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Deloitte.

Heads Up
ASIC's focus areas for December 2015 year ends

Contents

"Talking Points"

- ASIC is focused on the quality of financial reporting. Financial reports should provide useful and meaningful information for investors and other users. ASIC is not focused on immaterial disclosures that add unnecessary complexity or clutter to the financial reports.
- The areas of focus are consistent with the 30 June 2015 focus areas, and continue to be generally consistent with prior periods.
- Impairment of goodwill, other intangibles and property, plant and equipment remains the most significant concern. In particular, the use of unrealistic cash flows and assumptions and the lack of congruence between the cash flows used and the assets being tested for impairment.
- Specific emphasis should be placed on assets of companies in extractive industries and mining support services, as well as asset values that may be affected by digital disruption.
- Other areas of focus include the appropriateness of key accounting policy choices that can significantly affect reported results. These include off-balance sheet arrangements, revenue recognition, capitalisation or expensing of costs and tax accounting.
- Directors are called upon to challenge the accounting estimates and treatments applied in the financial report and obtain further advice where these do not reflect their understanding of the substance of the transaction or knowledge of the business.
- ASIC will continue to review the financial reports of proprietary companies and unlisted public companies based on complaints and other intelligence.

Background

On 12 November 2015, ASIC announced its areas of focus for 30 December 2015 financial reports of listed entities and other public interest entities. ASIC highlights that it will also continue to review proprietary and unlisted public companies where complaints are made or where ASIC has other information that highlights a review is necessary. ASIC is also proactively identifying those companies that have not lodged financial reports. Since July 2014 ASIC has successfully prosecuted a number of public companies for failing to lodge financial accounts.

The announcement of focus areas, issued in a form of a media release, is aimed at both directors and auditors and typically identifies those areas of financial reporting that are judgmental, entity specific and for which investors or other users demand high quality information.

The areas of focus are the same as those for June 2015 and continue to be broadly consistent with prior periods and comprise:

- Accounting estimates – impairment testing and asset values
- Accounting policy choices – off-balance sheet arrangements, revenue recognition, capitalisation or expensing of costs and tax accounting
- Disclosures - estimates and accounting policy judgments and the impact of the new revenue and financial instruments accounting standards.

In our experience, when entities receive enquiries from ASIC as part of its ongoing Financial Statement Surveillance Programme, the matters raised by ASIC are generally consistent with these areas of focus. In July 2014 ASIC commenced issuing media releases where entities agree to amend their previous or current financial reports as a result of ASIC's enquiries. In September 2015, 3 such media releases were issued, with a further 3 being issued in October 2015.

While the current media release makes no reference to the amortisation of intangible assets as a specific focus area (in contrast to those for 31 December 2014 financial reports), we would recommend that entities continue to pay particular attention to this area. In particular the appropriateness of amortisation periods, treatment of renewals and contractual restrictions that may limit the entity's ability to use the asset, the appropriateness of identifying assets as indefinite life and the commencement of amortisation.

We also would like to draw your attention to ASIC's Information Sheet on Impairment which explains directors' and board audit committees' responsibilities in connection with the testing of non-financial assets for impairment. This information sheet provides useful resource for directors when considering the need for impairment, and the adequacy of impairment work. It discusses matters including:

- the need for impairment testing
- the process for assessing impairment
- common issues with impairment calculations
- questions that may be asked of external auditors.

Please refer to the Heads Up issued by Deloitte on this topic.

This Heads Up provides an overview of ASIC's areas of focus for 30 December 2015 financial reports and the issues directors and preparers of financial statements should consider to ensure that they have appropriately addressed ASIC's concerns.

ASIC areas of focus for 30 December 2015 financial reports

In summary ASIC's key areas of focus are:

Focus area	Matters for consideration
Accounting estimates	

Impairment testing and asset values, specifically the recoverability of the carrying amounts of assets such as goodwill, other intangibles and property, plant and equipment.
• Identification of cash generating units at the correct level as required by AASB 136 *Impairment of Assets* ('AASB 136') and not at a higher level than operating segments.
• Reasonableness of cash flows and assumptions including consideration of historical cash flows, economic and market conditions, and the funding structure of the entity.
• Appropriateness of using a fair value less costs of disposal model (FVLCD). FVLCD should not be viewed as a means to use unreliable estimates that could not be used in a value in use (ViU) model.
• ViU models should:
  ○ use reliable cash flow estimates;
  ○ not use increasing cash flows after 5 years that exceed long term average growth rates; and
  ○ not include cash flows from restructurings or enhancing performance of assets.
• Congruence of cash flows to the carrying values used in the impairment testing approach, for example the inclusion of working capital balances.
• Discount rates should consider the different risks and geographical location attached to the assets or cash generating units being tested.
• The impairment test in AASB 136 is used for exploration and evaluation assets after technical feasibility and commercial viability have been demonstrated.
 	
ASIC has also specifically noted that particular consideration may need to be given to values of assets in the extractive industries or providing support services to extractive industries, as well as values of assets that may be affected by the risk of digital disruption.
	• Impairment is the most common area of concern and therefore entities should pay particular attention to ensuring that asset values in the balance sheet continue to be supportable.
	• The identification of cash generating units may be an area of significant judgment. Management should ensure that a proper analysis is performed and documented. Management should also consider the entity's business model and identified operating segments to ensure consistency, where appropriate, and that the impairment testing is not conducted at a level above an operating segment level.
	• Cash flows forecasts are required to be based on reasonable and supportable assumptions. Where prior forecasts have not been met, particular attention should be given to ensure the assumptions are reasonable and supportable, including consideration of external information and data available.
	• A number of ASIC enquiries relate to the use of a FVLCD model. AASB 13 *Fair Value Measurement* sets out specific requirements for determining fair value, including selecting a technique that maximises the use of observable inputs and minimises the use of unobservable inputs. This may include consideration of quoted prices or other observable market information, such as recent transactions of similar assets. To the extent these are not available, entities may use earnings multiples or discounted cash flows. However, careful consideration should be given to ensure that multiples are comparable or that the cash flows can be reliably estimated. In some cases multiple valuations techniques may need to be considered. Where this is the case, the reasonableness of the range of values indicated by those results should be considered such that the fair value selected is the point within that range that is most representative of fair value.
	• For exploration companies, the question of when an entity has moved out of the exploration phase into development is a matter of significant judgment. Entities should develop and disclose an

Focus area	Matters for consideration
	accounting policy to determine when reclassification should occur and ensure that once technical feasibility and commercial viability have been demonstrated, the assets are considered under the requirements of AASB 136 for impairment purposes.
Valuation of financial instruments, specifically where the values are not based on quoted prices or observable market data, including valuation of financial instruments by financial institutions.	The valuation of financial instruments that are not traded in an active market may be complex. We recommend that entities consult with their valuation advisors in respect such transactions.
Accounting policy choices	
Off-balance sheet arrangements Treatment of off-balance sheet arrangements, the accounting for joint arrangements and disclosures relating to structured entities should be carefully reviewed.	Accounting for joint arrangements in particular can be complex in practice, particularly in determining whether an arrangement satisfies the definition of a joint operation or not. Complexities are also evident in the accounting for increases and reductions of interests in joint arrangements, particularly joint operations and we recommend that preparers give such transactions particular attention.
Revenue recognition • Revenue should be recognised in accordance with the substance of the transaction. • Revenue should only be recognised when the services to which the revenue relates have been performed or risks and rewards of goods have passed to the buyer. • Multiple elements within a contract should be considered separately and the related revenue recognised accordingly.	• Entities should carefully consider their revenue recognition policies and, in particular, the timing of recognition, in relation to their material streams of revenue. • Revenue recognition relating to service contracts, multiple element arrangements, financial instruments and complex sale and licensing arrangements may need careful consideration. • We recommend that preparers also carefully consider their disclosures around accounting policies for revenue recognition and any significant judgements being made in the application of these accounting policies.
Capitalisation or expensing of costs Expenses should only be deferred when they meet the definition of an asset under the accounting standards; it is probable that future economic benefits will arise and the requirements of AASB 138 *Intangible Assets* ('AASB 138') are met.	• In practice, this question comes up most commonly in the context of AASB 138 and AASB 6 *Exploration for and Evaluation of Mineral Resources*. Management should carefully consider the requirements of the relevant standard and document the position adopted. • AASB 138 sets out specific requirements that need to be met in order to capitalise costs. Costs relating to start-up, training, relocation and research are required to be expensed.
Tax accounting • Understanding both the tax and accounting treatments and how differences between the two affect tax assets, liabilities and expenses. • Recent changes in legislation. • The recoverability of any deferred tax assets.	• Tax accounting is complex, practical difficulties are often experienced particularly in relation to deferred tax in the following areas which we recommend management pay particular attention to: ○ recoverability of deferred tax assets (and related disclosures), in particular where the

Focus area	Matters for consideration
	entity has suffered a loss in either the current or preceding period, undistributed profits of subsidiaries of equity accounted investments; ○ fair value adjustments in a business combination; ○ uncertain tax positions; and ○ consideration of different revenue and capital tax bases. • In addition, where the effective tax rate is significantly different to the statutory rate, entities should pay particular attention to the reasons for the differences and ensure that they are clearly described in the tax rate reconciliation.
Key disclosures	
Estimates and accounting policy judgments • Disclosures regarding sources of estimation uncertainty and significant judgments are important to users. • These disclosures should be specific to the assets, liabilities, income and expenses of the entity. • Disclosure of key assumptions and sensitivity analysis provide users with the ability to make their own assessment of asset values and the risk of impairment.	• AASB 101 *Presentation of Financial Statements* ('AASB 101') requires disclosure of judgments applied in selecting significant accounting policies to assist users understand the judgments made by management. • We believe that entities should pay particular attention in ensuring that such disclosures are both relevant and meaningful to their circumstances and relevant to events and transactions that have occurred in the reporting period. • AASB 101 also requires entities to disclose information about assumptions that an entity makes about the future and other major sources of estimation uncertainty at the end of the reporting that have a significant risk or resulting in a material adjustment to the carrying amount of assets and liabilities within the next financial year. • The disclosure should include details of both the nature of such assets and liabilities and their carrying amount at the end of the reporting period.
Impact of new revenue and financial instrument standards The notes to the financial statement should disclose the impact of the new requirements for recognising revenue and valuing financial instruments (including loan provision and hedge accounting).	• AASB 108 *Accounting Policies, Change in Accounting Estimates and Errors* ('AASB 108') requires disclosure of the impact that new standards would have on the financial statements, or if the impact is not known or able to be reasonably estimable, a statement to that effect. • In our view, AASB 108 only requires quantification of the impact where the entity is sufficiently advanced in their implementation projects that the impact can be reliably estimated. Therefore, if the entity has not yet begun its implementation project or is not able to reasonably estimable the impact, a statement should be made to that effect. • We recommend that to the extent that

Focus area	Matters for consideration
	management has not yet commenced their implementation projects, they should consider beginning these projects as soon as possible.

External links

- ASIC media release (15-331MR) Focus for 31 December 2015 financial reports
- ASIC media release (15-169MR) Findings from 31 December 2014 financial reports
- ASIC Information Sheet 203- *Impairment of non-financial assets: The role of directors*

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