KPMG
cutting through complexity

Reporting Update

18 November 2014, 14RU-008

ASIC focuses for 31 December 2014

ASIC has released its areas of focus for 31 December 2014 financial reports of listed and other entities of public interest with a large number and wide range of stakeholders. Although not specifically mentioned in the media release, ASIC does also review the financial reports of proprietary companies, and as such the areas of focus, should be considered by all entities.

The focus areas primarily fall into three broad areas being asset values (including impairment), accounting policy choices and key disclosures. Further details are outlined in **Appendix 1**, along with the questions that directors and preparers of financial reports should consider to ensure that they have appropriately addressed ASIC's concerns.

While the majority of ASIC's 31 December 2014 focus areas are consistent with those at 30 June 2014 and 31 December 2013, the following differences are noted:

- ASIC has highlighted particular consideration of the value of assets of companies in the extractive industries and mining support services, as well as asset values that may be affected by the risk of digital disruption.
- The valuation of financial instruments by financial institutions has been particularly mentioned in the context of the valuation of financial instruments where values are not based on quoted prices or observable market data.

KEY POINTS

- **Asset values and accounting policy choices receive continued ASIC focus**
- **Asset values in the extractive industries singled out**
- **The role of directors in understanding the accounting treatments and disclosures applied in financial reports continues to be emphasised**
- **ASIC keeps a focus on material disclosures of information useful to users of financial reports**

ACTION POINTS

- **Review and challenge accounting estimates and treatments, including disclosures, particularly for ASIC focus areas**

- ASIC has specifically emphasised the careful consideration of appropriate timing of revenue recognition in industries with complex sale and licensing arrangements that may include continuing obligations, such as software providers.
- Consistent with prior periods, ASIC has continued to highlight disclosing the impact of accounting standards that have been issued but are not yet effective. This time ASIC has singled out the upcoming requirements for recognising revenue which is expected to be released by the AASB before 31 December 2014.

ASIC has also advised that it will continue to focus on **material disclosures** of information useful to investors and other users of financial reports, and that it does not pursue immaterial disclosures that may add unnecessary clutter to financial reports. This message is consistent with KPMG's initiative of bringing clarity to financial statements by removing non-essential and irrelevant disclosures while still complying with relevant accounting standards and regulatory requirements.

KPMG Comments

Impairment testing and asset values

ASIC has again provided specific comment around impairment testing and asset values.

Recoverable amount is the higher of fair value less costs of disposal and value in use. When an entity chooses to determine recoverable amount by estimating fair value less costs of disposal, in accordance with AASB 13 *Fair Value Measurement*, it selects those valuation approaches and techniques that are appropriate in the circumstances and for which sufficient data is available to measure fair value. The technique chosen should maximise the use of relevant observable inputs and minimise the use of unobservable inputs. Generally an entity should first consider if there are quoted prices or other observable market information – for example recent sales of similar assets. Where this information is not available then an entity may use a technique that uses unobservable inputs, if reliable – for example a discounted cash flow technique or earnings multiple technique.

AASB 136 *Impairment of Assets* does not express a preference for either value in use or fair value less costs to dispose (i.e. 'methodology'). Therefore provided assumptions are reliable, the methodology likely to give rise to the highest recoverable amount should be used. ASIC has also expressed concern about moving from one methodology to another. We recommend that the methodology used to determine recoverable amount be fully documented, including rationales for changing methodology, and how management and directors have satisfied themselves regarding the reliability of the assumptions used.

KPMG Comments (continued)

Amortisation of intangible assets

The attachment to the ASIC media release observes that amortising time based intangible assets that are available for use should take place even if they have not yet generated revenue.

KPMG's view is that amortisation of intangible assets with finite useful lives should begin when the asset is available for use – i.e. when it is in the location and condition necessary for it to be capable of operating in a manner intended by management. In some cases, an intangible asset is to be used only in conjunction with other assets that are not yet available for use. For example, when an entity obtains a licence to operate an infrastructure network, it is possible to argue that the licence is not considered available for use while the infrastructure network asset is under construction and that amortisation of the licence does not commence until the asset group as a whole (licence and infrastructure network) is available for use.

Clients with time based intangible assets should consult with their accounting advisers and auditors.

Impact of new revenue standard

AASB 108 Accounting Policies, Changes in Accounting Estimates and Errors requires either a discussion of the impact that application would have on the financial statements, or if that impact is not known or reasonably estimable, a statement to that effect. Where projects to implement the standards are substantially complete and the impact is reasonably estimable then it must be disclosed. However, AASB 108 does not force an entity to commence and complete its implementation project to provide disclosures in years prior to implementation. Accordingly if the implementation project has not yet commenced or is not sufficiently advanced to "reasonably estimate" the impact then a statement to this effect should be made. ASIC's point is that entities making a statement that they are not advanced in their implementation projects may face questioning from ASIC and analysts as a result.

Appendix 1 – ASIC areas of focus

Asset values

ASIC guidance	*Questions to consider*	*Relevant guidance*
Impairment testing		
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 - Discounted cash flows are not used to determine fair value less costs of disposal where forecasts and assumptions are not reliable - Cash flows used are matched to carrying values of all assets that generate those cash flows - Cash generating units are not identified at too high a level	*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?* *If recoverable amount is determined using fair value less costs of disposal (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 cash generating units (CGUs) appropriately? Are any cash generating units greater than an operating segment where material goodwill exists?* *Have we disclosed the assumptions that have a significant risk of resulting in a material impairment adjustment in the next 12 months?* *Have we considered our continuous disclosure obligations if we suspect an impairment (See also ASX Guidance Note 8)?*	Example Public 2014-2015 – Notes 21 & 44(L),(S) Disclosure Checklist (September 2014) – Section 2.2 Insights into IFRS – Chapter 3.3 *Intangible assets and goodwill* and 3.10 *Impairment of non-financial assets*

Asset values (continued)

ASIC guidance	*Questions to consider*	*Relevant guidance*
Impairment testing cont...		
	If we have a CGU including 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?	
Amortisation of intangible assets		
Directors should also review the amortisation periods and methods applied for intangible assets, including: - amortisation of time based intangible assets that are available for use, even if they have not yet generated revenue - considering significant constraints on taking into account renewal periods for intangible assets - challenging the basis for any assertion that assets have an indefinite life	*Have we reviewed amortisation of intangible assets available for use, even if they have not yet generated revenue, to ensure amortisation periods and methods are appropriate?* *Have we ensured the useful life of intangible assets includes only periods covered by contractual rights and where renewal is not subject to significant cost?* *Have we considered the nature of the intangible asset and whether there is really no foreseeable limit to the period over which the asset is expected to generate net cash inflows for the entity?*	Insights into IFRS – Chapter 3.3 *Intangible assets and goodwill* and 3.10 *Impairment of non-financial assets*
Financial instruments		
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.	*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?*	Example Public 2014-2015 – Notes 31 & 44(P) Disclosure Checklist (September 2014) – Section 2.6

Accounting policy choices

ASIC guidance	Questions to consider	Relevant guidance
Off-balance sheet arrangements		
Directors should carefully review the treatment of off-balance sheet arrangements, the accounting for joint arrangements and disclosures relating to structured entities.	*Have we reviewed all previously consolidated and unconsolidated entities and off-balance sheet arrangements and made an ongoing assessment to determine if they should be consolidated under AASB 10 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 entity, or in determining whether we don't, despite holding more than half (control) or 20% (significant influence) or 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 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?*	Insights into IFRS – Chapter 2.4 *Fair value measurement,* 2.5 *Consolidation,* 3.5 *Associates and the equity method,* 3.6 *Joint arrangements* Example Public 2014-2015 – Notes 32 - 35 Standards on Issue

Accounting policy choices (continued)

ASIC guidance	*Questions to consider*	*Relevant guidance*
Revenue recognition and expense deferral		
Directors should review an entity's revenue recognition policies to ensure that revenue is recognised in accordance with the substance of the underlying transaction and expenses only deferred where there is an asset.	*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 discussed with our auditors any right to future income (e.g. deferred management or performance fees) which have been treated as financial assets?* *Are any of the expenses which we are capitalising exempt 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?*	Insights into IFRS – Chapter 3.3 *Intangible assets and goodwill* and 4.2 *Revenue*
Impact of new revenue standard		
Directors should ensure that financial reports disclose the impact of upcoming requirements for recognising revenue.	*Have we considered the impact of the new revenue standard?* *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?*	Insights into IFRS – Chapter 4.2A *Revenue: IFRS 15* IFRS Practice Issues publications

Accounting policy choices (continued)

ASIC guidance	*Questions to consider*	*Relevant guidance*
Tax effect accounting		
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.	*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?*	Insights into IFRS – Chapter 3.13 *Income taxes*

Key disclosures

ASIC guidance	*Questions to consider*	*Relevant guidance*
Estimates and accounting policy judgements		
Directors should ensure that the disclosures in the 31 December 2014 financial statements are sufficient to allow users to understand the sources of estimation uncertainty and significant judgements made in applying accounting policies	*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 when considering the completeness of disclosures made in relation to estimates?* *Have we explained any accounting policy choices that have involved significant judgement?*	Example Public 2014-2015 – Note 4 Disclosure Checklist (September 2014) – Section 1.4

The role of directors

ASIC guidance	*Questions to consider*	*Relevant guidance*
Directors should challenge the accounting estimates and treatments applied in the financial report. Directors should be 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.	*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?*	The Directors' Toolkit