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Technical Accounting Alert

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ASIC focus areas for 30 June 2020 financial reports

Introduction

The purpose of this Alert is to draw attention to the Australian Securities and Investments Commission's (ASIC) Media Release 20-157MR *Focuses for financial reporting under COVID-19 conditions*, which outlines ASIC's areas of focus for 30 June 2020 financial reports of listed entities and other entities of public interest with many stakeholders under COVID-19 conditions.

ASIC Chair James Shipton says, "In the current environment, the quality of financial reports and related disclosures is more important than ever for investors and to maintain confident and informed markets".

"Entities with businesses adversely affected by the COVID-19 pandemic should focus on the reporting of asset values and financial position. Investors will expect clear disclosure about the impacts on an entity's businesses, any risks and uncertainties, key assumptions, management strategies and future prospects".

Note that this document is heavily based on 20-157MR as issued by ASIC and accessed 5 August 2020. 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 entities may face some uncertainties about future economic and market conditions and the impact on their businesses in the future. Assumptions underlying estimates and assessments for financial reporting purposes should be reasonable and supportable. Assumptions should be realistic, and not overly optimistic or pessimistic. In preparing these forecasts and setting assumptions, we recommend that directors and preparers review Grant Thornton's guide "AASB 136 Impairment and COVID-19."

Useful and meaningful disclosures about the business impacts and potential uncertainties will be vital. Uncertainties may lead to a wider range of valid judgements on asset values and other estimates. Disclosures in the financial report about uncertainties, key assumptions and sensitivity analysis will be important to investors.

The OFR should complement the financial report and tell the story of how the entity's businesses are impacted by the COVID-19 pandemic. The underlying drivers of the results and financial position should be explained, as well as risks, management strategies and future prospects.

ASIC surveillance

ASIC plans to review the full-year financial reports of approximately 200 larger listed entities and other public interest entities as at 30 June 2020. The reviews will focus on entities and industries adversely affected by the current conditions. Adequacy of disclosure for entities whose businesses have been positively affected will also be reviewed.

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. Auditors may need to amend their procedures for remote work (for example, virtual stock counts and system walk-throughs) and where there are changes in the design or effective operation of internal controls.

Reporting deadlines

ASIC has extended the deadline for both listed and unlisted entities to lodge financial reports under Chapters 2M and 7 of the Corporations Act by one month for certain balance dates up to and including 7 July 2020 balance dates.

Where possible, entities should continue to lodge within the normal statutory deadlines having regard to the information needs of shareholders, creditors and other users of their financial reports, or to meet borrowing covenants or other obligations.

Frequently asked questions

ASIC has published frequently asked questions on the impact of COVID-19 on financial reports and audits (see ASIC COVID-19 implications for financial reporting and audit: Frequently asked questions (FAQs)) which provides additional information on matters such as:

- focus areas and factors to consider;
- disclosures in the financial report and OFR;
- the use of non-IFRS financial information;
- half-year report disclosures;
- director liability;
- loan and receivable provisioning;
- lessor accounting for rent concessions;
- the solvency statement by directors;
- the extensions of time for financial reporting;
- the 'no action' position on the timing of AGMs;
- virtual meetings; and

- reporting by auditors.

These FAQs are updated from time to time in response to emerging issues and changing circumstances.

Appendix: Focuses for financial reporting under COVID-19 conditions

This attachment provides further information on the focus areas for 30 June 2020 reporting. We recommend that the matters below be considered in conjunction with the Grant Thornton guide Accounting implications of coronavirus (COVID-19).

1 Factors affecting asset values, provisions and assessments to solvency and going concern

Factors to consider in relation to asset values, liabilities and assessments on solvency and going concern may include:

- business and economic factors
- industry-specific factors
- impact on customers, borrowers and lessees
- impact on supply chains
- exposures to overseas operations, transactions and currencies
- short-term versus long-term conditions
- duration of containment measures and business closures
- extent and duration of assistance and support by governments and others
- impact on short-term operating cash flows
- debt refinancing, borrowing covenants, lender forbearances and liquidity support
- modifications of debt and lease contracts
- capital raising
- management plans and response to the pandemic impacts.

These factors may also be relevant in assessing the ability of an entity's borrowers and debtors to meet their obligations to the entity, and the ability of key suppliers to continue to provide good and services to the entity.

This list is not intended to be exhaustive and there may be other factors to consider in the circumstances of individual entities. ASIC's FAQs also discuss matters that directors and auditors may consider in assessing the solvency of an 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

- Impairment testing 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 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.

- Given uncertainties, it may be necessary to use probability-weighted scenarios in making estimates of both fair value and value in use. In those cases, modelling risk may still need to be factored into the discount rate used in a discounted cash flow model.
- Disclosure of estimation uncertainties, key assumptions, and sensitivity analysis or information on probability-weighted scenarios. Key assumptions may include assumptions relating to the factors listed at the start of this attachment.

Value of property assets

- Factors adversely affecting the values of commercial and residential properties should be considered, despite any absence of market transactions. These may include
  - expected changes in office work practices affecting future space requirements of tenants;
  - possible changes in consumer preferences between ‘bricks and mortar’ retail and on-line shopping;
  - economic or industry impacts on future tenancy;
  - changes in the financial condition of existing tenants; and
  - restructuring of agreements with tenants.
  - The recent new lease accounting requirements, the treatment of rental concessions by lessors and lessees, and the impairment of lessee right-of-use assets. ASIC’s FAQs discuss the accounting for rental concessions by lessors.

Expected credit losses on loans and receivables

- The appropriateness of key assumptions used in determining expected credit losses. Assumptions should be reasonable and supportable.
- Any need for more reliable information about the circumstances of borrowers and debtors.
- Short-term liquidity issues for borrowers and debtors, as well as the financial condition and earning capacity of borrowers and debtors.
- Not applying a mechanistic approach in determining expected credit loses for loans or for receivables. Past models and historical experience may not be representative of current expectations. This applies to all loans and receivables, including a bank’s loan assets and a manufacturer’s trade receivables. A probability weighting of possible scenarios may be needed.
- Whether the rebuttable presumptions in the relevant accounting standard about loans in arrears for 30 days or 90 days can be rebutted under current loan repayment deferral arrangements for some borrowers who may have short-term liquidity issues but who are expected to meet their obligations thereafter.
- Disclosure of estimation uncertainties and key assumptions.

Value of other assets

- The value of Inventories, including where demand reduces and inventory levels increase.
- Whether it is probable that deferred tax assets will be realised.
- The impact of the COVID-19 pandemic on the value of investments in unlisted entities.

3 Provisions

Consideration should be given to the need for provisions for matters such as onerous contracts, 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. For example, information on receipts after year-end might provide more information on the recoverability of loans or receivables at year-end.

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, its businesses, its assets and its financial position and performance.

Disclosure 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, key assumptions and sensitivities. This will assist investors in understanding the approach taken, understanding potential future impacts and making comparisons between entities.
- Disclosures may include information on probability-weighted scenarios supporting judgements on asset values and other assessments.
- 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.

Disclosure 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. The overall picture should be clear and understandable. This should 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.
- Significant factors not attributable to the COVID-19 pandemic should be included and given appropriate prominence. For example, asset impairment or reduced performance may be due in whole or part to other factors that were already present or developing such as changes in consumer preferences and demand for products, new competitors or increased supply costs.

Assistance and support by governments and other

Entities should appropriately account for each type of support and assistance from government, lenders, landlords and others. Both the financial report and OFR should prominently disclose significant amounts, the commencement date and expected duration of support or assistance. Examples include JobKeeper, land tax relief, loan deferrals and restructuring, and rent deferrals and waivers.

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 a net tangible asset figure is presented by a lessee, there should be a prominent footnote on the same page explaining whether some, all or no lease right-of-use assets have been included.
- Disclosing the dollar impact on EBITDA of adopting the new lease standard. EBITDA no longer includes an expense for lease payments made by a lessee under leases that would have previously been classified as operating leases.

Disclosure in half-year reports

- Disclosure will also be key for half-year financial reports and directors' reports as at 30 June 2020. Given developments in the six months, these half-year reports may need to include a level of disclosure similar to that required in full-year reports about the impact of the COVID-19 pandemic and other significant factors.

ASIC's FAQs provide more information on disclosures in the financial report, disclosures in the OFR, and the use of non-IFRS financial information.

6 Reporting processes

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. This will minimise the risk that hindsight is applied when information, estimates and judgements are reviewed by others at a later time.

Any assumptions, estimates, assessments and forward-looking information should have a reasonable basis, and the market should be updated through continuous disclosure if circumstances change.

7 Other Matters

Other matters to consider may include hedge effectiveness, sales returns, and off-balance sheet exposures

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.