

# Technical Accounting Alert

## ASIC Financial Reporting Surveillance Programme

### Introduction

The purpose of this alert is to summarise matters arising from ASIC's review of 30 June 2008 financial reports, and to provide guidance to entities with 31 December 2008 reporting dates on areas of ASIC focus in the future.

ASIC expects to release review results every six months going forward to encourage timely improvements in financial reporting.

### Overview

Overall ASIC found that of the 30 June 2008 financial reports it reviewed, most complied with required market disclosures; however a number of areas for improvement were highlighted.

The following is a summary of the key findings of the review, including guidance for the December 2008 reporting period on these areas.

#### 1. Going Concern

In light of current market conditions, it was noted that directors should continue to focus on whether the use of the going concern assumption is still appropriate as a basis for preparing the financial report. With this in mind, directors should also be considering the effects of reduced liquidity and whether the entity has the ability to refinance debt or raise new funds, as well as compliance with any related lending covenants.

#### 2. Impairment of assets

It was also noted that write-downs of intangible assets at 30 June 2008 were less than one per cent of the total value of the related asset at balance date. Due to current market conditions, both locally and overseas, ASIC expects to see further write-downs of such assets in future reporting periods.

There were also a number of instances of non-compliance with required disclosures including the disclosure of:

- the discount rates and growth rates used in value-in-use calculations;
- explanations where entities are using forecast periods of greater than five years; and
- a sensitivity analysis in relation to changes in key assumptions.

It is important that entities have robust impairment review processes in place so as to provide investors with confidence in reported asset values.

In relation to impairment testing of cash generating units ("CGU's"), directors' are reminded that CGU's should be identified at sufficiently low levels in entities' businesses. Where units are identified at lower levels, there are potentially greater impairment losses, as the operations of one unit cannot be used to support the values of assets in other units.

### **3. Determining fair values**

Of the entities reviewed at 30 June 2008, it was found that \$187 billion of assets were carried at fair values. These assets included infrastructure assets, investment properties and financial instruments. Financial instruments at fair value were most significant for banks and insurance companies.

Interestingly, a significant number of the reported fair values were determined using director's valuations, and it was ASIC's view that additional disclosures should have been made in the financial report relating to the methods and significant assumptions used, including whether the fair value was supported by market evidence, and if not a disclosure of the other factors used.

It was acknowledged that some entities have made greater use of models to value financial instruments in the current year, however in order to further assist financial report users, entities should make maximum use of appropriate market-based information and fully disclose methods and assumptions in the financial report.

### **4. Off balance sheet arrangements**

As with the previous review, it has again been noted that some entities indicated in their financial reports and other public information that off balance sheet arrangements existed. Where this was the case, the financial reports provided no explanation regarding the nature and scale of these arrangements or reasons why these arrangements were not recognised on the balance sheet.

Further, ASIC will be seeking explanations from certain entities where equity accounting has been applied rather consolidation where the ownership interest is close to 50 per cent and other ownership interests are diversely held.

### **5. New financial instrument disclosures**

ASIC noted that minimal and at times generic financial instrument disclosures were provided; and that disclosures did not provide any insight on how an entity managed risks specifically related to their financial instruments.

It was noted that certain financial instrument disclosures did not indicate the extent of use of financial instruments by entities. Some examples include the omission of quantitative measure of risk disclosures, the provision of risk and hedging disclosures on a net basis rather than a gross basis, and that there was no information on exposures to notional underlying amounts under derivatives.

Further, a number of entities did not meet specific detailed AASB 7 disclosure requirements, resulting in:

- lack of information about security provided on borrowings;
- poor disclosure of debt maturity profiles;
- insufficient disclosure of risks associated with financial instruments; and
- poor disclosure of hedging arrangements.

### **Areas of note for December 2008 reporting periods**

As a result of the review of June 2008 financial reports, ASIC has highlighted the following as being of particular importance for December 2008 reporting periods.

- There should be an increasing focus of the impairment of intangible assets and other assets not reported at fair values (including relatively recently acquired assets);
- Directors should also continue to focus on the use of market information in determining fair value, including exposure to changes in the values of assets held by sponsored defined benefit superannuation funds.
- Directors must ensure they fully understand the risks and benefits relating to off balance sheet arrangements, giving regard to the risks that could flow under future adverse economic and market conditions when determining whether such arrangements should be on balance sheet.
- The adequacy of financial instrument disclosures must be reviewed each year, focussing on the needs of external financial report readers. Financial risks, fair values and assumptions change rapidly in current market conditions. We can expect users to pay particular attention to AASB 7 disclosures in the coming reporting periods.
- ASIC will also be focused on the impact of subsequent market movements on asset values in the context of continuous disclosure obligations.

### **Further information**

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