Grant Thornton

Technical Accounting Alert

ASIC's financial statement review and areas of focus for 30 June 2010

Introduction

The purpose of this alert is to provide details of the ASIC media release regarding the reviews performed on 31 December 2009 financial statements and suggested areas of focus for entities preparing 30 June 2010 financial statements.

Overview

ASIC reviewed 31 December 2009 financial reports for 130 entities, comprising 70 full year reports and 60 half year reports. ASIC intends to review the 30 June 2010 financial reports of 350 entities identified for scrutiny, including 250 listed entities and 100 unlisted entities with large numbers of users.

Based on the review of the 31 December 2009 financial reports and consideration of the current economic and business climate; ASIC has identified a number of key areas for continued focus for entities.

These have been summarised in this alert and further detail can be found by clicking on the link to the ASIC media release in the source reference section.

Focus areas

Going concern

There has been some reduction in the number of audit reports containing an emphasis of matter paragraph drawing attention to uncertainties concerning the ability of the entity to continue as a going concern, however uncertainty remains over the future economic climate in which many Australian entities operate.

The appropriateness of the going concern assumption in the preparation of financial reports continues to be an important area of focus. There are indications that credit may still be tight for some entities, entities should focus on the ability to refinance debt within the next 12 months and beyond. Entities should also review compliance with lending covenants.

Asset impairment

Writedowns were 5% of the total value of indefinite life intangible assets (including goodwill) for the 12 months to 31 December 2009, whereas writedowns were 11% of thte total value of indefinite life intangible assets (including goodwill) for the 12 months to 30 June 2009.

ASIC's experience is that impairment testing in one of the most difficult areas of financial report preparation for entities. A number of issues of compliance with AASB 136 *Impairment of Assets* identified in previous reviews continued to be prevalent at 31 December 2009. The most common of these were that:

- Unrealistically optimistic discount and growth rates were used.
- Cash flows were projected for more that five years in value in use calculations without any explanation justifying the longer period.
- Cash-generating units used for testing goodwill impairment, were not chosen at a sufficiently low level. For example, some CGUs were larger than the segments disclosed in the entity's segment reporting note.
- No sensitivity analysis disclosed for changes in key assumptions.
- A lack of disclosure of assumptions used in DCF calculations, particularly growth rates and discount rates.

Directors should continue to focus on asset values at 30 June 2010. Directors and audit committees have a key role in reviewing the appropriateness of cash flow projections, growth and discount rates, and other key assumptions. Given the complexity of this area, it is very important that directors employ an appropriate level of internal and external expertise.

Fair value of assets

Investment property

ASIC's review of financial reports for the year ended 31 December 2009 found that writedown of investment properties accounted for 8% of the carrying value of the properties, compared to the 12% noted during the review of the 30 June 2009 financial reports.

Entities should ensure that values reflect current market conditions and are properly supported.

Financial assets

Financial assets at fair value should be based on the best available market information. Where quoted prices in active markets are genuinely not available, fair values should be determined with the maximum use of market inputs and key assumptions should be disclosed appropriately. The disclosures required include the extent to which quoted prices or observable and non-observable market data are used in the measurement in accordance with AASB 7 *Financial Instruments: Disclosures* three level 'fair value hierarchy'.

Intangible assets

ASIC's review indicated some entities were carrying intangible assets at fair value in circumstances where it may not have been appropriate to do so.

Entities that are carrying intangible assets at fair value should review the basis for that treatment as ASIC has not yet seen intangible assets in Australia that would meet the criteria for fair value. Examples of intangible assets where the measurement basis has been challenged by ASIC are water rights, bed licences and liqor and gaming licenses.

Off balance sheet exposures

ASIC recently identified a couple of cases where entities should have consolidated other entities or should have included assets and liabilities that had been left off their balance sheet.

Directors and audit committees should carefully review any off-balance sheet arrangements to ensure that they are correctly treated – where arrangements remain off balance sheet, the nature and scale of the arrangements should be disclosed, together with the reason why they are not on balance sheet.

Financial instruments

Entities should ensure that there is sufficient disclosure to enable users of financial reports to evaluate the nature and extent of risks arising from finanicial instruments. For example, the review of 31 December 2009 financial statements found a number of entities not disclosing debt maturities for liabilities subject to floating interest rates (which is required under AASB 7), such disclosure is important for users of financial statements to enable them to assess an entity's exposure to interest rate risk.

AASB 9 *Financial Instruments* was released in late 2009, it represents the first phase of a three phase project to revise AASB 139 *Recognition and Measurement*. Although AASB 9 is not mandatory till 2013, it is available for early adoption in the preparation of 30 June 2010 financial statements. Entities who choose to early adopt this standard should ensure:

- they have correctly applied the transition provisions in the standard;
- where financial assets are measured at amortised cost, the classification is appropriate; and
- gains and losses on financial assets carried at fair value are correctly classified between income and expenses included in profit and loss and in other comprehensive income.

Current vs non-current classifications

The correct classification of liabilities and assets between current and non-current is important to an understanding of the financial position of an entity.

Directors and audit committees should ensure that there are appropriate processes to ensure the correct classification having regard to their knowledge of the business and its funding.

Other issues related to current market conditions

These include:

- failure to disclose significant judgements in applying accounting policies
- failure to disclose key assumptions and sources of estimation uncertainty
- inappropriate revenue recognition and expense recognition
- failure to disclose subsequent events

Non-statutory profits

ASIC reviewed 50 profit announcements of listed entities and found that 78% disclosed an alternative profit measure, with 11% of listed entities including alternative profit measures in their financial statements.

The financial statements should not include alternative profit measures. Disclosure of alternative profit measures in profit announcements should not be misleading and should not be given undue prominence compared to the statutory profit. If an alternative profit measure is presented there should also be a reconciliation to the statutory profit with explanations of adjustments.

Operating and financial review

At 30 June 2010 ASIC encourages directors to focus on the quality of the operating and financial review included in their annual reports. The Corporations Act 2001 requires listed public companies to provide information that members of the company would reasonably require to make an informed assessment of the operations and financial position, as well as business strategies and its prospects for future financial years.

Segment reporting

A new accounting standard, AASB 8 *Operating Segments*, applies to 30 June 2010 financial statements and results in changes to the segments reported by some entities. Entities should ensure they are appropriately complying with the new requirements of the standard, especially ensuring that the segments reported in the financial statements reflect the segments reported internally to the chief operating decision maker.

Financial statement disclosure

ASIC will be reviewing financial statements to ensure compliance with the revised AASB 101 *Presentation of Financial Statements*, including the correct classification of items between profit and loss and other comprehensive income.

Business combinations

As a result of the recent increase in the number of acquisitions and the revisions made to the business combinations and consolidation accounting standards, directors and auditors should focus on the accounting for these transactions. Special attention should be given to reverse acquisitions and common control transactions.

Employee share plan loans

The review of 31 December 2009 financial statements identified some entities accounting for non-recourse loans provided to employees to buy shares in the entity as financial assets. Although the accounting for these loans will depend on the individual circumstances, the loans may represent options in substance, where this is the case the accounting treatment should reflect this.

Source reference

ASIC media release 10-147

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