Guidance for financial reporting by licensing trusts in 2021

This document provides guidance to preparers of financial statements of licensing trusts (LTs) with a 31 March 2021 balance date that are prepared under the for-profit accounting standards. This guidance covers the following matters:

- Impairment assessments and testing.
- Disclosure expectations for Covid-19 impacts.
- Wage Subsidy.
- New going-concern disclosures.
- New and amended standards applied for the first time in 2021.
- Standards issued and not yet effective and not early adopted.

If you wish to discuss any of these matters further, please contact your audit team.

The illustrative disclosures in this guidance are for a fictitious licensing trust, Te Motu Licensing Trust (the Trust).

Impairment assessments and testing

Some LTs might be experiencing lower revenues due to the ongoing effects of the Covid-19 pandemic.

LTs will need to assess whether there continue to be indicators of impairment at 31 March 2021 for property, plant, and equipment, and investment property at cost. This assessment will need to be performed for each cash-generating unit (CGU), which would usually be at the outlet level. For example, an indicator of impairment would include where a hotel or restaurant is still experiencing reduced patronage.

If there is an indicator of impairment, an impairment test will need to be performed. This involves estimating the recoverable value of the CGU. NZ IAS 36 *Impairment of Assets* sets out the accounting requirements. It is the responsibility of the LT to assess for indicators of impairment and perform the impairment test when it is required.

Sometimes, significant estimates and assumptions will need to be made in performing impairment testing, such as forecasting future cash inflows in an uncertain environment and estimating an appropriate market-based discount rate. The discount rate should reflect the return investors would require if they were to choose an investment equivalent to the LT's asset. Guidance on estimating a discount rate is included in paragraphs 55 to 57 of NZ IAS 36.

When an impairment loss or reversal arises, the disclosure requirements of paragraphs 126 to 132 of NZ IAS 36 will also need to be considered. These include disclosing information on the methods and key assumptions used in estimating the value of the assets.

Disclosure expectations for Covid-19 impacts

While the risks and uncertainties associated with the Covid-19 pandemic have reduced since the 2020 financial statements were prepared, we expect that LTs will continue to disclose information in their 2021 financial statements about the impact that Covid-19 has had on their operations and financial statements during the year. The Covid-19 disclosures included in the 2020 financial statements will need updating to be relevant for the 2021 year.

This disclosure might cover significant impacts on:

- revenue, such as rental income, hospitality, and gaming;
- expenses, such as employee costs;
- balance sheet valuation uncertainties, such as the extent to which any significant valuation uncertainties disclosed in last year's financial statements are still present; and
- any continuing impairment indicators due to Covid-19.

A comprehensive illustrative disclosure is provided below. This will need to be tailored to suit the specific circumstances of each LT.

> *Note [xx] Impacts of Covid-19 on the Trust*
>
> *On 11 March 2020, the World Health Organisation declared the outbreak of Covid-19 a pandemic, and two weeks later the New Zealand Government declared a State of National Emergency. From this, the country was in lockdown at Alert Level 4 for the period 26 March 2020 to 27 April 2020 and remained in lockdown at Alert Level 3 until 13 May 2020. The country moved to Alert Level 1 on 9 June 2020. Additionally, parts of the country moved into Alert Level 2 for some time during August and September 2020 and during February and March 2021.*
>
> *The Government's response to Covid-19 included restricting access to commercial premises from 26 March to 13 May 2020.*
>
> *Alert Levels 3 and 4 required the public bar, restaurants, bottle stores, and gaming operations of the Trust to cease trading. Te Motu Hotel continued to trade on a limited basis, providing accommodation and meals for essential workers. The residential housing services remained open as an essential service.*
>
> *During the Alert Level 3 and 4 lockdowns, the Trust closed all sites that were unable to trade and implemented plans for staff to work from home where possible. Head Office staff moved to a 'work from home' model and hospitality staff remained at home until our sites were able to reopen.*

As the alert levels dropped, the Trust's operations progressively reopened, but with social distancing restrictions limiting customer numbers and reduced gaming machines available to play.

The closure and trading restrictions had only a moderate impact on the Trust's profitability for 2020/21 because domestic tourism provided some relief for the loss in international visitors.

Since returning to Alert Level 1 in early June 2020, the Trust's businesses have recovered well to now record sales at close to XX% of pre-Covid-19 levels. The Trust has taken steps to reduce expenditure and, as a result, is forecasting a similar level of pre-tax profit in the 2022 financial year to the 2021 financial year.

The main impacts on the Trust's financial statements due to Covid-19 are explained below:

Hospitality income

While revenue from our hospitality operations largely ceased during the 'lockdown' period and most costs continued, the nature of these businesses has meant that revenue returned to normal levels soon after the lockdown period ended.

Residential rental income

The residential housing services stayed open as an essential service. Therefore, there was no impact on income.

Commercial rental income

The Trust's commercial properties have a mix of tenants ranging from those able to operate as essential services through to hospitality businesses, which were significantly affected and were among the last to reopen.

The majority of tenants have continued to remain in place and honour the existing agreements in place, meaning that there have been minimal uncollected debts. All tenants across the group who were in place at the beginning of the lockdown period were provided one month free of rent and operating expenses, and a second month where only a 50% rent reduction was provided. Negotiations were entered into with several tenants to ensure that the return from properties was maximised.

Gaming machine operations

Te Motu Foundation's gaming machine operations were affected in the same way and timing as the Trust's businesses. Gaming machine revenue has returned to near similar levels as pre-Covid-19 levels after returning to Alert Level 1 in early June 2020. However, net profit was XX% lower than the March 2020 full-year results because of Covid-19 restrictions. This had a flow-on impact of reduced grants to the community compared to the previous year.

Revenue from wage subsidy

The Trust received the government wage subsidy of $XX for the initial 12-week period in April 2020, $XX from the wage subsidy extension that was available from 10 June 2020 to 1 September 2020, and $XX from the wage subsidy that was available from 4 March 2021 to 21 March 2021.

Operating expenses

As a result of Covid-19, the Trust has incurred lower than budgeted operating expenses, with fixed costs remaining steady and variable costs being reduced.

Payroll costs

Using funds from the Wage Subsidy, the Trust continued to pay its staff their regular entitlements. Te Motu Hotel has had the biggest impact on the Trust's trading and, because of Covid-19, had to complete a restructure of the hotel to reduce staff numbers.

Valuation of investment property

For the previous year's revaluation of investment property as at 31 March 2020, the Trust's external valuer included a statement in their valuation report that the assessed value was subject to "material valuation uncertainty" due to Covid-19. For the 31 March 2021 valuation, the valuer has noted that, while there remains some uncertainty about property values due to Covid-19, there was not a material valuation uncertainty as at 31 March 2021.

Carrying value of land and buildings

[If the land and buildings are carried at cost, the illustrative disclosure below assumes that there continued to be an impairment indicator at 31 March 2021.]

The ability of our hospitality businesses to operate during the 'Lockdown' period resulted in reduced revenue, while most costs excluding cost of sales remained fixed. This resulted in a reduced return on these assets.

The Trust performed an impairment test for the assets of sites whose trading conditions continued to be adversely affected by Covid-19 at 31 March 2021. Despite the reduced revenue from these assets creating some uncertainty in the recoverable amount, there was sufficient headroom between the carrying value and the recoverable amount.

[If the land and buildings were revalued, the illustrative disclosure is below.]

For the previous year's revaluation as at 31 March 2020, the Trust's external valuer included a statement in their valuation report that the assessed value was subject to "material valuation uncertainty" due to Covid-19. The Trust engaged its external valuer to assess whether the fair value of land and buildings as at 31 March 2021 differed materially to their carrying value at that date. The valuer has confirmed that fair value was not materially different to carrying value and also noted that, while there remained some uncertainty *about land and building values due to Covid-19, there was not a material valuation uncertainty as at 31 March 2021.*

Goodwill

Goodwill was partially impaired in the previous year by the negative effect that Covid-19 had on the number of international tourists visiting the Te Motu region and the subsequent reduction in our business sales. The Trust has performed an impairment test on the remaining goodwill balance at 31 March 2021 and concluded that no further impairment is required this year because the cash-generating unit's recoverable amount exceeds its carrying amount.

Managed funds

The fair value of managed funds decreased by a material amount in March 2020. The markets in which these funds are traded have been volatile since early March 2020 and during 2020/21 the value of these investments have recovered to pre-Covid-19 levels, although market uncertainty and volatility remain.

Wage subsidy

If an LT has recognised a material amount of Wage Subsidy during the year, an accounting policy will need to be included in its financial statements in accordance with NZ IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance.* The following is an illustrative example accounting policy for the Wage Subsidy:

Wage subsidy

A receivable and deferred revenue for the Wage Subsidy is initially recognised at the date a valid application form has been submitted that meets the Wage Subsidy Scheme's eligibility criteria. The receivable and deferred revenue liability are initially measured based on the amount of the subsidy claimed.

The deferred revenue liability is subsequently reduced and recognised as revenue over the subsidy period as the Trust pays its staff.

New going-concern disclosures

There have been amendments to FRS-44 *New Zealand Additional Disclosures* requiring additional going-concern disclosures where there is a material uncertainty over the going-concern assumption. When this is the case, an LT that prepares its financial statements on a going-concern basis is required to disclose the following:

a that there are one or more material uncertainties related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern;

b information about the principal events or conditions giving rise to those material uncertainties;

c information about management's plans to mitigate the effect of those events or conditions; and

d that, as a result of those material uncertainties, the entity may be unable to realise its assets and discharge its liabilities in the normal course of business.

New and amended standards applied for the first time in 2021

In preparing the 2021 financial statements, LTs will need to consider whether any new or amended standards applied for the first time have had an effect on the financial statements. The disclosures required by paragraph 28 of NZ IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* will need to be considered when a new or amended standard has had an effect on the financial statements.

In Table 1 below, we provide summary information on new and amended standards that came into effect for 31 March 2021 year-ends that might affect some LTs.

Note that not all new and amended standards are listed here. A complete list of new standards and amendments, including those not yet effective, can be viewed on the XRB's website at the following link https://www.xrb.govt.nz/accounting-standards/recent-approvals/

Table 1

Amendment	Brief outline
Going Concern Disclosure (Amendments to FRS-44)	This is discussed above.
2019 Omnibus Amendments to NZ IFRS	The amendment to FRS-44 requires that, if an International Financial Reporting Standard (IFRS® Standard) has been issued by the International Accounting Standards Board (IASB) but the equivalent New Zealand IFRS has not yet been issued by the External Reporting Board (XRB), an entity must disclose the information specified in paragraphs 30 and 31 of NZ IAS 8 in relation to that IFRS Standard. As at 11 May 2021, the IASB had issued *Deferred Tax Related to Assets and Liabilities Arising from a Single Transaction*, but this is yet to be adopted by the XRB. The amendments narrowed the scope of the recognition exemption in paragraphs 15 and 24 of IAS 12 *Income Taxes* (recognition exemption) so that it no longer applies to transactions that, on initial recognition, give rise to equal taxable and deductible temporary differences. If this amendment is applicable to the LT, then it will need to disclose this as standards issued and not yet effective and not early adopted, as noted in the next section below.

Amendment	Brief outline
Definition of a Business (Amendments to NZ IFRS 3)	This amendment might be relevant when an LT has acquired a business or a group of assets during the 2021 financial year. The amendments to NZ IFRS 3 *Business Combinations* clarify the definition of a business and provide guidance to help entities determine whether an acquisition is of a business or a group of assets. Entities are required to apply the amendments to business combinations for which the acquisition date is on or after the beginning of the current financial year (that is, from 1 April 2020 for 31 March 2021 reporters) and to asset acquisitions made on or after the beginning of the current financial year.
Definition of Material (Amendments to NZ IAS 1 and NZ IAS 8)	The definition of material has been amended and additional guidance provided to make it easier for entities to make materiality judgements in the preparation of their financial statements.
Covid-19-Related Rent Concessions	The amendment to NZ IFRS 16 *Leases* permits lessees, as a practical expedient, not to assess whether particular rent concessions occurring as a direct consequence of the Covid-19 pandemic are lease modifications and instead to account for those rent concessions as if they are not lease modifications. The amendment did not affect lessors. The amendment is effective for annual reporting periods beginning on or after 1 June 2020, with early application permitted. If this amendment is relevant to the LT, then it would beneficial to early adopt this amendment in the 2020/21 financial statements.
Covid-19-Related Rent Concessions beyond 30 June 2021	The above practical expedient has been extended by one year to include Covid-19-related rent concessions that reduce lease payments due on or before 30 June 2022. The amendment is effective for annual reporting periods beginning on or after 1 April 2021, with early application permitted. Consistent with the section above, if this amendment is relevant to the LT, then it would be beneficial to early adopt this amendment in the 2020/21 financial statements

Standards issued and not yet effective and not early adopted

When an LT has not yet applied a new or amended standard, paragraph 30 of NZ IAS 8 requires information to be disclosed about that new or amended standard. Our view is that this disclosure applies only to those new standards or amendments that will or might affect an LT's future financial statements.

In Table 2 below, we provide summary information on new and amended standards that have been issued and not yet effective that might affect some LTs in future reporting periods. Note that not all standards issued and not yet effective are listed here.

Table 2

Standard	Brief outline
Amendments to NZ IAS 1 – Classification of Liabilities as Current or Non-current	The amendments apply for annual reporting periods beginning on or after 1 January 2023. The amendments clarify a criterion in NZ IAS 1 for classifying a liability, such as loans, as non-current: the requirement for an entity to have the right to defer settlement of the liability for at least 12 months after the reporting period. An example disclosure is provided below.
Amendments to NZ IAS 1 – Disclosure of Accounting Policies	The amendments apply for annual reporting periods beginning on or after 1 January 2023. The amendments to NZ IAS 1 *Presentation of Financial Statements* require entities to disclose their material accounting policy information rather than their significant accounting policies. The amendments aim to improve the relevance of the information in the financial statements by helping an entity to: • identify and disclose accounting policy information that is material to users of financial statements; and • remove immaterial accounting policy information that might obscure material accounting policy information.

Where a new or amended standard will or might affect an LT's financial statements on adoption, the LT is required to provide the disclosures set out in paragraphs 30 and 31 of NZ IAS 8. The following is an example disclosure for the *Classification of liabilities as Current or Non-current* amendment.

Standards issued and not yet effective and not early adopted

Certain new accounting standards and amendments have been issued that are not mandatory for the 31 March 2021 financial year and have not been early adopted. Those new standards and amendments that are relevant to the Trust are:

<u>*Amendments to NZ IAS 1 – Classification of Liabilities as Current or Non-current*</u>

The amendments clarify a criterion in NZ IAS 1 for classifying a liability, such as loans, as non-current: the requirement for an entity to have the right to defer settlement of the liability for at least 12 months after the reporting period.

The amendments:

- *specify that an entity's right to defer settlement must exist at the end of the reporting period;*
- *clarify that classification is unaffected by management's intentions or expectations about whether the entity will exercise its right to defer settlement;*

- *clarify how lending conditions, such as loan covenants, affect classification; and*

- *clarify requirements for classifying liabilities an entity will or may settle by issuing its own equity instruments.*

The amendments are effective for annual reporting periods beginning on or after 1 January 2023 and must be applied retrospectively. The Trust will not early adopt these amendments and will first apply the amendments in the 31 March 2024 financial statements. The Trust is assessing the effect of these amendments on its loan agreements.

Where none of the changes have relevance to the LT, we recommend that this be disclosed. An example disclosure is provided below:

Standards issued and not yet effective and not early adopted

Certain new accounting standards and amendments have been issued that are not mandatory for the 31 March 2021 financial year and have not been early adopted by the Trust. The Trust has assessed that these are not likely to have an effect on its financial statements.

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May 2021

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