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Responding to ASIC areas of focus

Financial reporting under COVID-19 and the emerging economic recovery

- The Australian Securities and Investments Commission (ASIC) recently issued its focus areas for December 2021 year ends. These are complemented by ASIC's frequently asked questions (FAQs)
- ASIC also announced that it reviewed 150 listed entity financial reports as part of its surveillance program for 30 June 2021
- ASIC made inquiries of 29 entities on 53 matters, of which 14 matters (26%) related to impairment of non-financial assets, including goodwill and intangible assets, and expected credit losses on loans and receivables
- In addition, revenue recognition, recoverability of deferred tax assets, expense deferral, recognition of make-good provisions and classification of debt as current or non-current also continue to be areas of inquiry
- The review also focused on disclosures of material business risks. As a result ASIC has urged directors to place greater focus on disclosure of material business risks in the operating and financial review (OFR)
- The impact of COVID-19, combined with the uncertainties around recovery, 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. Appropriate documentation of these assumptions can assist in protecting both management and directors

"Many entities face uncertainties about the future economic and market conditions. We continue to raise inquiries where the assumptions about future cash flows appear unsupportable, and where the impacts of COVID-19 conditions on the business were not clearly disclosed."

Sean Hughes, ASIC Commissioner

- Key updates to areas of focus relative to prior periods include the:
  - Calculation of the net realisable value (NRV) of inventory and inclusion of all estimated costs necessary to make the sale
  - Contingent payments to selling shareholders in a business combination and whether they are remuneration for service
  - Accounting treatment of written put options over the non-controlling interest in a subsidiary
  - Disclosure of the impacts of changes in circumstances from prior reporting periods on financial statement line items
  - Disclosure of climate risks by listed entities in the OFR
  - The accounting for bed licences by aged care providers following announcements that these licences will be discontinued.

What are the top areas you should focus on for 31 December 2021?

ASIC has said that the current changing environment in which each company operates will affect its strategies and its assumptions about the future performance of its assets and businesses. This could significantly affect assessments of asset values, liabilities and therefore the financial position. It remains more important than ever that investors and markets are properly informed through a company's financial reports, OFR and related disclosures about the underlying drivers of results, key assumptions, strategies, future prospects and risks in both full-year and half-year reports, as well as the changes therein from the previous periods.

Supply chain disruptions, labour shortages, commodity prices and general inflationary pressures

Although not specifically mentioned by ASIC in their media release, supply chain disruptions, labour shortages, increasing commodity prices and general inflationary pressures have arisen in various parts of the world as a result of the lifting of COVID-19 restrictions, governmental stimulus packages and global trade tensions. These factors may have pervasive impacts on financial reports at 31 December 2021 and should also be considered.

Supply chain disruption may significantly increase the production and distribution costs for many entities. Labour shortages may manifest in the form of employee turnover and demands for higher wages across all levels of the organisation. Increasing commodity prices have also been a reality faced by many entities. In addition to supply chain pressures and labour shortages directly affecting an entity's operations, general price inflation may also increase the cost of inventory or fulfilling customer contracts.

These pressures can have an impact on the costs of specific contracts or more broadly on the costs of an entity's operations resulting in the possibility of impairment or net realisable values issues or, in extreme cases, questions over whether an entity remains a going concern.

The tables on the following pages provide a summary of the ASIC focus areas, as well as our insights into these and other important areas of focus for the December 2021 reporting season.

Going concern and subsequent events

Analysis	Considerations
Going concern It is important to carefully assess whether the current facts and circumstances may challenge the going concern basis of preparation. ASIC's FAQs provides a list of factors for directors to consider in relation to performing a going concern assessment. The assessment of whether an entity is a going concern is required up until the financial statements are authorised for issue. The Australian Accounting Standards Board (AASB) and Auditing and Assurance Standards Board (AUASB) issued a joint publication in May 2020 on the impacts of COVID-19 on going concern and the related assessments.	• 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: – The events or conditions that indicate uncertainties exist and the severity of the entity's current financial position – 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 – Feasibility of the plans or events that need to occur for the outcomes to be positive and why these outcomes are probable – Significant judgements made in reaching a conclusion that no material uncertainty exists – Other relevant information (e.g. existence of contingent liabilities) – To the extent that a material uncertainty exists, a summary of the material uncertainty relating to the going concern assumption, and therefore that the entity may be unable to realise its assets and discharge its liabilities in the normal course of business.
Subsequent events Given the rapidly changing business 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).	• 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 of the impact rather than no quantitative information at all • 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.

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

Easing of restrictions, lockdown measures and removal of border closures in various states and territories as of 31 December 2021 and their impacts on financial reports

As at 31 December 2021, most states in Australia have largely eased lockdown measures and border restrictions in line with the Federal Government's roadmap for easing of COVID-19 restrictions, with vaccination rates for eligible persons 16 years and older moving past the 90% level across the country. Australia's state and international borders have begun opening as we move into the post-pandemic era of 'living with COVID-19'. However, the potential risk posed by the Omicron variant remains a relative unknown as infections have increased exponentially in states where restrictions have eased. Daily infections during January 2022 are at their highest level in Australia since the start of the pandemic and these are forecast to increase further before reaching a peak. This has meant many businesses face critical staffing shortages as staff are required to isolate and unable to work, exacerbating the impacts of staff shortages and supply chain disruptions.

As this situation was in place, albeit evolving, as at and prior to 31 December 2021, it should be considered as part of the financial reporting at December 2021 in areas such as asset values, expected credit loss calculations and net realisable value (NRV) assessments of inventories as of 31 December 2021. The broader impacts on economic factors such as consumer confidence and business investment will depend on the existence of further outbreaks or increases in hospitalisations, and the restrictions, lockdown measures and other responses of governments to the developing situation. This may require scenario analyses considering the impacts of possible further restrictions, government responses and resultant economic conditions.

Although the easing of lockdowns and border restrictions (and the related Omicron wave) was in place before year end, there is every possibility of new or reintroduced restrictions, further lockdowns, border closures or other related changes in 2022. It will be important to closely monitor subsequent developments and determine the impacts on the financial report (which may be limited to additional subsequent event disclosure). The impacts to consider include the impact of staff shortages and supply chain disruptions experienced due to the rapid increase in infections and the potential for further support measures from governments or third parties in response to the current or emerging situation.

Disclosure of uncertainties, key assumptions made and sensitivity analysis will be important for users of financial reports, including as it relates to information and explanations presented in the OFR. This may include disclosure of the extent to which the COVID-19 outbreak, resultant restrictions and government responses 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 authorising the financial report for issue, including the impact of all relevant events that have occurred up to that date and expectations of future events that extend at least 12 months from the reporting date.

For more information, see the potentially analogous situation discussed in ASIC FAQ 2A: What was 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	Considerations
Non-financial assets, including 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 the approach and judgements involved in making reasonable and supportable estimates of cash flows. Further, users will be looking to the disclosures in the financial statements to understand the impact of COVID-19 on asset values. These disclosures should include a clear explanation of changes in key assumptions between reporting periods under COVID-19 conditions as circumstances change or become clearer.	*Cash flows* • Cash flow assumptions must be reasonable and supportable • Probability weighted cash flows that consider a range of possible scenarios on the expected economic recovery may in certain circumstances be more appropriate in this environment because of the inherent uncertainties, including, for example: – Assumptions around the economic impact of the Omicron variant – The impact of easing of restrictions, the resulting effect on infection rates and the possibility of further lockdowns, restrictions or border control measures – The impacts on cost structures and throughput of supply chain disruptions, labour shortages, increasing commodity prices and general inflation and the ability to pass such costs on to customers – The level to which business activities are expected to return • Growth rates may be lower than historical growth rates, but may have improved relative to the prior year expectations as the economic recovery from the pandemic continues to unfold and new economic conditions develop *Discount rates* • Discount rates will need to be carefully considered. While the Australian cash rate of 0.1% has been steady since November 2020 and the Reserve Bank of Australia (RBA) has indicated its intention to hold official rates at this level for some time, there is increasing market uncertainty surrounding the timing of the withdrawal of quantitative easing and when an increase in rates might occur. These uncertainties and volatilities are being reflected in higher longer-term market interest rates which may impact discount rates used in impairment testing • The inclusion of a specific risk premium may be necessary depending on the degree to which entities and cash flow scenarios are impacted by those market expectations and other effects such as the Omicron outbreak in late 2021 and the impact of easing of restrictions and border control measures *Disclosures* • Enhanced disclosure may be required, including key assumptions and changes thereto (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 assets arising from the application of 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 • Indicators for the reversal of impairments relative to the preceding period should be carefully considered, noting that impairment on goodwill can never be reversed.

Analysis	Considerations
Inventories and deferred tax assets The impact of COVID-19 should also be considered on the following asset values: • NRV of inventories, including whether all estimated costs of completion and costs necessary to make the sale have been taken into account in determining that NRV • Recoverability of deferred tax assets.	*IFRIC agenda decision – costs necessary to sell inventory* • In June 2021, the International Financial Reporting Standards® Interpretations Committee (IFRIC) received a request about the costs an entity includes as the 'estimated costs necessary to make the sale' when determining the NRV of inventories, in particular whether an entity includes all costs necessary to make the sale or only those that are incremental to the sale • The IFRIC concluded that IAS 2 *Inventories* (AASB 102) does not allow an entity to limit such costs to those that are incremental and thereby potentially exclude costs the entity must incur to sell its inventory but that are not incremental to a particular sale • IFRIC further said that an entity should use judgement to determine which costs are necessary to make the sale in the ordinary course of business considering its specific facts and circumstances, including the nature of the inventories • Entities with material costs necessary to make the sale of inventories should consider whether the current accounting policies are consistent with those envisaged by the IFRIC decision *Impacts of supply chain disruptions, labour shortages, increasing commodity prices and general inflationary pressures* • Increased production and distribution costs may result in a higher cost of inventories and entities may need to consider whether a write down to NRV is required • Changes to manufacturing processes to allow for delays in receiving components or the use of alternative components will need to be reflected in inventory costing calculations • Supply chain disruption can increase the time taken to produce a finished product and therefore, the volume of unfinished inventory at the reporting date. This can make the accuracy of systems and controls to ensure that raw materials and work in progress (some of which may be physically held by third parties) are properly recognised and measured more important *Disclosures* • Where the impact of implementing the IFRIC agenda decision is material, this should be treated and disclosed as a change in accounting policy • Where there is significant estimation uncertainty in determining values of NRV of inventory, key assumptions and uncertainties should be disclosed • Write downs of inventories should 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 deferred tax asset should be disclosed.

Further information

ASIC FAQs: What are some factors to consider for assets, liabilities and going concern assessments?

Deloitte publication: Clarity in financial reporting: Focusing on impairment issues for June 2017

IFRIC Agenda decision: Costs necessary to sell inventories (IAS 2)

Analysis	Considerations
Cloud computing arrangements The IFRIC published an agenda decision 'Configuration or Customisation Costs in a Cloud Computing Arrangement' on 27 April 2021. The decision confirms that certain configuration and customisation activities undertaken in implementing Software-as-a-Service (SaaS) arrangements may give rise to a separate asset in only limited circumstances, for example where the customer controls the intellectual property of the underlying software code. In all other instances, configuration and customisation costs will be recognised as an operating expense. The IFRIC's conclusions have changed accounting practice and may have a significant impact on entities that have undergone digital migration projects from on-premises to cloud-based software solutions.	*Change in accounting policy* • For those entities that did not adopt the change at 30 June 2021, the adoption of the IFRIC decision should be accounted for as a change in accounting policy. Comparative financial information will need to be retrospectively restated in order to derecognise previously capitalised costs • This requires disclosure of the impact to the opening balance sheet at the beginning of the comparative period ('third balance sheet') • The change in accounting policy will most likely result in a reduction in net assets and opening retained earnings due to the derecognition of previously capitalised costs, with a corresponding adjustment to profit or loss in the period that the costs were incurred. The amortisation of these previously capitalised costs to profit or loss will be replaced with an operating expense in the period that the services were received. • Comparative information will also need to be restated in half-year financial reports (illustrative disclosures are available in our December 2021 model half-year report) *Other considerations* • ASIC's FAQ had previously indicated that they expected there to be sufficient time to identify past amounts capitalised that should be expensed before financial reports for 30 June 2021 were completed. However, there may be instances in which entities were unable to determine the impact by 30 June 2021 and did not derecognise capitalised costs at that point, in which case ASIC has made it clear that it expects such entities to do so for 31 December 2021 reports • Broader business impacts that result from the change in accounting treatment may include compliance with loan covenants that reference, for example, EBIT (earnings before interest and tax), EBITDA (earnings before interest tax, depreciation and amortisation) and profit before tax. Debt ratios may be impacted as a result of the reduction in net assets • The resulting impact on business metrics or targets that are sensitive to changes in these profit measures may impact the determination of performance hurdles in long term incentive schemes or earn-out clauses in business combinations, and these may need to be revised or renegotiated as a result.

Further information

ASIC FAQ – What are some other areas of focus for companies, directors and auditors for financial reporting?

Deloitte publication: Clarity in financial reporting: Software-as-a-Service arrangements

Fair value of properties and unlisted investments

Analysis	Considerations
There can be challenges in determining the fair value of property assets in this environment, particularly in areas where there may be a lack of market transactions. ASIC has specifically referred to a number of factors that may adversely impact property values, such as expected changes in office space requirements of tenants, shifts towards on-line shopping, future economic or industry impacts of tenants, financial condition of tenants and restructured lease agreements.	*Potential changes in valuation* • Changes in valuation techniques may be required where market transactions are no longer available, or become available in the current period where these were not available in the prior period • Valuations typically performed on a rolling or cyclical basis may need to be reassessed to ensure fair values are relevant *Disclosures* • Fair value measurements may change their classification in the fair value hierarchy. For example, if there is an increase in the use of unobservable inputs, fair values may become level 3 measurements in the hierarchy, which requires substantially increased disclosures • Key disclosures for level 3 measurements include: – Valuation techniques used, changes thereto 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?

Expected credit losses on loans and receivables

Analysis	Considerations
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 approach) • Trade receivables and contract assets that do not contain a significant financing component (simplified approach) • Trade receivables and contract assets which contain a significant financing component and lease receivables (policy choice to adopt the simplified approach). ECLs reflect the entity's forward-looking expectations of future credit losses and may be particularly challenging in this environment. ASIC has highlighted the need to assess whether past historical experience continues to be representative of future expectations in forming judgements relating to expected loss rates. 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 communicating how forward-looking impacts relating to COVID-19 and other relevant forward-looking economic data have been incorporated into ECL estimates. Entities should not automatically look to the approach and assumptions adopted at the previous financial year end (or half year) when developing their ECL expectations. As the economic and regulatory environment evolves, this may necessitate a change in expectations.	*General* • Many entities received government support and in some cases increased trading conditions in the prior (2020) period. However, as this support is being removed and combined with the reduction in lockdown measures, restrictions and border closures and related rises in infection rates from Omicron, there is the potential for further negative impacts as it relates to collectability of amounts due from customers. Furthermore, the impacts of supply chain disruptions, labour shortages, increasing commodity prices and inflation may impact customers' cash flow. Accordingly, estimates and assumptions around the collectability of amounts due may need to be revisited *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. For example, some banks had offered payment holidays to a broad range of customers as a result of COVID-19, rather than tailoring it to the customer's specific situation. ECL models typically consider payment holidays as automatic triggers of evidence of hardship and thus a SICR. In this case, payments holidays were not necessarily indicators of SICR. However, with the removal of support by banks and the ending of payment holidays, it may be that customers who continue to be overdue may likely be representative of a SICR. Models will need to be regularly refined to reflect current economic conditions • In addition, incorporating the impact of multiple economic scenarios will likely require the use of model overlays with probability weighting of various economic recovery scenarios *Non-banking 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 to reflect changes to the portfolios 'shared risk characteristics' • Where non-banking entities hold interest-bearing assets, loans or guarantees (including from 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 from subsidiaries • The ECL model will need to incorporate forward-looking information, including consideration of probability weighting various economic scenarios.

Further information

ASIC FAQs: How does the approach to expected credit losses on loans and receivables change?

Deloitte publication: Expected credit loss accounting considerations related to Coronavirus Disease 2019

Deloitte publication: Accounting considerations related to the Coronavirus 2019 disease

Lease accounting, including rent concessions

Analysis	Considerations
Companies should by now have firmly entrenched into their business-as-usual reporting the new requirements in AASB 16 *Leases* (that first applied for years commencing on or after 1 January 2019). In response to COVID-19 and under the National Cabinet Mandatory Code of Conduct for commercial properties, many lessors have negotiated rent concessions with lessees, including waivers and/or deferrals of rent. The Code of Conduct provisions originally only applied to 31 March 2021. However, following the prolonged lockdowns in certain states from June 2021, certain states amended their regulation to extend the period of support. As such, revised agreements to waive or defer rent may have been negotiated during the financial reporting period to 31 December 2021 and may also have an ongoing effect, both from a rent relief and accounting perspective. The accounting for these rent concessions may be complicated and depends on the specific relief granted.	*Rent concessions* • AASB 16 was amended to allow lessees to elect a practical expedient to not treat COVID-19 related rent concessions as lease modifications if certain criteria are met. These criteria have also been added to ASIC's FAQs for reference • In April 2021, this amendment was extended to include the impact of rent concessions up to 30 June 2022 (previously 30 June 2021). An illustrative example of disclosures resulting from these amendments can be found in our Deloitte Australia Tier 1 model financial statements • No relief was provided for lessors. As a result, ASIC issued specific guidance for lessors providing such concessions *Sale and leasebacks* • Entities should carefully assess the appropriateness of sale and leaseback accounting, particularly where it is determined that the transfer meets the definition of a 'sale'. ASIC has historically made inquiries of entities where these transactions resulted in a material gain on sale *Disclosures* • Entities should disclose any significant judgements relating to lease accounting, including determining the lease term where renewal options exist • ASIC expects prominent disclosure of significant landlord support received, including amounts, commencement date and expected duration thereof • For lessors, the disclosure impacts to consider extend to judgements made in determining ECLs relating to lease receivables that are expected to be waived.

Net Tangible Asset (NTA) calculations and disclosures

AFSL licence requirements: In an April 2021 media release, ASIC announced changes to the financial requirements in relation to the treatment of leased assets, which allows certain AFS licensees, where that licensee is a lessee, to include right-of-use (ROU) assets in the calculation of their NTA and, where in limited circumstances the ROU asset is a current asset, adjusted surplus liquid funds and surplus liquid funds. The Corporations Instruments effecting these changes result from a consultation process and follow on from the previously issued temporary 'no-action position' for AFS licensees.

Appendix 4E and Appendix 4D disclosure of NTA under the ASX Listing Rules: It is understood that the ASX will accept a ROU asset being classified as tangible or intangible, following the nature of the underlying asset. So, for example, a ROU asset associated with a lease of plant and equipment is classified as tangible for the purposes of the NTA per share calculation.

Where NTA measures are disclosed, ASIC expects they are accompanied by a prominent footnote on the same page 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?

Liability recognition and other matters

Topic	Considerations
Onerous contracts, lease make-good and restructuring provisions	• The impacts of COVID-19 may result in the unavoidable costs of meeting existing contracts exceeding the benefits expected to be received and, as a result, the recognition of an onerous contract. Alternatively, restructuring initiatives may be considered or accelerated resulting in the recognition of provisions • When goods are being produced to satisfy an existing customer contract, increased costs arising from supply chain disruption, labour shortages, increasing commodity prices and inflationary pressures might reduce the profitability of a contract or even result in a loss. If an entity is unable to raise its prices under a revenue contract with customers, it should consider the potential accounting implications of reduced or negative profitability on a revenue contract, including the period in which to record a loss if applicable • Contrarily, with the emerging economic recovery, entities may assess contracts previously assessed as onerous as no longer onerous, which would require the related onerous contract provisions to be released • A number of entities have recorded adjustments to amounts recognised for make-good provisions following ASIC inquiries during the 6-month period since 1 July 2021. Entities should ensure the adequacy of provisions to meet obligations relating to contractual lease make-good clauses • Entities should also consider the need to recognise any potential liabilities associated with cyber breaches or other cyber-security incidents.
Off-balance sheet arrangements	• ASIC continues to give attention to off-balance sheet arrangements, such as interests in non-consolidated entities, and has historically made inquiries of entities about the basis for an entity's apparent derecognition of trade receivables under debtor securitisation facilities.
Revenue recognition, including variable consideration, contract modifications and disaggregated revenue disclosures	• Previous estimates of the transaction price may need to be reassessed because variable consideration (e.g. sales returns or liquidated damages) should only be included where it is highly probable it will not result in a significant reversal • Price inflation may result in the need for renegotiation of long-term supply contracts, which in turn may have potential accounting implications • 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 • For disclosure purposes, the disaggregation of 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 changes in the economic environment.

Topic	Considerations
Employee entitlements	• Labour shortages may manifest in the form of employee turnover and demands for higher wages at all levels of the organisation • Changes to employee benefit packages (whether via bonuses, additional share-based payment awards or otherwise) will also need to be assessed carefully and accounted for in accordance with the requirements of AASB 119 *Employee Benefits* or AASB 2 *Share-based Payment* • Increased employee turnover and the shortage of employees may also put stress on an entity's internal control environments. As employee responsibilities shift, entities should assess whether the appropriately skilled and trained individuals are in place to effectively design, implement, operate and monitor controls, including controls related to information technology • Entities should monitor the appropriateness of the discount rate used to measure any pension-related liabilities, particularly since even a seemingly small change in the discount rate can affect an entity's pension liability significantly. For example, higher interest rates may lead to decreases in pension liabilities and required employer contributions. However, such decreases may be offset by higher employee wages.
Contingent payments in business combinations dependent on employment	• 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 in the post-acquisition periods to which they relate and not as part of the consideration for the acquisition (and thus not part of the goodwill computation) • Estimates of the measurement of these contingent payments (whether as part of the consideration for the acquisition or as remuneration) will need to be revisited to reflect changes in circumstances from the prior year as the economic recovery continues.
Written put options over non-controlling interests	• When acquiring less than 100% of the equity interests in a business, it is common that there will be a mechanism whereby the remaining non-controlling interest (NCI) has the ability to sell their interest to the acquiring entity at some point in the future • AASB 132: *Financial Instruments: Presentation* is clear that contractual obligations that represent an obligation for an entity to acquire its own equity interest should be recorded as a financial liability for the present value of the gross redemption amount payable in cash (referred to as a 'gross obligation'), rather than as a derivative at fair value.

Topic	Considerations
Aged care providers bed licenses	• As communicated in ASIC's FAQs, aged care providers should review the carrying amount of aged care bed licenses in view of the announcement in the Federal Budget for 2021-22 and the decision by the Australian Government that the licenses will be discontinued from 1 July 2024, as a result of the reforms following the Royal Commission into Aged Care Quality and Safety • The Federal Department of Health subsequently released a discussion paper in September 2021 dealing with the proposed transition to the new regime • Aged care providers should consider how the discontinuation of the current licensing regime impacts intangible assets appearing on balance sheets, in particular whether to commence amortisation, change the amortisation period or whether the licenses should be impaired • Disclosure of significant judgements and sources of estimation uncertainty in this regard will also need to be considered.
Half-year financial reports	• Half-year reports must explain the events and transactions that are significant to understanding the changes in financial position and performance since the end of the previous annual financial report • With the inherent uncertainties and rapidly changing conditions under COVID-19 conditions, entities may need more disclosures than usual in their 31 December 2021 half-year financial reports to explain the impacts of changing conditions and significant developments that have occurred since the last full-year report • Half-year financial reports should provide disclosure on relevant matters including estimation uncertainties, key assumptions and liquidity risk disclosures. The half-year OFR should also disclose business impacts, underlying drivers of performance, strategies, risks and future prospects.
Dividends	• It is important that entities considering paying a dividend ensure they consider all appropriate accounting, legal and tax aspects before declaring a distribution • For entities incorporated under the *Corporations Act 2001*, the declaration of dividends is subject to the 'net assets test' in s.245T. In order to pay a dividend, an entity must have sufficient net assets, the declaration of a dividend must be fair and reasonable to the company's shareholders, and the payment of a dividend must not materially prejudice the company's ability to pay its creditors • Under Australian tax law, a dividend can only be franked if it is paid out of profits. Accordingly, a 'profits test' remains relevant for these purposes, and many argue that the profits test also remains relevant in relation to the declaration of dividends under the *Corporations Act 2001* • Entities seeking to pay a dividend, or frank a distribution, that is paid other than out profits available in the entity itself, should ensure appropriate legal and tax advice is sought.

Disclosure

<table>
<tr><th>Topics</th><th>Considerations</th></tr>
<tr><td>Significant judgements and estimates
Disclosures will be one of ASIC's key focus areas in December reporting. Entities can expect regulatory scrutiny to be rigorous.

This includes clearly disclosing changes in key assumptions between reporting periods under COVID-19 conditions as circumstances change or become clearer.

Early planning and timely preparation of accounting position papers will enable management and directors to make informed decisions on key estimates and judgements to support the quality of the financial information provided to the market.</td><td>• 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 Presentation of Financial Statements paragraphs 122 to 133
• Disclosures of significant estimates may include:
– Sources of estimation uncertainty
– Assumptions made
– Sensitivity and scenario analysis
• 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.</td></tr>
<tr><td>Government and other support
ASIC has emphasised that entities should prominently disclose support received from government or third parties, such as financiers and landlords. Key disclosures include:

• Significant amounts
• Commencement date
• Expected duration of the support.</td><td>• Examples of support include JobKeeper, JobSaver, various state-wide 2021 COVID-19 business grants, land tax relief, loan deferrals and restructuring, and rent concessions received during the reporting period
• For items that are recognised as government grants such as JobKeeper where 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
• 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
• Where entities voluntarily elect to return JobKeeper payments or other amounts, clear disclosure of material amounts returned should be made
• New JobKeeper obligations commenced on 14 September 2021 requiring listed entities that received JobKeeper payments to give notice to the relevant market operator in a JobKeeper notice within 60 days of the commencement date (in respect of prior periods), or otherwise within 60 days of finalisation of its financial report. This notice includes disclosure of, amongst other items, the total amount of JobKeeper payments the entity received and whether or not the entity made any voluntary repayments of such payments (including the amount of those repayments).</td></tr>
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Topics	Considerations
Supplier finance arrangements While not specifically mentioned by ASIC, significant supplier financing or other similar arrangements, should be clearly disclosed. In November 2021, the IASB published ED/2021/10 *Supplier Finance Arrangements*, that proposes to require new disclosures by entities participating in supplier finance arrangements as the buyer. The presentation of liabilities relating to supplier finance arrangements as trade and other payables or financing liabilities, and the presentation of related cash flows and note disclosures was previously discussed by the IFRIC with the finalisation of an agenda decision in December 2020, which ultimately lead to the release of the Exposure Draft.	• There is a continued focus from global regulators on supplier finance arrangements. Entities with material arrangements need to ensure that there is appropriate disclosure of these arrangements to enable users to assess the effect of these arrangements on the entity's liabilities and cash flows • In particular, entities should consider the substance of the arrangement and whether the nature of liabilities arising from supplier finance arrangements are trade and other payables or a borrowing. Consequently, entities should consider whether to present these liabilities as trade or other payables or as borrowings, or whether to present them separately in the statement of financial position • Whichever classification is deemed appropriate, clear disclosure should be provided of: – The entity's approach to the presentation of significant supplier financing arrangements – The carrying amount of the liabilities and the line item(s) in which they are presented – How supplier financing transactions have been presented in the entity's statement of cash flows – When supplier financing arrangements have been used as a tool to manage liquidity risk, the disclosures required by paragraph 39(c) of AASB 7 *Financial Instruments: Disclosures* • Although the proposals in ED/2021/10 are still in exposure draft phase, the proposals clarify and expand on the disclosure we would expect of entities with material supplier finance arrangements. We recommend entities with material arrangements consider the proposals of the ED in conjunction with the IFRIC agenda decision in developing their disclosures.
Current and non-current classification Entities should pay attention to the classification of assets and liabilities as current and non-current in the statement of financial position.	• The assessment of current vs. non-current classification may require consideration of maturity dates, payment terms and understanding the various covenants requirements and the related compliance with these covenants in debt agreements • Entities should ensure that current conditions are incorporated into the assessment of the entities compliance with covenants on or before the reporting date, and the resulting impact on the classification of liabilities as either current or non-current.

Topics	Considerations
Operating and financial review (OFR) and climate-related disclosures 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. On 15 December 2021, ASIC's media release urged greater focus on the disclosure of material business risks in the financial reports and stated that the OFR should contain information that investors would reasonably require to make an informed assessment of the entity's operations, financial position and business strategies, and prospects for future financial years, by disclosing material risks that may affect the achievement of these strategies or prospects. The OFR should identify and give appropriate prominence to all significant causes of adverse performance, not just those attributable to 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. ASIC has specifically called out that forward-looking information provided should have a reasonable basis. Further, ASIC has highlighted that climate-related risks could have a material impact on the future prospects of entities. ASIC encourages listed companies to use the Task Force on Climate-related Disclosures (TCFD) recommendations as the primary framework for voluntary climate-related disclosures.	*General* • The circumstances of companies and the environment can change significantly from one reporting period to the next under COVID-19 conditions. The continuing volatile economic conditions could significantly affect the assessment of asset values, liabilities and therefore the financial position The OFR should explain the underlying drivers of the financial position and performance, the risks, management strategies to address these risks, impacts from COVID-19 and future prospects for the business. ASIC specifically mentioned that it will continue to closely review financial reports to ensure that entities are correctly disclosing their material business risks. • ASIC regulatory guide section RG 247.62 – RG 247.63 provides guidance on what directors should consider in making these disclosures relating to material business risks. In particular, the regulatory guide notes that discussion about an entity's future prospects should be balanced and is likely to be misleading without referring to the material business risks that could adversely affect the achievement of the financial prospects described. *Climate-related disclosures* • In meeting their responsibilities in relation to climate reporting, ASIC encourages directors and senior management of listed companies to understand and continually reassess existing and emerging risks, including climate risk. Entities should develop and maintain strong and effective corporate governance to facilitate identifying and managing material risks. Further, directors should consider the disclosure of material business risks affecting future prospects in an OFR • ASIC identify climate change in ASIC Regulatory Guide section RG 247.66 as a systemic risk that could have a material impact on the future financial position, performance or prospects of entities. Directors of listed companies with material exposures to climate risk should consider disclosing information that would be relevant in this respect, and ASIC encourages the voluntary use of the TCFD recommendations • On 3 November 2021 at COP26, the IFRS foundation trustees announced the establishment of the International Sustainability Standards Board (ISSB), tasked with developing global high-quality sustainability disclosure standards to meet investors information needs. On the same date, the IFRS Foundation published a climate-related disclosures prototype standard to provide recommendations to the ISSB. We are expecting that the ISSB will endeavour to release global climate reporting standards during calendar year 2022.

Further information

ASIC FAQs: What disclosures should be made in the financial report? and What disclosures should be made in the OFR?

ASIC article: ASIC welcomes new International Sustainability Standards Board and updated climate-related disclosures guidance

ASIC article: Managing climate risk for directors

Deloitte publication: Disclosure of climate-related risks

Deloitte publication: Climate related risk disclosures – Answer the challenge of the TCFD recommendations

Non-IFRS measures

Analysis	Considerations
ASIC continues to focus on the disclosure of non-IFRS financial information. Volatility resulting from the emerging economic recovery, the impacts of Omicron, supply chain disruption, labour shortages, commodity prices and general inflationary pressures could result in an increase in entities seeking to utilise non-IFRS measures in communicating their financial performance and position to stakeholders or to otherwise exclude the impacts of some of these events from the entities reported profit measures. 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.	*Financial statements and notes* • Typically, non-IFRS measures should not be disclosed in the financial statements, except in presenting segment reporting or earnings per share information • It may be possible to quantify and disclose specific items of income or expense that arose solely due to the impact of COVID-19 in the notes. However, caution should be exercised to ensure that only those items that are solely related to COVID-19 are described as such, and that items that are related to the broader current economic environment are not labelled as being due to COVID-19 *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 from period to period and be unbiased, including both positive and negative impacts • ASIC has specifically called out that where asset impairment losses were excluded from a non-IFRS profit measure in a prior period, any subsequent impairment reversal should also be excluded from that measure for the current period.

Further information

ASIC FAQs: Can I use alternative profit measures that remove the impact of the COVID-19 pandemic?

Deloitte publication: Non-IFRS measures – enhancements or embellishments?

Extension of reporting deadlines for 31 December 2021 reports for unlisted entities

Where more time is needed to ensure that all the reporting and governance requirements are met appropriately, ASIC has provided extended deadlines for unlisted entities only, which provides an additional one month for entities with balance dates between 24 December 2021 and 7 January 2022. Note that there have been no deadline extensions provided for listed entities.

The extended deadlines may assist with current pressures on resourcing for the audits of entities, in order to provide adequate time for the completion of the audit process taking into account the challenges presented by COVID-19 conditions.

Further information

ASIC FAQ: Reporting deadlines and AGMs

ASIC article: ASIC to extend deadlines for 31 December 2021 unlisted entity financial reports

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 report so that users can clearly understand the impact of the COVID-19 environment and the emerging economic recovery, including significant changes in circumstances since the prior period, on the entity and its financial report.

Contacts

Jonathan Streng
Director
jstreng@deloitte.com.au

Frank Betkowski
Principal
fbetkowski@deloitte.com.au

Alison White
Partner
aliswhite@deloitte.com.au

Anna Crawford
Partner
acrawford@deloitte.com.au

Clive Mottershead
Partner
cmottershead@deloitte.com.au

Henri Venter
Partner
hventer@deloitte.com.au

Moana Overton
Partner
moverton@deloitte.com.au

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