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Responding to ASIC areas of focus

Financial reporting in times of risk and uncertainty

- The Australian Securities and Investments Commission (ASIC) recently issued its focus areas for June 2022 year ends
- ASIC also announced that it reviewed 70 listed entity financial reports as part of its surveillance for 31 December 2021, ten of which were IPOs in the past 18 months
- ASIC made inquiries of 18 entities on 31 matters. Ten related to insufficient disclosure of business risks in the operating and financial review (32%) and seven related to recoverability of asset values (23%)
- Recognition of restoration and lease make-good provisions, revenue recognition, expense deferral and classification of debt as current or non-current also continue to be areas of inquiry
- ASIC has urged directors to place greater focus on disclosure of material business risks in the operating and financial review (OFR), de-emphasising the impacts of COVID-19 in favour of broader economic risks and uncertainties like the impact of rising interest rates and oil prices, geopolitical risks (including the Russia-Ukraine conflict), discontinuation of financial support, changes in customer behaviours and availability of skilled staff and expertise
- ASIC has also emphasised the disclosure of environmental, social and governance risks and ensuring consistency between disclosures in the OFR and any other voluntary climate related disclosures provided
- In order to provide useful and meaningful information, in compiling the financial report 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. Appropriate documentation of these assumptions can assist in protecting both management and directors
- Additional ASIC updates relative to prior periods include the:
  - Disclosure of material penalties for non-compliance with sanctions imposed in relation to Russia
  - Ensuring the recognition of assets, liabilities, income and expenses in registered scheme balance sheets and income statements where scheme members have in substance pooled interest in assets and returns.

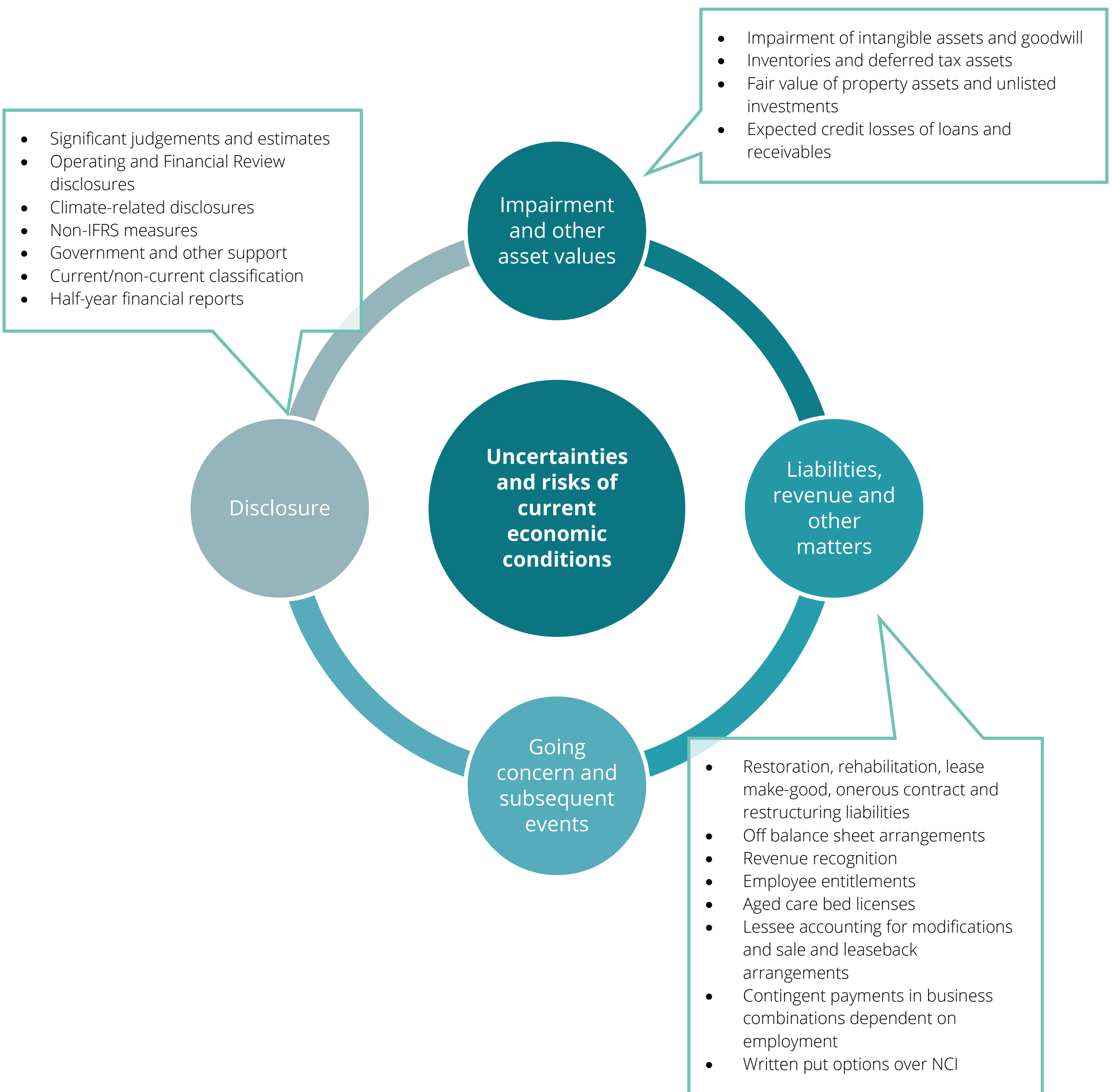
> Companies face changing market conditions and uncertainties. Directors should assess the impacts on financial performance, asset values and provisions to ensure demands for better information on uncertainties, assumptions, strategies and risks are met
>
> **Sean Hughes, ASIC Commissioner**

What are the top areas you should focus on for 30 June 2022?

ASIC has said that the current risks and uncertainties resulting from the changing economic environment in which each company operates may affect its strategies and its assumptions about the future performance of its assets and businesses. Companies will be affected differently depending on their industry, where they operate, how their suppliers and customers are affected and many other factors. This could significantly affect assessments of asset values and liabilities. In recent times, industries that ASIC has specifically identified as being affected include entities in, or connected with, the construction industry, commercial real estate and large carbon emitters.

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 , as well as the changes therein from the previous periods. Despite the inherent uncertainties relating to the current environment and challenges this poses for financial reporting, assumptions underlying estimates and assessments for financial reporting purposes should be reasonable and supportable.

The diagram below summarises the key themes which are discussed in further detail in the pages that follow.



The Russia-Ukraine conflict, climate and extreme weather events, rising interest rates, supply chain disruptions, labour shortages, commodity prices and general inflationary pressures

ASIC has de-emphasised the impacts of COVID-19 in its most recent focus areas for 30 June 2022 reports, as the path out of the pandemic in Australia has become clearer with confidence gradually increasing that the worst of the pandemic is behind us.

However, the COVID-19 pandemic preceded a number of economic and geopolitical shocks and these have not quietened down. On the contrary, uncertainty is as present as it was before, with the advent of the Russia-Ukraine conflict driving volatility in commodity prices and currencies, and floods and extreme rain events in Eastern Australia which have come as the global community moves towards 'living with' the COVID-19 pandemic. Australia has a newly elected government that appears to be willing to drive climate change issues as global warming remains an ever present threat to the sustainability of businesses. Supply chain disruptions, labour shortages, increasing commodity prices and general inflationary pressures have arisen in various parts of the world. Further, the Reserve Bank of Australia (RBA) has begun increasing interest rates with further increases looming on the horizon. These factors may have pervasive impacts on financial reports at 30 June 2022 and should be carefully considered in the preparation of the financial report.

Recent interest rate rises have increased the cost of borrowing (and therefore discount rates) which are an input into many valuation models and measurement calculations including incremental borrowing rates, recoverable amount calculations and provisions. Flooding in Eastern Australia has exacerbated the already existing supply chain disruption caused previously in part by the lack of migrant skilled workers and border restrictions, and may also significantly increase the production and distribution costs for many entities as well as putting inflationary pressure on goods. Labour shortages have manifested in the form of employee turnover and lead to demands for higher wages. Increasing commodity prices have also been a reality faced by many entities and oil prices have further contributed to the general inflationary environment for purchased goods and services.

These economic, geopolitical and environmental risks and uncertainties are pervasive to the preparation of an entity's financial report. They can have an impact on the assets, liabilities, incomes and expenses associated with specific contracts or more broadly on an entity's operations resulting in the possibility of issues around asset recoverability (e.g. impairment or net realisable values), measurement of liabilities and provisions or, in extreme cases, questions over whether an entity remains a going concern.

Uncertainty is pervasive in accounting and reporting. Accounting Standards accommodate this uncertainty through specific measurement requirements and associated disclosure requirements, and an overall requirement to explicitly call out key judgements made in applying the entity's accounting policies, information about assumptions about the future, and sources of estimation uncertainty. These disclosures are critical to a reader's understanding of the financial report and are key focus area for regulators.

The table below provides a summary of the ASIC focus areas, as well as our insights into these and other important areas of focus for the June 2022 reporting season.

Impairment and other asset values

Analysis

Non-financial assets, including goodwill and intangible assets

The impacts of current economic conditions may be pervasive to an entity's impairment testing of non-financial 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. The determination of recoverable amount is complex and addressing the uncertainties may require the exercise of a significant amount of judgement.

As part of this process, entities must determine how long current economic conditions are expected to be sustained. For instance, should inflation and supply constraints be considered temporary? Are employee costs forecast to increase? What does forward demand look like? Can cost increases be passed onto customers in the short and medium term? In times of higher uncertainty, it may be necessary to perform probability weighted analysis of various outcomes to arrive at a final model of recoverable amount.

Entities should consider the impact of market volatility when determining the appropriate date for impairment analysis, as inputs such as market capitalisation and the risk-free rate may move materially.

Further, users will be looking to the disclosures in the financial statements to understand the impact of current risks and uncertainties on asset values.

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.

Enhanced disclosure may be required, including the key inputs and assumptions used in the recoverable amount and changes thereto, and the extent to which inputs reflect past experience or are consistent with external sources. Sensitivity analysis should also be provided where a reasonable possible change in assumptions may give rise to an impairment.

Considerations

Cash flows

- Cash flows should be based on reasonable and supportable assumptions with greater weight placed on external observable evidence
- Entities should compare assumptions to past actual cash flows and historical results as well as consider their level of historical forecasting accuracy when forming cash flow estimates, but also noting that in the current environment, 'history may not be a guide to the future'
- Where a fair value approach is used, ASIC has raised questions about discounted cash flow methodologies that appear to be largely dependent on management's inputs
- Probability weighting a range of possible expected economic outcomes may be more appropriate in the current economic environment because of the inherent uncertainties, including, for example:
  - Direct or indirect impacts of the Russia-Ukraine conflict, including market volatility and increasing oil and other commodity prices
  - The impacts on cost structures and throughput of supply chain disruptions, labour shortages, general inflation
  - Consideration of direct and indirect impact of climate and extreme weather events, as well as the future impact of an entities' commitments to climate change and policies on climate and carbon emissions by government
  - The impacts of all of the above on working capital items (such as inventory and receivables) and capital investment assumptions
- Forecast demand as reflected in growth rates may be lower than long term historical growth rates and may have changed relative to prior year expectations as the economic recovery from the pandemic continues, tempered by new economic conditions that continue to develop
- Whether cost increases can be passed on to customers may require consideration of the price elasticity of the products and services
- Current year indicators for impairment reversals should be carefully considered in the overall context of current economic conditions and should be reasonable and supportable.

Discount rates

- Discount rates will need to be carefully considered. After the Australian cash rate remained at record lows for much of the COVID-19 pandemic, the Reserve Bank of Australia (RBA) increased this rate by 75 basis points during the first half of 2022, with every indication that further rates increases will occur during 2022 and into 2023. As at the time of writing this report, the Australian Government 10-year bond rate is close to 4%. These higher interest rates are likely to lead to a consequential increase to discount rates used in impairment testing and should be considered as a potential indicator of impairment
- In times of expectations of higher sustained uncertainty, it may also be reasonable to reassess the impacts on investor expectations for the cost of capital
- The inclusion of a risk premium may be necessary depending on the degree to which cash flow scenarios are impacted by risks and uncertainties, however noting that risks for which cash flows can or have already been adjusted should not also be adjusted for in the discount rate.

Analysis	Considerations
Inventories and deferred tax assets The impact of current economic conditions of risk and uncertainty should also be considered for the following asset values: • Net realisable value (NRV) of inventories, including whether all estimated costs of completion and costs necessary to make the sale have been taken into account • Recoverability of deferred tax assets.	*IFRIC agenda decision – costs necessary to sell inventory* • In June 2021, the IFRS Interpretations Committee (IFRIC®) finalised its agenda decision in relation to 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 excluding costs the entity must incur to sell its inventory but that are not incremental to a particular sale • An entity should use judgement to determine which costs are necessary to make the sale in the ordinary course of business considering its own specific facts and circumstances, including the nature of the inventories • Entities with material costs necessary to make the sale of inventories should consider whether their current accounting policies are consistent with those envisaged by the IFRIC agenda decision and ensure disclosure of the accounting policies are appropriately updated. *Impacts of extreme weather events, 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 • Abnormal wastage caused by any unexpected events that are not normal to the production process should be expensed and not capitalised • Changes to manufacturing processes to allow for delays in receiving supplies, 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 increase the volume of unfinished inventory at the reporting date. This can make the accuracy of systems and controls that ensure raw materials and work in progress (some of which may be physically held by third parties) are properly recognised and measured more critical to the financial report. *Deferred tax asset recoverability* • Assumptions made for estimating the recoverability of deferred tax assets should be consistent, where appropriate, with those made for impairment testing of goodwill and other non-financial assets • Where a deferred tax asset is recognised and the entity incurred a tax loss in either the current or prior period, the amount and nature of evidence supporting the recognition of the deferred tax asset should be disclosed. *Disclosures* • Where the impact of implementing an 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 the NRV of inventory, key assumptions and uncertainties should be disclosed • Write downs of inventories should be separately disclosed.

Further information

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

Analysis	Considerations
Fair value of properties and unlisted investments There can be challenges in determining the fair value of property assets in this uncertain economic environment, particularly in areas where there may be a lack of market transactions. Property and unlisted investments are typically 'level 3' in the fair value hierarchy, because their valuation inherently relies on judgement regarding unobservable inputs such as the entity's own data. Third party property valuations have increasingly included caveats to draw attention to the reduced reliability of observable market data. In addition, they draw upon historical pricing benchmarks and in the current environment consideration needs to be had to whether those pricing benchmarks are still relevant or require adjustment.	*Potential changes in valuation* • Valuations typically performed on a rolling or cyclical basis may need to be reassessed to ensure fair values are relevant and consider (at least) the factors that ASIC has specifically referred to such as rising interest rates, expected changes in office space requirements of tenants, on-line shopping trends, future economic or industry impacts of tenants, financial condition of tenants and restructured lease agreements • ASIC has identified that companies in the commercial property sector are likely to be specifically impacted by current economic conditions • Valuations in the commercial property sector draw upon historical pricing benchmarks and in the current environment consideration needs to be had to whether those pricing benchmarks are still relevant or require adjustments. In the absence of such considerations, changes in, or emphasis on alternative valuation techniques may be required • In arriving at valuations for entities with interests in countries directly impacted by the Russia-Ukraine conflict, consideration should be given to whether the relevant markets be accessed. *Disclosures* • The classification of fair value measurements within the fair value hierarchy may change. For example, if there is an increase in the use of unobservable inputs, fair values may become level 3 measurements in the hierarchy, requiring substantially increased disclosures • Key disclosures for level 3 measurements include: o Valuation techniques used, changes thereto and reason for changes o Quantitative information for significant unobservable inputs o Description of sensitivity to changes in unobservable inputs o Sensitivity analysis of unobservable inputs that change the fair value significantly.

Analysis

Expected credit losses on loans and receivables

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 uncertain 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 relevant forward-looking economic data has 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. ECL models are often complex and must evolve to reflect current conditions at each reporting date – rolling forward previous assumptions is unlikely to be appropriate in volatile environments.

Considerations

General

- Many entities received government support in prior periods. However, as this support is removed , there is the potential for further negative impacts relating to collectability of amounts due from customers
- Furthermore, the impacts of rising interest rates, 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
- Recent publicised business insolvencies in specific industries (e.g. building and construction) may mean that there is increased exposure to credit risk in specific industry sectors which should be carefully analysed. Such instances highlight the importance of obtaining up to date information about the circumstances of debtors, including liquidity issues, earning capacity and financial condition of these debtors.

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. With the removal of support and payment holidays by banks, it may be likely that customers who continue to be overdue as support is lifted indicates the presence of a SICR. Models will need to be regularly refined to reflect current economic conditions and uncertainties
- 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
- Recent interest rate increases are expected to negatively impact loans and mortgages collectability with resulting increases in the probability of default. Entities should assess their exposure to credit losses after considering the value of collateral held against these loans.

Non-banking entities

- The simplified approach (e.g. for trade receivables) is usually less complex because of the use of 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 those 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 from subsidiaries
- The ECL model will need to incorporate forward-looking information, including consideration of probability weighting various economic scenarios.

Liabilities, revenue and other matters

Topic	Considerations
Onerous contracts, mine site restoration provisions and lease make-good and restructuring provisions A number of entities have recently recorded adjustments to amounts recognised for mine site restoration and lease make-good provisions following ASIC inquiries. Entities should ensure the adequacy of these types of provisions to meet legal obligations relating to restoration, rehabilitation and lease make-good clauses.	• Entities should understand the nature of their obligations (both legal and constructive) for rehabilitation and lease make-good (is there a present obligation as a result of a past event) and thereafter consider the basis for their measurement • Liabilities for long term obligations such as rehabilitation, decommissioning and similar obligations can be significantly impacted by current economic conditions, including changes in interest rates impacting discount rates used to measure present value, inflation in costs (including employee costs) impacting expected cash outlays, and impacts of climate change affecting the timing of outlays. These factors can result in large changes in the measurement of provisions from period to period • 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 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 • The impacts of current economic conditions 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 • Restructuring provisions should only be recognised for costs necessarily related to the restructuring and to the extent that the entity has committed to a formal plan • Entities should also consider the need to recognise any other potential liabilities, including those arising from financial guarantee contracts or 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 derecognition of trade receivables under debtor securitisation facilities.

Topic	Considerations
Revenue recognition, including identification of performance obligations, variable consideration, contract modifications and disaggregated revenue disclosures	• In recent years, we have seen ASIC make a number of inquiries regarding the identification of performance obligations in licensing arrangements particularly where there may be multiple performance obligations that could impact the timing of revenue recognition • With adverse changes in prevailing economic conditions, 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 in revenue 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.
Employee entitlements	• Changes in inflation and the possibility of higher wages and salary costs than expected can also impact the measurement of long service provisions and other employee entitlements. Such provisions may not have changed significantly in recent years in a low wage growth environment • 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. As a higher interest rate environment is in place relative to prior periods, this may lead to decreases in pension liabilities and required employer contributions. However, such decreases may be offset by higher employee wages and reductions in plan assets.
Aged care providers bed licenses	• 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 (then) 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 legislation has not been formally passed and so the final position will depend on the newly elected government, however Labor has previously indicated that it supported this change • 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.

Topic	Considerations
Lease accounting COVID-19 has dramatically changed commercial real estate requirements across office space, retail and hospitality assets. There has been a significant increase in the extent of leases that have been renegotiated or modified as customers leasing requirements adapt to life after the pandemic. Further, as some entities look for ways to generate liquidity, sale and leaseback arrangements have become more common. ASIC has historically made inquiries of entities where these transactions resulted in a material gain on sale.	*Lease modifications* • Lease modifications should be accounted for from the effective date of the modification, which is typically the date that the modification is signed and becomes legally enforceable • Entities are reminded that the COVID-19 practical expedient for rent abatements is no longer available for any concessions that extend rent relief beyond 30 June 2022 • Revised discount rates should be determined, and current incremental borrowing rates are likely to be different from those applied in previous years in the environment of rising interest rates. *Sale and leaseback transactions* • 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'. Failure to satisfy the criteria for a 'sale' will mean that a financial liability is recognised for the cash proceeds received, with no gain or loss on the sale. *Other* • Right-of-use assets should be included in an entity's impairment testing processes, either at an individual asset level or a cash-generating unit level, depending on facts and circumstances.
Contingent payments in business combinations dependent on employment	• Although not specifically included in ASIC's focus areas for 30 June 2022 financial reports, ASIC has historically made inquiries of entities in situations where 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. Historically, ASIC has made inquiries of entities' accounting for these types of arrangements • 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.

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. Recent going concern issues for example in the building and construction industry have highlighted that specific industries are more vulnerable to the challenges posed by current economic conditions than others.	• The directors' declaration for an entity reporting under the *Corporations Act 2001* requires an explicit statement that the entity can pay its debts as and when they fall due. 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 • The impact of current economic conditions should be carefully considered in order to determine whether the assessment of solvency and going concern remains appropriate. In considering these requirements in an uncertain environment, entities will need to consider: o The extent of any operational disruption o Potential reduced demand for products and services o Contractual obligations due or anticipated o Potential liquidity and working capital shortfalls o Access to existing sources of capital (e.g. available lines of credit) • Additional disclosures are required when an entity exercises significant judgement in determining whether a material uncertainty regarding its ability to continue as a going concern exists.
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 may be 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.

Disclosure

Topics	Considerations
Significant judgements and estimates Disclosures will be one of ASIC's key focus areas in June 2022 reporting. Entities can expect regulatory scrutiny to be rigorous. This includes clearly disclosing changes in key assumptions between reporting periods under current economic conditions of increased risk, uncertainty and changing circumstances. 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.	• 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: o Sources of estimation uncertainty o Assumptions made o Sensitivity and scenario analysis • These significant judgements and estimates will differ from entity to entity, but most commonly relate to 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.
Government and other support ASIC has emphasised that entities should prominently disclose material amounts of support received from government or third parties, such as financiers and landlords.	• In the current period, the discontinuation of this support could potentially lead to going concern issues or even insolvencies and therefore this information could be critical to users understanding of an entities' financial position. • Key disclosures include: o Material amounts o Expected duration of the support o Impacts of discontinuation of support.
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 entity's compliance with covenants on or before the reporting date, and the resulting impact on the classification of liabilities as either current or non-current.
Half-year financial reports Half-year reports should 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 economic conditions in force, entities may need more disclosures than usual in their 30 June 2022 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 reports should provide disclosure on relevant matters including estimation uncertainties, key assumptions and liquidity risk disclosures.

Topics	Considerations
Operating and financial review (OFR) 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 current economic risks and uncertainties. On 15 December 2021, ASIC's media release urged greater focus on the disclosure of material business risks in the financial reports in order to balance disclosures about the entity's future prospects. The media release 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. ASIC has specifically called out that forward-looking information provided should have a reasonable basis. ASIC has also emphasised in their latest media release that the most significant business risks that could affect the achievement of the disclosed financial performance or outcomes should be provided, including a discussion of environmental, social and governance risks, whilst noting that an exhaustive list of generic risks that might potentially affect a large number of entities would not be helpful. Of the entities who received inquiries from ASIC, five have already lead to the entity releasing additional announcements or disclosures in response to ASIC's review of their financial report.	• The OFR should identify and give appropriate prominence to all significant causes of adverse performance, especially in the current rapidly changing business environment as the circumstance of companies can change significantly from one reporting to the next under current economic conditions. Over the past six months this could be relating to the floods in Eastern Australia and other severe weather events, supply chain disruptions, labour shortages, rising interest rates and general inflationary pressures • The OFR should explain the underlying drivers of the financial position and performance, the risks, management strategies to address these risks, 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 • Risks should be described in context – for example, why the risk is important or significant and its potential impact and, where relevant, factors within the control of management • ASIC regulatory guide section RG 247.62 – RG 247.63 provides guidance on what directors should consider in making 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, including climate.

Topics	Considerations
Climate-related disclosures Following the establishment of the International Sustainability Standards Board (ISSB) during 2021, in March 2022 the ISSB published two exposure drafts, namely 'IFRS S1' and 'IFRS S2'. Further, in May 2022 the ISSB announced the steps it intends to take to establish a comprehensive global baseline of sustainability disclosures. The IFRS Foundation has outlined how integrated reporting will be incorporated into the work of the IASB and ISSB. The speed of these global developments highlights the urgency of calls from the global investor community, regulators and standard setters for climate related reporting. Entities need to respond to these recent rapid global developments for standardised environmental, social and governance (ESG) reporting and be aware of recent Australian developments exploring how global developments might be implemented in the Australian context. 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 and consider reporting voluntarily under the TCFD framework in order to provide useful information to investors.	• ASIC has highlighted that climate-related risks could have a material impact on the future prospects of entities. 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 Task Force on Climate-related Disclosures (TCFD) recommendations as the primary framework for voluntary climate-related disclosures • As mentioned, the ISSB published two exposure drafts: o **Exposure Draft IFRS S1** ***General Requirements for Disclosure of Sustainability-related Financial Information*** – this exposure draft proposes requiring the disclosure of information about significant sustainability-related risks and opportunities (including, but not limited to, climate change). The exposure draft includes proposals for definitions and requirements that are consistent with the IASB® *Conceptual Framework for Financial Reporting,* IAS 1 *Presentation of Financial Statements* and IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* pronouncements for financial reporting. Sustainability-related financial disclosures would be required to be published at the same time as the financial statements o **Exposure Draft IFRS S2** ***Climate-related Disclosures*** – this exposure draft addresses climate change in more detail and incorporates the recommendations of the TCFD and includes metrics tailored to industry classifications derived from the industry-based Sustainability Accounting Standards Board (SASB) • Jurisdictional authorities will decide whether to require the application of IFRS Sustainability Disclosure Standards, just as they have decided whether to require the application of IFRS Accounting Standards. The ISSB does not have the right to mandate the application of its Standards. However, companies can choose to apply them. Comments on the ISSB proposals close on 29 July 2022 • Australia's newly elected Labor government's stated climate policy should be taken into account in impairment testing, useful life assessments of assets, provision estimation and other relevant financial reporting areas. In the future, it may be more likely that some form of sustainability reporting framework may be implemented in Australia, reinforcing regulatory and investor expectations for such reporting in the near and medium terms.

Further information

ASIC article: Managing climate risk for directors

ASIC article: ASIC encourages submissions to the ISSB consultation on global baseline climate and sustainability disclosures

Deloitte publication: iGAAP in focus – Sustainability reporting – ISSB proposes global baseline of sustainability disclosure standards for capital markets

Analysis	Considerations
Non-IFRS measures ASIC continues to focus on the disclosure of non-IFRS financial information. Volatility resulting from current economic events including supply chain disruption, labour shortages, commodity prices, rising interest rates, extreme weather events, geopolitical instability 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.	*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 once-off 'black swan' events such as the recent flood events in the notes. However, caution should be exercised to ensure that only those items that are solely related to these events are described as such, and that items that are related to the broader current economic environment are not labelled as being attributable thereto. *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?

Reporting deadlines for 30 June 2022 reports

Unlike in previous reporting periods where ASIC provided extended deadlines for certain entities in order to provide adequate time for the completion of the audit process taking into account the challenges presented by COVID-19 conditions, at the time of publishing this paper no extensions to reporting deadlines have been proposed by either ASIC or the ASX for listed entities.

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 current economic conditions of risk and uncertainty, including significant changes in circumstances since the prior period, on the entity and its financial report.

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