit risk,

- securities obtained and other elements which improve the lending conditions.

As regards financial instruments to which the requirements on impairment included in IFRS 9 apply, in accordance with paragraph 35A of IFRS 7, the entity applies the disclosure requirements laid down in paragraphs 35F–35N. The disclosures on credit risk made in accordance with paragraphs 35F–35N are supposed to allow the users of financial statements to understand the impact of credit risk on the amount, timing and uncertainty of future cash flows.

Disclosures regarding credit risk should also take into account additional indications set out in paragraphs B8A– B10 of Appendix B to IFRS 7, so below please see some of the disclosure requirements regarding credit risk.

In relation to disclosures on credit risk management practices, paragraph 35G(a) requires the disclosure of information based on the inputs and assumptions and estimation techniques used to apply the requirements regarding impairment laid down in IFRS 9. Additional guidance on compliance with requirements of that paragraph are provided in paragraph B8C of Appendix to IFRS 7, which states that the assumptions and inputs used by the entity to measure expected credit losses or determine the extent of increases in credit risk since initial recognition may include information obtained from internal historical information or rating reports, as well as assumptions about the expected life of financial instruments and the timing of sale of collateral.

However, in the case of changes in the loss allowance, according to paragraph 35H an entity must explain the reasons for those changes in the allowance for expected credit losses during the period. The required disclosures have been laid down in paragraph 35H, and additional guidance is given in paragraph B8D.

When disclosing information about the entity's credit risk exposure and about its significant credit risk concentrations (paragraph 35M), according to paragraph B8H, an entity should provide information that will enable users of financial statements to understand whether there are groups or portfolios of financial instruments with particular features that could affect a large portion of that group or portfolio of financial instruments, such as concentration to particular risks. A concentration of credit risk exists when a number of counterparties are located in a geographical region or are engaged in similar activities and have similar economic characteristics that would cause their ability to meet contractual obligations to be similarly affected by changes in economic or other conditions (e.g. geographical, industry or issuer-type concentrations).

Whereas in relation to all financial instruments which are subject to IFRS 7 but to which the requirements concerning impairment laid down in IFRS 9 do not apply, an entity must disclose, by class of financial instrument, information on the maximum exposure to credit risk specified in paragraph 36 of IFRS 7 and, as appropriate, paragraphs B9 and B10 of Appendix B to IFRS 7.

Liquidity risk

The disclosures regarding liquidity risk should allow users of financial statements to assess the level of the entity's exposure to issues affecting its ability to regulate its liabilities and the method of managing such risk.

The requirement to present the maturity analysis for non-derivative financial liabilities (including issued financial guarantee contracts) should be considered the primary disclosure requirement in the area of liquidity risk. The analysis consists in presenting remaining contractual maturities of financial liabilities by presenting remaining contractual maturities (paragraph 39(a) of IFRS 7). A separate maturity analysis applies to derivative financial liabilities (paragraph 39(b) of IFRS 7). Another requirement, closely related to the above-mentioned requirement, is the requirement to provide a description of liquidity risk management (paragraph 39(c) of IFRS 7).

When fulfilling the above-mentioned requirements of IFRS 7, one should take into account the requirements laid down in Appendix B (paragraphs B10A, B11, B11A-F), which forms an integral part of IFRS 7.

According to paragraph B11 of IFRS 7, in preparing the above maturity analysis for financial liabilities, an entity uses its judgement to determine an appropriate number of time bands. The use of judgement means setting such time bands which are the most appropriate for the situation of the issuer and its group. It should be stressed that the judgement mentioned in paragraph B11 of IFRS 7 does not mean free choice but indicates the need to assess and select a scope of disclosure which is appropriate for the issuer's situation and achievements, including the need to determine an appropriate number of time bands in the maturity analysis, as such information may affect the assessment of liquidity, and thus the decisions of investors. The supervisory practice shows that the failure to present time bands shorter than 12 months, especially where the issuer experiences difficulties in maintaining liquidity, prevents users of financial statements from assessing the nature and extent of liquidity risk, that is prevents the achievement of the objective for which such disclosures are required. Similarly, excessively broad time bands for maturities of liabilities (classified as current liabilities) do not reflect the concentration of payments in time and the user is unable to gauge what amounts are to be paid at the beginning of the disclosed period, and what amounts may be paid later in the period.

Please also note that as regards the disclosure of the description of liquidity risk management, especially for entities / groups in which there are uncertainties as to the ability to continue as a going concern or there is trouble maintaining liquidity, it is also important to disclose a maturity analysis for financial assets held for managing liquidity risk (paragraph 39(c) and paragraph B11E of IFRS 7). It should also be noted that disclosing the breakdown of the maturity analysis for financial assets by number of days past due does not fulfil the requirement regarding liquidity risk in question.

In our opinion, an important issue which the entities drawing up financial statements should pay attention to in the analysis of the entity's liquidity, and thus when disclosing information in that regard, is the existence, in business dealings, of contracts under which a counterparty may demand early repayment from the entity, e.g. PUT option in the case of issue of bonds, and so-called guarantee or suretyship contracts. Where an entity is a party to such contracts and they may be significant in terms of the entity's liquidity status, the entity should notify the users of its financial statements. For guarantee or suretyship contracts, the entity may not be a party to a liability at a particular point of time but it assumes additional risk that such liability will occur for it. Therefore, where such contracts are concluded, it is necessary to perform a continuous analysis of such contracts, and when drawing up financial statements, to assess whether there have been changes of circumstances which might give rise to such

liability and outflow of cash. To that end, such assessment must also involve appropriate inclusion of those issues in financial statements, i.e. in the description of liquidity risk management, where the circumstances indicate a probability of outflow of cash, and its value might have a material impact on the entity's liquidity status, and when disclosing the maturity analysis for financial liabilities by properly assigning amounts to time bands (paragraph B11C of IFRS 7).

We would also like to emphasise again that the description of liquidity risk management (paragraph 39(c) of IFRS 7) should be specific to a given entity, i.e. relate to individual characteristics of a given issuer, its industry and its circumstances in a given period of time. Providing information using vague and conventional linguistic expressions will not represent any added value for users of financial statements, and thus will not fulfil the purpose of drawing up financial statements.

At the same time, we would like to emphasise that the disclosures on risks associated with financial instruments should be either in the financial statements or incorporated by cross-reference from the financial statements to some other statement, e.g. a management report. However, incorporating information by cross-reference is only possible to the reports which are accessible to the users of financial statements on the same terms and within the same time frame as in the case of the financial statements. The said requirement has been laid down in paragraph 35C and paragraph B6 of IFRS 7. According to those provisions, the lack of such cross-reference will cause the financial statements to be incomplete.

To sum up, as mentioned in the introduction, the issues relating to the occurrence of risks associated with financial instruments, including liquidity risk and credit risk, are particularly important in the case of issuers/groups of companies which experience uncertainty as to their ability to continue as a going concern but not only in those cases. That is why we emphasise that providing fairand complete information on liquidity will help users of financial statements assess the validity of going concern basis and any potential uncertainty as to events or circumstances which may cast significant doubt upon the entity's ability to continue as a going concern, and this will improve compliance with the requirements of paragraph 25 of IAS 1. Issuers should therefore make every effort to ensure that information they provide, in particular information on liquidity risk, is fair and complete.

8.3. Capitalisation of development expenditure

According to IAS 38 *Intangible Assets*, no intangible assets arising from research shall be recognised, and the expenditure on research shall be recognised as an expense when it is incurred. An intangible asset may be identified, and related expenditure may be capitalised at the project's development phase, which is a more advanced phase, after the criteria defined in paragraph 57 of IAS 38 are fulfilled, i.e. after the issuer demonstrates:

- the technical feasibility of completing the intangible asset;
- its intention to complete the intangible asset;
- its ability to use or sell the intangible asset;
- how the intangible asset will generate probable future economic benefits;
- the availability of adequate technical, financial and other resources to complete the

development;

- its ability to measure reliably the expenditure attributable to the intangible asset during its development.

We would like to point out that in practice, the extent to which new intangible assets arising from development expenditure are recognised should be different depending on the industry and type of product the entity is working on. A good example is the pharmaceutical industry, where development expenditure does not result in automatic recognition of intangible assets. Such situation is usually caused by excessive uncertainty as to the final outcome of the ongoing activities and as to the technical feasibility of completing the intangible asset so that is will be available for economic use.

In our opinion, in the case of development of a new product in the pharmaceutical industry, the good evidence of technical feasibility of completing and commercialising an intangible asset is the authorisation from a competent regulatory authority in respect of the new products or production processes. In consequence, only a small portion of expenditure relating to the development of a new product or production process in the pharmaceutical industry may be capitalised.

As regards the development of biosimilar medicines, which are to be similar to reference medicinal products, i.e. the ones that are already available on the market, for which the patent has expired, the development focus mostly on finding new solutions with regard to the production process, which would be more effective than the solutions applied so far. Furthermore, the manufacturer of a biosimilar must demonstrate that the product obtained in the new process has the same qualities as the reference medicinal product so the regulatory authority require the manufacturer to carry out many laboratory tests and clinical trials. Therefore, in the case of development with respect to biosimilars, due to the need to develop a new production process and to conduct many clinical trials, whose positive results are necessary to obtain regulatory authorisation, we expect that issuers will capitalise the development expenditure of new products, i.e. after obtaining regulatory authorisation, or at a point in time close to obtaining it.

8.4. Effects of measures adopted by tax administration

Issuers and entities being part of groups of companies are subject to the measures adopted by tax administration, including tax inspection and other proceedings in respect of government levies. Such procedures may ultimately lead to an issuer being required to make additional payments to the tax authority in a given jurisdiction. Please note the requirements of IAS 37 *Provisions, contingent liabilities and contingent assets*, and IAS 12 *Income taxes*, the application of which may lead to the recognition of additional items on the liabilities side in the report on financial standing. Special attention should be paid to the provisions of IAS 37, which require that a provision should be recognised if:

- the entity has a present obligation as a result of a past event,
- it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation,
- a reliable estimate can be made of the amount of that obligation (paragraph 14 of IAS 37).

The standard contains rules which specify the above requirement for recognition of a provision.
We emphasise that the above requirements may be satisfied before a final and binding decision is made by the relevant tax authorities or courts. In particular, fiscal authorities, as part of their procedures, are often required to draw up and submit to entities official documents (e.g. official inspection reports, tax decisions of the first instance), which contain a position of the authority on the fact pattern and the amount of the tax due from the taxpayer. In our view, such official documents may represent a hard evidence of existence of an obligation relating to a probable obligation to make the payment, even if no final decision has been made yet.

We are aware that there may be cases where an entity, having made a successful appeal against the decision of the fiscal authority, received a refund of the overpayment. However, that does not change the fact that the entity first made the payment, i.e. there was an outflow of cash, which deteriorated the entity's economic standing. We expect that the issuers which received from a tax authority a notice (official report, decision) regarding the obligation to make additional payments but despite that failed to recognise a provision or liability on that account, have analysed the issue properly and are able to provide hard evidence to confirm that they will actually manage to avoid the payment, e.g. by making an effective appeal against the conclusion of the fiscal authority before the final decision is made or by suspending the enforcement of a given decision. In our view, if the issuer takes a critical stance on, or raises objections to, the preliminary findings of the fiscal authority, that represents a clear element of defence of the issuer's economic interests and may be ultimately reasonable from a legal standpoint. However, the mere act of undertaking – even reasonable – measures does not prejudge the possibility for the issuers to actually avoid the payment.

Please also see the KNF public statement of 29 March 2018 on the fulfilment of disclosure and reporting requirements, which also applies to the requirement to publish inside information relating to tax proceedings.

8.5. Application of IFRS 9 and IFRS 15

2018 was the first year of obligatory application, by issuers, of new standards: IFRS 9 *Financial Instruments*, and IFRS 15 *Revenue from Contracts with Customers*. Below please find the description of selected issues regarding the application of both standards.

IFRS 9

For reporting purposes, many entities would prefer the classification of financial assets to the category of financial assets measured at amortised cost. Such classification requires however that two conditions must be met (paragraph 4.1.2. of IFRS 9): a financial instrument must be held within a business model whose objective is to hold financial assets in order to collect contractual cash flows (*held to collect*, HTC), the contractual terms of that financial instrument give rise to cash flows that are solely payments of principal and interest (*solely payment of principle and interest*, SPPI). An asset must pass both the SPPI test and be included in the HTC model. Please note that the basis for assessing an asset for the SPPI test is provided by the contract relating to that instrument (cf. paragraph 4.1.2(b) of IFRS 9). Whereas the classification into the model depends on how groups of financial assets are managed together to achieve a certain business objective. The entity's business model does not depend on the

management's intentions for an individual instrument (cf. paragraph B4.1.2 of IFRS 9).

It should be noted that financial instruments are not classified into a model on the basis of intentions or declarations of the management but on the basis of the entity's actual activities (cf. paragraph B4.1.2B of IFRS 9).

The recognition and presentation of financial assets measured at amortised cost in IFRS 9 is inextricably linked with the issue of expected credit losses. Credit risk is inherent to any debt instrument and as a rule the standard requires estimation and recognition of a loss allowance for expected credit losses for all financial assets measured at amortised cost. We particularly stress that such obligation also applies to financial assets for which there has been no significant increase in credit risk since initial recognition (cf. paragraph 5.5.5. of IFRS 9). In such a case, however, the allowance must take into account 12-month expected credit losses.

A significant increase in credit risk relating to a financial asset measured at amortised cost gives rise to the obligation to recognise a loss allowance for lifetime expected credit losses (cf. paragraph 5.5.3 of IFRS 9). A probability of such increased risk should be assessed at each reporting date, which in practice means that issuers should assess credit risk of the relevant assets at the end of each quarter of the financial year. Note than the purpose of IFRS 9 is to identify an increase in credit risk prior to any default. According to paragraph B5.5.15 of IFRS 9, the assessment is made using reasonable and supportable information, and paragraph B5.5.17 of IFRS 9 contains a non-exhaustive list of events which may indicate a significant increase in credit risk The presumption that the credit risk has increased significantly when contractual payments are more than 30 days past due, as provided for in paragraph 5.5.11. of IFRS 9, serves only as a 'safety fuse', which sets the latest time for estimating and recognising the expected credit losses over the life of the relevant asset. Paragraph B5.5.51 of IFRS 9 does not require any detailed search for the purpose of assessing whether the credit risk has increased significantly. However, in our view, some doubts may occur as to the accuracy of financial statements where, for example, an issuer recognises significant assets on account of long-term financing but cannot obtain financial data on debtors or otherwise monitor their solvency.

Paragraph B5.5.35 of IFRS 9 provides for practical expedients to be applied in the measurement of expected credit losses, such as a provision matrix. It should be noted that such matrix should be based on the entity's historical data, and thus be specific to a given entity and individualised due to the application of the entity's own data for previous periods. Similarly as other methods for measuring expected credit losses, the provision matrix should also be reviewed regularly. The provision matrix should also consider the effect of new events and circumstances, which had no effect on past events, and so the historical data do not reflect such new events ad circumstances (cf. paragraph B5.5.51–B5.5.52 of IFRS 9).

According to paragraph B5.2.3 of IFRS 9, assets which are equity instruments are measured at fair value as at the reporting date. However, paragraphs B5.2.3–B5.2.6 of IFRS 9 provide that in certain specific cases the correct estimate of fair value may be the cost of an asset. It should be noted that such method of measuring the fair value of a financial instrument is an exception and should not become a rule among entities which apply IFRS 9. The standard contains, in paragraph B5.2.4 of IFRS 9, a non-exhaustive list of indicators which show that cost may not be representative of fair value, and requires the use of all information about the performance and operations of the entity in which funds were invested, to assess whether the

cost may still correspond to fair value. However, according to paragraph B5.2.6 of IFRS 9, cost is never representative of the best estimate of fair value in quoted equity instruments. At this point we would like to stress that the provision applies to quoted instruments and that it does not require that the market of such instruments be active or deep.

IFRS 15

The requirements of IFRS 15 regarding the recognition and measurement of certain types of revenue are based on a five-step model. The model comprises the following steps:

- identify the contract(s) with a customer;
- identify the performance obligations in the contract;
- determine the transaction price;
- allocate the transaction price to the performance obligations;
- recognise revenue when (or as) the entity satisfies a performance obligation.

We stress that correct recognition of revenue requires correct analysis and implementation of requirements regarding each of the above-mentioned elements. In particular, establishing the time of revenue recognition, or deciding whether the performance is satisfied on a one-off or continuous basis is not the primary or basic element of that analysis.

IFRS 15 regulates the transactions in which the counterparty is the customer. Please note that there may be contracts under which an entity receives payment or gains other economic benefits but the counterparty participates in a given project and also participates in those benefits and bears the relevant risk. IFRS 15 does not regulate the accounting treatment of the recognition of such contracts (cf. paragraph 6 of IFRS 15).

A contract under which revenue may be recognised should meet the basic requirements laid down in paragraphs 9–16 of IFRS 15. We would like to point at the need to assess, on a case-by-case basis, the contracts and contract templates, and at the need to ensure a particularly detailed analysis of framework agreements used by some entities. Some framework agreements may contain provisions which give rise to rights and obligations of the parties in the form of, for example, minimum quotas or volume of orders, and such contracts should be reflected in financial statements in accordance with IFRS 15. Other framework agreements only contain general terms and conditions, and only their specification in the form of detailed contracts (orders) results in enforceable obligations of counterparties.

Contractual relationships with customers should be reviewed for identification of each performance obligation. On one hand, a single uniform contract may provide for different obligations, which must be recognised separately for accounting purposes. On the other hand, one performance obligation assumed may be regulated in more than one contract. In that last case, IFRS 15 requires that such contracts be combined for reporting purposes (cf. paragraph 17(c) of IFRS 15).

In the context of identification of contractual obligations, it should also be noted that it is necessary to consider whether in a given relationship with a customer the entity acts as principal or agent, as referred to in paragraphs B34–B38 of IFRS 15. The main criterion for deciding whether the provider of performance is an agent or not is the occurrence of control of goods or services which constitute the object of the performance. Paragraph B37 of IFRS 15 lists examples of situations in which control of a good or service existed prior to the

satisfaction of the performance.

The prerequisite for recognising revenue relating to satisfaction of a performance proportionally over time is that the performance obligation must meet one of the requirements specified in paragraph 35 of IFRS 15. The general requirement of paragraph 35 of IFRS 15 is elaborated in paragraphs 36–37 and B2–B13 of IFRS 15. Please also note paragraph 35(c) of IFRS 15, which lays down two conditions which must be met jointly if a given performance is to be considered as a performance satisfied over time. One condition is the right to payment for the performance satisfied so far. In accordance with paragraph B9 of IFRS 15, we stress that the payment should include an amount close to the selling price of the goods transferred, not only potential lost profit. Moreover, the right to payment should be enforceable and the assessment of collectability of the payment should take into account – beside general provisions of law and contractual clauses – also legal precedents (cf. paragraph B12 of IFRS 15). It should be noted that such analysis should be performed already at the time the contract is concluded (paragraph 32 of IFRS 15).

Documentation

The new standards concerning financial instruments and revenue do not contain detailed requirements regarding the collection of documents (IFRS 15) or such requirements are limited (IFRS 9). However, according to the authors of the report, there are serious doubts as to the fairness of financial statements drawn up on the basis of analyses, judgements, opinions and assessments which take no permanent written form.

Please note than one of the obligatory characteristics of accounting books is their verifiability, which is ensured if the books allow for the ascertainment of correctness of entries made therein (Article 24(1) and (4) of the Accounting Act). Moreover, entity managers should take into account the obligation to provide the auditor with access to the supporting documents for the entries made in the books, as well as any other document and information which may be necessary to draw up the audit report (Article 67(1) of the Accounting Act).

Additionally, the Polish Financial Supervision Authority or its authorised representative have the right to request copies of documents and other information carriers relating to the issuers' compliance with information requirements (Article 68(1) of the Act on offering). Due to the above reasons, we believe that some elements of the implementation and application of IFRS 9 and IFRS 15 should take a permanent written form. In particular, we expect that the following will be documented:

- business models used by the entity with regard to financial assets;
- the analysis and assignment of each material financial asset (or group of assets) to a specific category provided for in IFRS 9;
- the method for measuring a significant increase in credit risk for financial assets measured at amortised cost;
- the method for estimating the expected tax losses for financial assets measured at amortised cost;
- the analysis of significant contracts, categories of contract or contract templates, performed by applying the five-step approach for the purpose of implementation of

IFRS 15;

provided that, obviously, the issues covered by the above-mentioned documents may have a material influence on the presentation of the entity's financial performance, financial position and cash flows.

8.6. Implementation of IFRS 16 and IFRS 17

On 1 January 2019, the new standard IFRS 16 became mandatory and replaced the previous rules defined in IAS 17 and related interpretations. IFRS 16 sets out the rules for recognition, measurement, presentation and disclosure of leases. The purpose of the standard is to ensure that the lessee and the lessor provide relevant information in a manner that faithfully represents those transactions. Such information provides the users of financial statements with a basis for assessing the effect that leases have on the entity's financial position, financial performance and cash flows.

According to IAS 17, operating lease was recognised off-balance sheet, and the effect of such a contract was only reflected in the income statement as third-party services. The new standard eliminates the distinction between operating lease and finance lease on the lessee's side. According to IFRS 16, an asset representing the lessee's right to use the underlying asset for the lease period and the lease liability must be recognised for all leases, except for short-term leases and the leases of low-value assets (cf. paragraph 5 of IFRS 16). Where a lessee benefits from an exemption from the obligation to recognise leases in the two above-mentioned cases, the lessee should recognise the lease payments as expenses on a straight-line basis over the lease term or in any other systematic way.

The rules for lease accounting on the lessor's side have not changed significantly as compared to IAS 17: the lessor who applies IFRS 16 will continue to classify and recognise the two separate types of lease—the operating lease and finance lease.

It should be noted that the elimination of the concept of operating lease on the lessee's side, and thus the off-balance sheet recognition of assets held under such lease and the need to recognise all such lease assets and liabilities in the balance sheet will affect the basis for calculation of generally applied financial ratios, such as debt ratios, liquidity ratios, or EBITDA, which might also affect the covenants in loan agreements.

Note that one of the European common enforcement priorities set by ESMA with regard to annual financial reports for 2018 is disclosure of the expected impact of implementation of IFRS 16. ESMA highlights the need for high-quality implementation of IFRS 16 and communication of its expected impact on the financial statements in the period of their initial application, as required by paragraphs 30–31 of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*. ESMA recommends that issuers, when providing these disclosures, focus on disclosing a concise entity-specific description of the changes introduced by IFRS 16 and the judgements and choices the entity has made thus enabling users to assess the impacts. In ESMA's view, this description should include, for example considerations such as the nature and characteristics of contract types, and, where significant judgement was involved, the main assumptions used in the determination of right-of-use assets and lease liabilities (such as assessment whether a contract contains a lease in line with paragraphs 9–11 of IFRS 16, determination of lease terms in accordance with paragraphs B34–B41 of IFRS

16 and discount rates as well as consideration of separation of the service and lease components of a contract).

ESMA notes that once IFRS 16 is applied, disclosures required by Appendix C of the standard relating to the initial application and chosen method of transition will need to be provided. Particularly, ESMA reminds issuers that when applying the simplified transition approach issuers are required by paragraph C12(b) of IFRS 16 to explain any difference between operating lease commitments disclosed applying IAS 17 and lease liabilities recognised as at the date of application of IFRS 16 and that, in accordance with paragraph C7 of IFRS 16, comparative information cannot be restated.

ESMA also encourages disclosure, where material, of assumptions and judgments used in estimating the discount rate used in determining the present value of the remaining lease payments and in recognising the right-of-use assets upon transition in accordance with paragraph C8 of IFRS 16. Finally, ESMA expects that, based on the 2018 accounts, users will try to make a link between minimum lease payments for operating leases disclosed based on the requirements of IAS 17 and IFRS 16 impacts; hence, issuers are encouraged to explain these differences.

In May 2017, the International Accounting Standards Board (IASB) published IFRS 17 *Insurance Contracts*, which replaces IFRS 4. The new standard is to be effective for annual reporting periods beginning on 1 January 2021 with earlier application permitted as long as IFRS 15 and IFRS 9 are also applied. The standard introduces a new approach to the recognition of revenue and profit/loss over the period of provision of insurance services, and uniform rules for measurement and presentation of all types of insurance contract. IFRS 17 is to ensure more transparency and comparability of financial statements of insurance undertakings. The standard has not been approved for application by the EU yet.

8.7. Audit at subsidiaries

Following the analysis of audit reports and review reports, we have found qualifications, additional explanations or disclaimers of opinion relating to the inclusion of consolidated financial statements to certain subsidiaries, which were not subject to the audit/review conducted by an auditor. Therefore, we would like to draw the attention of both issuers and auditors to the importance of audit/review of financial statements of the entities being part of groups of companies.

As mentioned in Chapter 5 of this report, members of management boards and supervisory boards are responsible for ensuring that the financial statements and the report on the group's operations meet the requirements laid down in laws (cf. Article 4a of the Accounting Act).

The duties of the entity's management and the rights of an auditor with regard to the audit of financial statements are specified in the Accounting Act. According to Article 67(1) of the Act, a manager of the audited entity must provide the auditor who performs the audit of financial statements with access to accounting books and supporting documents which form the basis for the entries therein, and must provide exhaustive information, explanations and statements necessary to draw up the audit report. The auditor is entitled to receive information on the course of the audit from the counterparties of the audited entity, including from banks and the entity's legal advisers, on the basis of authorisation granted by the manager of the audited entity (cf. Article 67(2) of the Act). In the case of an audit of financial statements of

a parent, pursuant to Article 67(3) of the Accounting Act, the powers of the statutory auditor referred to in Paragraphs 1 and 2 are also vested in subsidiaries, co-controlled undertakings and associates. The provisions of Paragraphs 1–3 apply accordingly to the audit of consolidated financial statements.

In consequence, when auditing consolidated financial statements, the auditor is committed to properly estimate and consider a series of risks resulting from the audit of financial statements comprising financial information of more than one entities, including the dependence on facts (circumstances). The auditor should properly design and apply the audit procedures and the entity's management must provide the auditor (the team that performs the audit of the group) with all information regarding the subsidiaries and their financial information, which the auditor deems necessary for the purpose of drawing up the audit report / issuing the report on review of consolidated financial statements. Note that performing an audit of financial statements, including consolidated financial statements, does not limit the responsibility of the management or persons responsible for corporate governance.

We reiterate the need to disclose reliable data for investors in consolidated financial statements. One of the basic requirements concerning financial reporting is the need for fair presentation, as referred to in paragraph 15 of IAS 1 *Presentation of Financial Statements* and in paragraph 3(1–3) of the Regulation on current and periodic information. In our view, to achieve that goal, parent companies must adopt, in advance, appropriate measures, i.e. audit or, as appropriate, review financial statements of subsidiaries, or include appropriate provisions in the terms of audit engagements with regard to the audit of consolidated financial statements to ensure that the auditor will carry out additional procedures with respect to financial information of subsidiaries.

8.8. Regulations of the European Commission amending IFRSs, published in 2018

Six Commission Regulations amending IFRSs were published in 2018:

1) COMMISSION REGULATION (EU) 2018/182 of 7 February 2018 amending Regulation (EC) No 1126/2008 adopting certain international accounting standards in accordance with Regulation (EC) No 1606/2002 of the European Parliament and of the Council as regards International Accounting Standard 28 and International Financial Reporting Standards 1 and 12

All entities shall apply the amendments to IAS 28 and IFRS 1, at the latest, as from the commencement date of the first financial year starting on or after 1 January 2018, and the amendments to IFRS 12, at the latest, as from the commencement date of the first financial year starting on or after 1 January 2017.

2) COMMISSION REGULATION (EU) 2018/289 of 26 February 2018 amending Regulation (EC) No 1126/2008 adopting certain international accounting standards in accordance with Regulation (EC) No 1606/2002 of the European Parliament and of the Council as regards International Financial Reporting Standard (IFRS) 2 'Share-based Payment'

All entities shall apply the amendments to IFRS 2, at the latest, as from the commencement date of the first financial year starting on or after 1 January 2018.

3) COMMISSION REGULATION (EU) 2018/400 of 14 March 2018 amending Regulation (EC) No 1126/2008 adopting certain international accounting standards in accordance with Regulation (EC) No 1606/2002 of the European Parliament and of the Council as regards International Accounting Standard (IAS) 40

All entities shall apply the amendments to IAS 40, at the latest, as from the commencement date of the first financial year starting on or after 1 January 2018.

4) COMMISSION REGULATION (EU) 2018/498 of 22 March 2018 amending Regulation (EC) No 1126/2008 adopting certain international accounting standards in accordance with Regulation (EC) No 1606/2002 of the European Parliament and of the Council as regards International Financial Reporting Standard 9

All entities shall apply the amendments to IFRS 9, at the latest, as from the commencement date of the first financial year starting on or after 1 January 2019.

5) COMMISSION REGULATION (EU) 2018/519 of 28 March 2018 amending Regulation (EC) No 1126/2008 adopting certain international accounting standards in accordance with Regulation (EC) No 1606/2002 of the European Parliament and of the Council as regards Interpretation 22 of the International Financial Reporting Interpretations Committee

All entities shall apply IFRIC 22, at the latest, as from the commencement date of the first financial year starting on or after 1 January 2018.

6) COMMISSION REGULATION (EU) 2018/1595 of 23 October 2018 amending Regulation (EC) No 1126/2008 adopting certain international accounting standards in accordance with Regulation (EC) No 1606/2002 of the European Parliament and of the Council as regards Interpretation 23 of the International Financial Reporting Interpretations Committee

All entities shall apply IFRIC 23, at the latest, as from the commencement date of the first financial year starting on or after 1 January 2019.

The full list of Commission Regulations regarding IFRS is available on European Commission website:
(www. ec.europa.eu, tab: Amending and supplementary acts / acts adopted on the basis of regulatory procedure with scrutiny (RPS))

or through the following websites:
- Polish Financial Supervision Authority (www.knf.gov.pl/en/, tab: Market / Regulations and practice / EU regulations / International accounting and financial reporting standards / Individual RPS acts adopting international accounting standards (IFRS/IAS) and related interpretations (IFRIC)

- Ministry of Finance[20] (www.mf.gov.pl, tab: Działalność / Rachunkowość / Międzynarodowe Standardy Rachunkowości / Rozporządzenia Komisji Europejskiej przyjmujące określone międzynarodowe standardy rachunkowości).

[20] www.mf.gov.pl

8.9. European Single Electronic Format

Under Article 4(7) of the Transparency Directive, all issuers whose securities are admitted to trading on regulated market in the territory of the European Union must draw up annual reports in a European Single Electronic Format (hereinafter: ESEF), with effect from 1 January 2020. On 17 December 2018, the European Commission published on its website the final draft of Regulation supplementing Directive 2004/109/EC of the European Parliament and of the Council with regard to regulatory technical standards on the specification of a single electronic reporting format[21]. According to the draft RTS:

- all annual reports must be prepared by issuers in XHTML format. The reports may be opened and displayed using a standard Internet browser;
- IFRS consolidated financial statements, being part of consolidated annual reports, are tagged using the XBRL markups language;
- the XBRL markups should be embedded in XHTML using the XBRL taxonomy in inline-XBRL format;
- the taxonomy to be used builds on the IFRS Taxonomy developed by the IFRS Foundation;
- as of 1 January 2020, with regard to primary financial statements (i.e. statement of financial position, statement of profit or loss and other comprehensive income, cash flow statement, statement of changes in equity) as well as basic information on the issuer contained in IFRS consolidated financial statements, a standard of detailed tagging applies. Moreover, as of 1 January 2022, with regard to the notes to financial statements, block tagging in the notes applies.

We encourage you to see further information and materials available on the ESMA website[22] (Policy activities > CORPORATE DISCLOSURE > European Single Electronic Format).

9. SUMMARY

The 2018 enforcement activities conducted by DSP/WR in the area of financial reporting of issuers of securities other than investment funds focused on:

- the review of 2017 financial statements and 2018 half-yearly statements of selected security issuers for their compliance with the applicable financial reporting framework, in particular IFRS,

- obtaining additional explanations from issuers and auditors pursuant to Article 68 of the Act on public offering, with regard to potential irregularities in the financial statements under review,

- issuing recommendations concerning the deficiencies and errors in the area of accounting policy application and disclosures in the financial statements, that were identified during the review, to put an end to any breach of information requirements.

[21] Final draft of Regulation of 17 December 2018 supplementing Directive 2004/109/EC of the European Parliament and of the Council with regard to regulatory technical standards on the specification of a single electronic reporting format

[22] https://www.esma.europa.eu/

Following the 2018 review of financial statements, that included nearly 22% of all securities issuers subject to our enforcement, we have identified the areas where the non-compliance with the applicable financial reporting framework was most common. In the period covered by this report, issuing recommendations to issuers was the primary enforcement tool intended to improve the quality of financial statements in those areas. This report contains a detailed description of the subject-matter of those recommendations. The most important recommendations concerned financial instruments (including disclosures on risk and impairment), threats to the ability to continue as a going concern and the impairment of non-financial assets.

This report also presents issues which require attention while drawing up financial statements for the financial year 2018 and subsequent reporting periods. As regards the above-mentioned issues, special attention should be paid to the provision of true and complete information on the risk associated with financial instruments, including changes to the disclosure requirements with respect to credit risk following the entry into force of IFRS 9. We would also like to draw your attention to the implementation of the new standard IFRS 16, which will significantly change the previous rules of lease recognition. Issuers should make every effort to disclose in their 2018 financial statements the quantitative effect of initial application of the standard.

The report also discusses certain issues regarding the new standards effective as of 1 January 2018: IFRS 9 and IFRS 15, IAS 38 with respect to capitalisation of development expenditure, IAS 37 and IAS 12 with respect to potential effects of tax inspections in the light of information requirements, as well as our expectations on how the issuers should apply those standards.

As regards practical application of IFRS, we encourage you to regularly visit the ESMA website and to read the ESMA publications concerning packages of decisions on the enforcement of financial information adopted by European supervisory authorities[23].

We believe that this report will contribute to the improvement in quality of the financial statements of securities issuers, including the coherent application of the applicable financial reporting framework and to the issuers' increasing compliance with reporting requirements. We encourage issuers and auditors to familiarise themselves with this document before the publication of the 2018 annual reports. We expect that the improvement in the quality of financial statements will lead to enhancing the investors' confidence in the information contained in the periodic reports that are made public.

[23] https://www.esma.europa.eu/press-news/esma-news/esma-publishes-22nd-extract-eecs-database

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