Technical Accounting Alert

ASIC focus areas for 30 June 2015 financial reports

Introduction

The purpose of this Alert is to draw attention to the Australian Securities and Investments Commission's (ASIC) Media Release 15-139MR *Focus areas for 30 June 2015 financial reports*, which outlines ASIC's areas of focus for 30 June 2015 financial reports of listed entities and other entities of public interest with many stakeholders.

Overview

The Media Release highlights ASIC's focus in the areas of:

1 Impairment testing and asset values
2 Off-balance sheet arrangements
3 Revenue recognition
4 Expense deferral
5 Tax accounting
6 Estimates and accounting policy judgements
7 Impact of new revenue and financial instrument standards

These areas are identical to the ASIC areas of focus for 31 December 2014 financial year (TA Alert 2014-14), except the following differences:

Revised areas	Deleted areas
• 'Off-balance sheet arrangements and new standards' changed to 'off-balance sheet arrangements' • 'Impact of new revenue standard' changed to 'impact of new revenue and financial instrument standards'	• Amortisation of intangible assets

Specific commentary is provided on the following areas:

Accounting estimates

1 Impairment testing and asset values

The recoverability of the carrying amounts of assets such as goodwill, other intangibles and property, plant and equipment continues to be an important area of ASIC's focus.

Directors and auditors are urged to ensure that:

a Cash flows and assumptions are reasonable having regard to matters such as historical cash flows, economic and market conditions, and funding costs. Where prior period cash flow projections have not been met, careful consideration should be given to whether current assumptions are reasonable and supportable.

b Discounted cash flows are not used to determine fair value less costs to sell where forecasts and assumptions are not reliable. Fair value less costs to sell should not be viewed as a means to use unreliable estimates that could not be used under a value in use model.

c Value in use calculations:

i Use sufficiently reliable cash flow estimates

ii Do not use increasing cash flows after five (5) years that exceed long term average growth rates, and without taking into account offsetting impacts on discount rates

iii Do not include cash flows from restructurings and improving or enhancing asset performance.

d Cash flows used are matched to carrying values of all assets that generate those cash flows, including inventories, receivables and tax balances.

e Different discount rates are used for cash generating units (CGUs) where the risks are different and the CGUs are located in different countries, and that similar discount rates are used where the risks are similar.

f CGUs are not identified at too high a level, including where cash inflows for individual assets are not largely independent. CGUs must not be at a higher level than the operating segments.

g The impairment test in AASB 136 *Impairment of Assets* is used for exploration and evaluation assets after technical feasibility and commercial viability have been demonstrated.

Particular consideration may need to be given to values of assets of companies in the extractive industries or providing support services to extractive industries, as well as values of assets that may be affected by the risk of digital disruption.

Directors and auditors are also urged to focus on the valuation of financial instruments, particularly where values are not based on quoted prices or observable market data. This includes the valuation of financial instruments by financial institutions.

Accounting policy choices

2 Off-balance sheet arrangements

Directors and auditors are advised to carefully review the treatment of off-balance sheet arrangements, the accounting for joint arrangements and disclosures relating to structured entities, and ensure compliance with AASB 10 *Consolidated Financial Statements*, AASB 11 *Joint Arrangements* and AASB 12 *Disclosure of Interests in Other Entities*.

3 Revenue recognition

This is a reminder that directors and auditors should review an entity's revenue recognition policies to ensure that revenue is recognised in accordance with the substance of the underlying transaction. This includes ensuring that:

a Services to which the revenue relates have been performed
b Control of relevant goods has passed to the buyer
c Where revenue relates to both the sale of goods and the provision of related services, revenue is appropriately allocated to the components and recognised accordingly
d Assets are property classified as financial or non-financial assets
e Revenue is recognised on financial instruments on the basis appropriate for the class of instrument

The appropriate timing of revenue recognition may also need careful consideration in industries with complex sale and licensing arrangements that may include continuing obligations, such as software providers.

4 Expense deferral

Directors and auditors are advised to ensure that expenses are only deferred where:

a There is an asset as defined in accounting standards
b It is probable that future economic benefits will arise
c The requirements of AASB 138 *Intangible Assets* are met, including:
 i Expensing start-up, training, relocation and research costs
 ii Ensuring that any amounts deferred meet the requirements concerning reliable measurement
 iii Development costs meet the six strict tests for deferral in paragraph 57 of AASB 138.

ASIC believes that, in order to assist users of financial reports to understand the results of an entity, it is important to ensure that items of income and expense are only included in other comprehensive income rather than in profit/loss where specifically permitted by accounting standards.

5 Tax accounting

ASIC notes that tax effect accounting can be complex and preparers of financial reports should ensure that:

a There is a proper understanding of both the tax and accounting treatments, and how differences between the two affect tax assets, liabilities and expenses
b The impact of any recent changes in legislation are considered
c The recoverability of any deferred tax asset is appropriately reviewed

Key disclosures

6 Estimates and accounting policy judgements

ASIC continues to identify inadequate disclosures regarding sources of estimation uncertainty and significant judgements in applying accounting policies.

Disclosures regarding sources of estimation uncertainty and significant judgements in applying accounting policies are important to allow users of the financial report to assess the reported financial position and performance of an entity. Accordingly, directors and auditors are urged to review the disclosures to ensure the necessary disclosures are made and are specific to the assets, liabilities, income and expenses of the entity.

ASIC also notes that disclosure of key assumptions and sensitivity analysis are important. These enable users of the financial report 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.

7 Impact of new revenue and financial instrument standards

Where a new accounting standard has not yet been applied, AASB 108 *Accounting Policies, Changes in Accounting Estimates and Errors* requires disclosure of this fact and known or reasonably estimable information relevant to assessing the possible impact that application of the new standard will have on the entity's financial report in the period of initial application.

ASIC states that directors and auditors should ensure that notes to the financial statements disclose the impact on future financial position and results of new requirements for recognising revenue (AASB 15 *Revenue from Contracts with Customers*) and for valuing financial instruments (AASB 9 *Financial Instruments* (2014)). These new requirements will apply to future financial reports and may significantly affect how and when revenue can be recognised, and the values of financial instruments (including loan provisioning and hedge accounting).

Where a more detailed assessment of these new standards is not possible, Grant Thornton encourages entities to perform at least a high level assessment and disclose the impact in June 2015 financial reports given the ASIC's specific focus on this disclosure.

Other matters

The ASIC media release also includes some commentary on the role of directors. It states that even though directors do not need to be accounting experts, they should seek explanation and professional advice supporting the accounting treatments chosen if needed and, where appropriate, challenge the accounting estimates and treatments applied in the financial report. Directors should particularly seek advice where a treatment does not reflect their understanding of the substance of an arrangement.

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 nationalaudit.support@au.gt.com.