ASIC focus areas: 31 December 2017

Reporting Update

15 December 2017, 17RU-006

Highlights

- New accounting standards
- Focus areas for 31 December 2017
- Directors have a primary responsibility
- Enhanced audit reports

No significant changes in ASIC focus areas

ASIC has released its areas of focus for 31 December 2017 reporting. While focus areas are consistent to prior reporting periods, all preparers (listed and unlisted) need to ensure all relevant aspects are addressed.

New accounting standards

In its regular call on preparers to focus on quality financial reporting – providing information that is useful and meaningful for users – ASIC has directed its comments to addressing the impacts of the major new accounting standards, particularly the two with the closest application date. The two relevant accounting standards are AASB 9 *Financial Instruments* and AASB 15 *Revenue from Contracts with Customers*. Both these standards have a date of initial application of financial years beginning on or after 1 January 2018 – the day following the end of the upcoming reporting period.

These new standards implement new requirements for two of ASIC's pervasive areas of focus in recent years, the recognition of revenue and the valuation of financial instruments.

Concern leads to urgent action call

ASIC is concerned at the lack of meaningful disclosures to investors and users of financial reports on the impacts of these standards to date. With their application imminent, ASIC has increased the urgency of its call for action in implementing the requirements. ASIC will be keenly noting the disclosures of the impacts that are required to be made for accounting standards that are issued but not yet effective. The standards do not only have an accounting impact, but systems and processes impacts too.

"The new standards will also have a broad business impact, for example systems and processes and compliance with financial condition requirements. It is important that directors and management ensure that entities are prepared for these new standards and inform investors and other financial report users of the impact on reported results. Therefore like

ASIC, we urge companies to progress their implementation projects relating to the new standards as a priority.

The nature and extent of possible impact disclosures will be dependent on how advanced management is with the implementation of its transition plan. However, the aim is for companies to progressively enhance the disclosures as new accounting policies are defined, estimation uncertainty reduces and the effective date of the new standards approaches.

Quantitative information may well be given only in the form of an impact range or a number that is appropriately caveated. However, where quantitative information is not yet available, then qualitative information like for example, the types of transactions, assets and liability balances impacted, and the key implementation issues that the company is working through would be expected to be disclosed."

Michael Voogt
Director, Department of Professional Practice

Focus areas for 31 December 2017

Once again ASIC has confirmed the three broad areas of focus as:

- accounting estimates (which include impairment testing and asset values)
- accounting policy choices
- key disclosures.

Further details are outlined in the Appendix – ASIC areas of focus: Guide for directors and preparers.

Asset values and related impairment testing is still high on ASIC's matters for attention. ASIC continues to question entities on both the bases of impairment calculations and the disclosures relating to models, assumptions and inputs. In the first half of the 2017calendar year, a number of companies have adjusted asset valuations, with the total adjustments impacting reported profit by over $700 million.

ASIC also questioned a number of preparers on the approaches used for revenue recognition in their financial reports.

Directors have a primary responsibility

Quality financial reports begin with directors

ASIC reminds directors of their primary responsibility for the quality of the financial report. Timely information that is well documented support, and been through appropriate analysis to enable independent audit thereof will promote high quality financial information being available to the market. Having access to appropriate expertise, especially in areas of complexity and judgement; and holding management to account for preparing timely and supported financial information is critical to achieving this quality.

ASIC also suggests that the Operating and Financial Review required by listed companies provides a platform for directors to consider including relevant information relating to current challenges facing companies. These include digital disruption, new technologies, climate change or cyber-security.

Enhanced audit reports

Matters of most significance to the auditor may correlate to ASIC focus areas

Enhanced audit reports provide users of financial reports with details of those matters that required significant audit attention in performing the audit. ASIC reminds directors and preparers to be mindful that the key audit matters described by the auditor may correlate to ASIC's focus areas, and that disclosures around these matters may require additional attention.

ASIC expects clear and understandable descriptions of key audit matters and the work performed around these matters. Key audit matters should also be specific to the circumstances of the company and the audit – not a generic, boilerplate comment.

ASIC areas of focus - Guide for directors and preparers

Accounting estimates

- ❑ Impairment testing
- ❑ Financial instruments

Accounting policy choices

- ❑ Off-balance sheet arrangements
- ❑ Revenue recognition and expense deferral
- ❑ Tax effect accounting

Key disclosures

- ❑ Estimates and accounting policy judgements
- ❑ Impact of new revenue, financial instruments, lease & insurance standards
- ❑ Role of directors

Accounting estimates

Impairment testing

ASIC guidance

Directors should carefully consider the need to impair goodwill and other assets.

For each reporting period it is important for directors to ensure:

- Cash flows and assumptions are reasonable and supportable
- Discounted cash flows are not used to determine fair value less costs of disposal where forecasts and assumptions are not reliable
- Value in use calculations use sufficiently reliable cash flow estimates
- Cash flows used are matched to carrying values of all assets that generate those cash flows
- Different discount rates are used for cash generating units (CGUs) where the risks are different
- CGUs are not identified at too high a level
- Goodwill is allocated to CGUs at the level that it is monitored internally
- Corporate costs and assets are appropriately allocated to CGUs

Questions to consider

Are the assumptions used in the calculation of recoverable amounts realistic? If there have been significant variances between prior period cash flow projections and actual results, have the cash flows or the alpha factor in the discount rate been adjusted to reflect this risk?

Have we considered whether other readily available information exists that can be used to calculate recoverable amount using an alternate valuation method or technique which can serve as a point of comparison to the values derived in the primary valuation method selected?

If in the previous year recoverable amount was determined using a value in use model, but is now being determined using a fair value less costs of disposal (FVLCD) technique, have we fully understood and documented the rationale for the change?

Have we checked the mathematical accuracy of the model?

If recoverable amount is determined using VIU, have we ensured the cash flows do not include those from strategic initiatives?

If recoverable amount is determined using FVLCD, are there quoted prices or other observable market information that can be used to determine FVLCD? If there is no observable market information to determine FVLCD, and a discounted cash flow or earnings multiple technique is used, are the inputs reliable?

Have we identified our CGUs appropriately? Are any CGUs greater than an operating segment where material goodwill exists?

Does the allocation of goodwill to CGUs reflect the level at which goodwill is monitored for internal purposes?

Have all corporate costs been allocated to CGUs on an appropriate basis?

Have corporate assets been allocated to CGUs where the allocation can be done on a reasonable and consistent basis?

Have we disclosed the assumptions that have a significant risk of resulting in a material impairment adjustment in the next 12 months?

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Accounting estimates

Impairment testing (continued)

ASIC guidance (cont)

- The impairment test in AASB 136 *Impairment of Assets* is used for exploration and evaluation assets after technical feasibility and commercial viability have been demonstrated
- The testing of exploration and evaluation assets during the exploration and evaluation phase uses appropriate fair values
- Consider the impact of risk of the following on asset values:
  - digital disruption
  - technological change
  - climate change
  - Brexit or
  - cybersecurity.

Questions to consider (cont)

Have we considered our continuous disclosure obligations if we suspect an impairment (See also ASX Guidance)?

If we have a CGU which includes goodwill or intangible assets with an indefinite useful life and a reasonably possible change in the key assumptions would result in an impairment have we fully disclosed the amount by which the assumptions must change to create an impairment?

Where market capitalisation is less than our net asset position, have we fully documented the methodology used to determine recoverable amount, including how we have satisfied ourselves regarding the reliability of the assumptions used, including our understanding of the drivers of the difference?

Where facts and circumstances suggest that the carrying amount of an exploration and evaluation asset may exceed its recoverable amount, have we used realistic assumptions and inputs in the calculation of recoverable amount, including mine restoration and closure costs?

Relevant KPMG guidance

Example Public 2017-18 – Notes 21 & 44(L),(S)

Annual Disclosure Checklist (September 2017) – Section 2.2

Insights into IFRS – Chapters:

- 3.3 *Intangible assets and goodwill*
- 3.10 *Impairment of non-financial assets*
- 5.11 *Extractive activities*

Accounting estimates

Financial instruments

ASIC guidance

Directors should focus on the valuation and disclosure of financial instruments, particularly where the value relies on assumptions that are not based on quoted prices or observable market data.

Questions to consider

Have the methods and significant assumptions used to value financial instruments been adequately disclosed?

Do our disclosures allow users to understand the nature and extent of our risks from financial instruments?

Are the disclosures meaningful and relevant to the operations of the entity?

Have we tailored our disclosures to our specific policies and procedures?

Relevant KPMG guidance

Example Public 2017-18 – Notes 31 & 44(P)

Annual Disclosure Checklist (September 2017) – Section 2.5

Accounting policy choices

Off-balance sheet arrangements

ASIC guidance

Directors should carefully review the treatment of off-balance sheet arrangements, the accounting for joint arrangements and disclosures relating to structured entities.

Questions to consider

Have we reviewed all consolidated and unconsolidated entities and off-balance sheet arrangements and made an ongoing assessment to determine if they should be consolidated under AASB 10 *Consolidated Financial Statements* having specific regard to whether all facts and circumstances have been considered in determining whether we have the power to direct activities that significantly affect returns?

Have we considered all relevant facts and circumstances in determining whether a joint arrangement provides the entity with rights to the 'net' assets of the arrangements (equity method) or contractual rights to individual assets or contractual responsibility for individual liabilities?

Have we disclosed:

- ❑ the significant judgments and assumptions made in determining whether we control, have joint control, or have significant influence of another

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Relevant KPMG guidance

Insights into IFRS – Chapters:

- ❑ 2.4 *Fair value measurement*
- ❑ 2.5 *Consolidation*
- ❑ 3.5 *Associates and the equity method*
- ❑ 3.6 *Joint arrangements*

Example Public 2017-18 – Notes 32-35

Accounting policy choices

Off-balance sheet arrangements (continued)

Questions to consider (cont)

entity, or in determining whether we don’t, despite holding more than half (control) or 20% (significant influence) of voting rights

- ❑ the nature of, and changes in, the risks associated with the entity’s interest in consolidated and unconsolidated entities
- ❑ the effect of restrictions on the reporting entity’s ability to access and use assets or settle liabilities of consolidated entities
- ❑ the interest that material non-controlling interests have in the group’s activities?

Have we considered the nature of the risks associated with our interests in consolidated and unconsolidated structured entities?

Have we made disclosures so that users are able to understand the nature and extent of these risks and interests?

Accounting policy choices

Revenue recognition and expense deferral

ASIC guidance

Directors should review an entity's revenue recognition policies to ensure that revenue is recognised in accordance with the substance of the underlying transaction.

Directors should ensure expenses are only deferred where there is an asset – a resource controlled from which future economic benefits are expected to flow to the entity.

Questions to consider

Have risks and rewards of ownership of the goods actually passed to the buyer, or have we already provided the service for which we are recognising revenue?

Have we appropriately allocated the revenue between any service component and physical goods that have been sold as part of the same transaction?

Have we considered the timing of the recognition of revenue where we have continuing obligations under the contract?

Have we properly classified any relevant assets as financial or non-financial assets?

Are any of the expenses which we are capitalising prohibited from capitalisation under AASB 138 *Intangible Assets*?

Do we have any future benefit from the expenses that we have capitalised and deferred?

Have we ensured that items of income and expense are only included in other comprehensive income where specifically permitted by the accounting standards?

Relevant KPMG guidance

Insights into IFRS – Chapters:

- 3.3 *Intangible assets and goodwill*
- 4.2 *Revenue*

Accounting policy choices

Tax effect accounting

ASIC guidance

Directors should ensure there is proper understanding of both the tax and accounting treatment of transactions, and how those impact tax assets, liabilities and expenses, taking into consideration the impact of any recent changes in legislation.

Directors should also ensure that the recoverability of deferred tax assets is appropriately reviewed.

Questions to consider

Are the forecasts used to assess the recoverability of deferred tax assets in-line with forecasts used to determine the recoverable amount of intangible assets and other non-current assets?

Have we considered the adequacy of disclosures around estimation uncertainty of the recoverability of deferred tax assets? (See estimates and accounting policy judgements below)

Have we reviewed the appropriateness of the tax treatment of any significant transactions, and ensured that those have been appropriately reflected in tax balances and explained in the financial statements?

Have we ensured all legislative changes that have been substantively enacted prior to year-end have been captured within the income tax calculations? Have we ensured that the impacts of all legislative changes that have been substantively enacted after year-end but before the financial statements are authorised for issue have been adequately disclosed?

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Relevant KPMG guidance

Insights into IFRS – Chapter 3.13 *Income taxes*

Example Public 2017-18 – Australian content: Voluntary tax disclosures Part A

Accounting policy choices

Tax effect accounting (continued)

Questions to consider (cont)

Have we disclosed the key tax to accounting differences in our financial report? Have we ensured that the disclosures communicate clearly all taxes paid?

Are we subject to the proposed Country by Country Reporting requirements? If yes, have we considered disclosing the amounts of taxes paid by jurisdiction?

Have we considered adopting the Voluntary Tax Transparency Code (the Code): Part A issued by the Board of Taxation in our financial report? If yes, are our disclosures in 'plain English' and do they embrace the spirit of the Code? Have we given appropriate consideration to the principles in RG 230 *Disclosing non-IFRS financial information* when disclosing an alternative effective tax rate?

Key disclosures

Estimates and accounting policy judgements

ASIC guidance

Directors should ensure that the disclosures in the 31 December 2017 financial statements are sufficient to allow users to understand the sources of estimation uncertainty and significant judgements made in applying accounting policies.

Disclosure of key assumptions and a sensitivity analysis are important.

Directors should be more mindful of the disclosure around sources of estimation and significant judgements due to the increased scrutiny with the new enhanced audit report.

Questions to consider

Have we explained areas where there is estimation uncertainty and the impact of that uncertainty?

Have we ensured that the disclosures made are specific to the assets, liabilities, income and expenses of the entity?

Have we disclosed the assumptions that have a significant risk of resulting in a material change in the carrying amount of assets and liabilities in the next 12 months?

Have we identified specifically the carrying amount that would be impacted by a change in assumptions and the nature of the assets?

Have we considered fair values determined under AASB 13 *Fair Value Measurement* when considering the completeness of disclosures made in relation to estimates?

Have we explained any accounting policy choices that involved significant judgement?

Have we considered the interrelationships between disclosures of estimates and significant judgements and what is included in key audit matters in the audit report?

Have we considered the impacts of sensitivity analysis on our calculations and need for disclosure?

Relevant KPMG guidance

Example Public 2017-18 – Note 4

Annual Disclosure Checklist (September 2017) – Section 1.4

Key disclosures

Impact of new revenue, financial instruments, lease & insurance standards

ASIC guidance

Directors should ensure that financial reports disclose the impact of upcoming requirements for how and when revenue is recognised, the values of financial instrument (including loan provisioning and hedge accounting), and assets and liabilities relating to leases. The IASB has also issued a new accounting standard for insurance companies.

Preparers should provide required disclosure in the notes to financial statements prior to the effective date of the new standards regarding known or reasonably estimable information relevant to assessing the possible impact that adoption of the new standards will have on the issuer's future financial statements.

It is reasonable for the market to expect that quantitative information will be available and disclosed for the reporting date that coincides with the start of the first comparative period that will be affected in a future financial report. Information that there will be no material impact may also be important information for the market.

Questions to consider

Have we considered the impact of the new revenue, financial instruments, leases and insurance standards?

Have we made the required disclosures in our financial report, commensurate with the progress of our assessment of the impact, for standards that have been issued but are not yet effective?

Relevant KPMG guidance

Example Public 2017-18 – Note 45

Insights into IFRS – Chapter 4.2A *Revenue*: *IFRS 15*

IFRS – Revenue

Insights into IFRS – Chapter 7A *Financial Instruments: IFRS 9 (2014)*

IFRS – Financial Instruments

Insights into IFRS – Chapter 5.1A *Leases*: *IFRS 16*

IFRS – Leases

IFRS - Insurance

Standards on Issue

Key disclosures

Role of directors

ASIC guidance

Directors should challenge the accounting estimates and treatments applied in the financial report.

Directors should ensure that persons with appropriate experience and expertise are involved in reviewing calculations supporting impairment or valuation of significant assets. They should review the cash flows and assumptions bearing in mind their knowledge of the business, its assets, and the future prospects of the business.

Questions to consider

Have we considered the appropriateness of all significant accounting estimates and accounting policy choices?

For complex and judgemental accounting estimates or treatments have we considered the need to obtain professional advice to support the accounting treatments chosen?

Have we considered our financial reporting responsibilities as detailed in ASIC Information Sheet 183 *Directors and financial reporting*?

Have we considered our responsibilities in ensuring the quality of the external audit of the financial report as detailed in ASIC Information Sheet 196 *Audit quality: the role of directors and audit committees?*

Have we considered our responsibilities regarding testing of non-financial assets for impairment as detailed in ASIC Information Sheet 203 *Impairment of non-financial assets: The role of directors and audit committees*

Relevant KPMG guidance

The Directors' Toolkit

kpmg.com.au

kpmg.com.au/app