TA Alert 2021-10
December 2021

# Technical Accounting Alert

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## ASIC findings from review of 30 June 2021 financial reports

### Introduction

The purpose of this Alert is to draw attention to the Australian Securities and Investments Commission's (ASIC) Media Release 21-354MR *ASIC review of 30 June 2021 financial reports*, announcing the results of ASIC's inspections of 150 listed entities.

This is a timely reminder for entities and their auditors who are currently in the process of preparing 31 December 2021 financial statements.

ASIC has specifically commented on the asset values and disclosures of business risks in the COVID-19 environment, acknowledge that whilst many companies have continued to make useful and meaningful disclosures as COVID-19 conditions evolve, some entities did not appear to give sufficient attention to the reporting of asset values and the disclosure of business risks in the Operating and Financial Review.

As many entities continue to face uncertainties about the future economic and market conditions due to COVID, disclosure of assumptions is key in this context. ASIC will continue to make inquiries where companies have made unrealistic and unsupportable assumption about future cash flows, and where disclosures did not clearly identify the impacts of COVID-19 conditions on the business.

### Overview

ASIC's findings categories are largely in line with its focus areas for 30 June 2021 financial reports in COVID conditions (refer to TA 2021-07). The findings are divided into ten broad categories, with specific commentary below on each:

1 Impairment

2 Expected credit losses on loans and receivables

3 Operating and financial review

4 Revenue recognition

5 Tax accounting

6 Expense deferral

7 Business combinations

8 Borrowings

9 Provisions

## Additional detail

### 1 Impairment

ASIC's inquiries on assessments of the recoverability of the carrying values of assets, including goodwill, other intangibles, and property, plant and equipment include:

(a) 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 or supportable having regard to matters such as historical trading results and the impact of and uncertainties due to COVID-19 conditions.

(b) Disclosures: ASIC still finds some entities that are not making the necessary disclosure of:

- key assumptions, including discount rates and growth rates;
- for fair value less costs to dispose, the valuation techniques and inputs used; and
- the events and circumstances leading to a reversal of previous impairment losses, including key assumptions.

These disclosures are important to investors and other users of financial reports given the subjectivity of these calculations/assessments. They enable users 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.

This item includes matters arising from the finalisation of impairment matters identified in our reviews of 31 December 2020 financial reports.

### 2 Expected credit losses on loans and receivables

ASIC made three inquiries in relation to expected credit losses (ECLs) on loans and receivables. In one case, we have inquired into the entity's approach to estimating ECL on its portfolio of invoice finance receivables. This includes the treatment of reassignment arrangements, and how forward-looking assumptions address the impacts of COVID-19.

### 3 Operating and financial review

ASIC raised several inquiries with entities about the adequacy of disclosure of risks to a company's strategy and future financial prospects outlined in their operating and financial review (OFR) (refer to 21-354MR).

### 4 Revenue recognition

ASIC made inquiries of six entities about revenue recognition. In one instance, we inquired about the timing of revenue recognition for the online sale of goods and whether control had passed to the customer at the time of dispatch. In another case, ASIC made inquiries about the nature and recognition of various fees for providing finance.

ASIC also inquired of an entity about whether labour hire services were provided as principal or agent. This matter was resolved with no changes to the financial report following further information and explanations from the entity.

### 5 Tax accounting

ASIC made inquiries of six entities on their accounting for income tax, including whether it is probable that future taxable income will be sufficient to recover deferred tax assets for tax losses. In one case, it appears that the use of tax losses relies on longer-term forecasts. In another case, there is a deferred tax asset for tax losses, despite a history of losses and a small current year profit supported by COVID-19 government assistance..

### 6 Expense deferral

ASIC made an inquiry about an entity's treatment of prepaid costs under an agreement for certain expenditure over a five-year period. The amount of prepaid costs increased significantly from the prior year and there was minimal disclosure about the arrangement. The company has committed to improving its disclosure of the arrangement in future financial reports.

ASIC also made inquiries of three entities on their response to the March 2021 IFRS Interpretations Committee agenda decision related to cloud computing costs for customers under Software as a Service arrangements. In one matter, the entity had increased software intangible assets but did not disclose whether the agenda decision could result in a material amount of capital costs being derecognised.

### 7 Business combinations

ASIC made inquiries into two matters related to acquisition accounting. In one instance, most of the consideration paid was attributed to goodwill and we are inquiring about the nature of the business that has been acquired. The other instance was resolved with no changes to the financial report following further information and explanations from the company.

### 8 Borrowings

ASIC made inquiries of two entities about their borrowing arrangements. An entity had erroneously classified unsecured debt maturing within 12 months of year end as non-current. The other inquiry relates to the classification of a convertible note as a liability, despite terms of the instrument indicating that there may be an equity component.

### 9 Provisions

ASIC made inquiries of two entities on the adequacy of make good provisions for leased properties in their 30 June 2020 financial reports. Both entities made adjustments in their June 2021 financial reports.

## Material changes

When a company makes material changes to information previously provided to the market following inquiries made by ASIC, ASIC makes a public announcement. In addition to improving the level of market transparency, these announcements are intended to make directors and auditors of other companies aware of ASIC's concerns so they can avoid similar issues.

## Other matters

Given the impact of COVID-19 on businesses, ASIC reminds directors and auditors to focus on impairment of assets in financial reports to ensure the market is properly informed about asset values and expected future performance implied by those values.

## Further information

If you wish to discuss any of the information included in this Technical Accounting Alert, please get in touch with your Grant Thornton Relationship Partner or a member of the Financial Reporting Advisory team at FRA@au.gt.com.