CPA Australia Podcast

Transcript:

ASIC’s financial report surveillance program focus areas for 30 June 2017 financial reports

Introduction: Hello and welcome to the CPA Australia Podcast, your source for business, leadership, and public practise accounting information.

Ram Subramanian: Hello and welcome to the CPA Australia podcast. I'm Ram Subramanian, Policy Adviser in reporting at CPA Australia. Joining us today is Doug Niven, Senior Executive Leader for Financial Reporting and Audit at the Australian Securities and Investments Commission. On 31st of May this year, ASIC published its focus areas for the 30th of June, 2017 financial reports and Doug is here with us today to discuss ASIC's focus areas and other important initiatives of ASIC to uphold the quality of financial reporting in Australia. Welcome, Doug, and thank you for joining us today.

Doug Niven: Thank you, Ram.

Ram Subramanian: The six monthly focus areas for financial reporting published by ASIC includes common and recurring themes. Doug, looking at the recurring focus areas that have featured for some years now, could you provide some background on what these focus areas are and what is so critical about these focus areas that ASIC finds it important to highlight them time and again?

Doug Niven: Definitely, you’re right. We have had a number of recurring themes over several years now. There have been some changes from time to time, but fundamentally, some of the key themes continue. We've currently got seven areas, I won't go into detail on all of them. One is around impairment testing and asset values. I'll come back to that. Second one, revenue recognition and it'd be good to talk a little bit further about that one as well, they're probably, by the way, the areas where we've got the most findings and most inquiries, which probably gives you a clue as to why they're still on the list. I say to people, "Wouldn't it be nice one year, not to be talking about impairment?" And hopefully, that will be the case sometime soon.

But the other ones, expense deferral, we do come across issues from time to time there and obviously, a little bit the flip side of the revenue recognition. Off balance sheet arrangements, tax accounting, it is a recurring focus, but relatively new in the list as well. And so we continue to look at that area and there are some issues there, but I perhaps won't go into detail on that one. We don't generally focus so much on disclosures as recognition of measurement. We're concerned about net assets, profit, but there are some key disclosures that we've been looking at. One is around disclosures on estimates and sources of estimation uncertainty and therefore, also, the accounting policy disclosures, which are quite important disclosures for investors.

The seventh area is the impact of the new accounting standards on revenue, financial instruments, leases and more recently, the recently issued one for insurance activities. We, of course, did a podcast on that one. I think it was in December. Someone will correct me. So I won't go into detail at all on that one. But perhaps if I just go back to the impairment in asset value one. Well, I've already indicated why that continues to be on the list and within it, yes, from time to time, there are some themes that changed. There's the obvious ones we still do have issues around people being unrealistic around the future cash flows, where the business is heading, sometimes also around the reason most have key assumptions whether it's discount rates. So those continue to be issues.

We do also have the ongoing issues around mismatches in cash flow models between the cash flows and the assets and liabilities relate to those. There are some relatively new bits in there. I won't go through the whole list. Obviously, you've mentioned to me releases on the website, but some of the newer ones are around allocation of corporate costs across cash generating units where impairments tested at that cash generating unit level. We have seen cases where the costs haven't been allocated and there is a reasonable basis to allocate them and that needs to be borne in mind.

Also, perhaps a little bit more technical, but as background cash generating units, you don't want to be borrowing cash flows from one cash generating unit, one part of the business, to support the value of assets in another part of the business. For goodwill, there are criteria to actually aggregate up cash generating units for the goodwill test ... Can’t be at higher level than segments, if you're disclosing your segments. But also, a relatively new issue is around the second criterion, which is around where you monitor the goodwill, and conscious there are some emerging different views around that. It's not as simple as saying, "Well, I actually test goodwill annually and you know, I've monitored it for the company as a whole, therefore can add everything up." It doesn't work that way. You need to look at some of the underlying guidance as well. It goes down to actually how you're managing the business as well and monitoring results and not necessarily to the bottom line either.

I should also add we do look at ... Ask people to focus on particular areas, particular industries, current themes in that area, obviously extractives, given what's happening in that sector. But we've had a relatively recent theme around digital disruption and you can think about industries that are affected. We put out some more recent media releases around companies that have made adjustments following our inquiries in industries that may be affected that way as well. So, certainly worthwhile thinking about that, and again perhaps a more recent one, might sound as though it's not actually linked to impairment of assets by the way, is around restoration provisions in the extractive industries and the reason for that is, well, from when you're doing the valuations you need to look at the common cash flows and there are some interesting technical issues there, which we won't go into now.

I did say just briefly I wouldn't cover revenue recognition. Yes, we do also have issues there. Perhaps nothing terribly new. The key ones are the obvious ones if you're delivering services, why are you recognising revenue before those services are actually provided? And there are some complexities in that area, but same thing with [inaudible 00:06:57]. Has control passed and then what do you do when you've got those multi-deliverable contracts? We are also very mindful of course of the new revenue standing coming in that area as well and it is interesting. There are cases where we'll raise questions about recognition under the current standard and obviously people are thinking, hopefully thinking very much about the new revenue standard, which is coming very soon, what the treatment is under that. And not always, but quite often it's the same treatment, but that's one to be aware of as well because that revenue standing can significantly change when you recognise revenue and certainly how you go about that process.

Ram Subramanian: You're referring there to AAS 15 of course, which comes in from the first of January 2018.

Doug Niven: That's right.

Ram Subramanian: Thank you, Doug. There are a few new themes at the front of the media release. Not quite referred to as focus areas, but regardless, these are new themes. And can you just tell us a little bit about these new themes that have been put at the front of the media release?

Doug Niven: Definitely. So obviously there's seven areas that we ask people to focus on, directors, and preparers, and auditors as well. And they're very important, it's not to suggest by the way we, in our surveillances, don't look at the financial report as a whole so we can raise other matters. But there are some important themes as you say that we wanted to draw out on the front of that media release.

And very briefly just running through them, but perhaps I'll come back to one in more detail, we wanted to hide the role of directors in management in the financial reporting process and we've been doing that in other ways through information sheets and other guidance. So it is worthwhile looking at our website as well for some of that material. But in that area, we thought it was timely thinking about your earlier question, well, why do we have some of these recurring themes? And what can you do about it? So it's not just about well, let's look at it where there's an issue, but perhaps it's also important for companies, directors, management to think about their own internal processes and what can be done in this space.

So, not confined to impairment, but very much highlighting the importance of having good internal processes to support the financial reporting, good controls and procedures, monitoring appropriate experience and expertise of course, but also if you don't have the expertise, particularly smaller organisations, drawing an external expertise as well. So we thought that was important from that perspective, but also very conscious that it all comes down to, in a lot of cases also, the project management around financial reporting and also the audit process. And if you engage with some of these issues very late in the reporting process, running up against deadlines, potentially people don't give enough attention to those. And so planning ahead is really key if you've got a major new transaction or concerned about impairment, whatever it may be, go through that. Think about accounting treatment issues on a timely basis, and that helps the auditors as well. Then rather them getting too involved in perhaps the company's own processes and not seeking independent questions as well, they can focus on what they're meant to be doing as well, which is good for audit quality, not only financial reporting quality as well.

I won't go through the others in detail. We did take the opportunity to highlight the new accounting standards, which I touched on earlier, revenue financial instruments and leases, and also new insurance one, and we'll continue to remind people about that ...

Perhaps I will just say one thing on that. Each of those standard in their own right can have a very significant impact on financial reporting together, probably the biggest changes since the adoption of IFRS in 2005. We are concerned that some companies and a little bit human nature may not be planning enough for these, and it is important that people engage with them now because they have real impacts. Markets will want to know what those impacts are, but there's also system process changes and some real business impacts, but I did I say I wouldn't talk too much about that one. So I'll move on.

Also enhanced audit reports, we've been looking at those and they'll be a focus area, as they're new. Material disclose, that we do talk about, but that's not so much a focus here, it's more message about cluttering financial reports. Client moneys is a new one as well. We do have some messages around the operating and financial review specific areas in that around thinking about whether it's disclosures on climate change and cyber security, and some messages around the proprietary company side of things as well.

Ram Subramanian: Thanks, Doug. You mentioned client moneys just then and it is a new theme that's highlighted in the media release from ASIC. Can you just tell us a little bit more about what ASIC wants to see happen in this area?

Doug Niven: We have had some concerns in this area for a little bit of time and how I'll advise some matters that we've seen, some more public than others, in terms of client moneys. Yes, we put it particularly in the context of Australian financial services licencees. There certainly are other businesses, by the way, that also hold client moneys and it's important to think about it in that space as well. But we are very much concerned to make sure that client moneys, not just from a financial reporting point of view, are properly treated by organisations and, obviously there's legislative requirements in the Australian financial services licencee space, and making appropriate disclosures. And the auditor of those is very important as well.

I think in some cases it has come to our attention that perhaps there's not appropriate systems and processes behind what's happening within organisation around client moneys to ensure that they're properly applied and safeguarded and that the liability side is accounted for as well. Also in some cases there have been auditors who perhaps haven't been doing what they should be doing in relation to these client moneys and just saying, well as long as the asset and liability are the same, that should be okay. The problem of course is they may look the same, but what if they're not actually the same? What if the assets aren't there? What if the liabilities aren't properly recorded? They can be record keeping, reconciliation issues and of course if something goes wrong and there's not enough assets there, then it can all end up very badly. So it is important to focus there. There are requirements for AFS licencees themselves and also in terms of the auditor of reporting in that area.

Ram Subramanian: Thanks, Doug. You mentioned the enhanced audit reports as well earlier. Now obviously ASIC, as an overseer of the audit profession, has a big role to play there. But given the focus of this media release is on financial report preparers, how does that tie in the issue of enhanced audit reports? How does that tie into this particular field?

Doug Niven: It actually ties in, in a sense, in a few ways. One is the obvious, audit quality, supporting the quality of financial reports. And also we would expect in relation to these enhanced audit reports, which we know include the key audit matters, matters of most significance in the audit, that there should be good dialogue around those sorts of issues anyway as part of the audit reporting process with audit committees and directors. There's also two-way dialogue around risk areas that directors are sharing with the auditor as well, but there's also a direct financial reporting link. One of the things we've been very focused on, and it fits in with another one of our key themes I mentioned earlier, is the auditor may actually highlight some things that they've spent a lot of time focusing on and question whether the company itself has adequate disclosure in these areas. And one that particularly comes to mind is that disclosure that's required around sources of estimation uncertainty and having disclosed it as specific to the entity and meaningful, also the one about the difficult accounting policy choices.

So there can be overlaps, of course there may be areas where the auditors put in the effort and therefore is actually reflecting that in key audit matters. And we highlighted this before the enhanced audit reports came in, obviously. The 31 December year ends with the first time they applied. To encourage [inaudible 00:16:31] and preparers to focus on these areas and make sure there's appropriate disclosure, they can also be followed through by the way [inaudible 00:16:38] in financial review as well.

So there is that direct link and we do understand anecdotally that the process with the enhanced audit reports has encouraged better disclosure in that area. We, yes, are looking at those and will be putting out a findings meeting release in relation to our findings from reviewing the 31 December financial reports at the end of June. In that release we will have a short part just about initial observations around the enhanced audit reports. We'll be doing more as a part of our audit inspection programme and of course looking at them again at 30 June really just to see what's happening with those reports. Sure, a lot of good effort is being put in by both professionals and companies and considering the key audit matters, but we also want to ensure that bad practises don't become entrenched as well ... Little bit early because we're putting together the results, but certainly early indications are that in some cases the key audit matters aren't as helpful as they could be from the point of view boilerplate language. They're not specific to the entity. Some of the things that they're saying around how the auditor responded to them may not be very well described. So there's certainly some opportunities there for a focus by auditors as well around those key audit matters.

Ram Subramanian: Okay. There's also reference to ASIC's sort of view of financial reports of Proprietary companies. Is there any change in ASIC's approach in its oversight of Propriety companies or is the reference to this segment of the market just reaffirming ASIC's current oversight activities?

Doug Niven: Bit of both, to be honest. So with the Proprietary company population, we take a little bit of a different approach as a starting point to the list entities of public interest entities where we have a proactive programme of selecting about 300 financial reports a year, doing reviews on them, contacting companies where we've got questions and so on. With the Proprietary companies, in terms of the content of the financial reports firstly, it has tended to be in recent years more on a reactive basis, where based on complaints, intelligence and so forth we would look at a financial report and that might trigger enquiries of a company.

But also there has been a question obviously around a lodgement of financial reports by Proprietary companies. We have the large small test and questions whether every company has been lodging financial reports. And on an ongoing basis we have a programme where we've tried to identify those companies and looking at industries, thinking about what companies should be reporting. But we have more recently, we'll probably cover this in more detail in a release down the track, been getting some better information to be able to identify those companies and, obviously a big "Thank you" to the Australian taxation office in that regard, we've got a good relationship with them in terms of information sharing obviously within legislative requirements. And we've been able to get better information, which assists us in understanding the sizes of some of these entities.

So we did actually undertake a very small pilot, initially using some of that data, wrote to 50 companies to understand whether they should be lodging financial reports. That was quite successful, but also helped us refine the process a little bit in terms of which entities we contact. And we have just recently written to another 1,000 companies, so I think that will help to address some of the questions around non-lodgement and equity and so forth. Yes, we do certainly get complaints about non-lodgements of financial reports, but this will assist with the process of making sure there's transparency and useful information to use as a financial report.

I will add one other interesting matter. There are actually quite a lot of documents that are lodged with ASIC. Which document is by far the most used and accessed from our database? You probably know the answer. The answer is the financial report.

Ram Subramanian: Well, that's very, very interesting. Thank you very much for that, Doug. And you've also given us a very good overview of ASIC's focus areas for 30th of June 2017 financial reports. So thank you once again, Doug.

Doug Niven: Thank you.

Ram Subramanian: For a transcript and more information on today's podcast, please visit www.cpaaustralia.com.au/podcast.Thank you for listening.

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