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A&A Accounting Technical

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Clarity in financial reporting

ASIC focus areas for December 2017 year ends and findings from the 30 June 2017 review

CONTENT

Talking points

- The seven areas of focus are consistent with those in December 2016 and June 2017. Impairment of goodwill, plant and equipment and exploration and evaluation assets continues to have significant focus.
- ASIC reviewed 220 financial reports of listed and other public interest entities at 30 June 2017. ASIC has contacted 50 entities requesting explanations of accounting treatment on 54 matters. 20 of these matters relate to impairment.
- In 2017 ASIC issued 19 announcements relating to companies that had made a material change to information previously provided to the market following inquiries by ASIC. 12 related to impairment (mainly in the media and extractive industries).
- ASIC highlights that directors are primarily responsible for the quality of the financial report. Companies should have the appropriate processes and documentation to support the accounting treatment and directors, where appropriate, should seek explanations and advice in order to challenge estimates and accounting treatments.
- Companies should be well prepared for the implementation of the new standards, including the need to provide disclosure of the potential impact in the financial statements. This may mean quantification of impacts at the reporting period coinciding with the start of the first comparative period or the start of the year of adoption, depending on the transitional method being applied.
- Auditors of listed entities are required to issue enhanced audit reports which outline key audit matters (KAMs) that require significant auditor attention. Where KAMs relate to accounting estimates and significant accounting policy choices, preparers and directors should ensure that appropriate disclosures are provided within the financial report.

Links to relevant ASIC media releases

17-423MR ASIC calls on preparers to focus on financial report quality and new requirements

17-437MR Findings from 30 June 2017 financial reports

For more information please see the following websites:

www.iasplus.com

www.deloitte.com

ASIC focus areas and findings from the 30 June 2017 review

On 8 December 2017 the Australian Securities and Investments Commission (ASIC) issued media release 17-423MR, which outlines its focus areas for 31 December 2017 financial reports of listed entities and other entities of public interest with many stakeholders. ASIC also reviews financial statements of proprietary companies and unlisted public companies, based on complaints and other intelligence. In particular, ASIC recently wrote to more than 1,000 proprietary companies that appeared to be large with no reporting exemption and had not lodged financial reports.

ASIC also issued media release 17-437MR relating to the findings from its review of 220 listed and other public interest entities 30 June 2017 financial reports. From the review, ASIC made inquiries of 50 entities requesting explanations of accounting treatments on 54 matters. Matters involving 18 of the entities have been concluded without any changes to their financial reporting. The findings are summarised in Table 1 below.

Table 1: Inquiries made by ASIC from reviews of the 30 June 2017 financial reports

Matter	Number of inquiries
Impairment and other asset values	20
Revenue recognition	8
Tax accounting	8
Expense deferral	4
Business combinations	3
Consolidating accounting	2
Operating segments	2
Other matters	7
Total	**54**

Since July 2014 ASIC has been publicly announcing when a company makes material changes to information previously provided to the market following inquiries by ASIC. ASIC's intentions is to:

- improve the level of market transparency and
- make directors and auditors of other companies more aware of ASIC's concerns so that they might avoid similar issues.

ASIC noted that the largest number of findings continue to relate to impairment of non-financial assets and inappropriate accounting treatments. It is therefore encouraging directors and auditors to continue focusing on values of assets and accounting policy choices in preparing their financial reports.

Key focus areas

ASIC still has seven focus areas that directors, preparers and auditors of financial reports should be aware of. These are generally consistent with June 2017 and December 2016:

- Impairment testing and asset values
- Revenue recognition
- Expense deferral
- Off-balance sheet arrangements
- Tax accounting
- Estimates and accounting policy judgements
- Impact of new revenue, financial instrument, lease and insurance standards

Further information on each of these can be found via the link to the media release above.

In 2017 ASIC issue 19 public announcements in relation to material changes by companies following ASIC's inquiries. 12 announcements related to the write down of goodwill, plant and equipment and exploration and evaluation assets. Other announcements related to revenue recognition and the appropriateness of non-consolidation of certain controlled entities. Extractive and media industries were the most prevalent in the announcements.

We recommend that companies continue to pay particular attention to the recoverability of the carrying amount of assets on the balance sheet. Our publication Clarity financial reporting- A focus on impairment Provides practical insight into the common areas encountered when performing impairment testing.

Other focus areas

a) The role of directors and management

Directors should take primarily responsible for the quality of the financial report, including ensuring that:

- Management produces quality financial information,
- Companies have appropriate processes and records to support the financial report,
- Companies apply appropriate experience and expertise, particularly in more difficult and complex areas, and
- Information is produced on a timely basis and supported by appropriate analysis and documentation for the independent audit.

It is the responsibility of management to prepare information supporting the accounting treatment and disclosures made in the financial reports. While directors do not need to be accounting experts, they do need to seek explanation and advice to support the accounting treatments chosen and, where appropriate, to challenge those estimates and treatments. This is particularly relevant where the treatment does not reflect their understanding of the substance of the arrangement.

ASIC has put together an Information Sheet to assist directors with their general financial reporting obligations. Directors should refer to *Information Sheet 183 Directors and financial reporting* for guidance on their general financial reporting obligations.

b) New accounting standards

In the media release, ASIC acknowledges that the introduction of major new accounting standards (AASB 15 *Revenue from Contracts with Customers*, AASB 9 *Financial Instruments*, and AASB 16 *Leases)* is more likely going to have a significant impact on financial reporting compared to the adoption of International Financial Reporting Standards in 2005.

ASIC also reiterated that it is the responsibility of directors and management to ensure that entities are ready for these new standards and inform stakeholders of the impact on reported results. This includes disclosing the impact of the standards in notes to the financial reports as required by AASB 108 *Accounting Policies, Changes in Accounting Estimates and Errors*. It is important to note that the AASB 108 requirements regarding disclosing the impact, does not apply to entities applying Tier 2 (RDR) reporting requirements (AASB 108 paragraph AusA1). The expectation is that the disclosures will include quantification of the impacts for the reporting date that coincides with the start of the first comparative period, depending on the chosen transitional method.

Our understanding from investors and analysts is that the market is keen to know how entities think these new standards will impact them and how they are progressing with implementation. We encourage directors and management to ensure that there is a robust implementation plan in place and to consider their strategy for communicating the expected impact as the application date for each new standard draws near.

Appropriate disclosures include:

- a detailed description of how key concepts will be implemented, and where relevant, the differences to the current approaches;
- an explanation of the timeline for implementation, including expected use of any of the transition practical expedients;
- if known or reasonably estimable, quantification of the possible impact; and
- when the quantitative information is not disclosed because it is unknown or not reasonably estimable, additional qualitative information enabling users to understand the magnitude of the expected impact on the financial statements of the issuer.

c) Operating and financial review

Another highlight by ASIC is the focus on listed companies disclosing information on risks that are likely to have a material impact on the financial results of the entity in future. ASIC has expanded the list of potential risks on future financial results of an entity to include, matters relating to digital disruption, new technologies, climate change, Brexit or cyber-security.

d) Enhanced audit reports

The audit reports of December listed reporters set out 'Key Audit Matters' (KAMs) for the first time in the 31 December 2016 financial reports. 31 December 2017 would be the second audit report that includes KAMs for the December reporters. ASIC reminds preparers and directors that KAMs may relate to accounting estimates, significant accounting policy choices, and business related matters which are normally disclosed as Operating and Financial Review (OFR) disclosures.

From its review of the 30 June 2017 financial reports, ASIC found that certain KAMs were described in general terms and not specific to the circumstances of the respective entities. In other cases, the audit procedures performed were not clearly described. It is therefore, recommended that KAMs are described succinctly, and are specific to the relevant facts and circumstances.

e) Material disclosures

Through its surveillance program, ASIC will continues to focus on the usefulness of material disclosures provided in financial reports to the stakeholders. Some of the information that ASIC will continue to ask for is the basis of accounting estimates and significant accounting policy choices. However, ASIC will not pursue immaterial disclosures given the current projects of the standards setters on better communication in financial reporting.

f) Client monies

ASIC emphasised the need for Australian financial services licensees to hold client monies separately in designated trust bank accounts. In addition, the Australian financial services licensees should apply the client monies as per the client instructions and the requirements of the Corporations Act. Auditors are required to test for material misstatement of assets and liabilities including client monies as well as the duty to report any breaches to ASIC.

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