AC Insights

Insights for reviewing financial reports

Insights on financial reporting using IFRSs

Issue C2020-3
Summer 2020

Contents

COVID-19 uncertainties affect your financial reporting

We know the virus has infected millions of people resulting in hundreds of thousands of deaths across the globe. We know the economy has been ravaged, and governments have committed enormous amounts of funds to support their citizens and businesses. But there is a lot we do not know. These unknowns have put unparalleled pressures on economies, markets, industries, and businesses in planning and reasonably predicting future courses of action.

The unknowns

Much is unknown about the COVID-19, how it behaves, and the extent and nature of immunity to the virus. Vaccines are seen as an answer to protecting us from the virus; however, whether and when a safe and effective vaccine will be developed, produced, and distributed is not guaranteed. We have maintained strict public health measures, but future waves of the virus continue to be possible.

In June 2020, the Government of Canada announced it would present Canada's fiscal and economic snapshot on July 8, 2020. At the time, Prime Minister Trudeau said, "I've consistently said that an economic and fiscal update would be unrealistic right now because it automatically includes projections for a year, three years, five years ahead of time, which quite frankly we simply couldn't make any responsible predictions about."

On June 22, 2020, Tiff Macklem, the Governor of the Bank of Canada said, "The pandemic has created a fog of uncertainty, and this has greatly complicated our ability to generate a clear outlook for growth and inflation." Macklem identified various sources of uncertainty, including the course of the COVID-19 virus, how global trade and supply chains will evolve, how domestic supply and demand will respond, whether consumer and business confidence will rebound, and whether there will be lasting changes to savings and spending habits.

Commentary from most industry and academic economists echo the same levels of uncertainty in planning and predicting the recovery from the pandemic. Most expect growth as businesses reopen, people go back to work, and return to "normal" family and social lives. Beyond that, there are many questions about the extent, speed, and profile of the recovery.

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In addition to the consequences of COVID-19, other geopolitical and social tensions have created additional uncertainties that may affect the recovery of the economy.

Doing things differently

The drastic public health measures have forced many consumers and businesses to do things differently. These new ways may become the "new normal" and disrupt existing business models and strategies. Some examples are:

- Increases in online shopping by both consumers and businesses;
- Shifts to working remotely;
- Permanent job losses as certain non-essential services do not recover;
- Changes in distribution models for everything from take-out meals to vehicles;
- New skills required for new business models focusing on technology;
- Return to work strategies by workers who are surviving on government subsidies and worrying about safety on the job; and
- Onshoring of production of products sourced from China and other foreign countries.

Decisions and judgments affected

These risks and uncertainties affect our decisions and judgments. For financial reporting, we must develop an understanding of and evaluate the impact of these risks and uncertainties on the accounting and disclosures. Below, we outline some things for you to consider in addressing these and other uncertainties, as well as certain developments by standard setters and regulators to aid companies in getting through these challenging times.

In the Spring 2020 edition of ***AC Insights***, we outlined various accounting and financial reporting matters that might require consideration because of the economic fallout from COVID-19. Many of these matters considered the subsequent measurement of assets that may be impaired. That guidance continues to be relevant to assessing the consequences of COVID-19. Even as the economy begins to recover, companies should not lose sight of the continuing risks and uncertainties associated with the recovery from the pandemic when considering how to account for and disclose transactions and events that have occurred during the second quarter of 2020. Companies will also need to explain the impact of COVID-19 on its operations, liquidity and capital resources, and risks in the MD&A.

In putting all of this together, companies need to ensure that disclosure controls and internal controls for financial reporting are maintained and updated as changes in processes and procedures occur.

Estimates in financial statements

Financial statements depend on estimates and judgment calls about future events and other matters that affect the recognition and measurement of assets, liabilities, revenues, and expenses. Assumptions, forecasts, and judgments are based on historical experience, current trends, and other factors, but also future expectations. Making specific estimates in the current environment will be exceedingly difficult, subjective, and complex. It is highly probable that some estimates will change in future periods as more precise information is available or actual outcomes occur.

Regulatory views
Measurements involving future cash flows, estimates of future selling prices and future costs, forward discount rates, and other future-oriented factors will most likely be affected by the uncertainties and risks related to the recovery. In May 2020, the CSA staff outlined points for management to consider in the development of estimates used in financial statements. In the CSA publication, ***COVID-19: Continuous Disclosure Obligations and Considerations for Issuers*** (CSA COVID Guide), the CSA

staff indicated they expected issuers to use the best available information to make well-reasoned judgments and estimates. Further, issuers should provide entity-specific disclosures of significant judgments and estimates in the notes to the financial statements. Issuers were reminded to consider whether their judgments and estimates need to be updated. Any changes to estimates should be prospectively reflected in the financial statements when new information becomes available.

In June 2020, Sagar Teotia, Chief Accountant of the SEC said, the Office of the Chief Accountant, "has consistently not objected to well-reasoned judgments that entities have made, and we will continue to apply this perspective. Companies should ensure that significant judgments and estimates are disclosed in a manner that is understandable and useful to investors, and that the resulting financial reporting reflects and is consistent with the company's specific facts and circumstances".

Companies should adequately document their judgments, assumptions, and decisions to provide evidence of being well-reasoned. Well-documented conclusions made contemporaneously are the best support when questions are raised later.

Enhanced disclosures
For significant estimates, disclosures may need to be enhanced to explain judgments used in making accounting decisions and the assumptions used in measurements. IAS 1: *Presentation of financial statements* also requires disclosure of assumptions and other major sources of estimation uncertainty that have a significant risk of resulting in a material adjustment to assets or liabilities within the next financial year. Entities should explain:

- the nature of the assumption or estimation uncertainty;
- the sensitivity of the carrying amount to methods, assumptions and estimates used, including the reasons for such sensitivities;
- the expected resolution of the uncertainty and range of reasonably possible outcomes; and
- the explanation of changes made to past assumptions if the uncertainty is still unresolved.

If it is impracticable to disclose the extent of the possible effects of alternative assumptions or outcomes, the disclosure should indicate it is reasonably possible that a material adjustment to the asset or liability may be needed in the next 12 months. Similar disclosures would be necessary for interim financial statements so investors can understand any new material uncertainties that have arisen since the latest annual financial statements.

Given the level of uncertainty about outcomes, companies will want to carefully consider how the risks and uncertainties affect the measurement of transactions and events and what disclosures are necessary to inform investors of uncertainties in the financial statements. Those disclosures may be inherently more uncertain as to whether there will still be further impairments or changes to estimates as the recovery of the economy evolves.

Going concern uncertainties

In our Spring 2020 edition of ***AC Insights***, we highlighted the importance of completing assessments of a company's ability to continue as a going concern when it is facing strained finances and critical liquidity issues. On May 11, 2020, staffs of Chartered Professional Accountants Canada, the Auditing and Assurance Standards Board, and CPAB reviewed management's and the auditor's responsibilities for going concern assessment in their webcast, ***COVID-19 Implications on Going Concern Assessments: Perspectives for Management, Auditors, and Directors*** (the Webcast). The Webcast is posted on the home page of the CPAB website (www.cpab-ccrc.ca) under the heading of *What's New*.

In a June 2020 speech, the SEC Chief Accountant also stressed the importance of considering whether relevant conditions and events, taken as a whole, raise substantial doubt about the entity's ability to meet its obligations as they become due within one year after the issuance of the financial statements. While there are subtle differences between IFRSs and US GAAP on the guidance for assessing going concern, the message is clear that the SEC staff is expecting issuers to make a robust assessment on going concern at each annual and interim period-end.

Management responsibilities
The Webcast highlighted that IFRSs require management to assess an entity's ability to continue as a going concern and make

disclosures of material uncertainties related to conditions or events that cast doubt on that ability.

The presenters indicated these assessments are difficult because management often may not have experience in making such assessments and the unknown nature and duration of the pandemic. Use of sensitivity analysis and downside scenarios will be indispensable tools in making the evaluation. Some key factors management should consider in making the assessment are:

- The extent of the deterioration in operating results;
- The extent of the decline in the value of cash flow generating assets resulting from uncollectible receivables or inventory losses; and
- Financing challenges due to changes in operations and any mitigations from government supports.

Auditor's responsibilities

A key point made in the Webcast was that auditors are not responsible for rectifying management's lack of robust analysis of the going concern issue. The auditor is responsible for evaluating management's assessment, including any forecasts and plans to mitigate concerns. Auditors would consider inputs and assumptions used by management, apply stress tests, consider alternate scenarios, and consider potential liquidity and solvency events. Auditors will likely consult with their subject matter specialists and quality management support groups. Management and audit committees should expect auditors to challenge management's analysis and assessment.

Audit committee involvement

Audit committees provide a valuable oversight function to the going concern assessment. An important starting point is an open dialogue among management, the auditors and the audit committee about the risks and uncertainties that may contribute to going concern issues. The audit committee will want to understand the support for management's assessments and the conclusions, and the work done by the auditor.

The Center for Audit Quality (CAQ) also released a publication, ***Going Concern: Management and auditor responsibilities***, on April 16, 2020, which reviews the technical requirements for management and the auditor under US GAAP and PCAOB standards, respectively. The publication outlines the key differences between management's and the auditor's requirements, which are consistent with the Webcast. The CAQ publication is available at www.thecaq.org under the tab *Explore Our Work / Resources*.

As the effects of the pandemic linger, some businesses will be facing more significant liquidity risks; it is crucial to complete a careful and robust assessment of those issues to ensure disclosures about material changes to these risks are made.

Heightened fraud risk

The pandemic may present opportunities for increased fraud as many people in the organization are focused on health and safety and keeping the operation sustainable as the way of doing business changes. The CAQ recently published a resource, ***Managing fraud risk, culture, and skepticism during COVID-19***, to heighten awareness of the risk for fraud and misconduct that might occur inside an organization.

The publication highlights:

- The importance of crisis planning and fraud risk management. While many are distracted by the pressures and urgency of responding to the pandemic's consequences on the business, management should continue to reinforce the fundamentals with an effective crisis management plan. The CAQ believes, "fraud prevention should not be an afterthought in crisis planning and response; it should be the starting point". The management and board should continue to challenge itself to assess whether fraud prevention controls are effective.
- COVID-19 presents a heightened fraud risk – the economic downturn presents potential sources for fraud resulting from:
  - *Pressure* – current work/life balance may increase pressure as employees cover for employees laid off or unable to work, and some employees will be under personal financial stress.
  - *Opportunity* – cutbacks in the workforce may create weaknesses in internal control that some may attempt to take advantage of, including the manipulation of manual processes and management overrides.
  - *Rationalization* – employees convince themselves they are "doing it for the

company," "no one will notice," "I'll pay it back," "it's no big deal," or "they owe it to me".

- Encouraging skepticism as a fraud deterrent – audit committee members, internal auditors, and financial team members need to hone their skepticism skills. Management needs to be proactive in maintaining internal controls during this period and adapting controls for a remote working environment. Audit committees should focus their questions on heightened areas of risks and how management is mitigating those risks.

- Keep your eye on corporate culture – companies need to support a culture of integrity, starting with an ethical tone at the top from management.

More insights into this critical issue can be obtained from the CAQ publication available at www.thecaq.org under the tab *Explore Our Work / Resources* or by consulting with your PwC engagement team.

While there are many challenges these days, companies should not ignore that these challenges may present opportunities for fraud. A review of internal controls may mitigate this risk.

Accounting for lease concessions

The IASB is watching the potential consequences of the pandemic and considering whether there are any reliefs needed to address unintended consequences or assist companies in preparing financial statements on a timely basis. In May 2020, the IASB addressed the accounting for rent concessions.

Lessors may be providing rent concessions to lessees such as rent holidays, rent reductions, and payment deferrals. To ease the accounting for these concessions by lessees, the IASB approved the amendment, *COVID-19-related rent concessions*, which supplies an optional practical expedient to IFRS 16: *Leases* for COVID-19-related rent concessions.

The expedient provides an exemption from evaluating whether a rent concession is a lease modification if it is granted before June 30, 2021, provided:

- The concession is a result of the COVID-19 pandemic;

- The revised lease payments are substantially the same or less than the original consideration in the lease contract before the concession was provided; and

- There are no other substantial changes to the terms and conditions of the lease.

Lessees applying the expedient would generally account for the changes in lease payments as variable lease payments included in profit or loss in the period that an event or condition triggers the payments. Disclosures of the application of the practical expedient and the amount included in profit or loss are required. The guidance is to be applied retrospectively. There were no changes made to the accounting rules for lessors.

The amendments should remove a significant burden for companies when accounting for what is hopefully short-term concessions to rent payments.

Accounting for government's response to COVID-19

The Government of Canada has provided a comprehensive COVID-19 Economic Response Plan to support businesses to blunt the impact of the pandemic, including:

- Subsidies for wages paid;
- Subsidies for other expenses in certain areas and sectors;
- Subsidies to lessors for rent concessions;

- Interest free and below-market interest rate loans; and
- Loan guarantees.

The US government passed the *Coronavirus Aid, Relief, and Economic Security (CARES) Act* on March 27, 2020. The *CARES Act* includes provisions to support businesses during the pandemic in the form of loans, grants, tax changes, and other types of relief. Other countries have also implemented various programs to support their businesses.

Subsidies and grants
Some of the government programs are complex and companies should first consider which party is the recipient of the subsidy or grant. Subsidies received by companies for expenses or reduction in revenues are considered government grants and should be accounted for using IAS 20: *Accounting for government grants and disclosure of government assistance.* Such grants may be presented either separately under a heading such as Other income or as a reduction of the related expense. Disclosures must explain the accounting policies for government assistance, the nature and extent of assistance recognized, and any unfulfilled conditions or contingencies related to the assistance recognized.

Below-market interest on loans
Companies may receive loans from the government with below-market interest rates. IAS 20 requires the benefit of the below-market interest rates to be accounted for as a government grant. The benefit is measured as the difference between the initial carrying value of the loan under IFRS 9 and the proceeds received. This guidance differs from US GAAP which does not require the imputation of interest on below-market interest rate loans from governments.

Income tax relief
Deferral of instalment or final payments have been permitted to assist companies with liquidity. There are no special accounting consequences resulting from these deferrals.

The *CARES Act* changed certain US Federal income tax provisions related to the carry back of net operating losses (NOLs). These provisions may allow companies to recognize deferred tax assets for existing NOLs, previously not considered more likely than not to be recoverable. Any change in assessment would be reflected in income in the period of enactment. Also, other changes were made to the limitations on interest deductions, alternate minimum tax refunds, and qualified improvement property, which may affect current and future tax consequences. Any grants related to income tax are within the scope of IAS 12: *Income taxes.* There may be several complexities in tax law in determining the amount of the release of the valuation allowances or other tax consequences. Companies may wish to consult with their US tax advisors to determine eligibility for these provisions and the related accounting consequences.

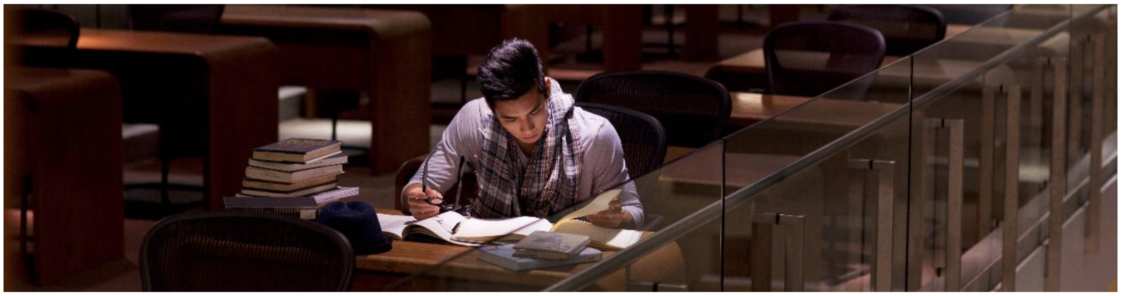
The government's response is a welcome relief for many companies. Companies should review the accounting, presentation, and disclosure of the relief so that investors understand the effect on their financial condition, operating results, and cash flows.

Disclosures of uncertainties in the MD&A

Risks and uncertainties are disclosed throughout the MD&A in the discussion and analysis of operating results, liquidity, and capital resources; commentary on critical accounting estimates, and disclosures about risks facing the issuer.

CSA COVID-19 Guide
The CSA COVID-19 Guide sets out the staffs' expectations for disclosures during these unprecedented times. Some highlights of the Guide are as follows:

- The *discussion of operations* in the MD&A should cover issuer-specific impacts and quantify the effects of each material factor, causing variances such as:
  - Demand for products and services;
  - Changes to costs, including price changes, increased health and safety costs, cost-saving measures or restructuring activities, facility closures, and changes to contracts and leases;
  - Changes to company personnel and related expenses;
  - Changes to supply chains and distribution channels and constraints on the supply of materials and other resources;
  - Shifts in the business model;
  - Changes in status, timing, and amount of capital expenditures and projects;
  - Impact of government subsidies and grants and insurance recoveries; and
  - Breaches or potential breaches of material contracts.



- The *discussion of liquidity and capital resources* should focus on cash flow needs, changes in the company's liquidity, actual or potential defaults or arrears in contractual payments or dividends, and planned remedies to these defaults and arrears, including:
  - How the company's short- and long-term liquidity has been affected by the consequences of COVID-19;
  - How working capital is affected by collections of account receivable and whether credit terms have been changed;
  - Whether the company is eligible for government subsidies and support;
  - How access to and cost of capital has changed;
  - How expenditures to maintain capacity, for planned growth, or development have been affected;
  - Whether the dividend policy of the company has been changed;
  - Whether the company will be able to meet its contractual obligations and satisfy covenants on debt and credit arrangements; and
  - What remedies the company considered to address liquidity concerns or uncertainties.

- Companies continuing to provide *forward-looking information* (FLI) should ensure reasonable assumptions and factors are used. Further, previously issued FLI should be updated or withdrawn when material assumptions and factors change along with disclosures of what has changed. Companies should consider whether:
  - There is still a reasonable basis for previously issued FLI;
  - The assumptions used are reasonable and entity-specific, and the disclosure of assumptions is adequate;
  - The disclosure of risk and risk factors of not meeting forward-looking results is sufficient; and
  - The impact of COVID-19 on future operations and liquidity is adequately explained.

- *Risk factors disclosures* should be entity-specific and not generic or boilerplate and explain specific steps to mitigate the risks. COVID-19 risks might include:
  - Disruptions to operations resulting from health and safety measures or government-imposed restrictions;
  - Disruptions or volatility of the capital markets, increased costs of capital, and ability to access funds;
  - Disruptions to supply chains;
  - Interruptions to or restrictions on delivery of products imposed by customers or governments; and
  - Reliance on major customers that have stopped or reduced operations.

The MD&A should clearly reflect the challenges companies have faced, including the uncertainties and risks they continue to face. Companies will want to consider the above noted factors in preparing their current and future disclosures in MD&A.

COVID-19 adjusted non-GAAP financial measures

Companies may be considering how to normalize their operating results by using non-GAAP measures (NGMs). The CSA noted that disclosures about NGMs should not describe an expense or loss as non-recurring, infrequent, or unusual when a similar expense or loss is expected to occur within the next two years or occurred in the prior two years. The CSA COVID-19 Guide cautions issuers that given the current level of uncertainty, there may be a limited basis for management to conclude that an expense or loss was non-recurring, infrequent or unusual.

In April 2020, the CAQ issued ***COVID-19 considerations for non-GAAP financial measures and performance metrics*** as a general information guide to non-GAAP financial measures (NGMs) as prescribed by the SEC. The publication reviews the technical requirements and the guidance issued by the SEC staff in the first quarter of 2020.

The CAQ believes “the audit committee can act as a bridge between management and investors by:

- assessing management’s reasons for presenting non-GAAP financial measures and performance metrics;
- considering the sufficiency of management’s related disclosures; and
- evaluating whether the measures present a fair and balanced view of the company’s performance.”

The audit committee might consider the following factors when evaluating NGMs adjusted for the effects of COVID-19:

- Do the measures and disclosures help investors understand how management and the audit committee evaluates the business?
- How and why the NGMs been changed to communicate the effects of COVID-19 and how will those changes be disclosed?
- Do the revised NGMs and related disclosures comply with regulatory rules and guidance?

NGMs can help investors understand how management reviews operating results. Adjustments for the effects of COVID-19 may be beneficial to understanding the current operating results, but companies should tread carefully to make sure the NGMs are not misleading.

COVID-19 and material change reports

A material change report is required when there has been a material change in the issuer's affairs. General COVID-19 impacts on an industry may not be considered a material change; however, if there are material issuer-specific implications, disclosures may be needed. Specific changes that might call for disclosures are significant disruptions in an entity's operations or workforce; negative changes in markets, the economy, or laws; critical supply chain delays or disruptions; changes in debt or credit arrangements; increased costs of revenue; or suspension of exports. Issuers should consult with their legal counsel to discuss when and whether material change reports are needed.

Filing extensions

In the Spring 2020 edition of ***AC Insights***, we outlined certain filing extensions available for the annual and first-quarter filings.

In May 2020, the CSA provided 60-days extensions for filings usually required between June 2, 2020, and September 30, 2020. Further, public companies can delay filings and deliveries of documents usually sent with information circulars for annual meetings. The filing of executive compensation disclosures can be postponed until December 31, 2020. Also, issuers may delay the mailing of financial statements and MD&A to shareholders that have requested a paper copy of those documents until December 31, 2020. Issuers are required to issue a news release disclosing the planned delays. Any required disclosures should be sent to investors to allow enough time to review the information before the annual general meetings.

In April 2020, the SEC staff also confirmed that MJDS filers could rely on any applicable filing extensions allowed by the CSA. MJDS filers should promptly disclose their reliance on the Canadian COVID-19-related relief.

These extensions provide issuers with more time to consider the consequences of COVID-19, as well as accommodate new working conditions. However, many of the uncertainties that are affecting financial reporting will not be resolved by these filing extensions and companies will have to make their best estimates and make changes when more information is available. Disclosures about estimates and uncertainties in the financial statements will be important to ensure investors understand the situation.

Relief for crowdfunding in US

In May 2020, the SEC provided temporary, conditional relief for established smaller companies affected by COVID-19 to use crowdfunding offering to meet their urgent funding needs. This relief is available to companies eligible under the Crowdfunding regulation provided they have been organized and operating for more than six months and have followed specific requirements of the *Securities Act*. This relief is available for offerings launched between the effective date of the temporary rules and August 31, 2020.

The amendment allows companies to initially omit financial statements, if they are not otherwise available, from the applicable offering statement. However, investment commitments can only be accepted after financial statements have been provided in the original or amended offering statement. If crowdfunding offerings have been more than US$107,000 and not more than US$250,000, the financial statements do not need to be reviewed by an independent public accountant. Instead, the financial statements and specific information from the issuer's federal tax returns can be provided with a certification from the principal executive officer. Sales of securities offered are allowed as soon as commitments for the targeted amount are received. Investors may cancel commitments for purchases for any reason within 48 hours. Closing of transactions can be accelerated.

Keeping up to date

As we have seen through the last three months, events are evolving quickly and there have been drastic changes to our lifestyles and how businesses operate. There is also much that is uncertain, and we all need to keep apprised of developments and their consequences.

For public companies, disclosures are important to keep investors and other stakeholders informed so they can understand the financial condition and operational sensitivities that drive financial performance and cash flows of your business.

If you have any questions about these issues and developments and how they affect your company, please consult with your engagement team.

IFRS update

During the most recently completed quarter, the IASB issued several amendments and annual improvements to existing standards, including to IFRS 17: *Insurance Contracts.* There were no significant developments on any major projects during the second quarter. The changes to the standards are explained below, except for the COVID-19-related amendment to IFRS 16: *Leases*. That amendment is described in the article *COVID-19 uncertainties affect your financial reporting*.

Resolving implementation issues for IFRS 17

IFRS 17: *Insurance contracts* was issued in May 2017 to introduce a consistent model for accounting for insurance contracts. As companies began implementation of IFRS 17, certain concerns and challenges have been raised. In June 2020, the IASB addressed these by issuing targeted amendments and clarifications to simplify some requirements and ease transition. These amendments are not intended to change the fundamental principles of IFRS 17.

The IASB decided to delay the effective date of IFRS 17 and its amendments by two years to annual periods beginning on or after January 1, 2023. The fixed expiry date of the temporary exemption from applying IFRS 9 set out in IFRS 4 was also deferred to the same date.

The main amendments to IFRS 17 include:

- Scope exclusions for some credit card or similar contracts, and some loan contracts;
- Allocation of part of contract acquisition costs are expected contract renewals;
- Contractual service margin attributable to investment services;
- Recovery of losses on reinsurance contracts held;
- Applicability of the risk mitigation options when mitigating financial risks using reinsurance contract held and non-derivative financial instruments at fair value through profit or loss;
- Inclusion of income tax payments and receipts that are specifically chargeable to the policyholder under the insurance contract in fulfilment cash flows;
- Presentation of insurance contract assets and liabilities in the statement of financial positions in portfolios rather than groups;
- An accounting policy choice to change the estimates made in previous interim financial statements when applying IFRS 17; and
- Selected transition reliefs.

These changes reflect feedback from companies and should help companies with the implementation of the standard. For more details on these amendments, companies should consult with members of their PwC engagement team.

Proceeds before intended use of property, plant and equipment

Amends IAS 16: *Property, plant and equipment*
Effective: January 1, 2022
Proceeds from selling items produced by property, plant, and equipment (PP&E) while these assets are being prepared for their intended use will no longer be deducted from the cost of the assets. These proceeds arise from sales of samples or initial runs of inventory produced when testing equipment to see if it is functioning properly. Instead, the proceeds and any related costs will be included in profit and loss. Costs included in profit or loss would be the costs of inventories as determined under IAS 2: *Inventories*, except for depreciation of the equipment, which only begins when the equipment is ready for its intended use. Other costs charged to profit or loss may include the cost of abnormal amounts of wasted materials, labour and overhead, and selling, general and administrative expenses. Judgment may be required in assessing whether individual costs are capitalizable.

The amendments also define testing as "assessing whether the technical and physical performance of the asset is such that the asset is capable of being used in the production or supply of goods or services, rental to others, or for administrative purposes". Financial performance or achievement of a certain operating level of the asset is not relevant to the assessment. This change may result in equipment being ready for its intended use earlier as operating performance, such as the volume of output, will no longer be relevant.

The amendments are to be applied retrospectively only to those items of PP&E ready for intended use on or after the beginning of the earliest period presented in the financial statements in which the amendment first applies.

These changes could have a significant impact on entities, mainly in extractive industries, that reduced the cost of an asset by proceeds from testing and before a specific operating performance was achieved. Management will also need to review their internal controls and processes to track sales during testing periods as well as identifying when PP&E is ready for its intended use.

Costs of fulfilling an onerous contract

Amends IAS 37: *Provisions, contingent liabilities and contingent assets*
Effective: January 1, 2022
IAS 37 defines an onerous contract 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. Unavoidable costs are the lower of the cost of fulfilling the contract and any compensation or penalties arising from failure to fulfil it. However, IAS 37 does not specify which costs to include in determining the cost of fulfilling a contract.

The recent amendment defines the cost of fulfilling a contract as "costs that relate directly to the contract". Examples of such costs include:

- Incremental costs such as direct labour to manufacture, deliver or provide products or services, and direct materials;
- An allocation of other costs directly related to contract activities such as contract management, insurance, and depreciation;
- Costs explicitly chargeable to the counterparty; and
- Additional costs incurred only because of the contract such as payments to subcontractors.

These provisions are to be applied retrospectively at the date of initial application with an adjustment to equity and without restatement of prior periods.

The amendment also clarified that impairment losses on assets used to fulfil the contract (rather than assets dedicated to the agreement) are to be recognized before a provision for an onerous contract is estimated.

The amendments may result in higher provisions for onerous contracts for entities that previously only included incremental costs in the costs to fulfil a contract.

Fees included in the '10 per cent' test for derecognition of financial liabilities

Annual improvement to IFRS 9: *Financial instruments*
Effective: January 1, 2020
In determining whether to derecognize a financial liability that has been modified or exchanged, an entity assesses whether the terms of the arrangement are substantially different. IFRS 9 indicates terms are substantially different if the discounted present value of cash flows under the new terms is at least 10 per cent different from the discounted present value of the remaining cash flows of the original financial liability. Any fees paid net of fees received are to be included in the test.

The IASB clarified that only fees paid or received between the borrower and the lender directly or on the other's behalf be included. Costs or fees paid to third parties are not included in the 10 per cent test.

Taxation and fair value measurements for biological asset

Annual improvement to IAS 41: *Agriculture*
Effective: January 1, 2022
Currently, cash flows for taxation are excluded from determining the fair value of biological assets. The annual improvement eliminates this exclusion to align the requirements with IFRS 13: *Fair value measurement* and a previous amendment to IAS 41 to allow pre-tax discount rates. This change is to be applied prospectively.

Other annual improvements

IFRS 1: *First-time adoption of International Financial Reporting Standards* was amended to allow a subsidiary of a parent company that has already adopted IFRSs to measure cumulative foreign currency translations reported by the parent when the subsidiary first adopting IFRSs.

IFRS 3: *Business combinations* was updated to align with cross-references with the 2018 Conceptual Framework for Financial Reporting and cross-reference guidance on certain types of liabilities and contingent liabilities to IAS 37*: Provisions, contingent liabilities and contingent assets* and IFRIC 21: *Levies*. These changes to cross-references are not expected to have any substantive impact on the accounting for or disclosures about business combinations.

IFRS 16: *Leases* was amended to remove an illustration of payments made by the lessor for leasehold improvements as the example was considered confusing and not essential to the standard.

CSA regulatory update

Improving mineral resource estimates

In June 2020, CSA Staff Notice 43-311: ***Review of mineral resource estimates in technical reports*** found deficiencies in several technical reports resulting in ten reports out of 86 reviewed being amended and refiled.

The staff scored the clarity adequacy of disclosures for 33 different elements about mineral resource estimates. Using this scoring methodology, staff issued ten comment letters to mining issuers with one or more areas of disclosures assessed to be significantly inadequate. These comment letters resulted in the amended filings. Six filings were amended to add disclosures to support the MREs, and four revised their MREs resulting in:

- One downgrade in the resource category;
- One reduction in the estimated tonnage or grade;
- One complete recalculation of an MRE, with historical verification of the data; and
- One retraction of an MRE.

The key findings of the review were as follows:

- Some technical reports lacked adequate disclosures on metal recoveries, assumed mining and processing methods and costs, and constraints applied to the MRE to support that the mineralized material had the potential to be mined and processed economically.
- Data, including legacy data from former operations, to support the MRE needs to be adequately verified and determined suitable by the qualified professional for use in the MRE.
- Disclosure of potential risks and uncertainties should be specific to the mineral project and not boilerplate disclosures that are general to the mining industry.
- Estimates of cut-off grade scenarios must meet the test of reasonable prospects, and the base case or preferred scenario should be disclosed.

The reviews did find certain aspects of the disclosures were well explained, including:

- The mechanics of the estimation process, including geological modelling of controls on the mineralization, statistical analysis of the data, interpolation methods, and validation tests on the block model.
- Quality control procedures for sampling and analysis.

The Notice provides a detailed analysis of the review findings based on seven themes of the assessment:

- The qualified person's relevant experience and purpose and terms of reference of the technical report.
- Procedures for sample preparation, security, analysis, and quality control.
- Geological controls of the mineralization of the property, including data sets used in the MRE and the criteria and methodology used to develop the mineral resource model.
- Analyses that quantify the statistical and spatial relationships of the variables (grades, dimensions, densities, and other data) used in the estimation process.
- Procedures and methodologies used to estimate and classify the mineral resource, including the steps taken to validate the mineral resource model.
- Different technical and economic assumptions used to determine that the estimated mineralized material has Reasonable Prospects.
- Compliance with NI 43-101 disclosure requirements for an MRE, including information about tonnage, grade, mineral resource categories, and a discussion about uncertainties or risk factors that could materially affect the MRE.

The Notice provides staff commentary on these various themes, which should be beneficial to issuers for preparation of future technical reports.

Copies of the full Notice can be obtained through the relevant securities administrators' websites.

Changes to rules

Transparency in debt markets

In June 2020, the CSA finalized amendments to NI 21-101: ***Marketplace operation*** and the related companion policy that will require trades in corporate and government debt securities to be made publicly available through Investment Industry Regulatory Organization of Canada (IIROC). The CSA worked with the Bank of Canada, the Department of Finance Canada, and IIROC on measures to increase the transparency in debt markets.

Information on trades by dealers and banks already reporting the information to IIROC will be made available starting on August 31, 2020. Information on trades by banks currently not reporting to IIROC will be available beginning May 31, 2021. These measures are expected to promote fair and efficient debt markets and increase investor protection by providing information on existing trading.

The details of these amendments can be found on the applicable CSA members' websites.

Easing up on at-market distributions

The CSA approved amendments NI 44-102: ***Shelf distributions*** and the related companion policy to allow issuers to make at-market distributions without obtaining exemptive relief from delivering a prospectus, as currently required. This amendment will enable at-market offerings of securities to be accelerated and more cost-effective. These amendments will become effective on August 31, 2020. More details of these amendments can be found on the applicable CSA members' websites.

Whistle-blower award

In April 2020, the OSC announced that it had awarded $525,000 to a company outsider that alerted the OSC to irregularities that outsider had identified through the outsider's in-depth market knowledge and industry expertise. Jeff Kehoe, the Director of Enforcement at the OSC, stated, "If you have independent analytical information that points to a potential violation of securities law, we want to hear from you."

Details of the case are confidential under the OSC's Whistle-blower Program.

SEC regulatory update

Disclosures about business acquisitions and disposals

In May 2020, the SEC amended its disclosure requirements applicable to acquisitions and dispositions of businesses, including real estate operations and investment companies. The amendments update rules that have been in place for decades. The objectives of the changes are to enhance the quality of the information investors received while reducing the cost and burdens to prepare the disclosures.

The key changes include:

- Updates to significance tests to determine whether financial statements are required for acquired and disposed of businesses;
- Revisions to the requirements for financial statements of acquired businesses including certain acquisitions of a component of an entity;
- Alignment of disclosures about acquisitions of real estate operations with those for other businesses;
- Tailoring of financial reporting requirements for fund acquisitions by registered investment companies and business development companies, which have not been outlined in this article; and
- Revision of the pro forma financial information requirements.

The SEC's main requirements for financial statement and pro forma disclosures for acquired and to be acquired businesses (collectively, acquired businesses) are generally outlined in Regulation S-X. Foreign private issuers using Form 20-F or other F forms for registration of securities are subject to these rules for financial statements of acquired and disposed of businesses.

Details of these changes are included in SEC Release 33-10786, 34-88194, and IC-33872, published by the SEC on May 20, 2020 (see www.sec.gov under the tab *Regulation / Final Rules*).

Revisions to significance tests

Significance tests are used to determine whether financial statements must be supplied for acquired and disposed of business as well as the number of periods required to be presented. Significance is assessed based on the definition of a significant subsidiary, which includes three tests commonly referred to as the investment test, the asset test, and the income test. Changes have been made to the investment and income tests. No changes were made to the asset test.

Investment test
Under the new investment test for an acquisition or disposition, the consolidated investments in and advances to the acquired or disposed of business are compared to the aggregate worldwide market value of the registrant's voting and non-voting common equity, including equity owned by affiliates (AWMV).

The investment in and advances to an acquired entity is based on the fair value of the consideration paid for the acquired entity, as determined under US GAAP or IFRSs, as applicable. The fair value of all contingent consideration is included unless payment is considered remote.

The AWMV is the average for the last five trading days of the registrant's most recently completed month before the earlier of the registrant's announcement date or agreement date of the acquisition or disposition. When AWMV is not available, such as in an initial public offering or when the registrant's stock is not publicly traded, the carrying value of the registrant's consolidated total assets as of the end of the most recently completed fiscal year is used.

Income test
The income test has been expanded to include a revenue component (in addition to the income component) to reduce the instances in which a registrant with marginal or break-even income will have a tested subsidiary deemed significant.

The revenue component test compares the acquirer's proportionate share of the acquired business' consolidated revenues to the acquirer's consolidated total revenues for the most recently completed fiscal year. The revenue component is not used if either entity did not have material revenues in each of the two most recently completed fiscal years. The income component test still compares the acquirer's proportionate share of pre-tax income from continuing operations of the acquired business to that of the acquirer.

For an acquisition, the significance is based on the lower of the revenue component or the income component. The amended rules also clarify and simplify areas such as income averaging and the use of absolute values, when applicable.

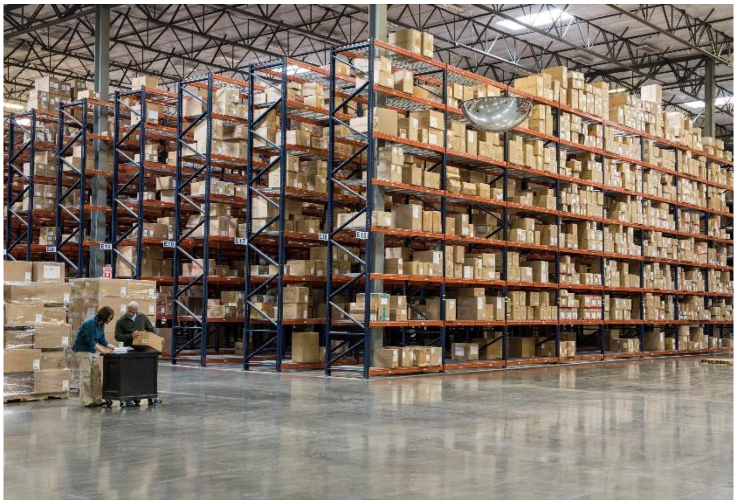
Use of pro forma financial information to measure significance
Registrants can measure significance using pro forma amounts that include significant business acquisitions and dispositions consummated after the latest fiscal year-end when the following conditions are met:

- the registrant has filed audited financial statements required for any such acquired or disposed of businesses; and
- the registrant has filed the pro forma financial information required for any such acquired or disposed of business.

If a registrant uses pro forma financial information to determine the significance of an acquisition or disposition, it must continue to do so for subsequent acquisitions and dispositions until its next annual report on Form 10-K or 20-F is filed.

Financial statement periods of acquired entities required

The number of years of audited financial statements of an acquired business required depends on the significance of the acquisition. Significance is based on the highest percentage of the three significant tests, as applicable. The maximum number of years for which audited financial statements are needed has been reduced from three years to two. The separate acquired business' financial statements can be omitted once the business has been included in the registrant's post-acquisition audited annual financial statements for either nine months or a full fiscal year, depending on significance.



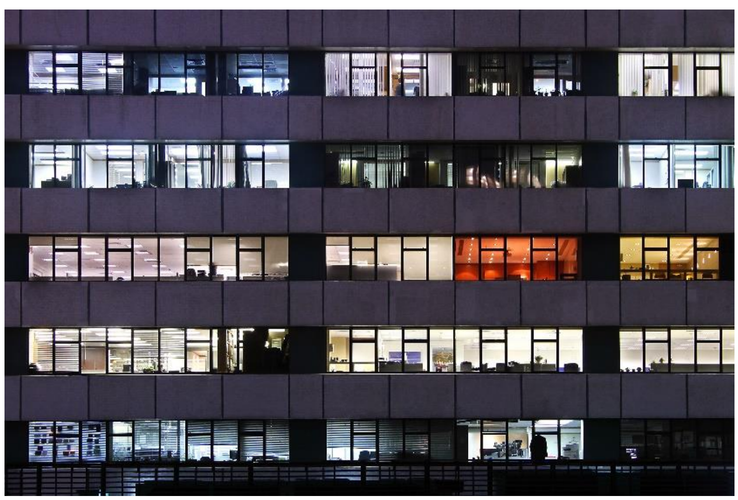
Under the revised rules, the thresholds for financial statements of acquired businesses are as follows:

- Significance < 20% – no financial statements required.
- Significance > 20% but < 40% – one year plus the most recent interim period (with comparative interim period not required).
- Significance > 40% – 2 years plus comparative interim periods.
- Aggregated significance of individual insignificant businesses acquired or to be acquired since the most recently completed annual period > 50% – audited financial statement as required for entities > 20% significant. Individually insignificant businesses include acquired business with significance < 20%, probable acquisitions with 50% significance > 50%, and completed significant acquisitions (> 20% and < 50%) acquired within 75 days of the registration filings.

Abbreviated financial statements for certain acquisitions

For an acquisition of a business that was part of a larger entity, abbreviated financial statements, consisting of a statement of assets and liabilities and a statement of revenues and expenses for all required periods, are permitted if the acquired business meets the following conditions:

- The total assets and total revenues (both after intercompany eliminations) of the acquired business constitute 20% or less of total consolidated assets and total consolidated revenues of the seller as of and for the most recently completed fiscal year (The SEC did not address acquisitions of businesses that exceed 20% of the seller's total assets or total revenues);
- The acquired business was not a separate entity, subsidiary, operating segment (as defined by US GAAP or IFRS, as applicable), or division during the periods for which the acquired business financial statements are required;
- Separate financial statements for the business have not previously been prepared; and
- The seller has not maintained the distinct and separate accounts necessary to present full financial statements of the business, and it is impracticable to prepare such financial statements.



The abbreviated financial statements must include substantially all expenses incurred by or on behalf of the acquired business during the pre-acquisition periods, including the cost of revenues, selling, distribution, marketing, general and administrative expenses, depreciation and amortization, and research and development expenses. Allocations of corporate overhead are not required.

The notes to the financial statements must also include:

- a description of expenses omitted and the reasons for the omission;
- an explanation of the impracticability of preparing financial statements that include the omitted expenses;
- a description of how the financial statements presented are not indicative of the financial condition or results of operations of the acquired business going forward because of the omitted expenses; and
- information about the business' operating, investing, and financing cash flows, to the extent available.

This guidance also applies to acquired businesses engaged in oil and gas producing activities, including certain unaudited disclosures required under ASC 932, ***Extractive Activities – Oil and Gas***, for each full year of operations presented.

Pro forma financial information for acquisitions/dispositions

The rules for pro forma financial information have been updated to simplify the requirements for adjustments and permit synergistic adjustments to be included in the pro forma financial information. Three types of adjustments are now allowed in preparing pro forma adjustments:

- Transaction accounting adjustments (presented in a separate column) reflecting the accounting to the transaction, such as required under US GAAP or IFRSs, as applicable;
- Autonomous entity adjustments (shown in a separate column) reflecting the operations and financial position as a stand-alone entity when the company was previously part of another entity (such as in a spin-off transaction); and
- Management's adjustments (presented only in the notes to the pro forma financial information in the form of reconciliations) reflecting forward-looking information to depict the effects of synergies and dis-synergies of an acquisition or disposition. These adjustments are optional and may be provided if they have a reasonable basis and are necessary to a fair statement of the pro forma financial information.

Reconciliations of foreign acquiree's financial statements

Financial statements of an acquired foreign business acquired by a foreign private issuer may be prepared using US GAAP, IFRSs, or home country GAAP. If home country GAAP is used, the financial statements must be reconciled to IFRSs if the foreign private issuer used IFRSs for its financial statements.

Further financial statements of an acquired foreign business might be prepared using IFRSs without reconciliation to US GAAP if the business would qualify as a foreign private issuer if it were a registrant.

Key changes relating to real estate operations

The rules now define real estate operation as a business that generates substantially all its revenues through the leasing of real property. The rules for financial statements of an acquired real estate operations and the related pro forma information has been harmonized with those for all other business acquisitions, except:

- For the investment test to determine significance, when AWMV for the acquirer is not available, the investment in the acquired operation would include any debt secured by properties to be acquired.
- For individual acquisitions, financial statements are required for one year only when significance is greater than 20%. There is not a higher threshold requiring two-year financial statements.

Effective date for amended SEC rules

The changes to the rules are applicable for registration statements initially filed after December 31, 2020. Early adoption is permitted provided the revisions to the rules are applied in their entirety.

More information

Navigating through these rules can be difficult. For more information, companies are invited to consult with their PwC engagement team, who can put you in contract with PwC personnel specializing in SEC filings.

SEC financial reporting actions

The SEC publishes the outcomes of its enforcements cases as they occur. We are providing a summary of cases involving financial and corporate reporting to provide audit committees with insights to matters the SEC Enforcement Division pursues.

Actions taken during the most recently completed quarter involved the following:

- Failure to disclose material facts about processes for estimating insurance losses and reserves, when the company deviated from their general actuarial process for estimating loss reserves as disclosed in its filings with the SEC. The company did not disclose that the CFO made adjustments exceeding US$300 million that did not consider the actuarial analyses and differed from the actuarial estimates. Specific factors and assumptions used by the CFO to make adjustments and comparisons of loss reserved to historical experience were not disclosed. Further, the company did not maintain sufficient supporting documentation for management's best estimate of the loss reserves. The company and the CFO settled the action by paying US$10.5 million.
- Failure to disclose perquisites and benefits provided to its former CEO fully. Perks granted during 2014 to 2018 not disclosed included personal use of corporate aircraft, helicopter trips and other personal travel, housing costs, transportation for family members, club memberships, tickets and transportation to entertainment events. The estimated amount of these perks was over US$1 million per year. The company agreed to a cease-and-desist order and paid a civil penalty of US$900,000.
- Failure by a private equity firm to establish and enforce policies and procedures to reasonably prevent the misuse of non-public information. The SEC alleged that the private equity firm obtained non-public information through its representative on the board about changes in senior management, adjustment to the company's hedging strategy, and decisions related to the company's assets, debt, and interest payments. After receiving this

information, the private equity firm purchased more than one million shares of the public company, representing 17% of the publicly available shares. The private equity firm consented to a cease-and-desist order and a censure and paid a civil penalty of one million dollars.

- Violation of the books and records and internal accounting control provisions of the *Foreign Corrupt Practices Act* (FCPA) by an international company and its former subsidiary. The company and its subsidiary were alleged to have engaged in schemes between 2012 and 2016 to make improper payments or to provide benefits to public and private entities in South Korea, Vietnam, and Greece in exchange for using company products. These schemes were known among certain managers of the local subsidiaries or affiliates. Between 2013 and 2015, the former subsidiary also used forged contracts as part of local financing arrangements. Significant losses were sustained on these arrangements and resulted in the company and its former subsidiary writing off more than $50 million in bad debts. The company agreed to cease and desist from committing FCPA violations, to pay over $112 million to settle charges, to pay criminal fines of $233 million under a deferred prosecution agreement, and to self-report on the status of its remediation and implementation of compliance measures.

Auditing update

Audits involving cryptoassets

Cryptoassets present many unique challenges, including how they are managed, how they behave and perform, and exposure to potential illegal activities. Auditing cryptoassets also present challenges for auditors. In May 2020, the PCAOB issues a ***Spotlight*** dealing with ***Audits Involving Cryptoassets***. The information provided in the ***Spotlight*** arises from PCAOB staff observations during inspections. The publication highlights matters the auditors should consider in auditing cryptoassets and questions the audit committee might consider asking the auditors.

Some matters the audit committee may wish to consider in the oversight of the auditors include:

- The experience of the engagement partner and other senior engagement team members with cryptoassets and the availability of relevant specialists to supplement the engagement team's expertise, if necessary.
- The auditor's understanding of the technology underlying the issuer's cryptoasset-related activities.
- Any specialized technology-based audit tools needed to identify, assess, and respond to risks of material misstatement.
- The auditor's understanding of the legal and regulatory implications of the issuer's cryptoasset-related activities.
- The monitoring of auditor independence considerations associated with audit engagements involving cryptoassets.
- Any policies and procedures used by the audit firm for the execution and monitoring of audit engagements involving cryptoassets, including consideration of the relevant risks.

The ***Spotlight*** provides an opportunity for management and audit committees to understand the auditing challenges and have an informed dialogue with the company's auditors on its auditing approach and conclusions.

The ***Spotlight*** is available on the PCAOB website at www.pcaobus.org on the home page under *Recent Activities*.

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