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Technical Accounting Alert

ASIC focus areas for 30 June 2013 financial reports

Introduction

The purpose of this Alert is to draw attention to the Australian Securities and Investments Commission's (ASIC) Media Release 13-160MR *Focuses for 30 June 2013 financial reports*, which commented on the results of ASIC reviews of financial reports for the year ended 31 December 2012 and announced its areas of focus for 30 June 2013 financial reports.

Overview

The Medial Release highlights ASIC's focus in the areas of:

1. operating and financial review
2. off-balance sheet arrangements and new standards
3. asset values and impairment testing
4. going concern
5. revenue recognition and expense deferral
6. financial instrument values
7. estimates and accounting policy judgements
8. non-IFRS financial information
9. related party disclosures
10. amortisation of intangible assets

While many of these areas are identical to the ASIC areas of focus for 31 December 2012 financial year (Media Release 12-292MR), there are a number of new inclusions to the 30 June 2013 list, namely operating and financial review in light of the recent ASIC Regulatory Guide RG 247 *Effective disclosure in an operating and financial review*, related party disclosures and amortisation of intangible assets. Furthermore, current vs. non-curent classification is no longer listed as a key area of focus (although it is mentioned in the context of 'financial instrument values').

Specific commentary is provided on the following areas:

1. Operating and financial review (OFR)

On 27 March 2013, ASIC issued RG 247 which sets out ASIC's expectation regarding the level of disclosures that listed entities will need to provide in an OFR in order to comply with section 299A(1) of *Corporations Act 2001*. RG 247 also provides ASIC's view on when/how the 'unreasonable prejudice' exemption should be applied.

In ASIC's view, the OFR forms part of the annual report and under the law should contain information that members of the entity would reasonably require to make an informed assessment of the entity's:

- operations;
- financial position; and
- business strategies and prospects for future financial years (unless the inclusion of specific information is likely to result in unreasonable prejudice to the entity).

In light of RG 247, ASIC expects directors of listed entities to ensure that the OFR for the financial year ending 30 June 2013 provides meaningful analysis and information on the underlying drivers of the financial performance and position, including relevant analysis at a segment level. The OFR should also explain the business model and strategies of the entity, and how business strategies are expected to impact on future financial performance.

ASIC does not expect forward looking information to contain numerical forecasts or the level of disclosure appearing in a prospectus. ASIC believes that any possible risk of entities being found liable for misleading or deceptive forward looking information can be dealt with by ensuring:

- the statements are properly framed as being based on the information available at the time;
- the statements have a reasonable basis; and
- there is ongoing compliance with continuous disclosure obligations when events or results overtake forward looking statements in the OFR.

For further information on RG 247, refer to our TA Alert 2013-04 *ASIC Regulatory Guide 247: Effective disclosure in an operating and financial review*.

2. Off-balance sheet arrangements and new standards

ASIC continues to make enquiries in relation to the non-consolidation of majority owned entities and the application of pre-existing and new consolidation standards. Accordingly, directors and auditors should carefully review the treatment of off-balance sheet arrangements under both the pre-existing and new consolidation standards where, for example, the entity has the majority interest and the right to benefits from another entity's activities or any underlying assets transferred to another entity.

AASB 10 *Consolidated Financial Statements*, AASB 11 *Joint Arrangements* and AASB 13 *Fair Value Measurement* apply for the first time for financial reporting periods beginning on or after 1 January 2013. The first two standards can significantly change the identification of controlled entities and accounting for joint arrangements. The third can affect aspects of the determination of fair values of financial instruments or other assets.

Where a new accounting standard has not yet been applied, AASB 108 *Accounting Policies, Changes in Accounting Estimates and Errors* requires disclosure of this fact and known or reasonably estimable information relevant to assessing the possible impact that application of the new standard will have on the entity's financial report in the period of initial application. ASIC notes that a number of entities it reviewed did not comply with this requirement.

For financial years ending on 30 June 2013, entities should provide meaningful note disclosure information about the impact of the new standards in accordance with AASB 108. ASIC believes that this disclosure should include quantitative information on the impact of the new standards. ASIC is of the view that it would be difficult to maintain that the impact of applying the new standards is not reasonably estimable given that 30 June 2013 is the end of the comparative period under those standards and that the entity will issue its 30 June 2013 financial report well into the first reporting period to which the new standards apply.

ASIC believes that it is not appropriate for entities to simply choose not to perform the necessary work. Where it is unclear as to whether an entity must be consolidated, the impact of both consolidating and not consolidating should be provided.

3. Asset values and impairment testing

ASIC continues to identify concerns regarding assessments of the recoverability of the carrying values of assets, including goodwill, other intangibles and property, plant and equipment.

As a result of ASIC inquiries, entities have made significant impairment write-downs of assets or improved their disclosures concerning impairment testing and fair values of assets. The table below summarises ASIC's particular concerns in this area:

Area of concern	ASIC comment
Mismatch of cash flows in present value calculations and assets tested	ASIC identified instances where entities have included cash flows in determining the recoverable amounts for a cash generating unit (CGU) but not compared them to the carrying values of all assets that generate those cash flows. By disregarding relevant assets, such as inventories, receivables and other items of working capital, which are realised through the cash flows used, there may appear to be headroom when there is, in fact, an impairment loss. Over the past year, entities have made substantial write downs following inquiries by ASIC in this area.

Area of concern	ASIC comment
Reasonableness of cash flows and assumptions	There continue to be cases where the cash flows and assumptions used by entities in determining recoverable amounts are not reasonable having regard to matters such as historical cash flows, the manner in which an entity is funded and market conditions. For example, ASIC identified instances where significant variances between prior period cash flow projections and actual results raised doubt about the assumptions applied in the current period. Analysis and consideration as to the impact on assumptions applied for the current year, in some cases demonstrated that the assumptions were not reasonable and supportable.
Identification of assets and cash generating units	Entities identifying CGUs at too high a level or using CGUs where cash flows for individual assets are largely independent remains a concern. The result is that cash flows from one asset or part of the business are incorrectly being used to support the carrying values of other assets.
Disclosures	Not making necessary disclosure of key assumptions underlying impairment calculations for material assets. These disclosures are important to investors and other users of financial reports given the subjectivity of the calculations.

In light of these concerns, ASIC expects directors and auditors to exercise professional scepticism and challenge the appropriateness of asset values and assumptions underlying impairment calculations, particularly in the context of current economic conditions and where prior period financial forecasts have not been met. Directors should continue to evaluate the existence of impairment indicators and assess the impact of these on their impairment testing.

It also remains important to appropriately identify assets and CGUs for impairment testing, and ensure that cash flows are matched with all of the assets supporting those cash flows.

Furthermore, disclosure of the key assumptions and associated sensitivity analysis is important to 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.

ASIC will continue to focus on entities with substantial assets held in emerging economies. Entities should also take into account any impact of the carbon tax when performing impairment testing of non-current assets.

4. Going concern

ASIC found instances where disclosures about the ability of entities to continue as a going concern were inadequate. In some cases, entities were reliant on financial support from their parent but this fact had not been disclosed, even though such information can be important to users of the financial report.

Directors need to be realistic with their assumptions about an entity's future prospects, particularly in the current environment or where the entity has continuing losses. Where an entity is assessed to be a going concern, but significant uncertainty exists, the entity must ensure that its financial report adequately discloses the uncertainty and why the directors consider the entity to be a going concern. Directors should continue to review the entity's ability to refinance maturing debt and ongoing compliance with loan covenants.

5. Revenue recognition and expense deferral

This is a reminder that 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 transaction. This includes:

- ensuring that services to which the revenue relates have been performed;
- ensuring that control of relevant goods has passed to the buyer;
- where revenue relates to both the sale of goods and the provision of related services, ensuring that revenue is appropriately allocated to the components and recognised accordingly;
- ensuring assets are properly classified as financial or non-financial assets; and
- recognising revenue on financial instruments on the basis appropriate for the class of instrument.

Similarly, directors and auditors should ensure that expenses are only deferred where:

- 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, as well as ensuring that any amounts deferred meet the requirements concerning reliable measurement.

ASIC believes that in order to assist users of financial reports to understand the results of an entity, it is important to ensure that items of income and expense are appropriately allocated between the profit and other comprehensive income.

6. Financial instrument values

ASIC expects directors and auditors to focus on the valuation of financial instruments as at 30 June 2013, particularly where the value relies on assumptions that are not based on quoted prices or observable market data. Assumptions should be supportable having regard to the nature of the financial instrument and the current economic conditions.

Furthermore, the methods and significant assumptions used to value financial instruments should be adequately disclosed. Directors should also focus on the classification of assets and liabilities between current and non-current.

Regard should also be given to AASB 13 *Fair Value Measurement*, which is mandatory for financial reporting periods beginning on or after 1 January 2013.

7. Estimates and accounting policy judgements

ASIC continues to identify inadequate disclosures regarding sources of estimation uncertainty and significant judgements in applying accounting policies.

In ASIC's view, disclosures in this area are important to allow users of the financial report to assess the reported financial position and performance of an entity with all relevant and necessary information. Accordingly, directors and auditors should review the disclosures in 30 June 2013 financial reports to ensure the necessary disclosures are made and are specific to the assets, liabilities, income and expenses of the entity.

8. Non-IFRS financial information

ASIC notes that the vast majority of entities it reviewed had followed the guidance in Regulatory Guide RG 230 *Disclosing non-IFRS financial information*. However, it found that a small number of entities:

- described items of expense as 'one-off' or 'non-recurring', even though they are inherent to the entity's business and occur every year or can be reasonably expected to recur;
- gave greater prominence to non-IFRS financial information in market announcements, investor and analyst presentations, and/or related media releases; and
- did not disclose whether the non-IFRS financial information had been subject to audit or review.

Following inquiries by ASIC, the entities concerned agreed to improve their disclosures.

At 30 June 2013, directors should continue to review their use of non-IFRS financial information against RG 230.

9. Related party disclosures

ASIC expects directors and auditors to ensure that related party disclosures are made in accordance with AASB 124 *Related Party Disclosures*. This information can assist investors in understanding the impact of related party transactions on the entity's financial performance and financial position, as well as the accountability of directors and management. This includes disclosing any relevant information on whether the transactions are on an arm's length basis, and any terms and conditions.

10. Amortisation of intangible assets

ASIC identified a small number of entities that did not amortise intangible assets with defined useful lives under agreements. While the assets had not yet generated any revenue, they were available for use. Amortisation should take place as the benefits of an intangible asset are consumed by the entity, which may not be the same as the period over which revenue is earned.

At 30 June 2013, directors and auditors should review the amortisation periods and methods applied for intangible assets.

Other matters

As part of the release of its focus areas for 30 June 2013, ASIC has also published the findings from its review of the 30 June 2013 and 31 December 2012 financial reports of 200 proprietary companies. For more details, please refer to Attachment 2 to Media Release 13-160MR *Findings for financial reports of proprietary companies*.

Further information

For further information on any of the information included in this TA alert, please contact your local Grant Thornton Australia contact or a member of the National Audit Support team at NAS@grantthornton.com.au.