Navigating ASIC's regulatory expectations

Improving corporate reporting quality by responding to ASIC's focus areas

ASIC released its June 2023 focus areas on 6 June 2023. The release of the focus areas follows a series of media releases and speeches over recent months that together outline the broad corporate reporting topics that are front and centre for the regulator.

Organisations must respond to these developments by ensuring relevant topics are carefully considered, addressed and documented.

In macro terms, the following are the critical areas of focus for most organisations:

- Environmental, social and governance (ESG) matters, with a particular focus on climate-related disclosures and greenwashing – and preparing for mandatory climate-related financial disclosures
- Clear disclosure in the operating and financial review (OFR), particularly in relation to business risks and ensuring consistency with the financial statements and other information
- Impairment considerations, using appropriate and detailed models rather than relying on market capitalisation
- Recognition of provisions, including rehabilitation and make good provisions, and disclosure of contingent liabilities
- Expected credit losses (ECL), focusing on forward looking assumptions and ensuring possible future losses are adequately factored into calculations.

Read on to understand ASIC's expectations for June 2023 reporting and beyond.

"Directors should ensure that investors are properly informed on the impact of changing and uncertain economic and market conditions, 'net zero' targets and other developments on financial position and future performance"

Danielle Press
ASIC Commissioner

Areas of most surveillance attention from ASIC this year

ASIC has formed their focus areas to respond to the prevalence of current economic conditions that have increased the risk and uncertainty within which businesses operate. High inflation and interest rates, supply chain disruptions, volatile commodity prices, labour shortages, wage growth as well as natural disasters and climate change are key considerations in the current economic environment.

Transparent communication and disclosure in each company's financial report, operating and financial review (OFR) and related disclosures of significant judgements, sources of estimation uncertainty and key inputs and assumptions applied in preparing financial reports, including sensitivity and scenario analysis, enhances value and responds to regulatory expectations. Entities will be affected differently depending on their business model and industry. Industries identified by ASIC that may be particularly affected by these factors include the construction industry, owners of commercial property, large carbon emitters and the agriculture industry.

The table below shows the areas where ASIC made announcements where entities adjusted their disclosures or accounting treatments for the 2022-2023 financial year.

We expect that regulatory surveillance will continue to focus on these areas, with greenwashing in particular getting increased attention from ASIC.

Key changes from prior periods

Climate and ESG – disclosures and greenwashing

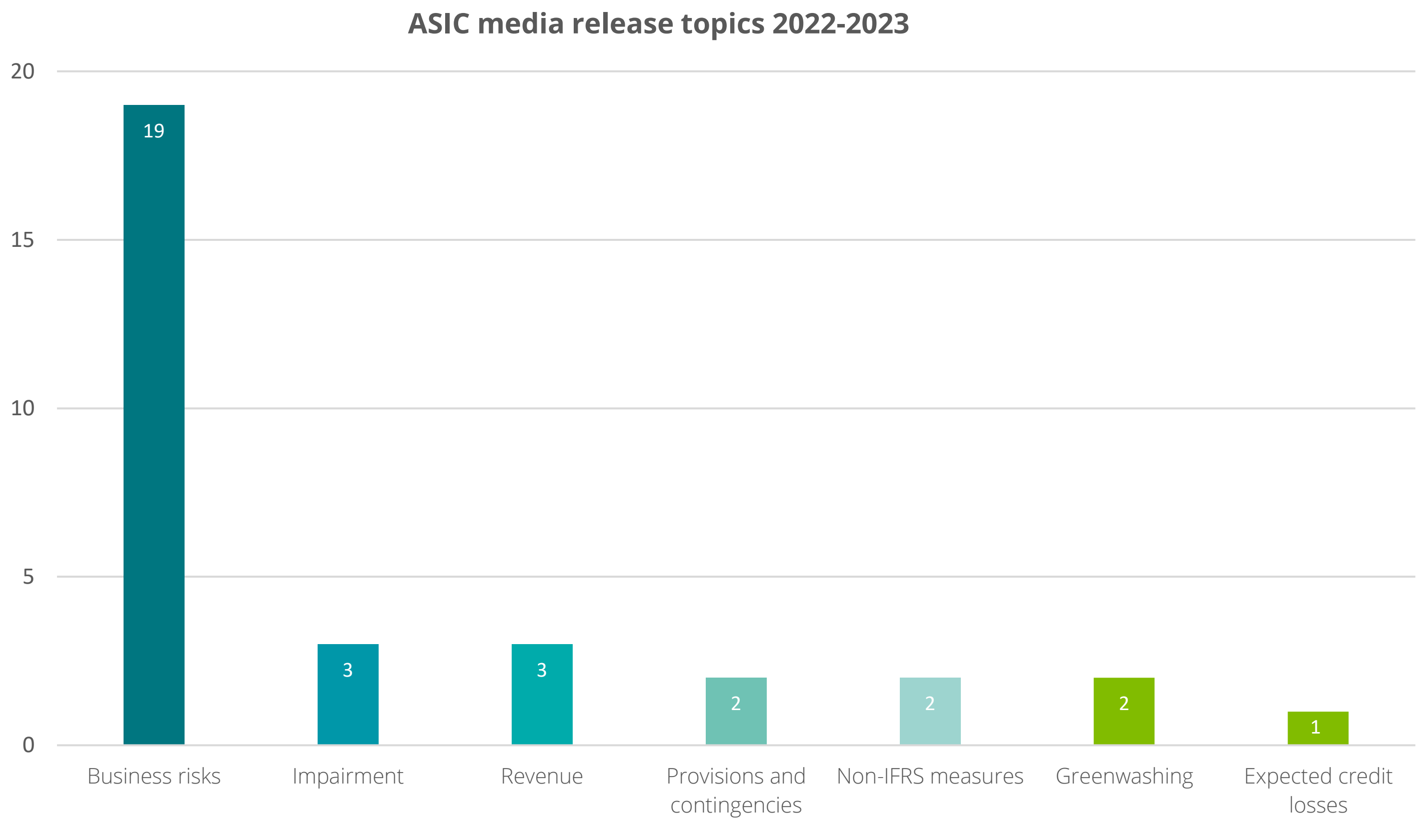
Impairment – use of market capitalisation and information about assumptions

Expected credit losses – increased focus on adequately considering future expected losses using forward looking information

Insurance – impacts or implementation of AASB 17

Income tax – impact of OECD Pillar Two reforms

Financial instruments – classification of financial assets



Source: ASIC media releases mentioning specific entities 1 July 2022 – 22 June 2023

Changing and uncertain market conditions remains key

We have outlined in detail the focus areas communicated by ASIC in previous publications for the December 2022 and June 2022 reporting periods. Overall, ASIC's focus areas remain broadly consistent with those for December 2022. However, we have summarised particular areas of emphasis or new areas relevant to June 2023 to be aware of below and included in the Appendix a more comprehensive summary of matters that have been raised by ASIC in past periods:

Operating and financial review (OFR)

- Disclosure of material business risks that may affect the achievement of an entity's strategies and prospects
- The entity's exposure to climate change risk in particular should be considered in this context. ASIC has specifically called out that consideration of the Taskforce for Climate-related Financial Disclosures (TCFD) recommendations will help position companies for future reporting obligations under the International Sustainability Standards Board (ISSB) standards
- ASIC has a strong focus on greenwashing, with additional funding provided for ASIC's enforcement in the May 2023 Federal Budget. ASIC' notes the principles in Information Sheet INFO 271 *How to avoid greenwashing when offering or promoting sustainability-related products* may apply to other entities including companies listed on a securities exchange or entities issuing green bonds. Entities must ensure that climate-related claims and disclosures are specific, supportable and documented, and are consistent with information elsewhere in the overall reporting suite
- Cybersecurity-related risks have been identified by ASIC, including the consideration of the impacts of cybersecurity events such as the extent and nature of personal data held and possible impacts on revenue
- Recent speeches indicate ASIC sees artificial intelligence (AI) as a high and important priority not just for wholesale markets, but the whole economy. Similarly to greenwashing, entities must ensure statements made about AI are specific and supportable
- Disclosing non-IFRS financial information should only be done outside of the financial statements, should be clearly reconciled to IFRS information and consistently defined to avoid being misleading.

Impairment and asset values

- Estimation uncertainties and key assumptions should be reviewed in light of changing conditions
- Assumptions in fair value less cost of disposal models should be supported with reference to market data, including consideration of comparable industry multiples
- Market capitalisation of an entity is a possible indicator of impairment but does not represent an appropriate fair value estimate of an underlying business. Market capitalisation, or in some industries, revenue to market capitalisation ratios, can be appropriate for valuation cross checks where comparable entities are available
- Cash flow forecast periods for value in use models should be a maximum of five years, unless a greater period can specifically be justified
- Consider historical forecasting accuracy and whether any current underperformance is an impairment indicator, as well as how this impacts the forecast cash flows in impairment models
- The impact of higher interest rates and inflation on forecast cash flows, noting inflation may differ between revenue and cost items due to the price elasticity of products and services
- The impact of the higher interest rate environment will also require a reassessment of whether the discount rate is still appropriate and reasonable. This may impact both the cost of equity and the cost of debt, along with the ability of the organisation to secure suitable levels of financing
- Any historical transactional benchmarks may need to be reconsidered as to their relevance in the current environment
- Reflection of factors that could adversely affect commercial and retail property values should be considered such as changes in office space requirements of tenants, on-line shopping trends, future economic or industry impacts on tenants, the financial condition of tenants and restructured lease agreements
- Consistency of assumptions used across impairment, deferred tax asset (DTA) recoverability and expected credit loss (ECL) calculations
- ASIC is calling for increased information on the impact of current market conditions on ECLs in both the financial and other sectors, including assessment of significant increases in credit risk for particular groups of lenders, adequacy of data, modelling and controls around ECLs and disclosure of key assumptions. ASIC also expects the use of forward looking assumptions and ensuring possible future losses are adequately factored into calculations.

Revenue recognition

- Licensing arrangements with multiple performance obligations that can impact timing of revenue recognition
- Timing of revenue recognition, in particular non-refundable upfront fees for setup activities and upfront loan establishment fees that should form part of the effective interest rate of the related financial instrument
- Communication of the entity's business model in the OFR, segment report, sustainability report and other market communication should be consistent with the entity's level and extent of disclosures of disaggregated revenue.

Provisions

- Consideration of the existence of legal or constructive obligations relating to lease make good provisions, rehabilitation or decommissioning liabilities (e.g. mine sites) and onerous contracts
- Higher interest rates and risk premiums impacting discount rates used in measuring and discounting liabilities
- ASIC regards estimates as a key part of preparing financial statements and therefore is unlikely to accept non-recognition of provisions due to an inability to reliably measure the provision
- Identifying existence of contingent liabilities including disclosure of the nature, timing and amount thereof.

Other matters

- Information about the impacts of the OECD 'Pillar Two' reforms where a group has operations in countries with enabling legislation substantively enacted
- Once off gains, for example, on sale and leaseback transactions
- Appropriate classification of financial assets applying AASB 9 *Financial Instruments* (at amortised cost, or fair value through profit or loss or other comprehensive income)
- Off balance sheet structures (e.g. interests in unconsolidated entities)
- Consideration of solvency and going concern assessments
- Subsequent events, including going concern, and whether they relate to conditions at year end
- For full years, disclosures in the notes of the impact of AASB 17 *Insurance Contracts*, (effective 1 January 2023) including quantification thereof, noting that AASB 17 also applies to non-insurers issuing 'insurance contracts'. For half-years, first time mandatory application of AASB 17 will be required
- Private health insurers should consider the impact of backlog of delayed procedures on deferred claim liabilities and the need for a liability for any commitment to return premiums for savings during the pandemic.

Further information

Clarity in financial reporting *Putting ASIC areas into focus*

Clarity in financial reporting *Responding to Pillar Two*

Conclusion

In the current environment and changing market conditions, we strongly recommend that entities carefully determine those areas of focus that require further attention in determining the appropriate application of Australian Accounting Standards and compliance with the *Corporations Act 2001*.

Uncertainty is pervasive in accounting and reporting. Accounting Standards accommodate this uncertainty through specific measurement requirements and associated disclosure requirements, and an overall requirement to explicitly call out key judgements made in applying the entity's accounting policies, information about assumptions about the future, and sources of estimation uncertainty. These disclosures are critical to a reader's understanding of the financial report and are key focus area for regulators.

Providing meaningful disclosures in the financial report and operating and financial review (OFR) so that users can clearly understand the impact of the current economic conditions of risk and uncertainty, including significant changes in circumstances since the prior period on the entity and its overall financial report will provide useful information to users and investors and meet expectations of regulators.

APPENDIX: POINTS TO CONSIDER IN RESPONDING TO ASIC FOCUS AREAS

For more detail on the areas listed below, see previous publications for the December 2022 and June 2022 reporting periods.

Impairment and other asset values

Non-financial assets, including goodwill and intangible assets

- Reasonable and supportable cash flows prioritising external inputs, historical forecasting accuracy considered, use of probability weighted scenarios and cross checks
- Fair value models using supportable inputs (particularly where significant management inputs used)
- Appropriateness of discount rates, given rising interest rates and uncertainties
- Consideration of differing inflationary impacts between costs and revenues
- Comparison to market capitalisation used as an impairment indicator but not a measure of recoverable amount
- Disclosures of key assumptions, sensitivity analyses and the impact of changing market conditions

Deferred tax assets (DTAs)

- Consistency of DTA recoverability assumptions with those in the asset impairment models and ECL calculations where appropriate
- Appropriate disclosures of support for DTAs recognised
- Management's evaluation of assumptions around the recognition of tax positions in relation to tax disputes

Fair value of properties and unlisted investments

- Potential changes in valuations to reflect changes in the economy, market and customer preference on the impact around fair value measurement (including level 3 measurements)

Expected credit losses (ECL)

- Models should reflect impact of changes in the current economy and market on collectability of receivables
- Consider ECL for all financial assets within scope of AASB 9
- Use of forward looking assumptions and adequate consideration of possible future losses.

Liabilities, revenue and other matters

Onerous contracts, site restoration, lease make-good and restructuring provisions

- Adequacy of provisions to meet legal/constructive obligations
- Measurement impact due to economic conditions e.g. changes in interest rates, discount rates, inflation and climate
- Identification of the existence of contingent liabilities and related disclosures
- Relying on inability to measure reliably for non-recognition of provisions in rare circumstances only
- Impact of delayed procedures on deferred claim liabilities and the need for a liability for any commitment to return premiums for savings by private health insurers (and for half-years, consistency with AASB 17 *Insurance Contracts)*.

Classification of financial assets

- Appropriate measurement in accordance with the classification criteria in AASB 9

Off balance sheet arrangements

- Examples include interests in non-consolidated entities and receivables under debtor securitisation facilities

Revenue recognition

- Accounting policy is assessed against the requirements of Accounting Standards and the relevant contractual documentation
- Assessment of performance obligations and impacts on the timing of revenue recognition
- Clearly disclosed revenue accounting policy
- Entity specific disaggregated revenue disclosure
- Appropriate recognition of licencing revenue and capitalisation of development costs

Lease accounting

- Appropriate accounting of sale and leaseback transactions depending on whether a 'sale' is met under AASB 15
- Appropriate accounting for rental concessions by lessees and lessors
- Inclusion of right-of-use assets in impairment assessments

Insurance recoveries

- Consideration of virtual certainty of the claim, supported by legal advice

Contingent payments in business combinations dependant on employment

- Recognised as post acquisition remuneration

Written put options over non-controlling interest

- Recognised as a 'gross obligation' (amount that is expected to be paid, not a derivative) and remeasured through profit or loss.

Going concern and subsequent events

Going concern and solvency

- Impact of current economic conditions that may challenge the going concern and solvency assessments and the going concern basis of preparation

Subsequent events

- Adjusting events appropriately adjusted for and non-adjusting events adequately disclosed.

Disclosures

Significant judgements and estimates

- Disclosures include sources of estimation uncertainty, key assumptions made, sensitivity and scenario analysis and any subsequent changes thereof

Current and non-current classification

- Impact of current conditions in light of maturity dates, payment terms and covenants on classification

Operating and financial review (OFR)

- Entity specific material business risks clearly disclosed
- Clear explanation of how current economic conditions have impacted the entity
- Consistency with information in financial statements (e.g. revenue disclosures, segment reporting, judgements and assumptions, recoverable amount)

Climate and cyber disclosures

- Explaining climate change risks and their potential impact on future prospects, including considering the TCFD recommendations
- Whether the entity is exposed to cybersecurity risks, including through loss of personal data or a denial of service attack

Pillar Two income taxes

- Impact of 'Pillar Two' income taxes where a group operates in countries that have substantively enacted enabling legislation

Non-IFRS financial information

- Non-IFRS measures appropriately calculated, not given undue prominence and reconciled to financial statements

Half-year financial reports

- Need for enhanced disclosures to explain changing conditions and significant developments

Impacts of new standards

- Disclosure of the impacts of AASB 17 *Insurance Contracts* (including quantification) in full-year reports
- Adoption of AASB 17 in half-year financial reports.

ASIC's uncertainties and risk examples

- Availability of skilled staff and expertise
- Impact of rising interest rates
- Inflationary impacts that may differ between costs and income
- Increases in energy and oil prices
- Geopolitical risks (including the Ukraine/Russia conflict)
- Climate change, climate-related events and transitioning to 'net zero'
- Technological changes and innovation
- COVID-19 conditions and restrictions
- Changes in customer preferences and online purchasing trends
- Discontinuation of government and other support
- Legislative and regulatory changes
- Other economic and market developments.

Contacts

Jonathan Streng
Director
jstreng@deloitte.com.au

Frank Betkowski
Principal
fbetkowski@deloitte.com.au

Alison White
Partner
aliswhite@deloitte.com.au

Anna Crawford
Partner
acrawford@deloitte.com.au

Moana Overton
Partner
moverton@deloitte.com.au