

SPECIAL GAAP REPORT

Colin Parker (former AASB member) and **Carmen Ridley** (current AASB member),
corporate reporting team, *GAAP Consulting*

Financial reporting and audit considerations for 31 December 2016

Introduction

As the 31 December reporting season has arrived, the *GAAP Consulting* team thought that it would be good to share several financial-reporting, ethical and auditing considerations with you.

We've listed them as:

- ASIC targets and concerns
- ASIC reminds companies to respond to new AASBs
- AASB standards operative
- Six ASIC-inspired corporate restatements
- Other financial-reporting reminders
- New guidance issued for management representations
- Enhanced audit reporting standard apply
- What finance executives need to know about new audit reporting
- Enhanced audit-reporting standards – what auditors must do
- Better understanding KAMs, and
- ASIC's audit-communication proposals.

We trust that you find this Special GAAP Report helpful and look forward to working with you to meet the challenges of 2017.

ASIC targets and concerns

The Australian Securities and Investments Commission (ASIC) has called on companies to provide financial reports that are useful and meaningful ahead of preparations for the period ending 31 December.

Announcing its focus areas for listed entities and other entities of public interest with many stakeholders, the commission highlighted key problem areas to address, urging companies, in particular, to adopt realistic valuations for asset values, appropriate accounting policies and to provide more effective communication of information.

While these focus areas are aimed at listed entities, in our experience many of them are equally applicable to most companies.

ASIC commissioner John Price said: 'As in previous reporting periods, directors and auditors should focus on values of assets and accounting policy choices. ASIC continues to see companies use unrealistic assumptions in testing the value of assets or that have applied inappropriate approaches in areas such as revenue recognition.'

The focus areas and ASIC's views about them are as follows:

Focus area	Explanation
Asset values	<p>ASIC encourages preparers of financial reports and their auditors to consider carefully the need to impair goodwill, inventories and other assets.</p> <p>ASIC continues to find impairment calculations based on unrealistic cash flows and assumptions as well as material mismatches between the cash flows used and the assets being tested for impairment.</p> <p>Fair values attributed to financial assets should also be based on appropriate models, assumptions and inputs.</p> <p>There should be particular focus on assets of companies in extractive industries and mining support services as well as asset values that might be affected by digital disruption.</p>
Accounting policy choices	<p>Directors and auditors should consider how the choice of accounting policy can affect reported results. These include the treatment of off-balance sheet arrangements, revenue recognition, expensing of costs that should not be included in asset values, tax accounting, and inventory pricing and rebates.</p>
Material disclosures	<p>ASIC's surveillance continues to focus on material disclosures of information useful to investors and others using financial reports such as assumptions supporting accounting estimates, significant accounting policy choices, and the impact of new reporting requirements.</p> <p>ASIC has said it will not pursue immaterial disclosures that may add unnecessary clutter to financial reports. The commission encourages efforts to communicate information more clearly in financial reports.</p>

Focus area	Explanation
KAMs, accounting estimates and disclosures, and OFRs	Auditors of listed entities will be required to issue enhanced audit reports from financial years ending on or after 15 December. These enhanced audit reports will outline key audit matters, being those matters that required significant auditor attention. Preparers and directors should be mindful that these matters may relate to accounting estimates and significant accounting policy choices that also require specific disclosures in financial reports as well as matters relating to the business that should be covered in the Operating and Financial Review.
Client monies	Australian financial services licensees should ensure that client monies are appropriately held in separate, designated trust bank accounts, and that monies are applied in accordance with client instructions and the requirements of the Corporations Act. ASIC reminds auditors of the importance of audit testing to obtain assurance that assets and liabilities are not materially misstated, that monies are dealt with appropriately, and that breaches are reported to ASIC in accordance with the Act and ASIC Regulatory Guide 34 <i>Auditors Obligations: Reporting to ASIC</i> .

As part of ASIC’s financial-reporting surveillance program, the commission will select financial reports for review according to risk-based criteria and at random to determine compliance with the Corporations Act and accounting standards. The commission also continues to review the financial reports of proprietary companies and unlisted public companies based on complaints and other intelligence.

It will identify and follow up companies that have not met their obligation to lodge financial reports.

ASIC reminds directors that, while it does not expect them to be accounting experts, they should seek explanation and advice supporting the accounting treatments chosen and, where appropriate, challenge the accounting estimates and treatments applied. They should particularly seek advice where a treatment does not reflect their understanding of the substance of an arrangement.

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*.

Appendix 1 *ASIC focuses for 31 December 2016 financial reports* is also worth reading.

Preparers and directors should be aware that if ASIC takes issue with an accounting treatment that cannot be justified, this may result in an investigation, the incurring of costs (legal and accounting), the need to restate financials, and the inevitable ASIC media release that may result in reputational damage and, for listed companies, a hit to share prices.

We have recently seen it happen several times. Getting things right should not be taken lightly.

ASIC reminds companies to respond to new AASBs

ASIC had reminded companies to respond immediately to major new standards.

Three new accounting standards coming into force over the next two years are expected to have the greatest impact on financial reporting since the adoption of International Financial Reporting Standards in 2005.

The new standards can significantly affect the reporting of revenue, values of financial instruments, loan loss provisions, and the impact of lease arrangements.

They are:

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

ASIC commissioner John Price said: ‘We remind directors and management of the importance of planning for the new standards and informing investors and other financial report users of the impact on reported results.

‘Auditors should be mindful of their responsibilities in the context of opining on financial reports, including any note disclosures. To maintain their independence, auditors should not be implementing new standards or advising on accounting treatments for their clients.

‘Given the extent of the changes to financial reporting, it is important to determine the extent of any impact now and to put in place implementation plans for these new standards. Public disclosure on the impact of the standards and timely implementation is important for investors and to retain market confidence.’

ASIC also said: ‘It is reasonable for the market to expect that quantitative information will be available and disclosed for the reporting date that coincides with the start of the first comparative period that will be affected in a future financial report. Information that there will be no material impact may also be important information for the market.’

Matters to consider for any implementation plans may include system changes, business impacts, impacts on compliance with financial requirements, disclosures required in financial reports before the standards’ effective dates, possible continuous-disclosure obligations, and the impact on any fundraising and other-transactions documents.

Issue	Matters to address
Implementation	<ul style="list-style-type: none"> • Directors and management should ensure that progress is monitored against plans and action taken where milestones are not met • Identify systems, processes, and any associated internal control changes needed to produce information required under the new standards, including related disclosures, and • Determine the impact on compliance with financial-condition requirements (e.g. loan covenants and regulatory capital requirements), future tax liabilities, the ability to pay dividends, and employee incentive schemes.
Financial statement disclosure	<ul style="list-style-type: none"> • Provide required disclosure in the notes to financial statements before new standards’ effective dates about 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.
Continuous disclosure	<ul style="list-style-type: none"> • Provide adequate information to the market on the company’s preparedness and the possible financial impact in accordance with any continuous-disclosure obligations.

Issue	Matters to address
Fund raising and other-transactions documents	<ul style="list-style-type: none"> • Providing appropriate disclosure of the standards' impact on fundraising and other-transactions documents • Consider how much prominence is given to financial information presented under existing and new standards in respect of proximity to the first financial report under the new standards and the size and extent of the effects of applying the new standards • Presenting past and prospective financial information in a document on a consistent basis or presenting information on both bases for an overlap period • Ensuring impacts on historical financial-statement information are presented clearly by general discussion, reconciliations of key items such as profit and net assets, and/or line-by-line reconciliations for one or more years. More detailed information and quantification may be required closer to the adopting of the new standards • Disclosing key assumptions made when applying the new standards to forecast information, and • Clearly identifying whether the old or new standards have been applied to particular information.

- AASB 101 *Presentation of Financial Statements*: Encourages the application of professional judgement in determining what information should be disclosed in financial statements.

Adoption of these amendments constitutes a change of accounting policy and needs to be considered in the context of transitional provisions (if any) in relevant amending standards, and the requirements of AASB 108 *Accounting Policies, Changes in Accounting Estimates and Errors*.

If you require technical assistance applying the amendments or have any other financial-reporting problems please contact us. We also undertake pre-issuance reviews of financial statements.

Our corporate reporting team of Carmen Ridley, a current member of AASB, Colin Parker, a former member of the AASB, Stephen LaGreca and Sonya Sinclair are ready to meet your needs.

Six ASIC-inspired corporate restatements

As a result of ASIC's financial-reporting and auditor-surveillance programs, six listed entities restated their 31 December financial results during the second half of 2016.

In the preparation and audit of financial statements, be mindful of circumstances that required the accounting to be amended to comply with accounting standards.

New Year's day was important for AASBs 9 and AASB 15. A third balance sheet was required. It also marked the start of accounting for financial instruments and revenue in accordance with the new standards affecting comparative information.

In relation to disclosure for 'issued but not yet operative standards', it is difficult to see how entities would not have a view as to the likely effect given 1 January date 'start date'.

Listed entities using non-GAAP performance measures should consider how AASBs 9 and 15 (also AASB 16 *Leases*) will affect them and their continued compliance with ASIC regulatory guidance.

AASB standards operative

The following amendments to accounting standards apply to the 31 December reporting date for annual financial statements:

- AASB 116 *Property, Plant and Equipment* and AASB 138 *Intangible Assets*: Prohibits revenue-based depreciation methods and generally assumes such methods are an inappropriate basis for amortising intangible assets
- AASB 11 *Joint Arrangements*: Adds new guidance on how to account for the acquisition of an interest in a joint operation that constitutes a business
- AASB 116 *Property, Plant and Equipment* and AASB 141 *Agriculture*: Includes bearer plants within the scope of AASB 16 and not AASB 141. Bearer plants no longer need to be valued at fair value less costs to sell
- AASB 127 *Separate Financial Statements*: Allows the use of the equity method to account for investments in subsidiaries, joint ventures and associates in separate financial statements
- AASB 10 *Consolidated Financial Statements*, AASB 12 *Disclosure of Interests in Other Entities* and AASB 128 *Investments in Associates and Joint Ventures*: Clarifies the requirements when accounting for investment entities when applying the consolidation investment entity exemption, and

Entity	Issue	Background
Frontier Capital Group Ltd	Goodwill-impairment presentation	<p>ASIC enquired about the recoverability of goodwill as part of its review of Frontier's financial report for the year ended 31 December 2015 and noted that the company has amended the presentation of its goodwill-impairment expense for the half-year ended 30 June.</p> <p>In the company's appendix 4D lodged with the Australian Securities Exchanges on 31 August, Frontier recognised an impairment expense of \$7,965,389 in other comprehensive income rather than a net loss – contrary to the requirements of accounting standards.</p> <p>In response to an enquiry by ASIC, the company has released an amended Consolidated Statement of Profit or Loss and other Comprehensive Income, which presents the impairment expense as a component of net loss for the period. Total comprehensive loss remains unchanged.</p>
Hillgrove Resources Ltd	Asset write-down by \$86.3m	<p>ASIC queried the company's impairment testing of mine assets and the recoverability of deferred tax assets for the year ended 31 December. The inquiries concerned the lack of observable inputs used to estimate fair value, failing to include the costs of disposal, and not using current balance-date forecasts for the copper price.</p> <p>The company subsequently recorded an impairment charge of \$67.1 million for its Kanmantoo copper mine and wrote down \$19.2 million of deferred tax assets in its results for the half-year ended 30 June.</p>

Entity	Issue	Background
Evolution Mining Ltd	Write down of mine by \$77.3m	ASIC had queried the company's auditor about the recoverable amount of Evolution's Pajingo gold mine in its financial report of 30 June 2015. In its 2016 report, the company recorded an impairment of \$77.3 million against the Pajingo assets on the basis of binding offers for them and their sale after the balance date.
Energy Resources of Australia Ltd	Asset writes down by \$161m	ASIC reviewed ERA's 31 December financial report and questioned the use of a single discount rate for different components of forecast cash flows in testing assets and liabilities for impairment. The company made a \$161 million impairment charge to non-current assets for the Ranger mine in its financial report for the half-year ended 30 June.
Melbourne IT Ltd	Accounting for convertible notes	ASIC inquired about Melbourne IT's financial report for the year ended 31 December where the company had recognised movements in the fair value of embedded derivatives that are a part of its convertible-note assets in other comprehensive income rather than profit and loss. In its financial report for the half-year ended 30 June, Melbourne IT changed its accounting to recognise the fair-value movements of embedded derivatives correctly in profit and loss.
Kalina Power Ltd	Deconsolidation	ASIC made inquiries about Kalina's deconsolidation of New Energy Asia in its financial report for the year ended 30 June 2015 and the subsequent reconsolidation of NEA in the 30 June 2016 financial report. Kalina sold a portion of its holding in NEA, reducing it below 50 per cent but retained power in, and control over, NEA due to other factors. Kalina will now treat NEA as never having been deconsolidated. Among other adjustments, an intangible asset of \$4.2 million recognised on reconsolidation will be reversed. The company will amend the accounting for its subsidiary New Energy Asia Limited (NEA) when it releases its half-year financial report for 31 December 2016.

Other financial-reporting reminders

Australian firms must use corporate rather than government bond rates to discount post-employment benefits and other long-term employee liabilities (such as long-service leave) under AASB 119 *Employee Benefits*. Rates are available on the G100 website (www.group100.com.au) and Milliman Australia's website (<http://au.milliman.com>).

ASIC has revised a myriad class orders during 2015 that affect financial reporting. Preparers and auditors who relied on them will find them substantially unchanged. But they should update their understanding of them and disclose update references.

New guidance issued for management representations

The Accounting Professional and Ethical Standards Board (APESB) has issued a new guidance note to assist professional accountants who prepare, review and approve management-representation statements. Preparers should consider incorporating it into their year-end close-out procedures.

APES GN 41 *Management Representations* is directed primarily at chief financial officers or those in senior finance roles. However, it also provides specific guidance on the specific responsibilities of professional accountants at differing levels of an organisation.

It highlights the importance of factors such as considering the context and purpose of management representations, using the work of others and acting with sufficient expertise in preparing management representations.

The APESB chair Nicola Roxon said that the guidance would improve a professional accountant's understanding of how to apply the APES 110 *Code of Ethics for Professional Accountants* to management representations.

'This guidance will help ensure management representations are prepared or presented fairly and honestly in accordance with the code, regardless of whether it is used internally by management or boards, or alternatively provided to an external party,' Ms Roxon said.

Enhanced audit reporting standard apply

The new suite of enhanced audit-reporting standards applies to periods ending on or after 15 December 2016. The new and revised standards affect general-purpose and special-purpose financial statements.

The suite of enhanced reporting standards are:

- ASA 700 *Forming an Opinion and Reporting on a Report*
- ASA 701 *Communicating Key Audit Matters in the Independent Auditor's Report*
- ASA 705 *Modifications to the Opinion in the Independent Auditor's Report*
- ASA 706 *Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report*
- ASA 720 *The Auditor's Responsibilities Relating to Other information*
- ASA 805 *Special Considerations – Audits of Single Financial Statements and Specific Elements, Accounts or Items of a Financial Statements*
- ASA 810 *Engagements to Report on Summary Financial Statements*
- ASA 570 *Going Concern*, and
- ASA 260 *Communicating with Those Charged with Governance*.

Conforming amendments resulting from the changes affect the following standards: ASA 210 (engagement terms), ASA 220 (quality control), ASA 230 (audit documentation), ASA 510 (initial engagements), ASA 540 (accounting estimates), ASA 580 (representations), ASA 600 (audit of groups) and ASA 710 (comparatives).

As well as the significant changes to the format and content of auditors' reports (including key audit matters for listed entities), there are significant changes to:

- An auditor's responsibility over other information
- Going-concern basis, and
- Audits of accounting disclosure.

The new auditing standards are likely to drive the following changes:

- Better alignment of financial-reporting disclosures with KAMs, also with 'other information' contained in the annual report
- Improved going concern disclosures, and
- Removal of immaterial disclosure and improved disclosures generally.

KAMs' requirements should also improve governance-reporting, auditors identifying likely KAMs during their planning and the half-yearly review.

The Auditing and Assurance Standards Board (AUASB) has published a set of frequently-asked questions to help with the adoption of enhanced auditor reporting that come into effect for the upcoming 31 December reporting season.

If you have not caught up with these changes, they were discussed in three of our recent GAAPinars (two in July and one in November) as well in *GAAP Alert* newsletters.

If you need help to understand, implement and comply with the new standards, please let us know. The assurance team of Colin Parker, Sonya Sinclair and Stephen LaGreca would be delighted to help.

What finance executives need to know about new audit reporting

Expert auditor Dan Montgomery has explored the nine most common questions asked by audit committee members and finance executives about new and enhanced audit reporting.

Mr Montgomery is a former deputy chairman of the IAASB and chair of the Auditor Reporting Implementation Working Group. His paper is called *More informative auditor's reports – what audit committees and finance executives need to know*.

The nine questions are:

- Is the auditor taking on a management role when communicating Key Audit Matters (KAMs)?
- Will the communication of these matters publicly have an adverse effect on the relationship, and the candid dialogue, between auditors and audit committees?
- Will investors and other users view KAMs as a 'scorecard' on management's performance, including the relative aggressiveness or conservatism of management's accounting policies and judgments?
- Will auditors limit the number of KAMs communicated or will they communicate more than necessary to avoid being second-guessed?
- How will auditors deal with significant matters that a company might not have publicly disclosed?
- Will the communication of KAMs lead to boilerplate language?
- What has been the market reaction in those jurisdictions that have already adopted new-style audit reporting?
- Will the new and more informative auditor's report add significantly more time and cost to audits and the financial-reporting process?
- Is there a link between new audit reporting and quality?

Enhanced audit-reporting standards – what auditors must do

During 2016, the *GAAP Consulting* team held three GAAPinars on enhanced audit reporting during which we discussed what auditors needed to do before 15 December and after.

In the main, the former related to policies, procedures and training (see my 11 July LinkedIn article *Enhanced audit-reporting standards – 15 things to do before 15 December 2016*.) The latter relate to operational issues for individual clients.

Let me share with you those post-15-December to do's:

1. Re-issue engagement letters for financial statements audit
2. Ensure that your audit program complies with new and revised standards
3. Revise planning of financial-statement audits that should include:
 - Reassessed audit risk in light of enhanced audit reporting standards (as well as ASIC targets and findings)
 - Revised layout and wording of the audit report
 - Communication with governance
 - 'Other information' expected timing (impact on audit report)
 - Disclosures (auditing material disclosures)
 - Going concern (reconsideration of approach, disclosures and reporting)
 - KAMs (and appropriate audit procedures)
 - Timetable revision
 - Budget/fee impact of more partner/manager involvement
 - Closer partner attention to key changes
 - Hot quality control review of audit plan for compliance and risk management
4. Update audit close-out report
5. Documentation discussions with governance
6. Timely internal/external consultations on issues such as going concern and KAMs
7. Hot/cold inspection of selected audit files for compliance with new standards
8. Audit-team meeting on how we went
9. Monitor learnings from audit profession and *GAAP Consulting*, and
10. Prepare for 30 June year-end and incorporate lessons learned.

Better understanding KAMs

Chartered Accountants ANZ has released *Enhanced auditor reporting – one year on*, which analyses the use of key audit matters (KAMs) in reports that have early-adopted auditor-reporting reforms. It is a handy reference.

The reforms have revolutionised audit reports – the principal communication between auditors and users of audited financial statements and is one of the biggest changes in auditor-reporting in decades.

The most significant change requires auditors to report on KAMs and applies initially to listed entities in Australia and listed issuers in New Zealand. Although the changes are not effective until 31 December 2016, some companies and their auditors have already elected to report in accordance with the new requirements.

CA ANZ identified 28 audit reports released with KAMs before 31 August. CA ANZ has analysed them and summarised findings in a short report that looks at common KAMs and number of KAM, among other differentiating factors.

ASIC's audit-communication proposals

ASIC's consultation paper 265 *Communicating audit findings to directors, audit committees or senior managers* has profound implications for the auditor-client relationship and audit firms' risk-management processes.

Comments on the paper closed on 30 September and ASIC is yet to formalise the proposals but is expected to do so soon.

When conducting audits for 31 December reporting period end, it would be prudent to keep the principles in the consultation paper front of mind.

The ASIC Act was amended in 2012 to allow the commission to communicate specific financial-reporting and audit findings identified from reviews of audit files to directors, audit committees and senior managers of companies, responsible entities and disclosing entities. The amendment aimed to help businesses properly manage their affairs.

The commission's audit inspections and financial-reporting surveillances:

- Predominantly focus on recognition and measurement issues involving potential material misstatements of profits and net assets arising from accounting policy choices and estimates (for example, asset values) rather than disclosure issues
- Exclude matters that are within a range of reasonable judgement, and
- Exclude genuine issues relating to the interpretation of accounting and auditing standards, which may be matters for international standards-setting bodies.

The paper sets out ASIC's proposed criteria for determining which findings it would communicate and those that it wouldn't. The commission has also outlined proposals to notify an audited entity's board that it will be reviewing files as part of its routine inspections.

The proposed criteria for communicating financial-reporting and audit findings are:

- That the communication of a material misstatement will assist in timely resolution of a matter
- That a finding from a previous year has not been addressed
- A planned enforcement action
- That independence requirements have not been met, and
- There was a failure to obtain reasonable assurance that a financial report was free of material misstatement across several key audit areas.

ASIC proposes to apply these criteria to the audit files it reviews rather than reporting all findings.

The commission contends that information from its reviews of audit files may assist directors to:

- Take action to address deficiencies in an entity's financial report
- Improve systems and processes supporting financial reporting, and
- Discuss with auditors actions to improve audit quality.

If an auditor does not address deficiencies, directors can seek the firm's resignation or removal.

ASIC's proposal to notify directors of a review are intended to enable them to go direct to auditors about any issues and concerns that might arise. The commission believes that this would enable directors to ask auditors about the steps they are taking to:

- Address any issues and concerns
- Improve audit quality, and
- Support investor and market confidence in the quality of financial reports.

ASIC will also consider whether its review findings should be communicated to other regulators, such as the Australian Prudential Regulation Authority and the Australian Taxation Office.



Carmen Ridley *GAAP Consulting team leader, corporate financial reporting services*
Carmen Ridley is an expert in financial reporting who was previously Associate Director in the technical team at Grant Thornton, National Technical Director of William Buck, and author of 'Understanding and Implementing the Reduced Disclosure Regime', and leads Corporate Financial Reporting Services team. Carmen is a member of the Australian Accounting Standards Board.



Stephen Newman is a corporate and commercial lawyer who also has considerable litigation and dispute-resolution experience. He has been a partner in well-known Melbourne CBD law firms and is now with Hope Earle Lawyers. He works closely with the GAAP Consulting team in providing advice on a range of matters, including the application of the Corporations Act 2001 to audit practice, the ASX Listing Rules, the application and interpretation of the auditing and accounting standards, audit-practice risk management, fraud detection and investigation, preparation of section 311 reports to ASIC, dealing with ASIC investigations and enforcement proceedings and auditor negligence and other civil claims.

Contact Us

Should you require any further information about the services provided or our team, please contact:



Colin Parker
Principal, GAAP Consulting
Head of the GAAP Consulting Network
Email colin@gaap.com.au
Mobile 0421 088 611
Postal GPO Box 1497,
Melbourne, Victoria 3001
Website www.gaap.com.au



Stephan LaGreca
*GAAP Consulting,
Corporate financial reporting services
– Sydney*

 GAAP Consulting  GAAP Consulting  Colin Parker

This communication provides general information current at the time of release. It is not intended that the information provide advice and should not be relied on as such. Professional advice should be sought prior to actions on any of the information contained herein.


GAAP Consulting
'Excellence in Financial Reporting'

Appendix 1 – ASIC focuses for 31 December 2016 financial reports

Focus area	Explanation
Accounting estimates – impairment testing and asset values	<p>Assets 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 focus.</p> <p>Impairment considerations It is important for directors and auditors to ensure:</p> <ul style="list-style-type: none"> • 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 • Discounted cash flows are not used to determine fair value less costs of disposal 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 • Value in use calculations: use sufficiently reliable cash flow estimates; 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, and do not include cash flows from restructurings and improving or enhancing asset performance • Cash flows used are matched to carrying values of all assets that generate those cash flows, including inventories, receivables and tax balances • 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 • CGUs are not identified at too high a level, including where cash inflows for individual assets are not largely independent • 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 • Corporate costs and assets are allocated to CGUs on an appropriate basis where it is reasonable to allocate them • The impairment test in AASB 136 <i>Impairment of assets</i> is used for exploration and evaluation assets after technical feasibility and commercial viability have been demonstrated, and • Appropriate use of fair values for testing exploration and evaluation assets during the exploration and evaluation phase. <p>Extractive industries and digital disruption Particular consideration may need to be given to values of assets of companies in the extractive industries and providing support services to extractive industries as well as values of assets that may be affected by the risk of digital disruption. 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.</p> <p>Inventories Focus should also be given to the pricing, valuation and accounting for inventories, including the net realisable value of inventories, possible technical or commercial obsolescence, and the substance of pricing and rebate arrangements.</p> <p>Financial instruments Directors and auditors should focus on the valuation of financial instruments, particularly where values are not based on quoted prices or observable market data. This includes the valuation of financial instruments by financial institutions.</p>
Accounting policy choices – off-balance sheet arrangements	Directors and auditors should carefully review the treatment of off-balance sheet arrangements, the accounting for joint arrangements and disclosures relating to structured entities.
Accounting policy choices – revenue recognition	<p>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.</p> <p>This includes ensuring that:</p> <ul style="list-style-type: none"> • Services to which the revenue relates have been performed • Control of relevant goods has passed to the buyer • 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 • Assets are properly classified as financial or non-financial assets, and • Revenue is recognised on financial instruments on the basis appropriate for the class of instrument. <p>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.</p>

Focus area	Explanation
Accounting policy choices – expense deferral	<p>Directors and auditors should ensure that expenses are only deferred where:</p> <ul style="list-style-type: none"> • There is an asset as defined in the accounting standards • It is probable that future economic benefits will arise, and • The requirements of the intangibles accounting standard are met, including; expensing start-up, training, relocation and research costs, ensuring that any amounts deferred meet the requirements concerning reliable measurement, and development costs meet the six strict tests for deferral. <p>To assist users of financial reports to understand the results of an entity, items of income and expense should be included only in other comprehensive income rather than profit/loss where specifically permitted by the accounting standards.</p>
Accounting policy choices – tax accounting	<p>Tax-effect accounting can be complex, and preparers of financial reports should ensure that:</p> <ul style="list-style-type: none"> • There is a proper understanding of both the tax and accounting treatments, and how differences between the two affect tax assets, liabilities and expenses • The impact of any recent changes in legislation are considered, and • The recoverability of any deferred tax asset is appropriately reviewed.
Key disclosures – estimates and accounting policy judgements	<p>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. Directors and auditors should ensure disclosures are made and are specific to the assets, liabilities, income and expenses of the entity.</p> <p>Disclosure of key assumptions and a 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.</p> <p>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.</p> <p>Preparers should note that the key audit matter disclosures may also refer to matters that should have been discussed in the Operating and Financial Review.</p>
Key disclosures – impact of new revenue and financial instruments standards	<p>Directors and auditors should ensure that notes to the financial statements disclose the impact on future financial position and results of new requirements for recognising revenue, for valuing financial instruments, and accounting for leases.</p> <p>These new requirements will apply to future financial reports and may significantly affect how and when revenue can be recognised, the values of financial instrument (including loan provisioning and hedge accounting), and assets and liabilities relating to leases.</p>