Technical Accounting Alert

TA 2018-09

ASIC focus areas for 31 December 2018 financial reports

Introduction

The purpose of this Alert is to draw attention to the Australian Securities and Investments Commission's (ASIC) Media Release 18-364MR *Major financial reporting changes and other focuses*, which outlines ASIC's areas of focus for 31 December 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 Operating and financial review
8 Non-IFRS financial information
9 Estimates and accounting policy judgements

These areas are similar to the ASIC areas of focus for the 30 June 2018 reporting period (TA Alert 2018-03), except the re-emergence of 'operating and financial review' and 'non-IFRS financial information'. These two additional areas had been removed from the list of ASIC focus areas a number of years ago but they have now re-emerged.

Specific commentary is provided on the following areas:

New accounting standards

1 Impact of new accounting standards

New accounting standards that will significantly affect reported results of many companies include:

- AASB 9 *Financial Instruments* (effective from 1 January 2018)
- AASB 15 *Revenue from Contracts with Customers* (effective from 1 January 2018)
- AASB 16 *Leases* (effective from 1 January 2019)

- AASB 17 *Insurance Contracts* (effective from 1 January 2021)
- Amendments to standards to apply the new definition and recognition criteria in the *Conceptual Framework for Financial Reporting* (effective 1 January 2020)

Both full-year and half-year financial reports at 31 December 2018 must comply with the new requirements on revenue recognition and financial instruments (including loan loss provisioning and hedge accounting). The reports must also disclose the future impact of the new leases and insurance accounting requirements as required by AASB 108 *Accounting Policies, Changes in Accounting Estimates and Errors*. ASIC notes that it is reasonable for the market to expect that companies will be able to quantify the impact of new standards, particularly for the leases standard.

ASIC is concerned 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.

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.

In addition, 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.

For more details on these new standards, please refer to our Technical Accounting Alert TA 2018-06 *What's new for December 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.

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

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

In applying the new revenue accounting standard, directors and auditors are reminded to review an entity's revenue recognition policies to ensure that revenue is recognised in accordance with the substance of the underlying transactions.

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*.

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.

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Key disclosures

7 Operating and financial review (OFR)

Listed companies are reminded that they should provide useful and meaningful information in the OFR about underlying drivers of the results and financial position, as well as business strategies and prospects for future financial years.

Entities should disclose risks and other matters that may have a material impact on their future financial position or performance. This could include, for example, matters relating to digital disruption, new technologies, climate change, Brexit or cyber-security. For more information see ASIC Regulatory Guide RG 247 *Effective disclosure in an operating and financial review*.

Directors may also consider whether it would be worthwhile to disclose additional information that would be relevant under integrated reporting, sustainability reporting or the recommendations of the Task Force on Climate-related Financial Disclosures where that information is not already required for the OFRs.

8 Non-IFRS financial information

Directors should also consider whether any non-IFRS financial information in the OFR or other documents outside the financial report is potentially misleading and is presented in accordance with ASIC Regulatory Guide RG 230 *Disclosing non-IFRS financial information*. RG 230 also covers limitations on the use of non-IFRS measures in the financial report (RG 230).

9 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.

Other matters

The ASIC media release also reminds directors that they are primarily responsible for the quality of the financial report. This includes ensuring that management produces quality financial information on a timely basis. Companies must have appropriate processes, records and analysis to support information in the financial report. Companies should also 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.

Further information can be found in ASIC Information Sheet 183 *Directors and financial reporting* and ASIC Information Sheet 203 *Impairment of non-financial assets: Materials for directors*.

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.