Financial Reporting Update 2021

What you need to know for the June and December 2021 reporting season

pwc

Welcome and agenda

1. Our regulatory environment
2. Areas of focus in the current standards
3. What's changing?
4. Climate risk reporting

1 Our regulatory environment

ASIC - top causes of restatements

HealthCo restates P&L, goodwill and contingent consideration.

ASIC questions gain on sale and lease back.

SoftwareCo removes related contract assets and deferred revenue.

OilCo impairs assets $60m after ASIC questions reasonableness of free cash flows .

TechnologyCo writes down non-financial assets and increases ECL.

FinanceCo reclassifies $41m from non-current to current liabilities.

Other regulatory updates

Casual employees

- Workpac v Rossato – the 2020 Federal Court decision in relation to casual versus permanent employee entitlements
- The *Fair Work Amendment Bill (Supporting Australia's Jobs and Economic Recovery) 2020 Bill* passed on 22 March 2021
- The Bill may impact your provisions or disclosures for casual employees

Extension of reporting deadlines

- ASIC has extended lodgement deadlines for listed and unlisted
- Extended by one month
- Applies to balance dates between 23 June 2021 to 7 July 2021
- ASX deadlines unchanged

2 Areas of focus in the current standards

Revenue

Common pitfalls

Liquidated damages - e.g. refund to the customer for late performance

- are NOT provisions or credit losses
- accounted for as a reduction in revenue
- revenue is subject to the ‘highly probable’ constraint

Non refundable upfront fees

- generally no upfront revenue is recognised
- recognise only when goods/services are provided
- ‘set up’ is not a service transferred to the customer

Leasing

Leasing in a post-COVID world

Commercial decision	Accounting consequence
Agree with landlord to reduce the office space leased	Apply lease modification accounting when the reduction is agreed: • derecognise the ***portion*** reduced - a P&L impact • remeasure the remaining portion
Decide to sublease excess office space	• test the excess space ROUA for impairment • determine whether the sublease is an operating or finance lease

Leasing

Leasing in a post-COVID world (cont’d)

Commercial decision	Accounting consequence
Won’t exercise extension option (previously expected)	Remeasure lease liability based on the reduced lease term
Rent concessions received for the medium term	If the practical expedient for COVID-related rent concessions can be applied, then take to P&L, otherwise remeasure ROUA/lease liability.

Leasing

Common issues

Transaction	Accounting consequence
Lease extensions	Remeasure ROUA and LLB at the date the extension is agreed, ***not*** when the extension period commences.
Landlord contributions on improvements	Are the improvements lessees assets or lessors assets? Lessee Assets → Lease incentive - reduce the lease liability & ROUA Lessor Assets → Lessor reimbursement of payments made on its behalf

Leasing

Common issues (cont'd)

Commercial decision/ transaction	Accounting consequence
Related party leases	• Leases vs shared space service • Enforceable terms for undocumented arrangements
Sale and Leaseback with variable lease payments	Consider recent exposure draft issued by the IASB

Tax

Uncertain tax position disclosures

- Differences of view with the ATO on transfer pricing is becoming more commonplace.
- Disclosure of info the ATO already knows is unlikely to 'seriously prejudice' the entity.

Hybrid mismatch rule

- Identify potential exposures due to cross-border arrangements within a group
- Consider required provisions or disclosures

Debt modifications

Debt modification and extinguishment

- Debt refinancing or restructuring
  - Modification (non-substantial change) vs extinguishment (substantial change)
  - Compare present value of remaining new and old cash flows using original EIR to discount
  - If difference is > 10% → extinguishment

Impact on hedge accounting

- Increased ineffectiveness
- Potential discontinuation of the hedges

Low interest rate environment - restructuring or refinancing to lock in these low rates

Interbank Offered Rates (IBOR) Reform

- Global market-wide reform of interest benchmarks
- Transitioning from quote based IBORs to transaction-based alternative rates (ARRs)

Impact of IBOR amendments to IFRS

Phase 1
Mandatory for all June 2021 reporters.

- Relief for certain prospective hedge accounting requirements
- IBOR reform should not generally cause hedge accounting to terminate
- **Disclose:** how you are managing the transition process as well as the extent of your risk exposure

Phase 2
Mandatory for all Dec 2021 reporters. Early adoption permitted.

- Relief for accounting of IBOR replacement - no immediate gain / loss
- Relief for changes made to hedge accounting relationships
- **Disclosure:** enable your readers to understand the effect of IBOR reform to your balance sheet and risk management strategy.

If you have non-current foreign currency debt with a floating rate you will likely be affected

3 What's changing

Reporting requirements in Australia

For-Profit entities

Special Purpose Financial Statements (SPFS) → no longer able to prepare statutory SPFS from 1 July 2021

Simplified Disclosure Regime (SDR)

Reduced Disclosure Regime (RDR) is being replaced with a Simplified Disclosure Regime (SDR). Mandatory from 1 July 2021.

The benefits of early adoption include:

- no restatement of comparatives for recognition and measurement changes
- no comparative disclosures for additional disclosures required
- no requirement to distinguish between errors and changes in accounting policies when transitioning from SPFS to GPFS

Not-for profit considerations

The removal of SPFS does not apply to NFP yet, but the replacement of RDR with SDR does apply.

Current / Non Current

Classification of liabilities

Narrow-scope amendment to AASB 101 *Presentation of Financial Statements*.

effective 1 Jan 2023

What's changed?

- Liabilities are classified as non-current if the entity has a substantive right to defer settlement for at least 12 months at the end of the reporting period.
- No longer refers to unconditional rights.

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The tentative decision by the IFRIC will require you to comply with the covenants at the end of the reporting period even if your lender does not test compliance until a later date.

IFRIC Agenda Decisions

Configuration or Customisation costs in a Cloud Computing Arrangement

Software as a Service (SaaS)

- E.G. Google Suite, Workday, Xero….
- Treatment of recurring fees - normally expensed as a service over the term of the arrangement
- Customisation or configuration costs
  - Intangible Asset only if you have the power to control, obtain the future economic benefits and to restrict others' access to it.
  - Analogy to AASB 15 revenue:
    - If distinct - expense as incurred
    - If integrated with the cloud computing services - the costs are deferred and recognised as expenses over the cloud computing service period.

IFRIC Agenda Decisions

Supply chain financing arrangements

- Balance Sheet Classification of liabilities subject to reverse factoring (supplier financing).
- Classified as Trade Payable only if it has similar nature and function to your trade payables:
  - it represents a liability to pay for goods or services,
  - when it is invoiced or formally agreed with the supplier, and
  - when it is part of the working capital used in the entity's normal operating cycle.
- Presentation in the Statement of Cash Flows
- Clear disclosures showing your exposure

4 Climate Risk Reporting

Climate Risk Reporting

Why the focus now?

- Investors seeking greater transparency
- Increased focus by regulators on reporting in this area
- Perceived misalignment between climate risk and financial reporting disclosures
- Potential impact on a wide range of industries and assets/liabilities

Climate Risk Reporting

What are we seeing?

- Impairments recognised in the market linked to changes in assumptions due to changes in business models
- Sensitivity analysis disclosures on a Paris Agreement-aligned scenario
- Valuers including ‘ESG Discount’ adjustments in discount rates
- Increasing focus by auditors

Climate Risk Reporting

What should we be thinking about in our financial reports?

- In short - consider level of support for conclusions and greater transparency
- Disclose impacts and key assumptions arising from climate risk in the financial statements
- Be consistent and provide better linkage between the OFR/ESG disclosures and the disclosures in the financial statements
- Document and consider disclosing the process which has led to a “not material” conclusion

Conclusion

The regulatory environment

What’s changing?

- Reporting requirements
- Current /Non-Current Definition
- IFRIC Agenda Decisions

Areas of focus in the current standards

- Revenue, Leasing, Tax &
- Financial Instruments

Increase focus on climate risk reporting

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Thank you