

The Financial Services Landscape

Madeleine Mattera



Introduction

- Update on COVID-19
- State of the economy
- Accounting issues for 30 June
- APRA & ASIC response
- Building the bridge

Jobs

Job subsidy plans are at breaking point



Prime Minister Scott Morrison has signalled the \$130 billion JobKeeper program could face cost blowouts while the \$14 billion JobSeeker may need to be reined in despite the biggest ever monthly collapse in employment.

Coronavirus pandemic

No role for unions in Labor policy rethink: Bracks



Labor elder Steve Bracks believes the party should largely ignore unions as it develops policies to assist the economic recovery and win the next election.

Jobs

The huge jobless rise could cost everyone a year's pay



The "wage scarring" effect of massive unemployment means workers could lose almost a year's income in the long term if recovery is not speedy, an economist warns.

All Things Accounting

Claire Scott, Darren Scammell




Housekeeping



This is an interactive session so we encourage your participation


Talking: Liz Davis

▼ Questions 

[Enter a question for staff]

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How to ask questions?

Submit your questions via the Questions panel



Agenda

1 AASB 9: Expected Credit Loss & COVID-19

2 Other COVID-19 financial reporting considerations

3 AASB 16: Leases

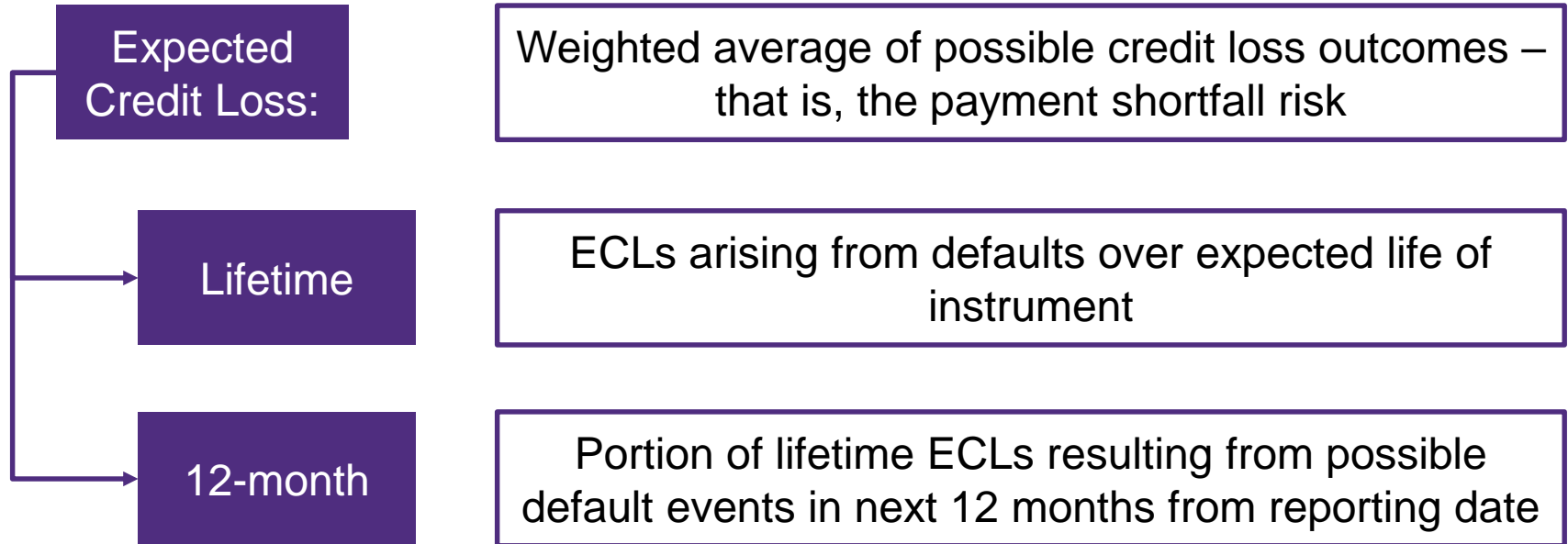


AASB 9 *Financial Instruments*

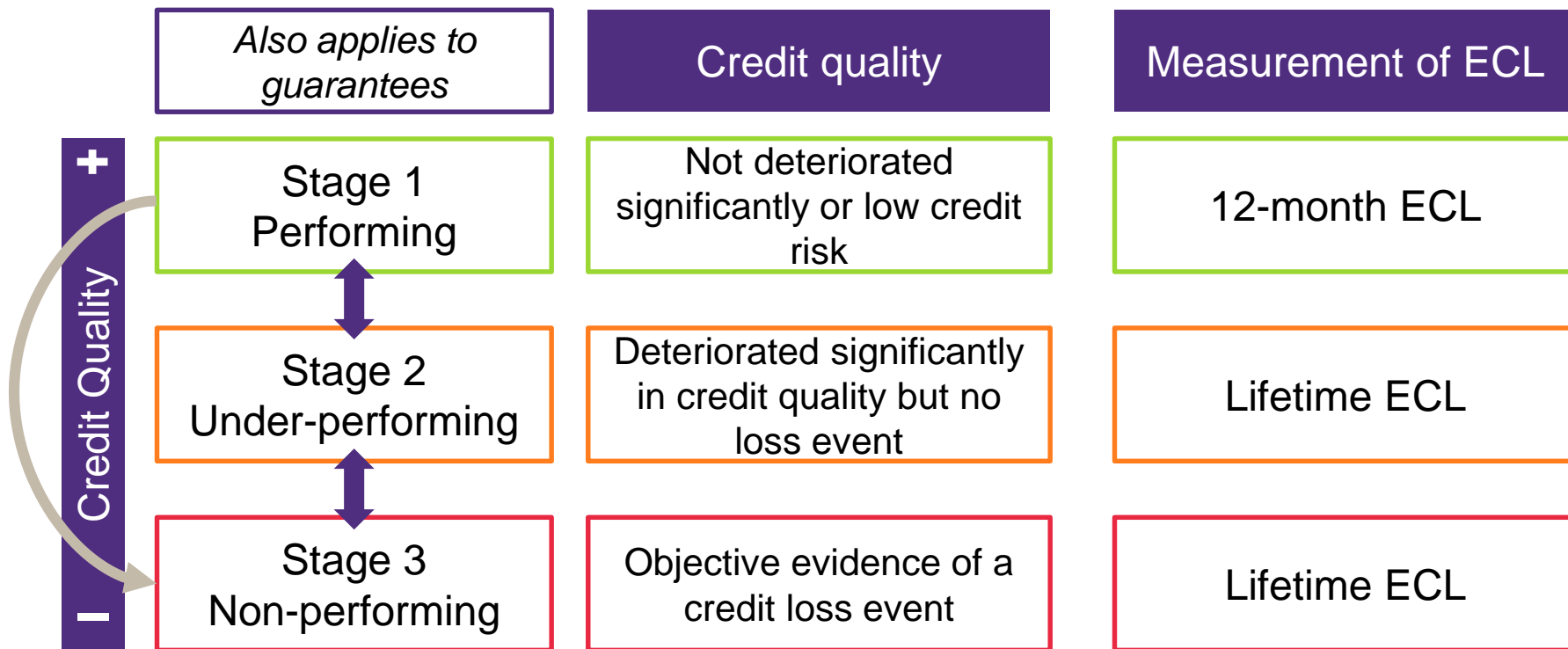
Expected credit losses & COVID-19

AASB 9 *Financial Instruments* - Expected Credit Loss

Refresh

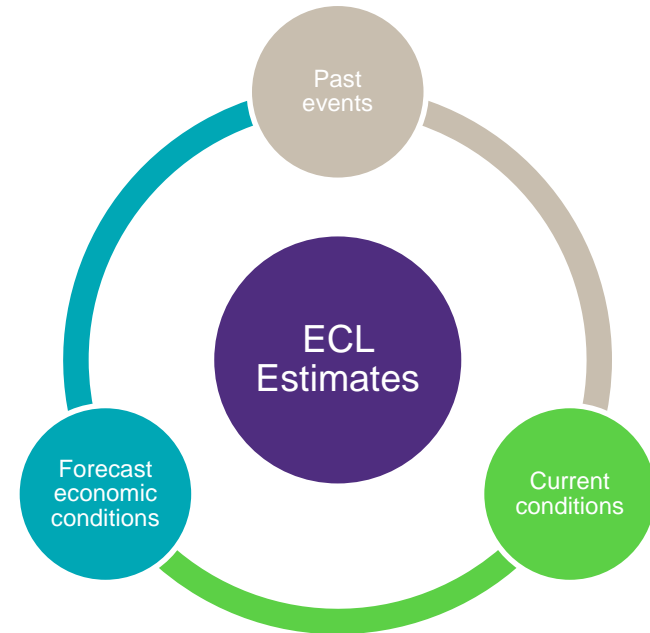


AASB 9 *Financial Instruments* - Expected Credit Loss



Applying ECL in COVID-19 environment

- Lifetime ECL to be recognised when there is significant increase in credit risk
 - Has risk of default occurring over the expected life increased?
 - Assessment based on reasonable and supportable information available without undue cost or effort
- Significant judgements on assumptions and whether they are appropriate in the current environment
 - Effect of COVID-19
 - Government support measures
- Consider post-model overlays or adjustments if effect of COVID-19 cannot be reflected in models



Response of Regulators

Consistent messaging globally ...



APRA advises regulatory approach to COVID 19 support (30 March 2020)



European Securities and Markets Authority (ESMA) *“suspension or delays in payments, should not be regarded as automatically having a one-to-one impact on the assessment of whether loans have suffered a SICR”*



IASB Letter 27 March 2020 IFRS 9 *“does not set bright lines or a mechanistic approach to determining when lifetime losses are required to be recognised”*



European Banking Authority *“IFRS 9 offers a certain degree of flexibility”*



European Central Bank *“avoid excessively procyclical assumptions in IFRS 9 models to determine provisions”*



Prudential Regulation Authority UK *(Update regarding treatment of deferral extensions 22 May 2020)*

Media messaging

RBA: 10pc contraction by June, then fast recovery likely

Banks struggle with new loan loss rules, bad debts tipped to hit \$14b

House prices set to fall as discounting doubles

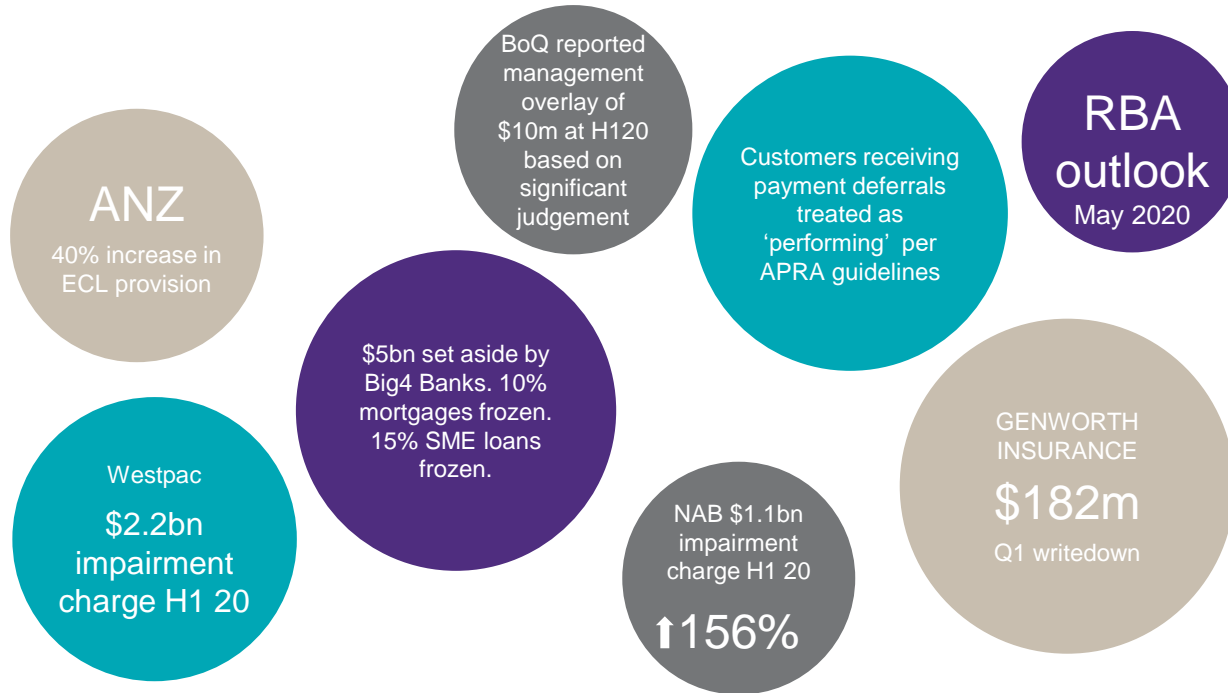
CBA signals \$1.5b COVID-19 hit

Banks groan under the weight of COVID-19

Unemployment jump set to break records

Why bankers hope they'll avoid a bad debt tsunami

What we have seen so far...



Significant uncertainties

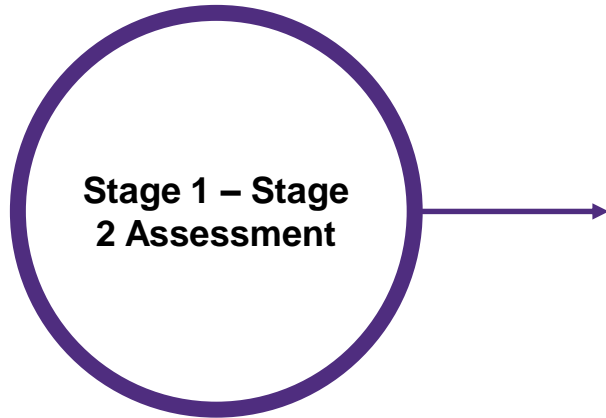
- Extent & duration of downturn
- Impact on GDP
- Unemployment
- House prices
- Industries impacted
- Government support package impact

AASB 9 ECL & COVID-19

What's expected

- 1 Consider reasonable changes to macro economic assumptions
- 2 Review available data points, RBA / ABS
- 3 Scenarios and stress testing (probability weighted)
- 4 Downside scenarios – clear prospect of recession
- 5 Significant Increase in Credit Risk (Stage 1 – stage 2 transition)
- 6 Post-model / management overlay

Assessing SICR



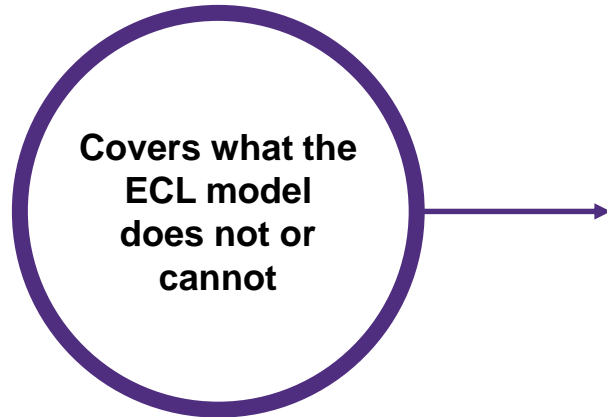
Industry / Sector / Geospatial / Portfolio analysis

Rebuttal of 30 day default assumptions?

Redefine criteria / apply additional criteria

Qualitative & quantitative factors

Post-model adjustment



Allow for additional risk factors

Judgement applied

Further provision for specific risk factors

Document assumptions – needs to be supportable

Allows for uncertainty /volatility that model cannot accommodate

Transparency & Disclosure

- Importance of providing all relevant disclosures related to actual and potential impacts of COVID-19

01

Judgements

1. SICR & ECL assessment
2. Use of forward-looking information

02

Events post balance date

1. Significant events / transactions

03

Overall impact

1. Financial position and performance
2. Risks & uncertainties

04

Changes since prior period

1. Sensitivity analysis
2. Range of variables

Other Considerations & Audit Implications



Fair Value Measurement

- Investment property
- Shares in unlisted entities (CUSCAL, P2P)
- Increased subjectivity
- Estimation uncertainty / assumptions
- Post balance sheet adjustments



Post Balance Date Events

- Adjusting / Non-adjusting
- Material change in asset values post year end
- Significant transactions
- Regulatory breaches
- Restructures
- Disclosures up to audit report date



Going Concern

- Auditor requirements
- Directors' responsibilities
- 12 months from reporting date
- Profitability, liquidity, capital, regulatory pressures
- Report material uncertainties
- Emphasis of Matter

Case study for 31/12/19 client

- Cash flow forecasts x 3 done for March 2020 – April 2021
 - Base case with expected hardships on 12 month plan (30%)
 - Stressed case with double expected hardships – 12 months (60%)
 - “break the bank” – no P or I for 12 months
 - Considered whether “material uncertainty” disclosure required
- Impacts on capital, liquidity also considered
- ECL for 31/12/19 does not take into account COVID-19

Audit Report impacts

Uncertainties emerging subsequent to half- year end – Emphasis of Matter

We draw attention to Note 5.5.4 in the Consolidated Interim Financial Report, which describes events subsequent to half-year end, specifically as they relate to the potential impact to the Consolidated Entity of COVID-19. These disclosures include potential associated impacts to the Consolidated Entity's future financial position and performance.

In our view, this issue is fundamental to the users' understanding of the Consolidated Interim Financial Report and the financial position and performance of the Consolidated Entity.

Our conclusion is not modified with respect of this matter.

Emphasis of Matter - Uncertainties of COVID-19 Impacts

We draw your attention to Note 1 Basis of Preparation under the heading 'Critical accounting assumptions and estimates' in the Consolidated Interim Financial Report. This note describes the impact of the ongoing COVID-19 pandemic on the Group's financial position and performance.

In our view, this matter is fundamental to the users understanding of the Consolidated Interim Financial Report and the financial position and performance of the Group. Our conclusion is not modified with respect to this matter.

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All Things Accounting

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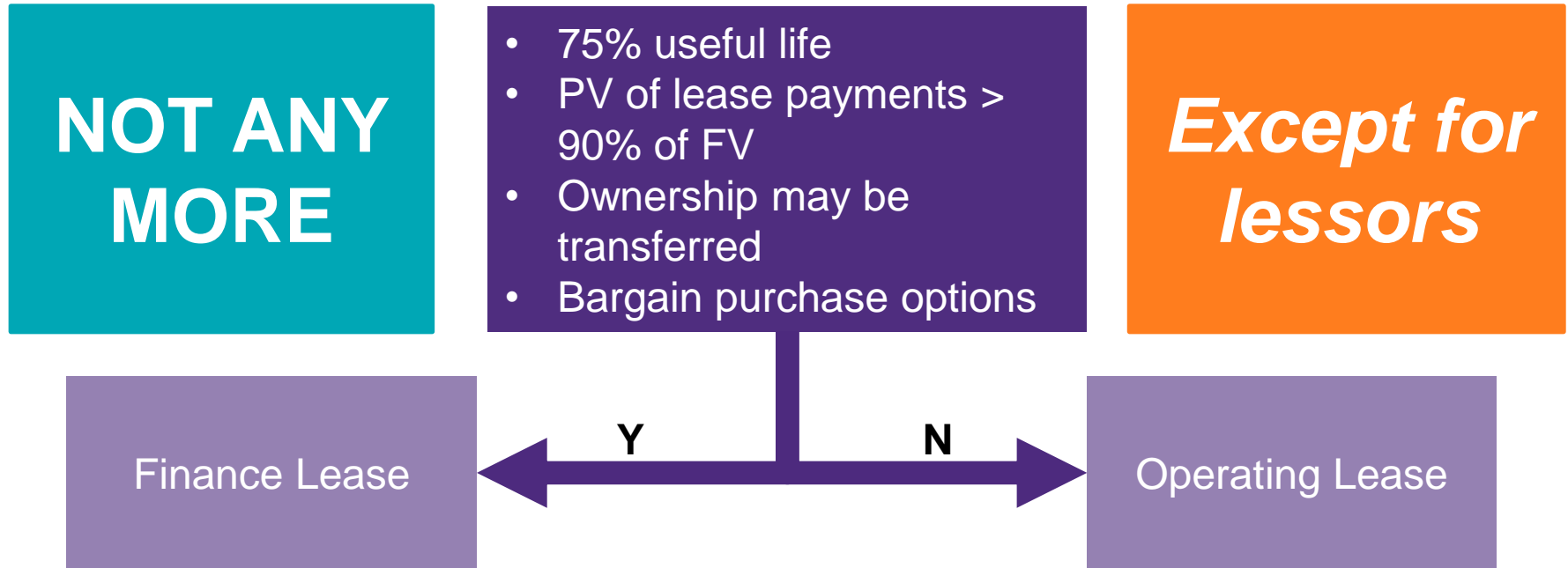


AASB 16 *Leasing* for ADIs

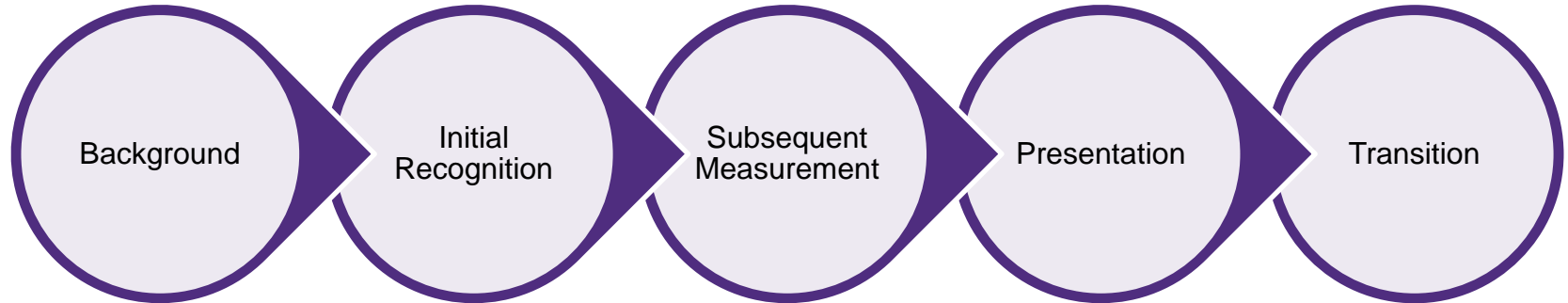
Who owns the plane?



The old leasing standard – Finance vs Operating



The new leasing standard - Accounting Implications



The new leasing standard - Background

Payments for control
of a specific asset

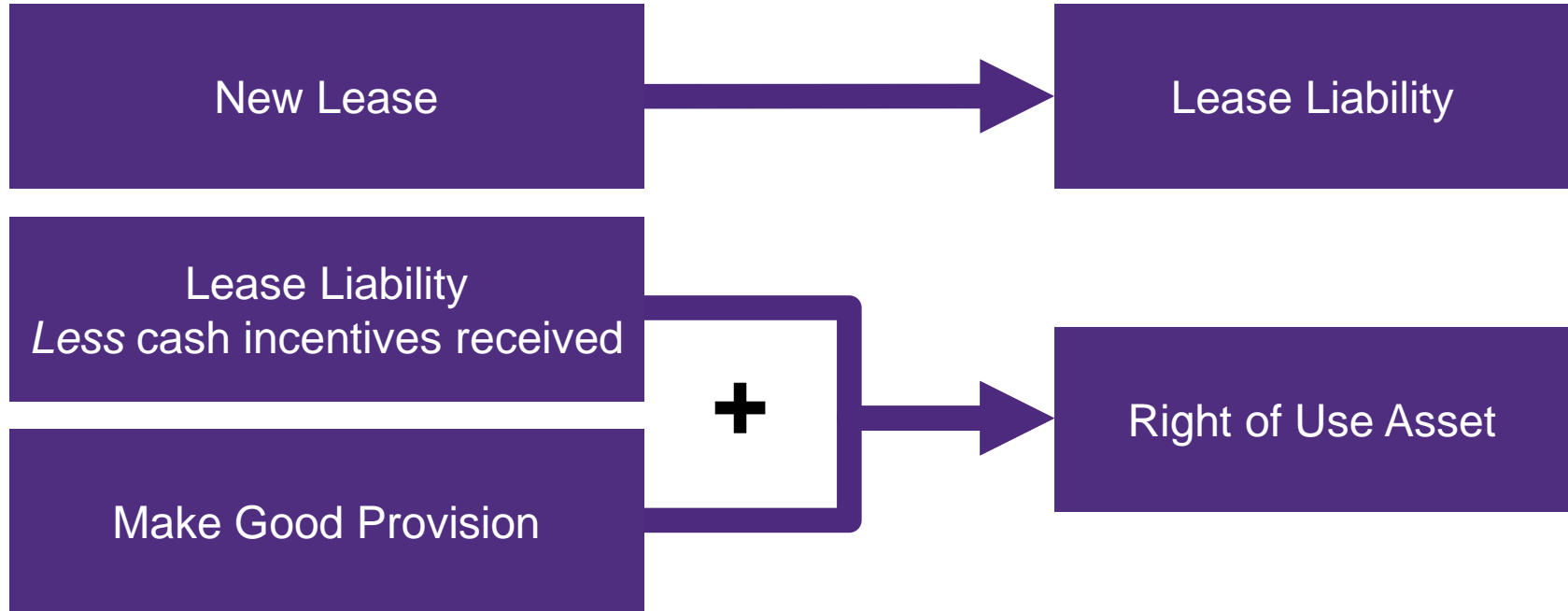
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Lease *

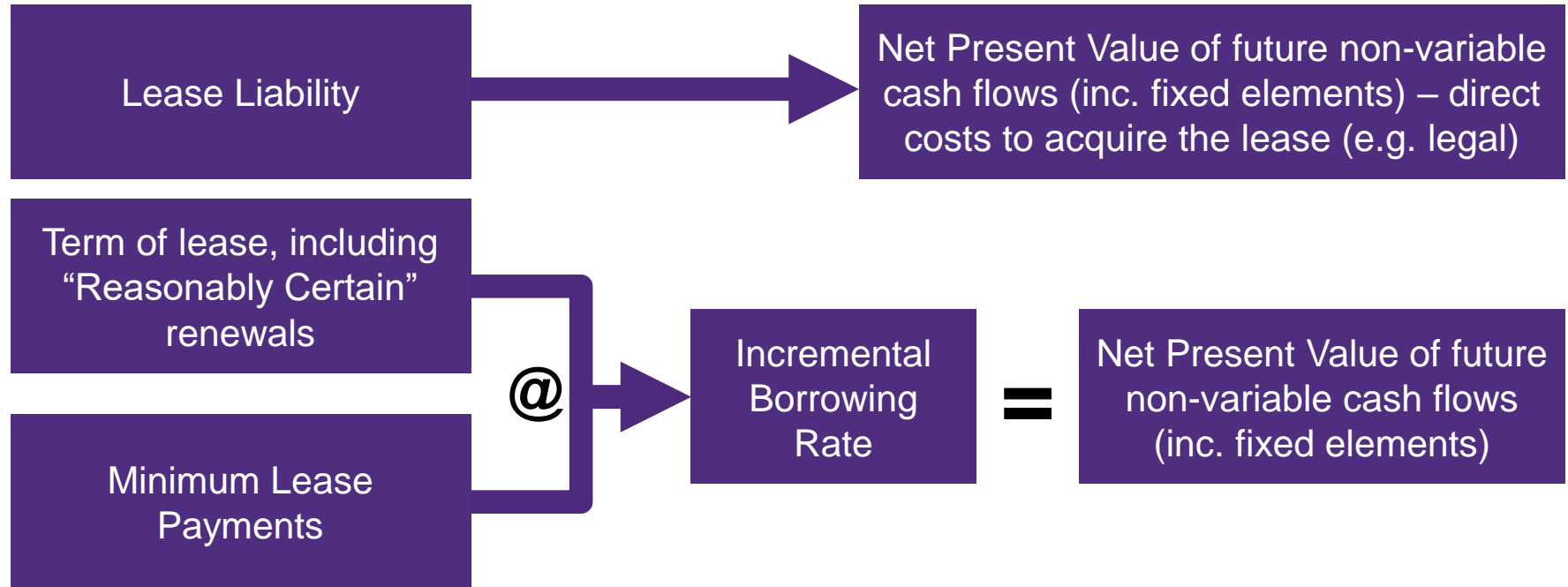
* Electable exceptions:

- Variable lease payments (such as turnover rents);
- Short-term leases (<= 12 months)
- Low value leases (e.g., <USD5,000)

The new leasing standard – Initial Measurement



The new leasing standard – Initial Measurement



The new leasing standard – Initial Measurement

Term	Definition
“Reasonably Certain” lease renewals	Where an option to renew exists and is held by the lessee, if it is “Reasonably Certain” (i.e. 90+% probability) assume renewal and include in term.
Minimum Lease Payments	Payments that are fixed, or in-substance fixed (which is a high hurdle) (and are ex-GST). For leases with CPI increases, assume that the current payment will continue into the future. For leases with market increases, assume a reset to the initial payment on the lease until the uncertainty is resolved. Note: This is as defined by IFRIC and is mandatory

The new leasing standard – Initial Measurement

Term	Definition
Incremental Borrowing Rate	The arms-length rate that a third party would lend to the lessee, assuming: <ul style="list-style-type: none"><li data-bbox="595 459 1070 489">• Finance period = Lease Term<li data-bbox="595 497 1219 527">• The underlying asset is held as security
Make Good Provision	Many building leases have an underlying requirement to “make good” the leased premises. Notwithstanding these are often not exercised, AASB 137 (and now AASB 16) require that the expected cost of this “make good” liability be recognised as an asset upon initial recognition. AASB 16 requires this to be included in the ROU Asset. Legacy, this was required to be included in PPE (AASB 116).

The new leasing standard – Subsequent Measurement



Right of Use
Asset

Depreciate over
lease life

The new leasing standard – Subsequent Measurement



Lease Liability

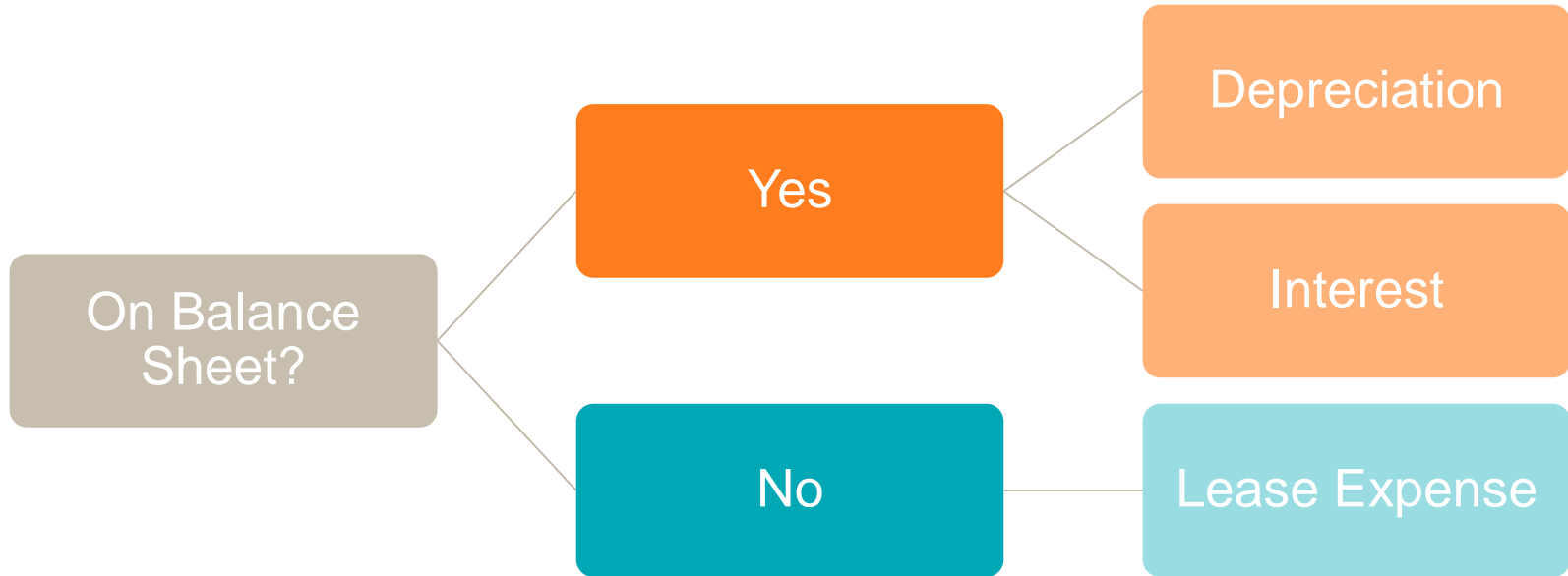
Reduce by
payments

Increase with
interest charge

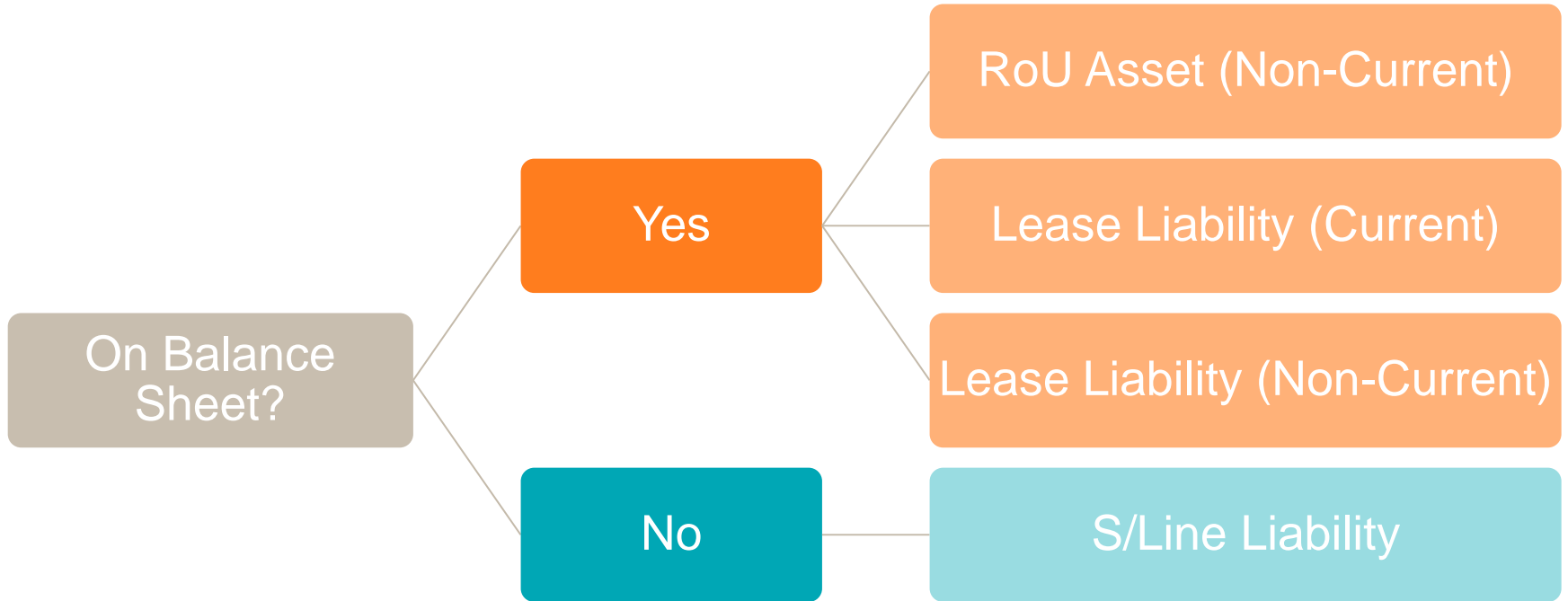
The new leasing standard – Subsequent Measurement

$$\text{Interest Charge} = \text{Lease Liability Balance} \times \text{Incremental Borrowing Rate}$$

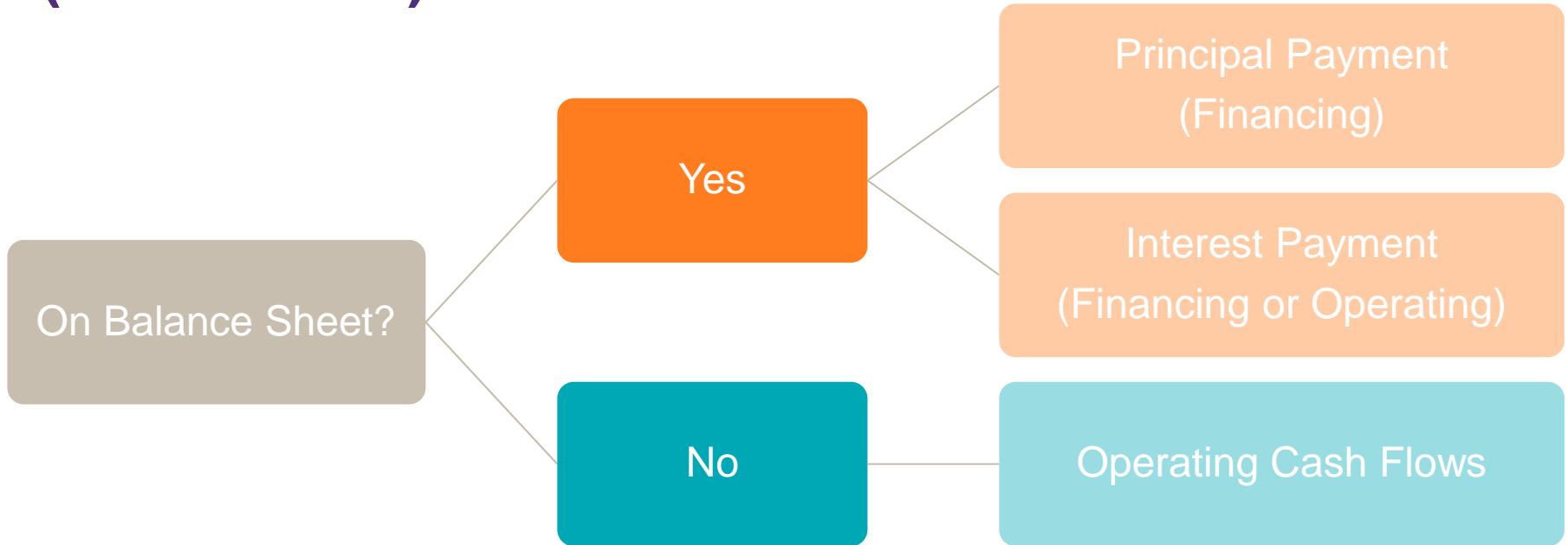
The new leasing standard – Presentation (Income Statement)



The new leasing standard – Presentation (Balance Sheet)



The new leasing standard – Presentation (Cash Flows)



The new leasing standard – Transition

Full Retrospective

Full restatement
of historic
financial periods

Modified Retrospective (Option 1)

No restatement

More complex

More comparable

Modified Retrospective (Option 2)

No restatement

Less complex

Less comparable

The new leasing standard – Disclosures

Special Purpose Financial Statements do NOT apply the AASB 16 disclosures.

What is required to make them true and fair, and not mislead users?

General Purpose DO apply the AASB 16 disclosures, with very little RDR relief.

Generally, the larger firms have released financial statement models or descriptions of requirements.

Other considerations

Category	Dec 2019HY	Dec 2018HY	Change
Non-Current Assets	2,000	1,300	+54%
Total Assets	3,600	2,800	+29%
Total Liabilities	2,500	1,800	+39%

Based on a public company's 31 December 2019 interim financial report.

Other considerations

Category	Change
Non-Current Assets	+54%
Total Assets	+29%
Total Liabilities	+39%

Are covenants complied with?

How does this impact goodwill impairment?

*Excerpt: Public Co Limited
31 December 2019
Condensed consolidated balance sheet*

Other considerations - Impairment

Indefinite-lived Intangibles require impairment testing *AASB 136.10*

Leases are allocated to a CGU

The example's assets increased 29%

Liabilities are not allocated to a CGU in a ViU *AASB 136.76(b)*

ViU can reasonably be expected to increase 29%

Lease cash flows are primarily financing in nature *AASB 16.50*

Issue: Is a lease replacement cost required to maintain cash flows?

Issue: What is the impact on WACC where a change in gearing has occurred?

Potential outcome: Negative NPV results in additional impairment.

Thank you

Questions

If you would like to find out more, please get in touch.



Madeleine Mattera

Partner & National Head of
Financial Services

+61 2 8297 2773

madeleine.mattera@au.gt.com



Claire Gilmartin

Partner & Head of Banking

+61 2 8297 2469

claire.scott@au.gt.com



Darren Scammell

Partner & Head of Financial
Services, Victoria

+61 3 8663 6135

darren.scammell@au.gt.com