Technical Accounting Alert

TA 2022-05

ASIC focus areas for 30 June 2022 financial reports

INTRODUCTION

The purpose of this Alert is to draw attention to the Australian Securities and Investments Commission's (ASIC) Media Release 22-124MR *ASIC highlights focus areas for 30 June 2022 reporting*.

ASIC Commissioner Sean Hughes says "Many companies are facing changing market conditions and uncertainties. Directors and preparers should assess the impact on current and future performance, asset values and provisions. They should also ensure that increasing demands for better information for investors on uncertainties, key assumptions, business strategies and risks are met as required under the existing reporting regime for both annual and half-year reports."

Note that this document is heavily based on 22-124MR as issued by ASIC and accessed on 1 June 2022. Certain additions/amendments have been made for clarity and/or inclusion of additional guidance only.

OVERVIEW

The Media Release highlights ASIC's expectation that directors, preparers, and auditors focus on the areas of:

1. Asset values;
2. Provisions;
3. Solvency and going concern assessments;
4. Events occurring after year-end and before completing the financial report; and
5. Disclosures in the financial report and Operating and Financial Review (OFR).

These items are explored in more detail in the Appendix to this document.

Specifically, ASIC has highlighted that companies will be affected differently depending on their industry, where they operate, how their suppliers and customers are affected, and a range of other factors. Companies may continue to face some uncertainties about future economic and market conditions, and the impact on their businesses. Assumptions underlying estimates and assessments for financial reporting purposes should be reasonable and supportable.

Industries that may be particularly affected include the construction industry, owners of commercial property and large carbon emitters.

Uncertainties may lead to a wider range of valid judgements on asset values and other estimates. These uncertainties may change from period to period. Disclosures in the financial report about uncertainties, key assumptions and sensitivity analysis will be important to investors.

The Operating and Financial Review (OFR) should complement the financial report and tell the story of how the entity's businesses are impacted by both COVID-19 and non-COVID-19 factors. The underlying drivers of the results and financial position should be explained, as well as risks, management strategies and future prospects. Forward-looking information should have a reasonable basis and the market should be updated through continuous disclosure if circumstances change. Further guidance can be found in ASIC's Regulatory Guide 247 Effective disclosure in an operating and financial review.

THE REPORTING PROCESS

ASIC expects appropriate experience and expertise to be applied in the reporting and audit processes, particularly in more difficult and complex areas, such as asset values and other estimates.

Directors and auditors should be given sufficient time to consider reporting issues and to challenge assumptions, estimates and assessments.

Directors should make appropriate enquiries of management to ensure that key processes and internal controls have operated effectively during periods of remote work.

The circumstances in which judgements on accounting estimates and forward-looking information have been made, and the basis for those judgements, should be properly documented at the time and disclosed as appropriate.

ASIC SURVEILLANCE

ASIC plans to review the full-year financial reports of selected larger listed entities and other public interest entities as at 30 June 2022.

APPENDIX: FOCUS AREAS FOR 30 JUNE 2022 REPORTS

1. Uncertainties and risks

A number of uncertainties and risk that may affect asset values, liabilities and assessments of solvency and going concern include:

- COVID-19 conditions and restrictions during the reporting period;
- changes in customer preferences and online purchasing trends;
- use of virtual meetings and more flexible working arrangements;
- the discontinuation of financial and other support from governments, lenders and lessors, including any possible increases in the level of insolvencies;
- the availability of skilled staff and expertise;
- ongoing restrictions to deal with COVID-19 in different jurisdictions;
- the impact of rising interest rates on future cash flows and on discount rates used in valuing assets and liabilities;
- increases in oil prices;
- geopolitical risks, including the Ukraine/Russia conflict;

- commitments and policies on climate and carbon emissions by governments;
- technological changes and innovation;
- legislative and regulatory changes; and
- other economic and market developments.

This list is not intended to be exhaustive and there may be other factors to consider in the circumstances of individual entities. These factors may also be relevant in assessing the ability of an entity's borrowers, debtors and lessees to meet their obligations to the entity, and the ability of key suppliers to continue to provide goods and services to the entity.

2. Asset values

Examples of matters that may require the focus of directors, preparers and auditors in relation to asset values in the current environment include:

Impairment of non-financial assets

- Goodwill, indefinite useful life intangible assets and intangible assets not yet available for use must be tested for impairment annually. Entities adversely impacted in the current environment may have new or continuing indicators of impairment that require impairment testing for other non-financial assets.
- The appropriateness of key assumptions supporting the recoverable amount of non-financial assets.
- Disclosure of estimation uncertainties, changing key assumptions, and sensitivity analysis or information on probability-weighted scenarios. Key assumptions may include assumptions relating to the factors listed in the covering release.

Values of property assets

- Factors that could adversely affect commercial and residential property values should be considered such as changes in office space requirements of tenants, on-line shopping trends, future economic or industry impacts on tenants, the financial condition of tenants and restructured lease agreements.
- The lease accounting requirements, the treatment of rental concessions by lessors and lessees, and the impairment of lessee right-of-use assets.

Expected credit losses on loans and receivables

- Whether key assumptions used in determining expected credit losses are reasonable and supportable.
- Any need for more reliable and up-to-date information about the circumstances of borrowers and debtors.
- Short-term liquidity issues, financial condition and earning capacity of borrowers and debtors.
- The extent to which past history of credit losses remains relevant in assessing expected credit losses.
- Disclosure of estimation uncertainties and key assumptions.

Value of other assets

- The net realisable value of inventories, including whether all estimated costs of completion and necessary to make the sale have been taken into account in determining net realisable value.
- Whether it is probable that deferred tax assets will be realised.
- The value of investments in unlisted entities.

3. Provisions

Consideration should be given to the need for and adequacy of provisions for matters such as onerous contracts, leased property make good, mine site restoration, financial guarantees given and restructuring.

4. Subsequent events

Events occurring after year-end and before completing the financial report should be reviewed as to whether they affect assets, liabilities, income or expenses at year-end or relate to new conditions requiring disclosure.

5. Disclosures

Considerations on disclosure include:

General considerations

- When considering the information that should be disclosed in the financial report and OFR, directors and preparers should put themselves in the shoes of investors and consider what information investors would want to know.
- Disclosures should be specific to the circumstances of the entity and its businesses, assets, financial position and performance.
- Changes from the previous period should be considered and disclosed.

Disclosures in the financial report

- Uncertainties may lead to a wider range of valid judgements on asset values and estimates. The financial report should disclose uncertainties, changing key assumptions and sensitivities. This will assist investors in understanding the approach taken, understanding potential future impacts and making comparisons between entities. Entities should also explain where uncertainties have changed since the previous full-year and half-year financial reports.
- The appropriate classification of assets and liabilities between current and non-current categories on the statement of financial position should be considered. That may have regard to matters such as maturity dates, payment terms and compliance with debt covenants.

Disclosures in the OFR

- The OFR should complement the financial report and tell the story of how the entity's businesses are impacted by the COVID-19 pandemic and changing circumstances. The overall picture should be clear, understandable, and be supported by information that will enable investors to understand the significant factors affecting the entity, its businesses and the value of its assets.
- The OFR should explain the underlying drivers of the results and financial position, as well as risks, management strategies and future prospects.
- All significant factors should be included and given appropriate prominence.
- The most significant business risks at whole-of-entity level that could affect the achievement of the disclosed financial performance or outcomes should be provided, including a discussion of environmental, social and governance risks. The risks will vary depending upon the nature and businesses of the entity and its business strategies. An exhaustive list of generic risks that might potentially affect a large number of entities would not be helpful. 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.

- Climate change risk could have a material impact on the future prospects of entities. Directors may also consider whether to disclose information that would be relevant under the recommendations of the Task Force on Climate-related Financial Disclosures. (Note: Climate-change-related risk disclosures in the OFR and in any voluntary disclosures (such as those recommended by the TCFD) should not be inconsistent. See also Report 593 Climate risk disclosure by Australia's listed companies (REP 593)).

Assistance and support from others

- Entities should appropriately account for each type of support and assistance from government, lenders, landlords and others during the reporting period. Material amounts should be disclosed with the duration of the support or assistance, and any impact from its discontinuation.

Non-IFRS financial information

- Any non-IFRS profit measures in the OFR or market announcements should not be presented in a potentially misleading manner.
- Where asset impairment losses were excluded from a non-IFRS profit measure in a prior period, any impairment reversal should also be excluded from that measure.

Disclosure in half-year reports

- Disclosure will also be important for half-year financial reports and directors' reports as at 30 June 2022. Half-year reports should disclose information on significant developments and changes in circumstances since 31 December 2021.

6. Other Matters

- Consideration of whether off-balance sheet exposures should be recognised on-balance sheet, such as interests in non-consolidated entities.
- In relation to aged care providers, review of the treatment of aged care bed licenses following the announcement in May 2021 that the licences will be discontinued on 1 July 2024 and subsequent information from the Department of Health.
- Disclosure of material penalties for non-compliance with sanctions imposed in Australia or elsewhere in relation to Russia.
- Ensuring the recognition of assets, liabilities, income and expenses in registered scheme balance sheets and income statements where individual scheme members have pooled interests in assets and returns with some or all other members in substance.

FURTHER INFORMATION

If you wish to discuss any of the information included in this Technical Accounting Alert, please get in touch with your local Grant Thornton Australia contact or a member of the National Assurance Quality Team at national.assurance.quality@au.gt.com.