Potential Accounting Impacts of COVID-19

Introduction

Covid-19 is likely to have an impact on many entities' financial statements in the public and private sectors, including substantial disclosures. Government agencies in particular, need to consider the impacts of specific actions undertaken by the Government in responding to Covid-19. For instance, determining the appropriate financial period in which to reflect the costs and liabilities associated with a policy intervention.

This paper identifies some key areas that should be considered, and will be updated as further information is available.

Post-Balance Date Events

It is expected that Government decisions taken to address Covid-19 are the relevant events under AASB 110 *Events after the Reporting Period*, rather than the pandemic itself. It is also expected that such decisions, where made after 30 June 2020, would be non-adjusting post balance date events. The exception might be where the Government enacts a legislative provision that has direct unavoidable consequences.

Example

A Government makes an announcement on 25 June, and then takes actions as a direct consequence of that decision, after 30 June. The financial impacts are possibly adjusting post-balance date events, if the Government had no option but to take those direct actions as a direct result of the decision and the financial consequences are related to circumstances up to 30 June. However, if the subsequent actions required discretion, they are likely non-adjusting events.

Impacts

- Any decisions taken before 30 June, will need to be carefully assessed, because the financial impacts of actioning those decision after 30 June may need to be reflected in the 30 June 2020 financial statements.
- Agencies and TSSA will likely need to make substantial disclosures regarding post-balance date events in their 2020 financial statements.

Going Concern

If any agencies have their continued existence put into material doubt, as a result of Covid-19, this should be disclosed and in extreme cases, the financials restated to recoverable values. This assessment should take into account all available information about the future, which is at least, but is not limited to, twelve months from the end of the reporting period. The assessment needs to be made at the date the agency's financial report is issued.

In practice, this is likely to mean the Audit Office will request more letters of financial support for those agencies , where Covid-19 results in net liabilities on balances sheets, or doubts over future revenues, or where agencies can only continue with a substantial increase in support that has not been announced.

Fair Value

Financial investments will likely have a significantly lower value at 30 June 2020, due to declines in financial markets. Dividends and other returns will also likely be much lower than budgeted. Foreign currency derivatives will be impacted by significant volatility in the currency markets.

The State measures its physical non-current assets at fair value. Treasury Policy TPP14-01 *Valuation of Physical Non-Current Assets at Fair Value* (TPP 14-01), requires comprehensive external revaluations every 3 or 5 years, depending on the asset class. In other years there is a requirement for a management assessment of whether a full revaluation is required.

In many cases, physical non-current assets may have experienced substantial declines in value as a result of the current economic environment, eg market values of land. In these instances, TPP 14-01 may indicate full external comprehensive valuations are required, that have not been planned to date. This also applies to right-of-use assets arising from leases recognised under the new leasing standard from 1 July 2019.

There are likely to be practical challenges in obtaining external valuations in the current environment and late in the financial reporting cycle. It is therefore, critical that management identify assets with potential significant changes in fair value and advises Treasury as soon as possible of impediments to valuation processes.

Management should also assess how the carrying value of physical non-current assets compares to fair value where a comprehensive valuation has not been conducted and the appropriateness of applying indices in the current environment.

Impacts

- Fair values of financial assets are likely to be negatively impacted.
- TPP 14-01 may indicate that agencies need to consider additional external comprehensive valuations, that have not been planned for 2020.
- Fair values of other assets may be negatively impacted – eg work-in-progress, intangible assets etc.
- Potential practical issues, e.g. availability and timeliness of market data and practical impediments to performance of external valuations.

Impairments

Asset impairments are linked to asset fair values (above). AASB 136 *Impairment of Assets* (AASB 136) requires impairment assessments where impairment events have occurred, like Covid-19. Because government financial statements generally report fair values, instead of historical costs, impairment assessments are generally covered through the fair value process.

Provisions and Other Liabilities

With significant transactions and decisions as a result of Covid-19, it will be particularly important to consider the application of AASB 137 *Provisions, Contingent Liabilities and Contingent Assets* (AASB 137), in determining whether provisions or contingent liabilities or assets should be recorded at year-end. Assumptions and estimates used in estimating provisions may also be subject to change, including relevant discounts rates.

AASB 137 also contains guidance specific to the recognition of liabilities arising from local government and government existing public policies, budget policies, election promises or statements of intent (paras. Aus26.1 and Aus16.2). In some instances, a liability is recognised where a government has little, if any, discretion to avoid a sacrifice of future economic benefits, such as clear and formal policy to provide financial aid to victims of disasters.

Agencies also need to carefully assess liabilities and recoveries arising under insurance type arrangements.

Superannuation Liabilities
The State has substantial liabilities for its defined benefits superannuation obligations. The current economic environment is likely to have a significant impact the value of assets in those funds.

Impacts
- Substantial increase in defined benefits superannuation liability is likely.

Onerous Contracts
AASB 137 *Provisions, Contingent Liabilities and Contingent Assets* (AASB 137) contains requirements to recognise liabilities for onerous contracts. An onerous contract is defined as:

'… a contract in which the unavoidable costs of meeting the obligations under the contract exceed the economic benefits expected to be received under it.' [AASB 137.10]

Impacts
At the point in time a contract becomes onerous, a provision must be recognised as a liability for the net unavoidable costs of exiting the contract. For non-cancellable contracts this will be the cost of fulfilling the contract, or any penalties if lower.

Where the impact of Covid-19 results in increased costs to meet, or reduced benefits from, an executory contract, management need to assess whether the contract has become onerous and a provision needs to be recognised.

Revenue Recognition
Timing of revenue recognition should be considered. Agencies should consider related impacts on recoverability of receivables and estimates of expected credit losses.

Expected Credit Losses
It is likely Expected Credit Losses (CCLs) will increase to reflect changes in the ability of third parties to settle their debts. Material changes to the method of calculating ECLs will need to be appropriately disclosed.

Impacts
- ECLs (ie provisions) against receivables may increase substantially.
- Agencies need to consider the appropriateness of their existing methodologies for predicting future ECLs.

General Disclosures
Multiple Accounting Standards require disclosures in respect of material assumptions and sensitivity analyses. In addition, AASB 101 *Presentation of Financial Statements* (AASB 101) requires disclosures about sources of estimation uncertainty [AASB 101.25].

Where the impact of Covid-19 is material to an agency, appropriate disclosures will need to be made. Examples of items that may need to be considered, include those discussed above, as well as:

- Useful lives of depreciable non-current assets
- Provisions for outstanding claims from third parties
- Contingent liabilities, commitments and guarantees
- Net realisable value of inventories
- Additional disclosures for managing credit or liquidly risk exposure