‘DECLUTTERING’ YOUR FINANCIAL STATEMENTS – THE ASX TOP 100 EXPERIENCE

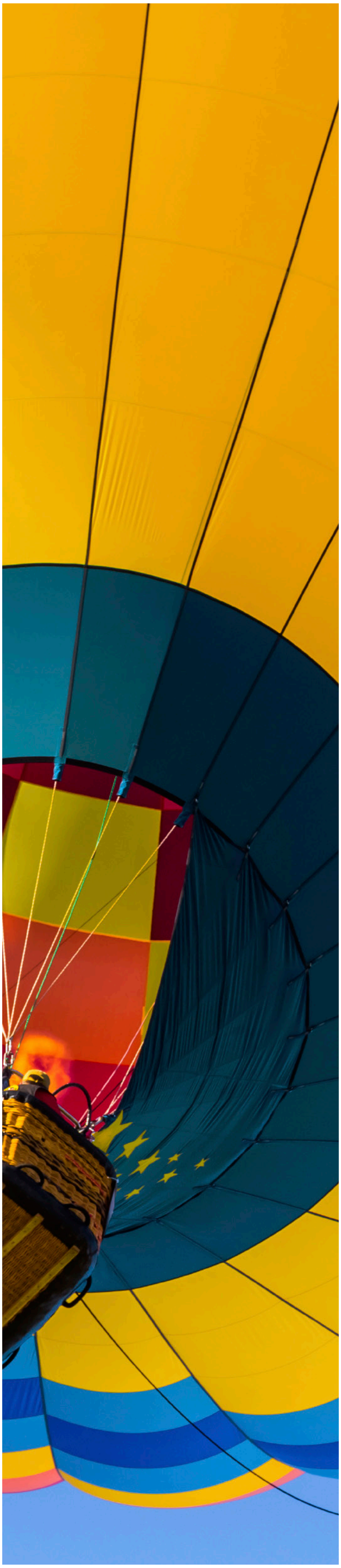
Many smaller listed and unlisted entities preparing full general purpose financial statements, may be putting off starting the ‘decluttering’ process because the task seems too daunting. In our October Accounting News we showcased an easy way for **all entities** to kick start the ‘decluttering’ process simply by critically analysing and culling all unnecessary accounting policies.

This month we will use the ASX Top 100 experience, from their 2015 annual reports, to identify additional easy steps that **all entities** can follow to further ‘declutter’ their financial statements.

What do we mean by ‘decluttering’

In January 2015, the Australian Accounting Standards Board issued AASB 2015-2 *Amendments to Australian Accounting Standards – Disclosure Initiative: Amendments to AASB 101* which clarified that:

- Notes to the financial statements only need to be included if they are material (even if they form part of a list of black-letter, mandatory disclosures)
- Notes can now be in any order and need not follow the order of the four primary financial statements. For example, notes can now be grouped by operating activities, or by how items are measured (e.g. all items at fair value)
- Balance sheet categories can be further disaggregated if this is relevant to a user's understanding of the entity's financial position (e.g. an entity with significant balances of goodwill and brand names can present each of these separately in the balance sheet to meet the requirement to disclose intangibles)
- Only significant accounting policies need to be disclosed (a laundry list (summary) is no longer required).



ASX Top 100 decluttering statistics

Decluttering by ASX Top 100 companies	
2014 annual reports	**2015 annual reports**
17%	51%

Our review of these ASX Top 100 financial reports reveals the following interesting, and encouraging, statistics:

- 51% of companies have undergone a decluttering process, compared to only 17% in 2014
- Approximately 60% of all companies had fewer pages in their 2015 annual reports compared to 2014, with about 2/3 of these companies reducing the number of pages by more than 10% from 2014
- More than half the companies had fewer notes in their 2015 financial statements than previous versions
- About a quarter of companies chose to disclose key estimates and judgements within the body of the note for the item subject to estimation or judgement (often in a box to highlight the importance).

Of the 51% of companies that have started the 'decluttering' process:

- About 80% moved most of their accounting policies into the relevant note (e.g. under a 'Recognition and measurement' section), thus eliminating superfluous accounting policies because there was no related transaction or balance. Many of these companies included overarching accounting policies either as one of the first notes, or within one of the final notes
- Approximately 15% chose to move all their existing policies to the back of the financial statements. The remaining companies retained their accounting policies up front, placed soon after the primary financial statements (e.g. as note 1 or 2)
- About 65% of companies reordered and re-grouped the notes in a more meaningful way
- Approximately 80% of companies appeared to make an attempt to remove immaterial disclosures.

The 'Four R's' - More easy steps for smaller entities to start the 'decluttering' process

The table below summarises the 'Four R's' to decluttering your financial statements, i.e. remove, reorder, re-group and re-emphasise.

Steps to improve the financial statements

Remove	• Remove unnecessary accounting policies • Tailor 'boilerplate' wording on accounting policies to suit client circumstances • Remove redundant disclosures • Remove any disclosures duplicated in multiple places • Make use of cross references.
Reorder	• Move the accounting policies to the relevant note • Move key accounting estimates and judgements to relevant note • Move key information to the beginning of the financial statements.
Re-group	• Group similar information within the same note • Group related notes together • Consider introducing sections to the financial statements.
Re-emphasise	• Highlight key changes in the financial statements • Emphasise key information • Consider use of non-technical language for certain disclosures.

Remove

Step one – Accounting policies – remove and tailor

This is the simplest place to start. Last month we demonstrated how redundant accounting policies can easily be identified and removed. This includes deleting whole policies, as well as parts of policies where the entity does not have related transactions and balances.

Many smaller listed entities, as well as unlisted entities, preparing full general purpose financial statements, are tempted to 'copy and paste' accounting policies from the most convenient model financial statements, with little thought given to the appropriateness of the model wording to the specific entity's circumstances. All accounting policies should therefore be tailored. This process is facilitated by following steps one and two of the 'reorder' process (refer discussion below).

Step two – Remove redundant disclosures

Many companies are afraid to drop disclosures from financial statements when they are no longer relevant. For example, valuation assumptions for share-based payment calculations are often seen in the notes, even after the options have vested. These can be removed two years after the options were granted, as disclosure is only required in the year of grant, and perhaps as comparatives in the following year.

Step three – Remove duplicate disclosure

Many listed entities include in their remuneration reports detailed assumptions for key management option valuations when these disclosures already appear in the notes. Australian Accounting Standards and s300A remuneration report disclosures no longer include any duplications. Therefore all duplicate disclosures should be removed.

Another example often occurs where land and buildings are revalued. We often still see old AASB 116 fair value information disclosed in the PPE note, and then being repeated in a separate fair value note with AASB 13 *Fair Value Measurement* disclosures.

Step four – Remove immaterial disclosures

Many entities include significant disclosures for transactions and balances that are not quantitatively or qualitatively material to the financial statements. These immaterial disclosures may be in the form of accounting policies, other numerical information or narrative that is superfluous to users. These immaterial disclosures should be removed as they draw the users' attention away from key information.

An example could be a company including significant disclosure for other assets and prepayments when the balances are trivial.

Reorder

Step one – Accounting policies – move to relevant note

About half of the ASX Top 100 companies moved their accounting policies into the relevant note. For example, the revenue recognition policy was moved to the 'revenue' note.

Moving all accounting policies to the relevant note, and merely keeping the 'Basis of Preparation' and sundry policies in a separate 'accounting policies' note will help with step one of the 'remove' section above (i.e. remove unnecessary accounting policies and tailor).

If you currently used an untailored laundry list of accounting policies from a model set of accounts you are likely to find that many policies will have nowhere to go. These should all be deleted.

You are also likely to find that your current policies are not adequately tailored, and do not fully explain how particular transactions and balances are recognised and measured. This is your chance to fix them. We recommend the use of plain English when tailoring accounting policies.

Step two – Key accounting estimates and judgements - move to relevant note

A quarter of the ASX Top 100 companies moved their key estimates and judgements into the relevant note in the financial statements.

Many of these companies placed this disclosure in a highlighted box within the relevant note.

Step three – Move key information to the beginning
Of the 30% of the ASX Top 100 entities that reordered and re-grouped notes, many moved performance information near the beginning of the notes. This includes having segment reporting or performance notes first. Some entities also included a **'highlights'** or **'key changes during the year'** section after the primary financial statements to give the reader a summarised view of major events that impacted the entity during the year.

Re-group

Step one – Group similar information within same note and group related notes together (including in sections)
Many entities we reviewed grouped similar items together into sections. For example, the following is one possible way of grouping notes:

- Results (this section could include segment information, revenue, expenses, income tax and EPS)
- Operating assets and liabilities (this section could include trade receivables, trade payables, PPE, intangibles and provisions)
- Capital and financing (this section could include capital risk management, dividends, equity, borrowings, derivatives and financial risk management)
- Group structure (material subsidiaries, joint ventures and associates, parent entity disclosures and deed of cross guarantee)
- Other (cash flow reconciliation, held for sale assets and discontinued operations, related parties, KMP disclosures)
- Unrecognised items (commitments and contingencies and subsequent events).

Alternatively, entities that do not wish to group notes in this way could opt instead to include similar information in the same note, e.g. all fair value disclosures, or all financial instruments in one note.

Re-emphasise

Many larger listed entities are re-emphasising key information by:

a. Highlighting changes from prior years at the front of the notes (just after the primary financial statements)
b. Emphasising key information (e.g. by putting a coloured box around 'key estimate and judgement' disclosures within the relevant note), and
c. Using non-technical language (some larger listed entities are including a 'keeping it simple' box in each note, explaining how each transaction and balance works).

While we do not expect a significant uptake on points a. and b. above by smaller entities, it is always a good idea to keep language used in financial statements simple, non-technical, and in plain English.

Initial steps that smaller entities can take

If all the steps discussed above are daunting, the following key changes can be made when drafting next year's financial statements. These key changes will significantly improve and 'declutter' your financial statements.

Remove unnecessary accounting policies	Remove duplicated and redundant disclosures	Move the accounting policies to the relevant note
Move accounting estimates and judgements to the relevant note	Remove disclosures that are old/no longer relevant	Tailor boilerplate wording

Sense of urgency - Next year's financial statements must be 'decluttered'

Preparers of financial statements should be aware that the 'decluttering' requirements apply to annual reporting periods beginning on or after 1 January 2016. This means that next year's financial statements need a revamp/rewrite if you have a 31 December reporting date, or the year after (2017) if you have a June reporting date. With this in mind, it is time to start planning NOW how you will meet these deadlines.