



Technical Accounting Alert

TA 2018-03

ASIC focus areas for 30 June 2018 financial reports

Introduction

The purpose of this Alert is to draw attention to the Australian Securities and Investments Commission's (ASIC) Media Release 18-159MR [Major changes affecting reported net assets and profit, and other focuses for 30 June 2018 reporting](#), which outlines ASIC's areas of focus for 30 June 2018 financial reports of listed entities and other entities of public interest with many stakeholders.

Overview

The Media Release highlights ASIC's focus in the areas of:

- 1 Impact of new accounting standards
- 2 Impairment testing and asset values
- 3 Revenue recognition
- 4 Expense deferral
- 5 Off-balance sheet arrangements
- 6 Tax accounting
- 7 Estimates and accounting policy judgements

Apart from the emphasis of the impact of new accounting standards, these areas are similar in form to the ASIC areas of focus for the 31 December 2017 reporting period ([TA Alert 2017-11](#)).

Specific commentary is provided on the following areas:

New accounting standards

1 Impact of new accounting standards

ASIC notes with concern that some companies may not have adequately prepared for the impact of new accounting standards that can significantly affect results reported to the market, indicating that some companies need to give urgent attention to the impact of the standards on reported results, systems, processes and their businesses.

Directors and preparers are reminded to be mindful of legislative obligations, including the requirement for companies to keep financial records that correctly record and explain their transactions and financial position and performance, and that would enable true and fair financial statements to be prepared and audited.

The new standards can have real business impacts (e.g. compliance with debt covenants or regulatory financial condition requirements, tax liabilities, dividend paying capacity, and remuneration schemes) as well as the need to implement new systems and processes.

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Directors and preparers should consider any continuous disclosure obligations and the need to keep the market informed, as well as the impact on any fundraising and other transaction documents.

New standards at a glance

Where a new accounting standard has not yet been applied, AASB 108 *Accounting Policies, Changes in Accounting Estimates and Errors* requires disclosure of this fact and known or reasonably estimable information relevant to assessing the possible impact that application of the new standard will have on the entity's financial report in the period of initial application.

New accounting standards (and their application dates) that will significantly affect reported results of many companies include:

- AASB 9 *Financial Instruments* (1 January 2018)
- AASB 15 *Revenue from Contracts with Customers* (1 January 2018)
- AASB 16 *Leases* (1 January 2019)
- AASB 17 *Insurance Contracts* (1 January 2021)
- Amendments to standards to apply the new definition and recognition criteria in the *Conceptual Framework for Financial Reporting* (1 January 2020)

For more details on these new standards, please refer to our *Alert* ([TA 2018-01](#)).

The new accounting standards may significantly affect how and when revenue can be recognised, the values of financial instruments (including loan provisioning and hedge accounting), reported assets and liabilities relating to leases, accounting by insurance companies, and the general identification and recognition of assets, liabilities, income and expenses. The standards also introduce new disclosure requirements.

Full-year reports at 30 June 2018 must disclose the future impact of these new accounting standards.

ASIC notes that it is reasonable for the market to expect that companies will be able to quantify the impact of the new standards, particularly for the revenue, financial instrument and lease standards.

Any results forecast for the 2018/9 year disclosed to the market should be consistent with the accounting basis required by the new standards for that year. Public disclosure on the impact of the standards and timely implementation is important for investors and market confidence.

Information that there will be no material impact may also be important information for the market.

Half-year financial reports at 30 June 2018 must comply with the new requirements for revenue recognition and financial instrument valuation. ASIC will review selected 30 June 2018 half-year reports, focusing on compliance with the new standards.

Reports complying with IFRS – In March 2018, the International Accounting Standards Board released a new Conceptual Framework. Amendments were made to international standards to apply new definition and recognition criteria for assets, liabilities, income and expenses in the Framework will apply for years commencing 1 January 2020 where the criteria are not inconsistent with a specific requirement of an accounting standard.

While the Australian equivalent standards have not yet been amended, companies that are required to make an explicit unreserved statement of compliance with IFRS will need to make note disclosure at 30 June 2018 of the future impact of the criteria in the new framework in order to make that statement.

Leases - ASIC emphasises that the new leases standard will bring all leases onto the balance sheet and apply a new measurement basis. Where companies choose to apply the new requirements in comparative information in their 30 June 2020 financial report, new lease balances will be needed as at 30 June 2018.



Accounting estimates

2 Impairment testing and asset values

The recoverability of the carrying amounts of assets such as goodwill, other intangibles and property, plant and equipment continues to be an important area of ASIC's focus.

Directors and auditors need to ensure that:

- a** Cash flows and assumptions are reasonable having regard to matters such as historical cash flows, economic and market conditions, and funding costs. Where prior period cash flow projections have not been met, careful consideration should be given to whether current assumptions are reasonable and supportable.
- b** Discounted cash flows are not used to determine fair value less costs to sell where forecasts and assumptions are not reliable. Fair value less costs to sell should not be viewed as a means to use unreliable estimates that could not be used under a value in use model.
- c** Value in use calculations:
 - i** Use sufficiently reliable cash flow estimates;
 - ii** Do not use increasing cash flows after five years that exceed long term average growth rates, and without taking into account offsetting impacts on discount rates;
 - iii** Do not include cash flows from restructurings and improving or enhancing asset performance.
- d** Cash flows used are matched to carrying values of all assets that generate those cash flows, including inventories, receivables and tax balances.
- e** Different discount rates are used for cash generating units (CGUs) where the risks are different and the CGUs are located in different countries, and that similar discount rates are used where the risks are similar.
- f** CGUs are not identified at too high a level, including where cash inflows for individual assets are not largely independent.
- g** CGUs for testing goodwill are not grouped at a higher level than the operating segments or the level at which goodwill is monitored for internal management purposes.
- h** Corporate costs and assets are allocated to CGUs on an appropriate basis where it is reasonable to allocate them.
- i** Appropriate use of fair values for testing exploration and evaluation assets during the exploration and evaluation phase.
- j** Royalty relief or earnings multiple models are not used unless they are sufficiently reliable and market based assumptions are available that are specific to the company's assets and circumstances.

Further information can be found in [ASIC Information Sheet 203](#) *Impairment of non-financial assets: Materials for directors*.

Particular consideration may need to be given to values of assets of companies in the extractive industries or providing support services to extractive industries, including assets during the exploration and evaluation phase.

In addition to considering asset values in the extractive industries, Directors and auditors should also focus on the adequacy and treatment of any liabilities required for mine restoration and closure costs.

Asset values may also be affected by market changes, digital disruption, technological change, climate change, Brexit or cybersecurity.

Focus should also be given to the pricing, valuation and accounting for inventories, including the net realisable value, possible technical or commercial obsolescence, and the substance of pricing and rebate arrangements.



Directors and auditors are urged to focus on the valuation of financial instruments, particularly where values are not based on quoted prices or observable market data. Fair values should be based on the appropriate models, assumptions and inputs.

Accounting policy choices

3 Revenue recognition

Directors and auditors should review an entity's revenue recognition policies to ensure that revenue is recognised in accordance with the substance of the underlying transactions. This includes ensuring that:

- a Services to which the revenue relates have been performed;
- b Control of relevant goods has passed to the buyer;
- c Where revenue relates to both the sale of goods and the provision of related services, revenue is appropriately allocated to the components and recognised accordingly;
- d Assets are properly classified as financial or non-financial assets;
- e Revenue is recognised on financial instruments on the basis appropriate for the class of instrument.

The appropriate timing of revenue recognition may also need careful consideration in industries with complex sale and licensing arrangements that may include continuing obligations, such as software providers.

As a reminder, for 30 June 2018 half year reports, the new revenue standard applies.

4 Expense deferral

Directors and auditors are advised to ensure that expenses are only deferred where:

- a There is an asset as defined in accounting standards;
- b It is probable that future economic benefits will arise;
- c The requirements of AASB 138 *Intangible Assets* are met, including:
 - i Expensing start-up, training, relocation and research costs;
 - ii Ensuring that any amounts deferred meet the requirements concerning reliable measurement;
 - iii Development costs meet the six strict tests for deferral in paragraph 57 of AASB 138.

5 Off-balance sheet arrangements

Directors and auditors are advised to carefully review the treatment of off-balance sheet arrangements, the accounting for joint arrangements and disclosures relating to structured entities, and ensure compliance with AASB 10 *Consolidated Financial Statements*, AASB 11 *Joint Arrangements* and AASB 12 *Disclosure of Interests in Other Entities*.

Client monies held may also give rise to on-balance sheet assets and liabilities. Whether or not on balance sheet, systems and processes should be in place to ensure any monies are sufficient to meet liabilities to clients.

6 Tax accounting

Tax effect accounting is often complex. Accordingly, preparers of financial reports should ensure that:

- a There is a proper understanding of both the tax and accounting treatments, and how differences between the two affect tax assets, liabilities and expenses;
- b The impact of any recent changes in legislation are considered;



- c The recoverability of any deferred tax asset is appropriately reviewed.

Key disclosures

7 Estimates and accounting policy judgements

ASIC continues to identify inadequate disclosures regarding sources of estimation uncertainty and significant judgements in applying accounting policies.

Disclosures regarding sources of estimation uncertainty and significant judgements in applying accounting policies are important to allow users of the financial report to assess the reported financial position and performance of an entity. Accordingly, Directors and auditors are urged to review the disclosures to ensure the necessary disclosures are made and are specific to the assets, liabilities, income and expenses of the entity.

ASIC also notes that disclosure of key assumptions and sensitivity analysis are important. These enable users of the financial report to make their own assessments about the carrying values of the entity's assets and risk of impairment given the estimation uncertainty associated with many asset valuations.

Preparers should be particularly mindful to make these disclosures as this information may be revealed under key audit matter disclosures in the new enhanced audit reports for listed entities. Key audit matters may also refer to matters that should have been discussed in the Operating and Financial Review.

Other matters

The ASIC media release also includes commentary on:

- the role of directors and management – directors are primarily responsible for the quality of the financial report and this includes ensuring that management produces quality financial information. Companies must have appropriate processes and records to support information in the financial report rather than simply relying on the independent auditor. Companies should apply appropriate experience and expertise, particularly in more difficult and complex areas such as accounting estimates (including impairment of non-financial assets), accounting policies (such as revenue recognition) and taxation.
- operating and financial review – Listed companies should continue to disclose information on risks and other matters that may have a material impact on the future financial position or performance of the entity. This could include, for example, matters relating to digital disruption, new technologies, climate change, Brexit or cyber-security. Refer to ASIC Regulatory Guide RG 247 [*Effective disclosure in an operating and financial review*](#) for more information.
- material disclosures – Efforts should be made to communicate information more clearly in financial reports; ASIC will not pursue immaterial disclosures that may add unnecessary clutter to financial reports.
- proprietary companies – ASIC continues to review the financial reports of proprietary companies and unlisted public companies, based on complaints and other intelligence, writing to more than 1,000 proprietary companies that appeared to be large with no reporting exemption and had not lodged financial reports. The Regulator will be writing to several hundred more companies in similar circumstances later this year.

Further information

If you wish to discuss any of the information included in this Technical Accounting Alert, please get in touch with your local Grant Thornton Australia contact or a member of the National Assurance Quality Team at national.assurance.quality@au.gt.com.