



## Clarity in financial reporting

### Regulatory focus areas – financial reporting in a COVID-19 environment

- The Australian Securities and Investments Commission (ASIC) has recently issued its [focus areas](#) for financial reporting in a COVID-19 environment. These are complemented by ASIC's frequently asked questions ([FAQs](#)) which are updated as circumstances evolve
- ASIC intends to review 200 full-year financial reports of larger listed entities and other public interest entities as part of its financial reporting surveillance for 30 June 2020. This review will focus on entities and industries adversely affected by the current conditions. ASIC will also review the adequacy of disclosure by entities that have been positively impacted
- Impairment of non-financial assets, such as goodwill and intangible assets has historically received strong focus from ASIC in its surveillance program and we anticipate that this will continue
- The impact of COVID-19 on both local and global economies, combined with the uncertainties it creates, introduces significant challenges in preparing financial reports. It is important to provide clear disclosures of the impacts on the entity, the uncertainties the entity faces, and the significant judgements and estimates made in compiling the financial report
- Documentation of the basis for, and the assumptions made, in determining significant judgements and estimates will assist in protecting both management and directors
- Areas to focus on include:
  - Going concern and subsequent events
  - Impairment of non-financial assets and other asset values, including inventory and deferred tax assets
  - Fair value of properties and investments in unlisted entities
  - Expected credit losses of loans and receivables
  - Lease accounting, including rent concessions
  - Liability recognition, including onerous contract and restructuring provisions
  - COVID-19 disclosures in the financial report and operating and financial review
  - Non-IFRS measures.

“... the quality of financial reports and related disclosures is more important than ever for investors and to maintain confident and informed markets”

**James Shipton, ASIC Chair**

## What are the top areas you should focus on for 30 June 2020?

The table below aims to provide a summary of ASIC focus areas, as well as our insights into these and other important areas for the June reporting season.

### Going concern and subsequent events

Analysis	Considerations
<p><b>Going concern</b></p> <p>It is important to carefully assess whether the current facts and circumstances may challenge the going concern basis of preparation.</p> <p>The assessment of whether an entity is a going concern is required up until the financial statements are authorised for issue.</p> <p>The Australian Accounting Standards Board and Auditing and Assurance Standards Board have issued a <a href="#">joint publication</a> on the impacts of COVID-19 on going concern, and the related assessments.</p>	<ul style="list-style-type: none"><li>• Disclosure is required when an entity exercises significant judgement in determining whether a material uncertainty regarding its ability to continue as a going concern exists. Potential disclosures include:<ul style="list-style-type: none"><li>– The events or conditions that indicate uncertainties exist and the severity of the entity's current financial position</li><li>– Management's plans to mitigate the financial position and whether they are within management's control or subject to third party actions, the status of the plans and their interdependency</li><li>– Feasibility of the plans or events that need to occur for the outcomes to be positive and why the outcomes are probable</li><li>– A summary of the existence of a material uncertainty and therefore that the entity may be unable to realise its assets and discharge its liabilities in the normal course of business</li><li>– Significant judgements resulting in the conclusion that no material uncertainty exists</li><li>– Other relevant information (e.g. contingent liabilities).</li></ul></li></ul>
<p><b>Subsequent events</b></p> <p>Given the rapidly changing environment, entities should carefully consider information that becomes available after the balance date, but before the financial statements are authorised for issue, to assess whether the financial statements should be adjusted or whether it reflects a change in conditions after the reporting date (and therefore disclosure is required).</p>	<ul style="list-style-type: none"><li>• If non-adjusting events are material, the nature of the event and estimate of its financial effect should be disclosed. The estimate does not need to be precise and it is preferable to provide a range as to the impact rather than no quantitative information</li><li>• However, where the impact cannot be reasonably estimated, a qualitative description should be provided, along with a statement that it is not possible to estimate the effect.</li></ul>



#### Further information

[ASIC FAQs: What are some factors to consider for assets, liabilities and going concern assessments?](#)

[Deloitte publication: What is the impact of COVID-19 on your going concern assessment?](#)

[AASB/AUASB publication: The impact of COVID-19 on Going Concern and Related Assessments](#)



## Impact of restrictions in Victoria and changes to JobKeeper on 30 June 2020 financial reports

UPDATED

ASIC has provided guidance in relation to impact of the Melbourne-wide Stage 3 and Stage 4 restrictions and the changes to the Federal Government’s JobKeeper support that were announced subsequent to 30 June 2020. This guidance was updated and expanded on 11 August 2020.

In ASIC’s view, the impact of these events on entities will depend on their exposures to the Victorian market, such as operations, suppliers and/or customers in Victoria. Entities may also be affected by the changes to JobKeeper and by general economic impacts flowing from the events.

ASIC further notes the following in relation to these developments:

“While these are new events that have occurred after 30 June 2020, they may affect assessments of asset values (such as assessments of impairment of non-financial assets, expected credit losses on loans and receivables, and fair values of investment assets), solvency and going concern.”

ASIC provides the following specific guidance on how these impacts may impact financial reporting at 30 June 2020:

### Asset values

Each company that is significantly affected directly or indirectly by the conditions in Victoria or the changes to JobKeeper could be expected to take the following approach in assessing discounted future cash flows supporting asset values as at 30 June 2020:

Event	Proportion of probability weighted scenarios	Weighting given
Expectation of Melbourne-wide Stage 3 restrictions	High proportion	High weighting
Expectation of some form of extension of JobKeeper	Some proportion	Some weighting
Expectation of some form of further restrictions in Victoria*	Small proportion	Low weighting

\* *The specific restrictions applying in Victoria from 2 August 2020 would not have been envisaged at 30 June 2020.*

Different companies may model larger or smaller numbers of scenarios or use other methods to achieve a similar outcome.

Disclosure on uncertainties, key assumptions and sensitivity analysis will be important for users of financial reports, as well as information and explanations presented in the operating and financial review. This may include disclosure of the extent to which the events in Victoria are factored into the determination of asset values and the estimate of the financial effect of subsequent events.

### Solvency and going concern assessments

Assessments of solvency and going concern should be based on conditions existing at the date of finalising the financial report for release, including the impact of all events that occurred up to that date and expectations of future events.

For more information, see [ASIC FAQ 2A: What is the impact of restrictions in Victoria and changes to JobKeeper on financial reports for periods ended 30 June 2020?](#)

## Impairment and other asset values

### Analysis

#### **Non-financial assets, such as goodwill and intangible assets**

The impacts of COVID-19 may be pervasive to an entity's impairment testing of non-financial assets under AASB 136 *Impairment of Assets*.

The most challenging area of the impairment test is likely to be making reasonable and supportable estimates of cash flows.

Users will be looking to the disclosures in the financial statements to understand the impact of COVID-19 on asset values.

### Considerations

#### *Cash flows*

- Cash flow assumptions should be reasonable and supportable
- Probability weighted cash flows that consider a range of possible scenarios on the expected speed of recovery and level to which business activities are expected to return (e.g. 'W-shape', 'V-shape' or 'U-shape' scenarios) may be more appropriate in this environment because of the inherent uncertainties
- Long-term growth rates may be lower than previous estimates

#### *Discount rates*

- Discount rates will need to be carefully considered. While the return on government bonds has decreased, discount rates may not decrease because credit spreads have increased, and the current volatility may necessitate the inclusion of a specific risk premium

#### *Disclosures*

- Enhanced disclosure may be required, including key assumptions (and the extent to which they reflect past experience or are consistent with external sources), period of projected cash flows, growth rates in the terminal value, discount rates, sensitivity analysis (where a reasonable possible change in assumption may give rise to an impairment) and scenario analysis (including possible recovery outcomes)

#### *Other considerations*

- Where market capitalisation is less than the carrying amount of net assets, this may raise questions around the recoverability of the assets
- Impairment models should include the impact of testing any right-of-use asset arising from the adoption AASB 16 *Leases*
- Assumptions relating to cash flow forecasts for impairment testing should be consistent, where appropriate, with areas such as going concern, expected credit losses and deferred tax asset recoverability.

#### **Inventories and deferred tax assets**

The impact of COVID-19 should also be considered on the following asset values:

- Net realisable value of inventories, including a reduction of demand or increase in inventory levels
- Recoverability of deferred tax assets.

#### *Disclosures*

- Where there is significant estimation uncertainty in determining these values, key assumptions and uncertainties should be disclosed
- Write downs of inventories should also be separately disclosed
- Where a deferred tax asset is recognised and the entity incurred a loss in either the current or prior period and utilisation is dependent on future taxable profits in excess of the profits arising from the reversal of existing taxable temporary differences, the amount and nature of evidence supporting the recognition of the asset should be disclosed.



### **Further information**

[ASIC FAQs: What are some factors to consider for assets, liabilities and going concern assessments?](#)

[Deloitte publication: Impairment: A diagnosis](#)

[Deloitte publication: Clarity in financial reporting: Focusing on impairment issues for June 2017](#)

## Clarity in financial reporting

Regulatory focus areas – financial reporting in a COVID-19 environment

### Fair value of properties and unlisted investments

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#### Analysis

There are several challenges in making fair value estimates in this environment.

ASIC has specifically referred to a number of factors that may adversely impact property values, such as expected changes in work practices, changes to on-line shopping from the traditional 'bricks and mortar' businesses and economic or industry impacts on future tenancy.

#### Considerations

##### *Potential changes in valuation*

- Changes in valuation techniques may be required where market transactions are no longer available
- Valuations typically performed on a rolling basis may need to be reassessed.

##### *Disclosures*

- If there is an increase in the use of unobservable inputs, the fair values may become level 3 measurements in the fair value hierarchy, with substantially increased disclosure requirements
- Key disclosures include:
  - Valuation techniques used, changes and reason for changes
  - Quantitative information for significant unobservable inputs
  - Description of sensitivity to changes in unobservable inputs
  - Sensitivity analysis of unobservable inputs that change the fair value significantly.



#### Further information

[Deloitte publication: What is the impact of COVID-19 on your unlisted asset valuation?](#)

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## Expected credit losses on loans and receivables

### Analysis

Expected credit losses (ECLs) are recognised for:

- Interest-bearing financial assets, such as commercial loans and mortgages, issued loan commitments and issued financial guarantee contracts (general model)
- Trade receivables, contract assets and lease receivables (simplified approach)<sup>1</sup>.

ECLs reflect the entity's forward-looking expectations of future credit losses and may be particularly challenging in this environment. ASIC has cautioned against using a mechanistic approach and highlighted that past models and historical experience may not be representative of expectations.

The significance of the judgements in determining ECLs mean that entities need transparent disclosures, including both qualitative and quantitative information of the uncertainties and key assumptions. This may include how forward-looking impacts of COVID-19 have been incorporated into ECLs estimates.

### Considerations

#### *Banking entities*

- For staging purposes (i.e. 12-month ECL vs lifetime ECL), estimation of the probability of default will be impacted by whether there has been a significant increase in credit risk (SICR) since initial recognition. In the current environment, banks have offered payment holidays to a broad range of customers, rather than tailoring it to the customer's specific situation. ECL models typically consider payment holidays as evidence of hardship and thus a SICR. However, in this case, payment holidays are not necessarily indicators of SICR. Models will need to be amended to consider this
- In addition, incorporating the impact of multiple economic scenarios, will likely require the use of model overlays with probability weighting of various scenarios (e.g. 'W-shape', 'V-shape' or 'U-shape' scenarios)

#### *Non-bank corporate entities*

- The simplified approach (e.g. for trade receivables) is usually less complex because of using average historical credit losses on a group of trade receivables with shared risk characteristics. In estimating ECLs, historical loss rates are adjusted to reflect current conditions and estimates of future economic conditions. To do this the portfolio may need to be further disaggregated and model overlays will likely be necessary to incorporate forward-looking information, including consideration of probability weighting various economic scenarios
- Where such entities hold interest-bearing assets, loans or guarantees (including involving joint ventures or associates), the general model will need to be applied
- Similarly, in separate financial statements, the general model will need to be applied in respect of long-term intercompany debt.



### Further information

[ASIC FAQs: How does the approach to expected credit losses on loans and receivables change?](#)

[Deloitte publication: What is the impact of COVID-19 on your unlisted asset valuations?](#)

[Deloitte publication: IFRS in Focus – Accounting considerations related to the Coronavirus 2019 disease](#)

<sup>1</sup> The election of the use of the simplified approach is a policy choice

### Lease accounting, including rent concessions

#### Analysis

For June reporters, AASB 16 *Leases* is effective for the first time and entities should provide disclosure of the adoption of the new standard.

In response to COVID-19, many lessors have been negotiating rent concessions with lessees, including waivers and/or deferrals of rent. The accounting for these rent concessions may be complicated and depends on the specific relief granted.

#### Considerations

##### *Rent concessions*

- AASB 16 was recently amended to allow lessees to elect a practical expedient to not treat COVID-19 related concessions as modifications if certain criteria are met. In such cases, the amendment requires that lessees should disclose the amount recognised in profit or loss in the period
- No relief was provided for lessors. As a result, ASIC issued specific [guidance](#) for lessors that are providing such concessions

##### *Disclosures*

- Entities should disclose any significant judgements, including determining the lease term where renewal options exist
- ASIC expects prominent disclosure of significant concessions – amounts, commencement date and expected duration of relief
- For lessors, the disclosure impacts extend to judgements made in determining ECLs relating to operating lease receivables that are expected to be waived

##### *Operating and financial review*

- ASIC has also indicated that entities that disclose an EBITDA measure, should disclose the dollar impact of adopting AASB 16 on that EBITDA measure. This is because AASB 16 results in the recognition of depreciation on the right-of-use (ROU) asset and interest on the lease liability, both of which are excluded from EBITDA. Previously EBITDA included the operating lease expense.



#### Net Tangible Asset (NTA) calculations and disclosures

*AFSL licence requirements:* ASIC has previously stated that ROU assets are intangible assets for the purpose of the licence requirements. This may impact whether an entity breaches the financial resource requirements because intangible assets are not taken into account, but lease liabilities are. As a result ASIC has issued a temporary [“no-action” position](#) that will apply until further notice. This position allows licensees to include ROU assets in the financial resources requirements and means that ASIC will not take regulatory action against licensees relating to past breaches from ROU assets not being able to be included in determining whether the requirements are met.

*NTA disclosures:* AASB 16 does not specify whether a ROU asset is tangible or intangible. Rather it requires lessees to present the ROU asset within the same line as a corresponding owned asset would be presented or disclose them separately. As a result, where such measures are disclosed, ASIC expects they are accompanied by a prominent footnote explaining whether all, some or no ROU assets have been included in the calculation of NTA.



#### Further information

[ASIC FAQs: How should a landlord account for rent concessions?](#)

[Deloitte publication: IFRS in Focus – Accounting considerations related to the Coronavirus 2019 disease](#)

## Liability recognition and other matters

Topic	Considerations
<b>Onerous contracts and restructuring provisions</b>	<ul style="list-style-type: none"><li>The impacts of COVID-19 may result in the unavoidable costs of meeting existing contracts exceeding the benefits expected and, as a result, the recognition of an onerous contract. Alternatively, restructuring initiatives may be considered or accelerated resulting in the recognition of provisions.</li></ul>
<b>Casual employment and leave entitlements</b>	<ul style="list-style-type: none"><li>In May 2020 the full bench of the Federal Court delivered its judgement in the matter of <i>WorkPac vs Rossato</i>. WorkPac has applied to the High Court for special leave to appeal this judgement. The judgement provides employers with guidance in applying the definition of a 'casual' employee and ruled that the employer could not 'offset' payments made as casual loading against leave entitlements owed under the Fair Work Act</li><li>Entities that employ 'casuals' should assess whether these employees continue to meet the definition under the Fair Work Act and, if not, consider whether they should provide for additional employee entitlements (including, annual leave, personal and carer's leave, compassionate leave, public holiday pay and redundancy payments) for past and present 'casual employees' who were employed in circumstances covered by the Court decision in <i>WorkPac vs Rossato</i>. Entities may need to seek legal advice in determining the appropriate accounting treatment.</li></ul>
<b>Revenue recognition, including variable consideration, contract modifications and disaggregated revenue disclosures</b>	<ul style="list-style-type: none"><li>Previous estimates of the transaction price may need to be reassessed because variable consideration (e.g. sales returns or liquidated damages) is only included where it is highly probable it will not result in a significant reversal</li><li>Modifications of customer contracts may have a significant impact on the timing and amount of revenue recognised in a period and should be assessed when the modifications are being negotiated</li><li>Disclosure of disaggregated revenue into categories that depict how the nature, amount, timing and uncertainty of revenue and cash flows are impacted by economic factors may need to be reassessed given the change in the economic environment.</li></ul>
<b>Contingent payments in business combinations dependent on employment</b>	<ul style="list-style-type: none"><li>Often business acquisitions include payments to the former owners of the acquired business in return for them remaining in employment (commonly referred to as earnout payments). When such payments are forfeited if the former owner does not remain in the employ of the entity, these payments should be recognised as remuneration and not as part of the consideration for the acquisition.</li></ul>
<b>Client monies</b>	<ul style="list-style-type: none"><li>When arrangements are entered into that involve client funds being held in trusts or similar facilities, entities should consider who controls the funds whether these funds represent an asset of the entity or not</li><li>Any restrictions on the transferability of cash should be transparently disclosed.</li></ul>

**COVID-19 disclosures**

<b>Topics</b>	<b>Considerations</b>
<p><b>Significant judgements and estimates</b> Disclosures will be one of ASIC’s key focus areas in June reporting. Entities can expect regulatory scrutiny to be rigorous.</p> <p>Early planning and timely preparation of position papers will enable management and directors to make informed decisions on key estimates and judgements and will support the quality of the financial information provided to the market.</p>	<ul style="list-style-type: none"> <li>• Entities should disclose all significant judgements and estimates. The disclosures should be specific to the entity including the impact on particular assets, liabilities, revenues and expenses as outlined in AASB 101 <i>Presentation of Financial Statements</i> paragraphs 122 to 133</li> <li>• Disclosures of significant estimates may include: <ul style="list-style-type: none"> <li>– Sources of estimation uncertainty</li> <li>– Assumptions made</li> <li>– Sensitivity and scenario analysis</li> </ul> </li> <li>• These significant judgements and estimates will differ from entity to entity, but most commonly include impairment of assets, fair values of investment property and investments, expected credit losses of loans and receivables, recovery of deferred tax assets and the assessment of the entity’s ability to continue as a going concern.</li> </ul>
<p><b>Government and other support</b> ASIC has emphasised that entities should prominently disclose support from government or third parties, such as financiers and landlords. Key disclosures include:</p> <ul style="list-style-type: none"> <li>• Significant amounts</li> <li>• Commencement date</li> <li>• Expected duration of the support.</li> </ul>	<ul style="list-style-type: none"> <li>• Examples include: JobKeeper, land tax relief, loan deferrals and restructuring and rent concessions</li> <li>• For items that are recognised as government grants such as JobKeeper and the related employee cost is expensed, for-profit entities have an accounting policy choice to present the grant income as other income, or alternatively deduct the grant from the related expense.</li> <li>• Where material, the accounting policy for these grants should be clearly disclosed together with the nature and extent of such grants. Separate disclosure is particularly important where the grant has been deducted from the related expense.</li> </ul>
<p><b>Supply chain financing arrangements</b> While not specifically mentioned by ASIC significant supplier financing or other similar arrangements, should be clearly disclosed.</p>	<ul style="list-style-type: none"> <li>• The presentation of such liabilities as trade and other payables or financing liabilities, presentation of related cash flows and note disclosures was discussed by the IFRS Interpretations Committee at its <a href="#">June meeting</a>.</li> <li>• Disclosures may include separate presentation of the amounts payable, key terms of the arrangements, accounting judgements applied in determining whether to present such amounts as payables or borrowings and how the risk and exposures are managed.</li> </ul>
<p><b>Current and non-current classification</b> Entities should pay attention to the classification of assets and liabilities between current and non-current in the statement of financial position.</p>	<ul style="list-style-type: none"> <li>• This may require consideration of maturity dates, payment terms and understanding the various covenants requirements and the related compliance with these covenants</li> <li>• Disclosures of these facilities, including specific liquidity disclosures are critical when they are material to the entity’s funding or viability.</li> </ul>
<p><b>Operating and financial review (OFR)</b> ASIC has emphasised that the OFR should complement the financial report and tell the story of how the entity’s business is impacted by COVID-19. The overall picture should be clear and understandable and supported by information to enable investors to understand the significant factors affecting the businesses and asset values.</p>	<ul style="list-style-type: none"> <li>• The OFR should identify and give appropriate prominence to all significant causes of adverse performance, not just those attributable to COVID-19</li> <li>• The OFR should explain the underlying drivers of the financial position and performance, the risks, management strategies to address the risk and impacts from COVID-19 and future prospects for the business.</li> </ul>

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### Further information

[ASIC FAQs: What disclosures should be made in the financial report? What disclosures should be made in the OFR?](#)

## Non-IFRS measures

### Analysis

ASIC continues to focus on the disclosure of non-IFRS financial information. The unprecedented nature of COVID-19 will result in additional non-IFRS measures disclosed in financial reports.

ASIC has specifically stated that non-IFRS profit measures that purport to show the result had COVID-19 not occurred or splitting profit or loss between a pre and post-COVID period is likely to be misleading.

### Considerations

#### *Financial statements and notes*

- Typically, non-IFRS measures may not be disclosed in the financial statements, except in segment reporting or earnings per share
- It may be possible to quantify and disclose in the notes, specific items of income or expense that arose solely due to the impact of COVID-19. However, caution should be exercised to ensure that only those items that are solely relate to COVID-19 are described as such

#### *Documents other than financial statements (OFR or investor presentations)*

- Non-IFRS measures should be appropriately reconciled to IFRS measures and not given undue prominence
- Non-IFRS measures should also be consistently determined and unbiased, including both positive and negative impacts.



### Further information

[ASIC FAQs: Can I use alternative profit measures that remove the impact of the COVID-19 pandemic?](#)

[Deloitte publication: Clarity in financial reporting: Non-IFRS measures – enhancements or embellishments?](#)

## Conclusion

We strongly recommend that entities:

- Carefully determine those areas of focus that require further attention in determining the appropriate application of Australian Accounting Standards
- Document the basis and assumptions for key judgements and estimates related to these areas
- Provide meaningful disclosures in the financial statements so that users can clearly understand the impact of the COVID-19 environment on the entity and its financial report.

Where more time is needed to ensure that all the reporting and governance requirements are met appropriately, ASIC has provided [extended deadlines](#) for both listed and unlisted entities.

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