# Clarity in financial reporting

## Summary of key actions, developments and dates in financial reporting for June 2020

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# Key actions

*Topics to focus on right now*

## Transparency is key to June reporting

The impacts of the COVID-19 crisis on both the local and global economies, combined with the uncertainties it has created, introduces significant challenges in preparing financial reports for June 2020.

An important response to these challenges is to enhance the transparency of the financial report so that readers understand the impacts of the crisis on the entity and the decisions, judgements and uncertainties involved in compiling the financial report.

ASIC has also announced that disclosures will be one of its key focus areas in June reporting. Entities can expect regulatory scrutiny to be rigorous. 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.

Transparency is particularly important in the following areas:

### Significant judgements and estimates

The COVID-19 crisis has led to more variability and uncertainty underlying the preparation of the financial report. As a result, a broader range of disclosures, in both full year and half-year reports may be required, including consideration of AASB 101 *Presentation of Financial Statements* paragraphs 122, 125 and 129, amongst others. Disclosures may include:

- Sources of estimation uncertainty
- Assumptions made
- Sensitivity and scenario analysis.

Key estimates and judgements 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.

Entities should also take care to ensure that assumptions relating to future cash flows are consistent across the different estimates and judgements, and any differences are attributable to different requirements of the relevant accounting standard.

The broader financial reporting package should also address how the business is impacted by COVID-19, its strategies in response and its prospects. This may require discussion of the underlying drivers of financial performance, strategies and risks, impacts on supply and demand, covenant compliance and lending arrangements and liquidity management (either in the financial statements or the operating and financial review).

### Impairment

The impacts of COVID-19 may be pervasive to an entity's impairment testing under AASB 136 *Impairment of Assets* and users will be looking to the financial statements, more than ever, to understand the impact of COVID-19 on asset values.

The most challenging area of the impairment test is likely to be making reasonable and supportable estimates of cash flows. In contrast to prior tests which may have been determined using a single estimate of cash flows over the forecast period, entities may now use a weighted probability approach to cash flows which considers a range of possible scenarios on the speed at which recovery is expected as well as the level to which business activities are expected to return. Terminal value cash flows and long term growth rates may also be more modest than previous estimates.

Given the COVID-19 crisis, more disclosure is expected and may include:

- Key assumptions
- Description of approach to each of the key assumptions, whether they reflect past experience, whether they are consistent with external sources of information, and, if not, how and why they are different from past experience or external sources
- Period of projected cash flows, growth rates in the terminal value and discounts rates
- Sensitivity analysis, where a reasonably possible change in a key assumption could cause impairment
- Scenario analysis, including possible recovery outcomes.

## Government support

Where the entity has taken advantage of the various government COVID-19 support packages such as JobKeeper or loan guarantees, it is important the nature and impacts of these schemes are clearly disclosed.

Overall, readers of the financial statements should be able to understand:

- What support the entity has received
- How the support has been accounted for
- How it has impacted the financial position, financial performance and cash flows of the entity, including, where appropriate areas such as segment reporting, impairment and operating and financial review.

## Non-IFRS profit measures

Information about the impact of COVID-19 on the entity's results is useful to investors and it is important to disclose the underlying drivers of results in the operating and financial review. However, ASIC is concerned that entities may disclose non-IFRS profit measures that purport to show the result had COVID-19 not occurred and has therefore published an FAQ to provide additional guidance.

ASIC's view is that any non-IFRS profit measures should be unbiased and not used to avoid presenting 'bad news' to the market. Measures purporting to show the result had the impact of the COVID-19 pandemic not occurred are likely to be misleading as they will be hypothetical and may not show the actual performance of an entity. It may also not be possible to reliably identify and separately quantify the impact of the COVID-19 pandemic.

Furthermore, ASIC has stated that presenting a split of profit or loss between pre-COVID-19 and post-COVID-19 periods is problematic and can be potentially misleading.

## Fair value measurements

The impacts of COVID-19 may require changes in valuation techniques (e.g. market transactions may not be available) and changes in categorisation of fair value measurements in the 'fair value hierarchy' (often to 'Level 3'). This is particularly relevant for direct and indirect investments in properties and infrastructure and other unlisted investments.

AASB 13 *Fair Value Measurements* requires disclosures about both recurring and non-recurring fair value measurements, particularly those categorised as 'Level 3' in the fair value hierarchy, and may include the following disclosures:

- Valuation techniques used, changes in those techniques and reason for change
- Quantitative information about the significant unobservable inputs used in the fair value measurements
- Narrative description of sensitivity to changes in unobservable inputs
- Sensitivity analysis of unobservable inputs that change fair values significantly.

## Going concern

Consistent with the conclusion reached by the IFRS Interpretations Committee in July 2014, disclosure is required when an entity concludes there is no material uncertainty regarding its ability to continue as a going concern but reaching this conclusion involved significant judgement. This requires disclosure of the significant judgements made and is important to provide users of the financial statements with enough information to understand the pressures on liquidity, viability and solvency.

The AASB and AUASB have issued a joint publication on the impacts of COVID-19 on going concern and related assessments which includes a section on going concern disclosures in various scenarios.

Potential disclosures where there is significant judgement in determining whether a material uncertainty exists may include:

- Commentary on the events or conditions (e.g. deterioration in the financial results, working capital or cash constraints) that indicate the uncertainties exist at or arose post the balance date and the severity of the entity's current financial position
- Commentary on management's plans and options (e.g. capital raising, refinancing, or cost reductions etc) 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 options and their interdependency
- Commentary on the feasibility of the plans or events that need to occur for the outcomes to be positive and why the outcomes are probable
- Based on the above:
  - A summary of the existence of material uncertainty and therefore the entity may be unable to realise its assets and discharge its liabilities in the normal course of business or
  - Significant judgements in management's evaluation that no material uncertainty exists e.g. evidence that plans are effective, additional financing, waiver of covenants, loan guarantees, government grants
- Other relevant information (e.g. interface with contingent liabilities such as legal claims).

## Subsequent events

Each subsequent event should be assessed in accordance with AASB 110 *Events After the Reporting Period* to determine whether it provides evidence of conditions that existed at the end of the reporting period (and therefore should be adjusted for in the financial statements) or whether it reflects a change in conditions after the reporting date (and therefore disclosure is required).

For example, if a debtor is placed into voluntary administration soon after the reporting date, should this be taken into account in determining the expected credit losses at reporting date? We expect this assessment may involve significant judgement for the June reporting period, and therefore management should allow sufficient time in its reporting calendar to consider such events.

If non-adjusting events are material, an entity is required to disclose the nature of the event and an estimate of its financial effect. The estimate does not need to be precise. It is preferable to provide a range of estimated effects as an indication of impact to not providing any quantitative information at all. However, where the quantitative effect cannot be reasonably estimated, a qualitative description should be provided, along with a statement that it is not possible to estimate the effect.

## Liquidity risk management

Liquidity disclosures, including how the entity manages its liquidity risk, are particularly important in this time of uncertainty. Entities should consider how the use of working capital enhancement or management techniques is reflected in the entity's disclosure of its liquidity risk management as required by AASB 7 *Financial Instruments: Disclosures*.

Entities should also consider the specific disclosure requirements for transfers of financial assets as required by AASB 7 when financial assets are sold to fund working capital needs and the accounting policies and judgements applied in determining the balance sheet and cash flow statement presentation of amounts due and paid when supplier finance and reverse factoring arrangements are used.

This could include separate presentation of amounts payable, key terms of arrangements, accounting judgements applied in determining whether to present such amounts as payables or borrowings and how risks and exposures are managed.

**Action:** COVID-19 is likely to have a pervasive impact on many financial statements. Each entity must ensure that the impacts of COVID-19 and other events and circumstances are transparently disclosed throughout the financial statements.

**More information:** See the tools below.

## Helpful tools for June reporting

The following resources are available to assist with reporting at 30 June 2020:

### Key resources

- Deloitte Accounting Research Tool – a 'one-stop shop' to iGAAP, IFRS and more with great search functionality (subscription required for some content)
- Model financial statements and Australian financial reporting guide – illustrative examples of disclosures and guidance on the Australian financial reporting framework

### *Clarity in financial reporting* newsletters relevant for June reporting:

- A diagnosis for your impairment assessment
- What is the impact of COVID-19 on your unlisted asset valuations?
- Learnings from ASIC findings — considerations for next reporting season
- Focusing on impairment issues
- Disclosure of climate-related risks
- Non-IFRS measures – enhancements or embellishments?
- Revised financial reporting deadlines due to COVID-19

### Recent *IFRS in Focus* publications relevant for June reporting:

- IASB finalises amendment to IFRS 16 'Leases' regarding COVID-19-related rent concessions
- Accounting considerations related to the Coronavirus 2019 Disease
- COVID-19 and financial reporting under IFRS Standards
- Expected credit loss accounting considerations related to Coronavirus Disease 2019

### Other COVID-19 resources related to financial reporting:

- Deloitte COVID Accounting Navigator – centralised platform of Deloitte services to assist with financial reporting requirements in response to the COVID-19 pandemic
- Economic scenarios for the COVID-19 recovery – guiding strategic, financial and operational decisions (from Deloitte Access Economics)
- IAS Plus COVID-19 page
- IAS Plus COVID-19 video series
- AASB coronavirus (COVID-19) guidance
- AASB-AUASB publication: *The impact of coronavirus on financial reporting and the auditor's considerations*
- AASB-AUASB publication: *The impact of COVID-19 on going concern and other related assessments*
- ASIC COVID-19 implications for financial reporting and audit
- ASIC COVID-19 information
- ASX action on COVID-19
- UK FRC Guide – COVID-19 – Resources, action, the future
- UK FRC Guide – COVID-19 – Going concern, risk and viability

**Action:** Use these helpful resources during the upcoming reporting season.

## Lessee rent concession amendment finalised

The IASB and AASB have finalised amendments to provide lessees with a practical expedient not to assess whether COVID-19-related rent concessions are lease modifications and allows lessees to account for such rent concessions as if they were not lease modifications.

The practical expedient will only apply to rent concessions as a direct consequence of COVID-19 that meet all of the following conditions:

- The change in lease payments results in revised consideration for the lease that is substantially the same as, or less than, the consideration for the lease immediately preceding the change
- Any reduction in lease payments affects only payments originally due on or before 30 June 2021
- There is no substantive change to other terms and conditions.

A lessee that applies the practical expedient would generally account for:

- The forgiveness or waiver of lease payments as a variable lease payment. The lessee would therefore derecognise that part of the lease liability that has been extinguished by the forgiveness of lease payments with a corresponding credit in profit or loss, the timing of which will depend on the facts and circumstances
- A change in lease payments that reduces payments in one period but proportionally increases payments in another (such that there is no change to the overall consideration for the lease and only the timing of individual payments changes), by continuing to recognise interest on the liability and reduce that liability for payments made to the lessor. This will necessitate a recalculation of the amortisation table using the original discount rate.

If the lease payments are reduced in one period but increased by a lower amount in a later period (hence the total consideration is lower) the change in lease payments incorporates both a forgiveness of payments and deferred lease payments.

The lease liability recognised by a lessee applying the practical expedient would represent the present value of future lease payments owing to the lessor.

The lessee also discloses the amount recognised in profit or loss to reflect changes in lease payments arising from COVID-19-related rent concessions.

The amendment applies on a modified retrospective basis for annual reporting periods beginning on or after 1 June 2020.

**Action:** Many entities have negotiated, or are still in the process of negotiating, rent concessions as a result of the COVID-19 pandemic. Entities intending to rely on the practical expedient should put in the place the necessary process to adopt the amendments early, e.g. for entities reporting under the *Corporations Act 2001*, appropriate directors' resolutions for early adoption must be made under s.334(5).

**More information:** IFRS in Focus newsletter

## New audit remuneration disclosures

In February 2020, the Federal Parliamentary Joint Committee on Corporations and Financial Services released *Regulation of Auditing in Australia: Interim Report* (available at parlinfo.aph.gov.au). This report includes a recommendation to introduce defined categories and associated fee disclosure requirements in relation to audit and non-audit services.

Entities are encouraged to provide transparent and expanded disclosures in their financial reports at 30 June 2020. Suggested categories include:

- Fees to the group auditor for the audit or review of the statutory financial reports of the Group, subsidiaries and joint operations
- Fees for statutory assurance services that are required by legislation to be provided by the auditor (e.g. certain reporting to APRA, Queensland Building and Construction Commission reports, AFSL Form FS 71)
- Fees for other assurance and agreed-upon procedures under other legislation or contractual arrangements (e.g. assurance on revenue information under a royalty agreement, comfort letters or agreed-upon procedures on other reports) when there is discretion as to whether the service is provided by the auditor or another firm
- Fees for other services (e.g. tax compliance).

**Action:** We encourage entities to adopt these disclosures in their financial reports.

# Key developments

*A summary of topics you need to know about. For a full summary of international developments, see IFRS on Point*

## Tax law expands entities required to prepare 'GPFS' for 30 June 2020

Recent tax legislation changes how large taxpayers are classified and widens those required to lodge general purpose financial statements (GPFS).

The new requirements amend the *Income Tax Assessment Act 1997* and *Tax Administration Act 1953* to introduce a new 'CBC reporting entities' category which will have obligations for country-by-country reporting and, if the entity is a corporate tax entity that prepares tax returns (e.g. a head entity in a tax-consolidated group), the lodgement of GPFS with either ASIC or the Australian Tax Office.

Entities already facing a GPFS requirement for tax purposes will not be impacted, and will continue to prepare GPFS, albeit as 'CBC reporting entities' rather than as 'significant global entities'.

Our Clarity newsletter provides an overview of the changes.

**Why now?** The requirements apply retrospectively to income years commencing on or after 1 July 2019. Therefore, newly captured entities with June year ends (or shorter periods commencing after 1 July 2019) will have to prepare GPFS in the current period.

For the purposes of considering whether the A$1 billion global annual income threshold is met (therefore requiring GPFS), the net of entities captured is extended to:

- Groups that have not previously prepared consolidated financial statements (e.g. foreign entities or trust and partnerships that currently have no requirement to prepare financial statements)
- Groups that have only prepared stand alone financial statements (e.g. entities that qualified for exemption from consolidation or foreign entities that are subject to different accounting standards)
- Entities, which were part of a group, but not consolidated due to being immaterial.

This may introduce a new requirement to prepare GPFS for:

- Groups using non-corporate structures, e.g. trust, partnerships
- Some privately held groups
- Entities controlled by foreign parents, or foreign entities operating permanent establishments in Australia
- Groups with ultimate parent entities previously preparing 'stand-alone' financial statements.

**More information:** *Clarity* publication, Tax Insights: *Expanded definition of Significant Global Entity – 10 June 2020*

# Key dates

*Important dates that are the most relevant at the current time.*

## Revised reporting deadlines update

As noted in our May 2020 newsletter, ASIC has enacted temporary extensions for reporting obligations in light of COVID-19.

In addition, the ASX has issued a waiver that permits entities to comply with the revised ASIC deadlines in meeting the ASX Listing Rules. The waiver imposes additional conditions, with the effect that listed entities must:

- Lodge the Appendix 4E or Appendix 4D in the normal timeframes
- Lodge unaudited accounts in lieu of audited information where the relief is relied upon
- Announce to the market that the entity is relying on the extension
- Keep the market informed of changes to the unaudited accounts
- Comply with the extended ASIC lodgement deadline for lodgement of the audited financial report.

Our *Clarity* newsletter provides a handy summary of the revised deadlines.

**More information:** *Clarity* publication, Class Waiver Decision – Extended Reporting and Lodgment Deadlines

## Client financial reporting updates

In light of COVID-19 we have changed our May 2020 Client Financial Reporting Update to be delivered virtually. There are three webinars available:

- **COVID financial reporting** – Covers basis of preparation and disclosures, impairment and fair values, financial instruments, leases, government grants and tax impacts, revenue and onerous contracts and other impacts
- **For-profit entity financial reporting update** – Discusses risks from bushfires, COVID-19 and climate change, ASIC focus areas, new standards and interpretations and changes to the Australian reporting framework
- **Not-for-profit (NFP) entity financial reporting update** – Covers NFP-specific COVID-19 considerations, new accounting standards, AASB developments, regulatory updates and the ACNC legislative review.

Most readers should have already received an invitation, however, the webinars can be accessed by registering here

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