Financial reporting considerations in uncertain times

The impact of COVID-19

COVID-19 is testing the resilience and agility of entities as they tackle multiple challenges, such as supporting their staff and the community, and managing sustainable operations. Management should continue to assess the impact of COVID-19 on their financial results and internal control environment.

The Australian Accounting Standards Board (AASB) and the Auditing and Assurance Standards Board (AUASB) are continuing to issue guidance to financial statement preparers, management, directors and auditors on their respective websites.

This fact sheet provides guidance for financial reporting areas that may be impacted by COVID-19, including:

- cash flow management and going concern
- recoverability of receivables
- valuation of property, plant and equipment
- fair value of financial assets and liabilities
- accounting for rent concessions by lessees
- increased disclosures explaining changes in position and performance and the impact of COVID-19
- changes in contingent liabilities and guarantees
- events after reporting date
- other accounting standards.

Some of these risks also translate to a heightened risk of fraud that will require increased attention from management. Entities should also identify changes to controls from new working arrangements which increase the risk of misstatements in financial reports.

The areas and consider points for entities are outlined below.

Cash flow management and going concern	What to consider
Material uncertainties that cast significant doubt on an entity's ability to continue as a going concern may include the extent of COVID-19's effect on future revenue and costs, and the unknown duration of the event. Several revenue streams, such as investment revenue, sale of goods and services, and rental income, may be reduced. Timing of cash inflows may also be impacted. Due to the volatile markets, it is likely that profits and, therefore, dividends will be impacted.	Entities should consider future information for at least 12 months after the reporting date when assessing going concern (AASB 101). For example, existing financial resources and expiry of funding sources, financial health of key suppliers and customers, government stimulus, travel bans, community restrictions, and government assistance if conditions continue to deteriorate. Entities should develop workable plans to address projected cash flow issues, such as reducing discretionary expenses or obtaining required approvals for funding facilities. Entities will need to consider cash requirements and their reliance on investment income to support future capital works and operational spending.
Recoverability of receivables	**What to consider**
There is an increased likelihood that debtors may take longer to pay and, in some instances, not be able to pay what they owe.	Governments, through public sector entities, have introduced assistance to the public (for example, grants, tax reductions, and relief from user charges and fees). They also collect revenue through taxation, fees and charges. There is an increased risk relating to the recovery of related receivables. Based on reasonable and supportable forward-looking information, entities should reassess whether there has been a change in the risk of default by debtors. Consider the industry your entity operates in, the wholistic effect of COVID-19 on the supply and customer base, and the likelihood of the debtor's ability to rebound from the economic shut-down. If it is deemed that the risk of default does exist, your entity should determine the probability of default and the loss that is likely to arise. Entities should follow the expected credit loss model (impairment), introduced in AASB 9.

Valuation of property, plant and equipment

Economic uncertainty and imposed community restrictions may impact the ability of valuers to accurately perform comprehensive and/or desktop valuations and meet the fair value measurement requirements of AASB 13 *Fair Value Measurement*.

What to consider

Entities need to consider a number of factors depending on whether the fair value measurement is determined using current replacement cost or an income-based approach.

For current replacement cost valuations of public infrastructure and specialised buildings, we are not currently anticipating a significant change in value as a result of COVID-19:

- In terms of gross replacement costs, a lot of construction work will pause, meaning that there is less data available to make judgements. There is not yet evidence that construction costs will be higher or lower when work recommences. For accumulated depreciation, the condition and useful life of these long-lived assets is unlikely to change due to the virus.
- During the current situation, your entity may not be able to undertake a comprehensive valuation. For example, due to travel restrictions on valuers. We have a fact sheet on what could constitute a suitable alternative valuation when site visits are not able to be performed by external valuers.

For the income-based approach:

- discount rates (that is, weighted average cost of capital (WACC)) are expected to be impacted, particularly post-February 2020
- cash flow forecasts would need to be revisited
- economic and financial announcements and directions, including ministerial directions, are likely to impact cash flows
- re-prioritisation in deploying resources.

For assets reported at cost, there may be impairment indicators resulting from economic impacts of COVID-19.

Fair value of financial assets and liabilities

Entities value financial assets and liabilities that are not quoted and/or highly illiquid assets using a model that may use significant unobservable inputs. The current economic situation could negatively impact the assumptions and judgements that entities use in these valuation models.

What to consider

Consideration needs to be given to the:

- assumptions and judgements that your entity uses in determining the input (for example, interest rates)
- appropriateness of the classification of financial assets and liabilities under the fair value hierarchy.

For entities relying on a portfolio of financial assets to offset long-term borrowings, review unfolding economic conditions and assess impact over potential solvency and going concern issues.

We have issued a blog on *Managing your investments in times of volatility*.

Accounting for rent concessions by lessees	What to consider
As a result of COVID-19, some lessees may receive 'rent holidays' and other concessions from their lessors. In some cases, these may be considered as a lease modification under AASB 16 *Leases,* requiring remeasurement of the lease liability using a revised discount rate. This could have an impact on the accounting of the right-of-use assets and the associated liabilities. Amendments to AASB 16 to provide relief from complex modification accounting for COVID-19-related rent concessions are expected by early June.	Entities will need to consider whether any rent concessions meet the conditions of the relief in the finalised amendments to AASB 16, including timing of any rent concessions and any other modifications to the lease, such as term extensions.
Financial statement disclosure	**What to consider**
COVID-19 will impact several disclosures relating to judgement and estimates in the financial statements, as well as disclosures under AASB 1055 *Budgetary Reporting*.	Entities should: • consider disclosing additional information about significant judgements and estimates that COVID-19-related events have impacted. This might include relevant sensitivity analysis disclosures • revisit the going concern assessment disclosed in their financial statements • consider the appropriateness of their classification of debts between current and non-current. They should explain major variances between budget and actual amounts with a description of the causes, rather than nature, of those variances.
Provisions, contingencies and guarantees	**What to consider**
Government entities provide a variety of guarantees and are exposed to contingent liabilities. The likelihood of contingent liabilities becoming real, or guarantees needing to be paid, may increase due to changed economic circumstances arising from COVID-19.	Not all arrangements will be implemented as planned. Review whether delays and variations to arrangements will result in a change to obligations or crystallise a change in how the arrangement is categorised.
Other accounting standards	**What to consider**
While we have highlighted some of the common accounting standards expected to be affected, other accounting standards may affect entities' individual circumstances.	Other accounting standards may apply—for example, employee benefits for timing of estimated leave payments and provisions for onerous contracts. Government grant standards and tax effect accounting implications may also affect for-profit entities.
Events after reporting date	**What to consider**
Conditions may have changed between the reporting date and when the financial statements are approved.	Entities will need to consider whether, and the extent of, any adjustment to or disclosure in the financial statements is required to inform users of changes since the reporting date. For example, changes to judgements and estimates used in the preparation of the financial statements.

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T: (07) 3149 6000
M: qao@qao.qld.gov.au
W: qao.qld.gov.au
53 Albert Street, Brisbane Qld 4000

Queensland Audit Office

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