Deloitte.

A&A Accounting Technical

June 2019

Clarity in financial reporting

ASIC focus areas for June 2019 reporting

ASIC focus areas

Link to ASIC media release

[19-143MR Major financial reporting changes and other focuses]

Talking points

- The Australian Securities and Investments Commission (ASIC) announced its focus areas for the June 2019 reporting season on 17 June 2019. In this publication we describe these focus areas and include our insights.

- Four main topics are covered in ASIC's focus areas for June 2019:
  - New accounting standards
  - Accounting estimates
  - Accounting policy choices
  - Key disclosures

  The areas of focus are the same as those for December 2018 and continue to be broadly consistent with prior periods.

- ASIC will review more than 200 full year financial reports during the 30 June 2019 cycle to promote quality financial reporting as well as useful and meaningful information for investors.

- ASIC noted that:
  - Major new accounting standards will have the greatest impact on financial reporting for many companies since the adoption of International Financial Reporting Standards (IFRS) in 2005.
  - Full year reports at 30 June 2019 must comply with the new accounting standards on revenue recognition and financial instruments (including hedge accounting and loan loss provisioning).
  - Full year reports must also disclose the future impact of new lease accounting requirements, accounting by insurers for insurance contracts and the impact of the new Conceptual Framework on the definition and recognition criteria for assets, liabilities, income and expenses.
  - Required disclosure on the effect of new standards is more extensive than that made by many companies for the 31 December 2018 half-year reports.

For more information, please see the following websites:

www.iasplus.com

www.deloitte.com

ASIC focus areas in the previous three years

ASIC announces its focus areas related to financial reports twice a year (June and December). Since 2016 these focus areas have remained broadly consistent, with the only change being the addition of two focus areas in December 2018, relating to disclosures of non-IFRS measures and disclosures in the operating and financial review (OFR).

Focus areas	December 2018 to June 2019	June 2016 to June 2018
1) New accounting standards		
(a) Impact of the new standards	✔	✔
2) Accounting estimates		
(a) Impairment testing and asset values	✔	✔
3) Accounting policy choices		
(a) Revenue recognition	✔	✔
(b) Expense deferral	✔	✔
(c) Off-balance sheet arrangements	✔	✔
(d) Tax accounting	✔	✔
4) Key disclosures		
(a) Operating and financial review (OFR)	✔	-
(b) Non-IFRS financial information	✔	-
(c) Estimates and accounting policy judgements	✔	✔

As evident from the above, the continued focus on new accounting standards, accounting estimates and accounting policy choices indicates that ASIC continues to identify issues in these focus areas. We note that more than 50% of the findings from ASIC's review of financial reports since December 2015 relate to impairment testing and asset values, revenue recognition and tax accounting. Entities should therefore pay particular attention to these areas and ensure that these are appropriately accounted for and disclosed in the financial reports.

ASIC focus areas for 30 June 2019 reporting season

On 17 June 2019 ASIC announced its focus areas for 30 June 2019 financial reports (19-143MR Major financial reporting changes and other focuses). The key focus areas are as follows:

Key focus areas

Topic	Considerations	Additional thoughts
1) New accounting standards		
(a) Impact of new accounting standards adopted	New accounting standards that are effective for June 2019 year-ends: • AASB 9 *Financial Instruments* (applies from years commencing 1 January 2018) • AASB 15 *Revenue from Contracts with Customers* (applies from years commencing 1 January 2018). New accounting standard that is effective for June 2019 half-year reports: • AASB 16 *Leases* (applies from years commencing 1 January 2019).	**What if the new accounting standards have no material impact?** Consistent with ASIC's view, we believe that disclosing information indicating that new accounting standards have no material impact is important to the market. An entity should not disregard the process of performing an adequate assessment to determine the quantitative impact of the new accounting standards and should disclose how these conclusions have been reached. Also, these new standards require a number of additional disclosures and care needs to be taken that

Topic	Considerations	Additional thoughts
	The new accounting standards are expected to impact not only the financial statements themselves, but also to have a flow on impact to items such as debt covenants, tax liabilities, dividend paying capacity and remuneration schemes. These standards also introduce new disclosure requirements. Besides timely implementation and adequate disclosures, ASIC expects entities to consider their continuous disclosure obligations in keeping the market informed.	all relevant disclosures are provided.
(b) Future impact of new lease accounting and other new accounting standards	AASB 108 *Accounting Policies, Changes in Accounting Estimates and Errors* requires disclosure of the impact of new accounting standards which are not yet effective. New accounting standards that are not yet effective are: • AASB 16 *Leases* (applies from years commencing 1 January 2019)[1] • AASB 17 *Insurance Contracts* (applies from years commencing 1 January 2021)[2]. In particular, ASIC has a view that It is reasonable for the market to expect entities to be in a position to quantify the known or reasonably estimable impact of AASB 16 in the last set of results prior to adopting the new leases standard. For June reporters, the notes to the 30 June 2019 financial statements should therefore disclose the impact of AASB 16 on the financial statements in the period of initial application.	When presenting profit forecasts, entities with June 2019 year-ends that will be disclosing their forecast results for the 2019/20 year should prepare those forecasts using the accounting basis required for the 2020 financial year, which will include AASB 16.
(c) New conceptual framework	A new conceptual framework that contains new definition and recognition criteria for assets, liabilities, income and expenses will apply for years commencing from 1 January 2020. Companies will need to make note disclosure at 30 June 2019 of the future impact of the criteria in the new framework.	**Who would be impacted and what should be disclosed?** Entities that may be impacted include those that rely on the principles in the current AASB's *Framework for the Preparation and Presentation of Financial Statements* to determine and develop appropriate accounting policies due to there not being specific requirements in an Australian Accounting Standard. Entities should assess their existing accounting policies and form an expectation of whether the AASB's new *Conceptual Framework for Financial Reporting*[3] would impact the financial statements and if the expected impact is known, such information should be disclosed. If the entity has not assessed the impact and cannot yet form a view, such information should also be clearly communicated. Refer to the AASB media release and Conceptual Framework for Financial Reporting for more details.

[1] AASB 16 is not yet effective for June 2019 year-ends, but is effective for June 2019 June half-year year-ends.

[2] The International Accounting Standards Board has proposed to defer the application date of AASB 17 to years commencing 1 January 2022.

[3] In Australia, the new Conceptual Framework is applicable only for for-profit entities that have public accountability and are required by legislation to comply with Australian Accounting Standards.

Topic	Considerations	Additional thoughts
2) Accounting estimates		
(a) Impairment testing and asset values	ASIC will continue focusing on the recoverability of the carrying amounts of assets such as goodwill, other intangibles and property, plant and equipment. Directors and auditors should ensure the methodology and assumptions used for determining the recoverable amount are appropriate. ASIC has indicated that other focus areas relating to asset values include: • Companies affected by climate change, market changes, digital disruption, technological change or Brexit • The valuation of financial instruments, particularly where values are not based on quoted prices or observable market data. Fair values should be based on appropriate models, assumptions and inputs.	**What are common issues we see in practice?** In practice, we are still seeing a significant number of queries from ASIC in relation to impairment assumptions and calculations. In particular, careful consideration is needed when determining the identification of cash-generating units, cash flow assumptions, fair value calculations (especially in relation to the use of market participant assumptions) and disclosure of key assumptions and the sensitivity of the headroom to reasonable changes in assumptions. It is also important to be mindful that the assumptions used to support impairment are not inconsistent with those used to support the recoverability of deferred tax and going concern assessments. Where market capitalisation is less than the carrying amount of the net assets, this may indicate possible questions around the recoverability of goodwill, intangible assets and other tangible assets. In this case, particular consideration should also be given to investment property and property, plant and equipment which is measured at fair value in accordance with AASB 13 *Fair Value Measurement*. **Accessing information** See ASIC Information Sheet 203 Impairment of non-financial assets: Materials for directors (INFO 203). For further guidance, see Deloitte's Clarity publication Focusing on impairment issues for June 2017.
3) Accounting policy choices		
(a) Revenue recognition	Directors and auditors should review and ensure that the revenue recognition policies reflect the substance of the underlying transactions. AASB 15 has more detailed requirements than the previous standards and requires specific disclosure of key judgements and assumptions made in developing accounting policies for revenue recognition.	Regardless of whether AASB 15 has an immaterial impact to an entity, the entity must review the accounting policies to align them with AASB 15 requirements. The application of the new revenue guidance is complex. Specific consideration should be given to identifying the contractual performance obligations and the judgements applied when assessing the timing of revenue recognition, either over time or at a point in time. ASIC may focus on cases where there has been a significant change to the revenue recognition. For example, a change in the determination of whether an entity is acting as principal or agent. Where the ratio of trade receivables related to revenue is high or there is an increase in the ratio year-to-year, this could also be regarded as an indication of deterioration of credit quality and thereby raises questions regarding the recognition of revenue and related impairment of trade receivables.

Topic	Considerations	Additional thoughts
(b) Expense deferral	Directors and auditors should ensure that expenses are only deferred where the definition of an asset and the recognition criteria are met. Furthermore, expense deferral relating to internally generated intangible assets is only permitted where the requirements of AASB 138 *Intangible Assets* are met.	**What about contract costs under AASB 15?** Contract costs (i.e. costs to obtain or fulfil a contract with a customer) that meet the criteria for capitalisation under AASB 15 are required to be capitalised and amortised. In forming a view as to whether the amounts should be capitalised, preparers should carefully consider the relevant detailed requirements in AASB 15. There are also specific disclosure requirements for any assets recognised from the costs to obtain or fulfil a contract with a customer.
(c) Off-balance sheet arrangements	Directors and auditors should review: • The treatment of off-balance sheet arrangements; • Whether other entities are controlled and should be consolidated • The accounting for joint arrangements; • Disclosures relating to structured entities.	Entities should also consider whether client monies held will give rise to on-balance sheet assets and liabilities.
(d) Tax accounting	Preparers should: • Understand the tax and accounting treatments which may affect tax assets, liabilities and expenses • Consider any recent changes in legislation; • Review the recoverability of any deferred tax assets.	**Interpretation 23 *Uncertainty over Income Tax Treatments*** Interpretation 23 clarifies the application of AASB 112 *Income Taxes* specifically when it is unclear how tax law applies to a particular transaction or circumstances. The Interpretation requires an entity to consider the probability of whether the Australian Taxation Office (or other taxation authority) will or will not accept an uncertain tax treatment. These considerations include the changes in company tax rates or tax legislation such as thin capitalisation rules. Although the Interpretation is effective for financial years beginning on or after 1 January 2019, entities should consider disclosure of the impact for June financial reports.
4) Key disclosures		
(a) Operating and financial review (OFR)	ASIC continues to emphasise that listed companies should disclose information on risks and matters that are likely to have a material impact on the future financial results. Some of these risk areas include, matters relating to climate change, market changes, digital disruption, new technologies, Brexit and cyber-security. ASIC also highlighted that directors should consider disclosing information that would be relevant under integrated reporting, sustainability reporting or the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD) where that information is not already included in the OFR. In September 2018, the ASIC released Report 593 Climate risk disclosure by Australia's listed companies (REP 593) which shows that 17% of listed entities in their sample reviewed identified climate risk as a material risk in the entities OFR. ASIC will keep monitoring climate risk disclosure practices.	Directors should consider the guidance in ASIC Regulatory Guide RG 247 Effective disclosure in an operating and financial review on providing useful and meaningful information to shareholders or unit holders when preparing an OFR to be presented in the directors' report. The *Corporations Act 2001* provides an exemption from disclosing information about business strategies and prospects for future financial years, if disclosure of that information is likely to result in 'unreasonable prejudice' to the entity. Entities must carefully evaluate and establish the basis for relying on the exemption before any information is omitted. We would generally not expect listed entities to avail themselves of the commercial prejudice exemption. ASIC has released 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.

Topic	Considerations	Additional thoughts
		To further understand the TCFD recommendations, refer to Deloitte's publication on Climate-related risk assessments and financial disclosures. More information is also available on the Deloitte dedicated climate change website. The publication has been released by Deloitte in collaboration with the Institute of Chartered Accountants in England and Wales (ICAEW). In May 2019, the AASB also released an updated version of Climate-related and other emerging risks disclosures: assessing financial statement materiality using AASB Practice Statement 2. The paper guides directors, preparers and auditors when preparing and auditing financial statements. Even though the guidance is not mandatory, it represents the IASB's best practice interpretation of materiality in the context of climate and other emerging risks.
(b) Non-IFRS financial information	Sometimes referred to as 'alternative performance measures' or 'non-GAAP measures', directors should determine whether any non-IFRS financial information (such as underlying earnings, headline earnings, normalised earnings etc.) in the OFR or other documents outside the financial report can be considered misleading to users.	We are seeing an increasing number of inquiries from ASIC in this area. Entities should consider ASIC Regulatory Guide RG 230 Disclosing non-IFRS financial information if there is any non-IFRS financial information disclosed in the financial and other reports. Entities should ensure that users are not misled by giving undue prominence to these alternative performance measures when presenting and disclosing non-IFRS information. If preparers believe that non-IFRS information is necessary to enable users to understand an entities financial performance, these should be reconciled to statutory IFRS figures in the financial report.
(c) Estimates and accounting policy judgements	Ensure adequate estimates and accounting policy judgements disclosures, and key assumptions and sensitivity analysis disclosures are made. These disclosures should be specific to the assets, liabilities, income and expenses of the entity.	Entities must consider and disclose estimates and key judgements particularly in relation to the new accounting standards issued (e.g. AASB 9, AASB 15 and AASB 16). This would be in addition to the other areas of judgements, estimates and assumptions.

Conclusion

Through the announcement of its focus areas for 30 June 2019 financial reports, ASIC has called on companies to focus on new requirements that can materially affect reported assets, liabilities and profits. Focus on impairment testing, accounting policy choices and judgements and estimates will continue. We strongly recommend that ASIC's published focus areas are appropriately considered when preparing entities financial reports.

Contacts

Prajita Balavinodan
Manager
Melbourne
pbalavinodan@deloitte.com.au

Jonathan Streng
Director
Sydney
jstreng@deloitte.com.au

Moana Overton
Principal
Melbourne
moverton@deloitte.com.au

Alison White
Partner
Sydney
aliswhite@deloitte.com.au

Clive Mottershead
Partner
Melbourne
cmottershead@deloitte.com.au

Anna Crawford
Partner
Sydney
acrawford@deloitte.com.au

Deloitte Touche Tohmatsu Limited
Grosvenor Place
225 George Street
Sydney NSW 2000
Australia