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Technical Accounting Alert

ASIC's financial statement review and areas of focus for 31 December 2010

Introduction

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

Overview

ASIC reviewed 30 June 2010 financial reports for 250 listed and 100 unlisted entities which had a large number of users of their financial reports. In current economic conditions, these reviews continued to focus on areas including going concern assumptions, asset impairments and fair values of assets.

A new area of focus for ASIC this year was the reporting of performance. ASIC reviewed the quality of the Operating and Financial Review section of the annual report and the use of non-statutory financial information for 50 of the top 200 listed companies. For the full 350 entities, ASIC reviewed the segment reporting disclosures and the classification of items within total comprehensive income. These will again be key focus areas for 31 December 2010 financial reports. ASIC intends to review the financial reports of 130 listed entities for years ending 31 December 2010.

These focus areas 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.

(1) Reporting Performance and Business Drivers

a. Operating and Financial Review (OFR)

Many listed companies provided what they considered to be minimum disclosures, but which would not appear to comply with the obligation to provide information members would reasonably require. The OFR often lacked information and explanations that would provide users with an understanding of the drivers of an entity's performance.

b. Alternative Profits

The Corporations Act and accounting standards restrict the use of alternative financial statements and profit measures in financial reports. There is more flexibility in market announcements, but there is a statutory requirement to ensure that these disclosures are not misleading.

c. Segment Reporting

Directors must have regard to the core principle in AASB 8 'Operating Segments' that requires entities to disclose information enabling users to evaluate the nature and financial effects of the business activities in which the entities engage and the economic environments in which they operate. Entities should review whether to reconsider whether the segments they are proposing to disclose in their upcoming financial reports meet the requirements of AASB 8.

(2) Control and Significant Influence

a. Control and Significant Influence

ASIC identified a number of instances where an entity holds more than a 50% interest in another entity but does not consolidate the investee. In some cases, the entity has an economic interest greater than 80% but claims that it does not have control. ASIC is currently reviewing these cases, but is concerned that there are some cases where non-consolidation seems to be based on the ability of another party to make one type of decision that would not seem to impact on control. ASIC is also making enquiries of some entities that hold an ownership interest of between 20% and 50% in another entity but have not equity accounted their investment, claiming that there is no significant influence over the investee. The substance of all investor/investee relationships needs to be considered in determining whether significant. influence exists.

b. Off-balance sheet Investments

Directors and audit committees should continue to monitor off-balance sheet investments to ensure the treatment is appropriate. Where arrangements remain off balance sheet, the details of the arrangements should be disclosed, together with the reasons why they are not on balance sheet.

(3) Current Market Conditions

a. Going Concern

The question of whether the going concern assumption is appropriate remains an important issue. Entities should continue to focus on their financing arrangements, particularly their compliance with lending covenants and their ability to refinance debt due for repayment.

b. Asset Impairment

Impairment testing continues to be a troublesome area for entities and their directors; common issues identified included: the use of unrealistically optimistic discount and growth rates; flawed discounted cash flow methodology; the failure to disclose carrying amounts allocated to each CGU and the basis for determining recoverable amount; a lack of disclosure of assumptions used in DCF calculations; and no sensitivity analysis disclosed for changes in key assumptions. The assumptions used in impairment testing must be reasonable and supportable, and the correct methodology applied. If necessary expertise is not available internally, directors should ensure that appropriate external resources are utilised to meet the impairment testing requirements.

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c. Fair Value of Assets

A number of entities carrying investment properties at fair value failed to appropriately disclose the methods and significant assumptions applied in determining the fair values.

d. Financial Assets at Fair Value

These should be valued by reference to quoted prices in active markets, including most ASX-listed securities. A careful assessment should be made as to whether or not there is an active market. Where there is an inactive market, fair values should be determined with the maximum use of market inputs, and key assumptions should be disclosed.

e. Financial Instrument Disclosures

Entities should make adequate disclosures to enable users of financial reports to understand and evaluate the nature and extent of the specific market, credit and liquidity risks associated with its use of financial instruments. Disclosures should be meaningful to users, and specific disclosures should be made rather than boilerplate disclosures.

f. 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 and should review the classification having regard to their knowledge of the business and its funding.

g. Disclosures for Estimates and Accounting Policy Judgements

AASB 101 'Presentation of Financial Statements' requires entities to disclose significant judgements in applying accounting policies and sources of estimation uncertainty. These disclosures should be specific to the entity and its assets, liabilities, equity, income and expenses.

(4) Other Matters

a. Business Combinations

With a recent increase in the number of acquisitions, and relatively new business combination and consolidation accounting standards, directors and auditors should focus on the accounting for these transactions, including appropriate treatments of reverse acquisitions and common control transactions.

b. Debt vs Equity

Directors and auditors should ensure that financial instruments classified as equity are correctly classified when there are indications the substance of the transaction might be debt.

c. Other Comprehensive Income

Directors and auditors should ensure the correct classification of items between profit and loss and other comprehensive income; and

d. Providing Information, Explanations and Assistance to Auditors:

Information was withheld from the auditors of two separate entities on the basis that the information was confidential. Confidentiality agreements or concerns do not override the requirements of the Corporations Act for officers to provide the auditors with the information, explanations or other assistance they require for the purposes of an audit or review. Where auditors become aware that information has not been provided, they should consider how that affects their audit opinion and whether there is a need to report a suspected contravention of the Corporations Act to ASIC.

Source reference

ASIC media release 10-282AD

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