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Technical Accounting Alert

ASIC's financial statement review and areas of focus for 30 June 2011

Introduction

The purpose of this alert is to provide details of the ASIC media release regarding the reviews performed on 31 December 2010 financial statements and suggested areas of focus for entities preparing 30 June 2011 financial statements.

Overview

ASIC reviewed 31 December 2010 annual financial reports and related disclosures for 130 listed entities. Segment reporting, consolidation of controlled entities and asset impairment are some of the continuing areas of focus for ASIC for 30 June 2011 following this recent financial report review.

ASIC continued its focus on 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 of 130 listed companies.

Other areas of focus that ASIC has highlighted from this review for 30 June 2011 are:

- Use of going concern assumption;
- Fair value of financial assets;
- Financial instrument disclosures;
- Disclosures of estimates and accounting policy judgements;
- Accounting for business combinations; and
- Related party disclosures.

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.

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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.

In addition, directors need to ensure those segments are presented on a consistent basis from period to period. Where there is a change in continuing segments, the reasons for the change and comparable prior period information should also be presented.

(2) Control and Significant Influence

ASIC continued to identify cases where reporting entities have not consolidated their controlled entities even though the ownership interest has been as high as 90%. Directors should have regard to the overall substance of such arrangements in determining whether there is control.

In addition, the overall substance of all investor/investee relationships needs to be considered in determining whether significant influence exists, and equity accounting is required.

(3) Current Market Conditions

a. Going Concern

The question of whether the going concern assumption is appropriate remains an important issue. Where material uncertainties exist that may cast significant doubt upon an entity's ability to continue as a going concern, those uncertainities must be disclosed. Entities should continue to focus on their ability to refinance debt due for repayment and any foreseeable increases in the cost of borrowing.

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; the allocation of goodwill to CGUs; 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. Financial Assets at Fair Value

A number of financial reports reviewed:-

(1) did not contain the required disclosure of fair value measurements of financial assets and liabilities using a three level 'fair value hierarchy' that reflects the extent to which quoted prices or observable and non-observable market data are used in the measurement.

(2) failed to disclose the methods and assumptions they used to determine fair values of financial assets.

(3) failed to disclose an ageing analysis of financial assets that are past due but not impaired, or an analysis of financial assets that are individually determined to be impaired.

d. 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.

e. 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 continued increase in the number of acquisitions, directors and auditors should focus on the accounting for these transactions, including appropriate treatments of reverse acquisitions, common control transactions and transaction costs, as well as the appropriateness of purchase price allocations.

b. Related Party Disclosures

Understanding the impact on financial position and performance of related parties and transactions and balances with such parties is important to investors and other users of financial reports. Directors should ensure compliance with the disclosure requirements for the financial report under accounting standards and for the directors' report under the Corporations Act 2001 (the Corporations Act).

Source reference

ASIC media release 11-139MR

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