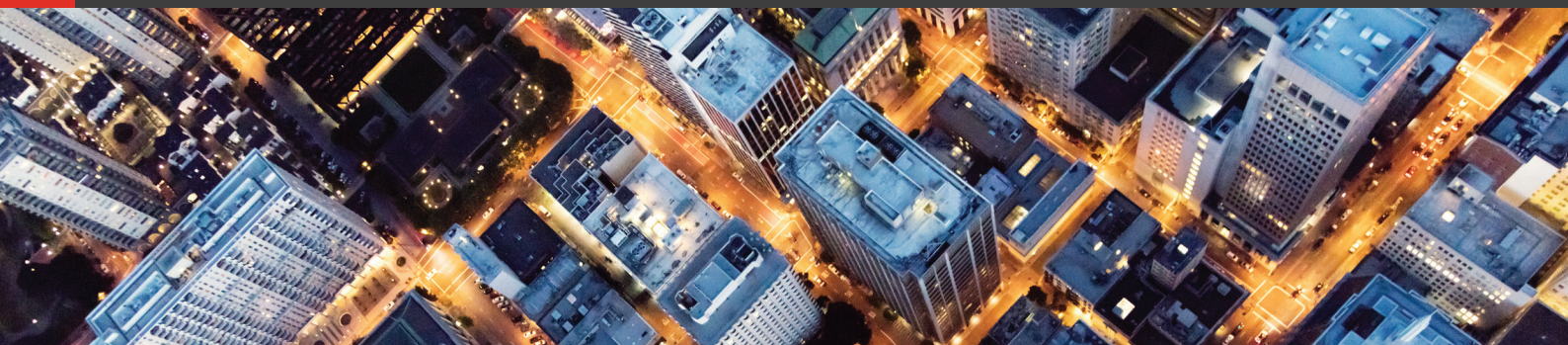
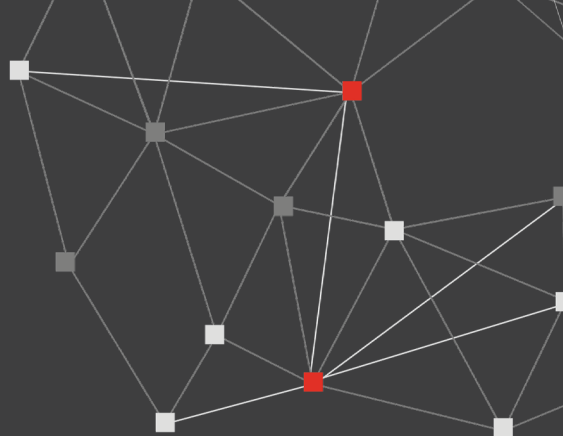


# How has COVID-19 affected financial reporting?



## Analysis of the impact on March to May NZX50 reporters

In the early days of New Zealand's COVID-19-induced lockdown, market commentators speculated on the likely impact on financial reporting. Many of this country's largest businesses have now reported their full-year earnings and released financial statements. In this overview we examine the implications of the pandemic on financial reporting and how auditors have responded.

### Utilising NZX reporting relief

Of the businesses listed on the NZX50, 13 have 31 March balance dates and one has a May financial reporting date. All these entities have now reported.

The NZX had provided some relief, due to the challenges of preparing financial statements during Alert Level 4 lockdown, in the form of a 30 day extension on the usual two month reporting requirement under the listing rules. Five of the entities that have now reported utilised this relief. However, there does not appear to be any correlation between the extent of the impact of COVID-19 and whether they employed the relief provided.

#### Number of NZX50 audits completed

<b>Deloitte</b>	<b>3</b>
<b>KPMG</b>	<b>2</b>
<b>EY</b>	<b>2</b>
<b>PwC</b>	<b>7</b>

Source: NZX50 (30 June 2020)

### Reporting the impact of COVID-19

Z Energy was the first company to report the impact of COVID-19 in a significant way by including in the financial statements a comprehensive note by key financial statement line item. This set a benchmark with ten of the reporters that followed including a detailed COVID-19 related note.

Of the four that didn't include a specific COVID-19 note, two covered the related impact in other notes relevant to the financial statement line items. The remaining two revealed little impact from COVID-19 – in both these cases revenue had actually increased as a result of the pandemic.

## Key findings:



# 14 businesses

on the NZX50 have now completed their financial reporting

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# 5 businesses

utilised the NZX's 30 day extension on reporting requirements

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# 1 business

had a qualified audit report

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# 13 businesses

had 'clean' audit reports

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# 10 reporters

included a detailed COVID-19-related note in the financial statements

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# 8 reporters

with investment property highlighted material uncertainty clauses included by the registered valuers in their valuations

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# 2 reporters

did not declare a dividend as a result of COVID-19 uncertainty



# No new KAMS

included in audit reports as a result of COVID-19

## The particular challenges of property

One of the greatest impacts has been the challenges presented by the property market, particularly the lack of commercial property transactional activity leading up to 31 March and since.

New Zealand valuers, in line with their peers around the world, included in their property valuations at 31 March and 31 May a material valuation uncertainty clause. This clause highlighted that less certainty, and consequently a higher degree of caution, should be attached to valuations as a result of COVID-19. Valuers also noted that entities should keep the property valuations under frequent review as they may change significantly, and unexpectedly, over short periods of time.

Investment property is a key feature of 14 reporters. Of the 14 reporters, there are five investment property vehicles, two retirement village operators and Infratil which holds substantial investment property. All these eight businesses highlighted the material uncertainty clauses included by the registered valuers in their valuations and the greater uncertainty there was in the property values than in the past.

Three of these entities included new information to help those using the financial statements to understand the sensitivities of changes in key inputs to the valuations due to COVID-19. For example, assumptions around rental rebates and the impact on the valuation of changes in these. This shows businesses are responding to the FMA's request to tell the story of COVID-19 in their financial statements, particularly where judgements and assumptions were made.

## Impact on future revenue and performance

In this group of reporters only a few impairments have been identified as a result of the impact of COVID-19 on future revenues or performance:

- Z Energy acknowledged that the value of Caltex customer contracts was impacted and resulted in a \$61m impairment.
- Stride Property wrote off a small amount of work in progress. This related to the proposed redevelopment of the Johnsonville Shopping Centre and the uncertainty over the outlook for the retail sector.

All entities appear to have considered the risk of a decline in collections from customers of balances owing at 31 March or 31 May and increased the allowance for future losses.




Only two entities did not declare a dividend as a result of the impact of COVID-19. Both these businesses were more significantly impacted by the pandemic than many of the other reporters. This may suggest this grouping of reporters are in a better position to weather the economic uncertainty.

## Identifying subsequent events

A key factor for the March reporters, in particular, to consider was whether they had identified any key subsequent events which investors should be informed of. Given the uncertainty, there was likely to be an expectation that major events would be disclosed. However, little was actually disclosed. Z Energy reported its May capital raise and Infratil called out the shareholder support arrangements provided to its subsidiaries Wellington International Airport and RetireAustralia. Several of the investment property entities identified the likely future impact on gross rentals as they negotiated rental abatements and relief with tenants.

## What was the impact on audit reports?

Earlier this year, we used the analogy of traffic lights to indicate areas of concern and where readers of audit reports should focus their attention. The table below illustrates the outcome for the 14 March to May NZX50 reporters:

Audit report type		
	<b>Clean</b> (the audit report does not include any areas of concern)	13
	<b>Clean but with a warning</b> (the audit report includes some areas of concern for users of financial reports to be aware of)	0
	<b>Qualified</b> (a report where the auditor has not had all the necessary information needed)	1

## What do the 13 'green' audit reports reveal?

All reports were required to include key audit matters (KAMs). The auditor uses KAMs to tell the story of their audit, especially when significant effort was needed. Given these unprecedented times, there was an expectation that we might see a change in KAMs from those reported in the previous year. However, we have not seen any new KAMs specifically as a result of COVID-19.

In one report the auditor did include a paragraph in front of the KAMs noting the overall impact of COVID-19 and that the underlying audit risk had increased. The auditor noted it impacted the nature and extent of audit evidence they had to gather.

PwC reordered their audit report to elevate the importance of KAMs and included them earlier in the document. We also used bolding and italics within the KAM explanations to highlight significant matters believed to be more important to readers.

The naming of KAMs was changed in many audit reports to include COVID-19 clearly in the title. For example, those related to investment property valuation were labelled *Valuation of investment property including material uncertainty arising from COVID-19* or similar. In some cases, the auditor identified how they had changed their audit procedures in light of the pandemic to consider impacts such as those with respect to rental abatements and relief for tenants.

## Was the March and May reporting season unprecedented?

While COVID-19 has had significant impact and has led to greater uncertainty, especially in relation to commercial property valuations, the reporting consequences have not been unprecedented for these 14 businesses. They have responded well to the challenges and clearly adapted their financial reporting to ensure the impacts of COVID-19 on their entity was told in a way that the users of the financial reports could understand.

The relief provided by the NZX and FMA was used in a third of cases indicating it was needed.

Auditors use the audit report to tell the story of their audit and we hope the changes we have seen have been noticed by readers. We encourage savvy investors to use audit reports to help them frame questions for the Directors at Annual Shareholders meetings and bring greater transparency to financial reporting.

This overview follows our earlier paper looking into the [likely impact of COVID-19 on audit reports](#) published in May 2020. If you have any questions or would like to know more, please get in touch.

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