Guidance on Impacts of COVID-19 for Disclosures in Financial Statements

DISCLOSURES		
Guidance overview	This guidance identifies considerations arising from Covid-19. The guidance therefore only provides a brief summary of the requirements in AASB 101 *Presentation of Financial Statements* (AASB 101), and agencies should refer to AASB 101, the disclosure requirements within applicable accounting standards and TPP 20-01 *Financial Reporting Code for NSW General Government Sector Entities* where applicable when preparing disclosures. Agencies should also ensure any disclosures relating to Covid-19 made *outside* of the financial statements are consistent with disclosures in their financial report.	**Research sources**
Heightened disclosures are expected in the current Covid-19 environment	The economic uncertainty related to Covid-19 makes the need for full disclosure of judgements, assumptions and sensitive estimates particularly important. The key requirements for disclosures of significant judgments, assumptions and estimation uncertainty can be found in AASB 101 *Presentation of Financial Statements* (AASB 101): **AASB 101.122 An entity shall disclose, along with its significant accounting policies or other notes, the judgements, apart from those involving estimations (see paragraph 125), that management has made in the process of applying the entity's accounting policies and that have the most significant effect on the amounts recognised in the financial statements.** **AASB 101.125 An entity shall disclose information about the assumptions it makes about the future, and other major sources of estimation uncertainty at the end of the reporting period, that have a significant risk of resulting in a material adjustment to the carrying amounts of assets and liabilities within the next financial year. In respect of those assets and liabilities, the notes shall include details of:** **(a) their nature, and**	AASB 101.122-133 FRC (UK) Covid-19 Guidance AASB 2018-7 (Amendments to definition of materiality)

	(b) their carrying amount as at the end of the reporting period. Significant judgments usually relate to applying accounting standards, where management has had to exercise significant judgement in determining the accounting treatment and typically relate to how something is characterised. For example: • Assessment of control under AASB 10, or significant influence under AASB 128; • Lessor classification as finance or operating lease; • Whether lease options are reasonably certain to be exercised; • Classification of financial instruments; and • Risk of default in estimating expected credit losses. Sources of estimation uncertainty are typically related to the measurement of assets and liabilities. For example, uncertainties in relation to: • Determining fair values or recoverable amounts of assets using estimated future cash flows, risk adjusted discount rates etc); • Actuarial assumptions for defined benefit superannuation obligations; • Assumptions about the timing and amount of future cash flows in measuring provisions and contingencies; • Forward looking estimates in expected credit losses; and • Estimates of future variable revenue. The disclosure requirements for significant judgements and estimation uncertainty are separately distinguished in AASB 101. In the current Covid-19 environment, it is likely there will be: • New matters that have material assumptions, estimates and management judgements; and • Major revisions of existing matters, due to significantly changed assumptions and uncertainties. It will therefore be particularly important to provide as much context as possible for the assumptions and predictions underlying the amounts in the financial statements. Suitable	

	disclosure of a particular matter may address both the requirements to disclose significant judgments and sources of estimation uncertainty together. It is important to note disclosure is required for those assumptions and sources of estimation uncertainty that have a <u>significant risk of resulting in a **material** adjustment</u> to the carrying amount of assets and liabilities <u>**within the next financial year**</u>. Information is **material** if omitting, misstating or obscuring it could reasonably be expected to influence decisions that the primary users of general purpose financial statements make on the basis of those financial statements[1]. <u>Note:</u> Other accounting standards also include specific disclosure requirements that relate to estimates and uncertainties (e.g. AASB 137 or AASB 13). However, compliance with these specific disclosures may not be sufficient to meet AASB 101 requirements. (AASB 101.129 provides expectations around sensitivities which may not be required under a specific standard).	
Key features of disclosures	Further guidance is provided in paragraphs AASB 101.122-133. This includes examples of the types of disclosures an entity might make. Disclosures for significant judgments should: • Be specific to an entity’s circumstance • Include why the judgment was made • Include why it is significant (i.e. effect on financial statements) • How the conclusion was reached Disclosures for sources of estimation uncertainty should: • Be specific and explain the nature of the assumption or uncertainty • Include the carrying amount of the affected assets/liabilities with sensitivity analysis • Include the expected resolution of an uncertainty and ranges of possible outcomes • Include an explanation of changes made to past assumptions	AASB 101

[1] AASB 2018-7 Amendments to Australia Accounting Standards – Definition of Material (amendments to AASB 101.7)

Key challenges	Disclosures will be unique to the individual circumstances of your agency – the nature and extent of the information provided will vary according to the nature of the assumption and other circumstances[2]. Disclosure around estimation uncertainty is sometimes described as 'an art not a science' and it is important to prepare disclosures to provide sufficient information to allow the users to understand how these assumptions and judgments were formed and why. It will be important to look ahead and consider disclosures before year end, as this will assist in identifying areas where assumptions/estimates may have significantly changed from previous financial years or are subject to significant uncertainty. This will allow time to challenge and gather further information. Where applicable, agencies should also consider disclosing the reasons assumptions and estimation uncertainty have not materially changed due to Covid-19, where users of financial statements might reasonably expect there to be material changes.	
Notes that <u>may</u> be impacted in 2019-20	There are a number of notes that may be impacted and require increased disclosures as a result of recent natural disasters and Covid-19, including: <u>Fair value of property, plant and equipment (PPE) - Level 3.</u> • Previous valuation approaches may no longer be appropriate (e.g. market approach may not be appropriate in an extreme recessionary environment). Disclosures will need to explain any changes. • Assumptions regarding inputs to valuations will possibly change and be less reliable due to the economic uncertainty under Covid-19. Agencies will need to disclose information about changes in the reliability of assumptions; and significant changes in assumptions. • For example, future cash flows may change and/or be less reliable, when applying the income approach to determine fair value. Careful consideration should be given to how long cash flows are expected to be impacted by Covid-19, and the profile of the recovery of cash flows. Additional disclosures on the sensitivity of carrying amounts to changes in assumptions may be appropriate.	

[2] AASB 101.129

	• Other assumptions that may change significantly include: discount rates, adjustments for risk, market data. <u>Impairment of non-financial assets</u> • Natural disasters and Covid-19, may in some instances result in impairment through damage, obsolescence, loss of demand or service potential. • Additional disclosures may be necessary to explain why assets were impaired or not impaired. • Assumptions regarding inputs to recoverable amounts estimates will possibly change and be less reliable in the circumstances. Agencies will need to disclose information about the reliability of assumptions; and significant changes in assumptions. • For example, where there is uncertainty in cash flow projection assumptions used in value-in-use calculations, additional disclosures on the sensitivity of carrying amounts to changes in assumptions may be appropriate. • Additional line items may be appropriate to present impairments for specific asset classes e.g. investments, goodwill, PPE etc. <u>Financial instruments</u> • Changes in market prices and cash flow forecasts, as well as greater risks and uncertainties due to Covid-19 may significantly change the fair values of assets and liabilities. • Assumptions regarding inputs to valuations will possibly change and be less reliable due to the economic uncertainty under Covid-19. Agencies will need to disclose any significant changes in assumptions and changes to the reliability of those assumptions. • Increased uncertainty in valuation assumptions due to Covid-19, could mean assets or liabilities move between Level 2 and Level 3 where unobservable inputs have become significant. For example, a counterparty may encounter financial difficulties and where credit risk may not have been a significant input in previous years, measurement may now require a credit risk adjustment which is not based on observable inputs (as it reflects the credit risk specific to the counterparty). • Agencies may need to make disclosures if their business model for managing financial assets has changed as a result of COVID-19. • Additional disclosures may be required in respect of changes to how an agency manages changes in risk exposures. For example:	

	- Increased credit risk, due to counterparties encountering financial difficulty, may prompt management to introduce new credit limits to manage credit risk. - The current environment may increase exposure to liquidity risk and require changes to how an agency manages settlement of its financial liabilities. - Agencies may have new types of financial instruments as a result of Government's response to natural disasters or Covid-19. For example, new financial guarantee contracts. - Agencies will need to include disclosures where a contingent liability has changed to a liability. - Substantial modifications to the terms and conditions of a financial liability, require derecognition of this original financial liability and a new financial liability to be recognised at fair value. This new financial liability will be measured using a revised discount rate. This will result in a gain or loss recognised in the profit or loss and may significantly change the carrying value of that liability. Disclosure of such circumstances and assumptions would be required.	
	<u>Expected credit losses</u> (ECLs) - Credit risk has increased in the current environment. Some agencies will have changed terms and conditions with counterparties. For example, offering deferred payment terms to counterparties. - The use of historical data to estimate future expected collections, will need to be reassessed. Historical data is likely to be far less reliable in the current economic environment. - Where historical data is used, adjustments for the future are likely to change significantly. - Disclosures regarding increased uncertainty over the collection of receivables may be appropriate. - Agencies will need to disclose any changes to the methodology and assumptions for determining impairment of receivables, for example changes in the ECL that result from moving from the 12 month ECL basis to the Lifetime ECL basis.	**Refer to guidance issued to agencies *"Impacts of Covid-19 on ECLs"***
	<u>Inventories</u> - Inventories held for distribution may experience a loss of service potential as a result of Covid-19. - Agencies will be required to disclose significant judgments applied in determining whether there has been a loss of service potential.	**Refer to guidance issued to agencies *"Guidance on Likely Impacts of COVID-19 for Inventories"***

	- e.g. the basis on which any loss of service potential is assessed, such as current replacement cost or functional or technical obsolescence. - Disclosure of assumptions and the basis for estimates, in measuring the loss of service potential, will be required. <u>Superannuation and long-term provisions (including employee provisions)</u> - Assumptions and inputs to actuarial estimates are likely to have changed significantly. - Carrying values of plan assets are likely to have declined significantly. - Disclosures will be required in respect of significant changes to assumptions and estimates. - e.g. discount rate, CPI, salary increases, mortality rates etc. - Agencies should consider disclosures around increased uncertainties relating to assumptions. For example, where there is increased uncertainty relating to an assumption, sensitivity disclosures may need to include additional or a broader range of scenarios. <u>Events after the reporting period</u> - Disclosure where significant judgement is exercised in determining whether an event is adjusting/non-adjusting, for example where there are movements in market evidence available after the reporting period that relate to 30 June 2020 values. <u>General</u> - Line items within notes to the financial statements - consider whether any material new line items will be required or whether line items need to be disaggregated further as a result of Covid-19 related impacts e.g. new grants, new expenses - Contingent assets & liabilities and commitments – consider disclosure of any government initiatives relating to Covid-19 or new commitments relating to reprioritisation of committed capital projects - Useful lives of assets - consider disclosures around any material changes to the useful lives of assets and significant judgements applied - Budget Review Note – explanations for variances to Budgeted amounts, in accordance with AASB 1055 Budgetary Reporting may need to include references to the impact of Covid-19 or natural disasters. - Appropriations and Revenue – consider disclosing impact of additional or reduced income due to Covid-19 or natural disasters.	

	• Administered Items – agencies should consider whether disclosures in relation to Covid-19 and natural disasters are required in relation to administered items.	
Next steps – consider areas where additional disclosures will be required and seek further guidance from Treasury	Where considered necessary Treasury may publish further guidance on specific areas/notes that are expected to be impacted. Please contact the Treasury Accounting Policy and Complex Transactions Advisory team to discuss specific concerns and to seek further guidance around disclosures. accpol@treasury.nsw.gov.au	