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A&A Accounting Technical

Clarity *in financial reporting*

- ***ASIC focus areas for December 2016 year ends***
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Talking Points

- Companies should provide information to users of the financial reports that is useful and meaningful. Directors and auditors should focus on asset valuations and accounting policy choices. The seven specific areas of focus are consistent with those in June 2016 and prior periods.
- ASIC continues to focus on material disclosures of information useful to investors and encourages efforts to communicate this information more clearly in financial reports.
- Auditors of listed entities will be required to disclose information on Key Audit Matters (KAMs) in enhanced audit reports from financial years ending on or after 15 December 2016. Directors should ensure that relevant information is already disclosed in the financial report and in the Operating and Financial Review.
- The new accounting standards on revenue, financial instruments and leases are expected to have the greatest impact on financial reporting since the adoption of International Financial Reporting Standards (IFRS) in 2005.
- ASIC highlights the need to determine the extent of any impact and put in place implementation plans for these new standards including consideration of system changes, business and compliance impacts, as well as disclosure obligations.
- Companies need to provide 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.
- The level of a company's disclosures should increase with the progress in its implementation of the new standards, which will occur as the effective dates approach.

16-428MR ASIC calls on preparers to focus on useful and meaningful financial reports

ASIC has announced its focus areas for 31 December 2016 financial reports of listed entities and other entities of public interest with many stakeholders. As at June 2016, they have highlighted that companies should adopt realistic valuations for asset values and use appropriate accounting policies.

ASIC will continue to focus on material disclosures such as assumptions supporting accounting estimates, significant accounting policy choices and the impact of new reporting requirements. They encourage companies to communicate information more clearly in their financial reports.

The areas of focus are the same as those for June 2016 and continue to be broadly consistent with prior periods;

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

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

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 changes in assumptions. Also 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.

Enhanced audit reports

Auditors of listed entities will be required to issue enhanced audit reports for financial years ending on or after 15 December 2016. These enhanced audit reports include KAMs, being those matters that required significant auditor attention in performing the audit. ASIC is reminding preparers and directors to be mindful that these matters may relate to accounting estimates and significant accounting policy choices which also require specific disclosures in the financial report, as well as matters relating to the business that should also be covered in the Operating and Financial Review (OFR).

We encourage preparers and directors to consider the above-mentioned areas of focus when assessing which accounting policies should be disclosed in the notes to the financial statements, as, where relevant to an entity, these may be raised as KAMs by their auditor. Furthermore, we recommend a critical assessment of those items disclosed in the financial report as significant judgements or major sources of estimation uncertainty to ensure that these are specific to the entity's operations and not inconsistent with those matters identified as KAMs by their auditor.

Not all KAMs identified by the auditor will relate to disclosures in the financial statements. For example, a major change of IT system may result in a KAM in the year of transition. While this change may not be disclosed in the notes to the financial statements, depending on the significance of its impact on an entity's operations, it may be highlighted in the OFR.

16-442MR Companies need to respond to major new accounting standards

The disclosure requirements required in relation to new and revised accounting pronouncements need to be carefully considered where they have not yet been adopted. AASB 108 *Accounting Policies, Changes in Accounting Estimates and Errors* requires an entity to disclose any known or reasonably estimable information about the possible impact that the application of new Accounting Standards will have on the entity's financial statements in the period of initial application. This requirement does not apply to entities applying Tier 2 (RDR) reporting requirements.

In December 2016, ASIC issued press release 16-442MR Companies need to respond to major new accounting standards. In ASIC's view, the impact of the new standards on revenue, financial instruments and leases on reported results could be "even more significant than was the case with the adoption of IFRS". ASIC points out various matters that should be considered in any implementation plans for the new standards, including required system changes, business impacts, impacts on compliance with financial requirements, disclosures required in financial reports prior to the effective dates of the standards, possible continuous disclosure obligations, and the impact on fundraising or other transaction documents.

The link to the media release above provides more guidance on these topics, and notes that listed entities should provide adequate information to the market on the company's preparedness and the possible financial impact in accordance with any continuous disclosure obligations.

The guidance from ASIC is consistent with the views of other regulators. For example:

The International Organization of Securities Commissions (IOSCO), of which ASIC is a member, has published a Statement on Implementation of New Accounting Standards related to revenue, financial instruments, and leases. The statement emphasizes the need for transparent issuer disclosures relevant to assessing the possible impacts of adopting the new standards and providing investors with timely and decision-useful information. IOSCO believes the level of an issuer's disclosures should increase with the progress in its implementation of the new standards, which will occur as their effective dates approach. Furthermore, the qualitative and quantitative disclosures must be timely, issuer-specific, and sufficiently robust and detailed. The full statement is available at www.iosco.org.

The European Securities and Markets Authority (ESMA), while not directly applicable in an Australian context, has issued specific guidance and anticipates that issuers provide progressively more entity-specific qualitative and quantitative information about the application of the new standards. ESMA expects that, for most issuers, the impacts (or the magnitude of its impacts) of initial application will be known or reasonably estimable as the effective dates approach. The full ESMA guidance is available at www.esma.europa.eu.

With the new Accounting Standards on leases, revenue and financial instruments introducing significant changes in the future, entities need to ensure that they comply with the requirements of AASB 108 and respond to regulatory expectations.

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.

Listed entities also need to consider their responsibilities under continuous disclosure requirements. Entities looking to undertake an Initial Public Offering should consider the need to disclose the expected impact of the new standards in their prospectus. They will also need to consider the basis on which past and forecast information is prepared and ensure that they have identified clearly whether the old or new standards have been applied to particular information.

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