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Technical Accounting Alert TA 2019-11

ASIC findings from review of 31 December 2018 financial reports

Introduction

The purpose of this Alert is to draw attention to the Australian Securities and Investments Commission's (ASIC) Media Release 19-206MR *Findings from 31 December 2018 financial reports*, announcing the results of ASIC's inspections of 85 full-year and 40 half-year December 2018 financial reports of listed entities and other entities of public interest with many stakeholders.

This is a timely reminder for entities and their auditors who are currently in the process of finalising 30 June 2019 financial statements.

Overview

ASIC's findings categories are largely in line with its focus areas for 31 December 2018 and 30 June 2019 financial reports (refer to TA 2018-09 and TA 2019-04 respectively). The findings are divided into eight broad categories, with specific commentary below on each:

1 Asset values and impairment testing
2 Revenue recognition
3 Tax accounting
4 Consolidation accounting
5 New accounting standards
6 Non-IFRS financial information
7 Operating and financial review
8 Estimates and accounting policy judgements

Accounting estimates

1 Asset values and impairment testing

ASIC continues to identify concerns regarding assessments of the recoverability of the carrying values of assets, including goodwill, exploration and evaluation expenditure, and property, plant and equipment.

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 cash flows, economic and market conditions, and funding costs.

In particular, ASIC found cases where:

- assumptions derived from external sources were not assessed for consistency and relevance; and
- the entity's forecast cash flows did not appear reasonable and had exceeded actual cash flows for a number of reporting periods.

Determining the carrying amount of cash generating units

There are cases where entities appear to:

- have identified cash generating units (CGUs) at too high a level despite cash inflows being largely independent, resulting in cash flows from one asset or part of the business being incorrectly used to support the carrying values of other assets;
- have not included all assets that generate the cash inflows in the carrying amount of a CGU, such as inventories and trade receivables and tax balances; and
- have incorrectly deducted liabilities from the carrying amount of a CGU.

Use of fair value

ASIC still sees entities using discounted cash flow techniques to estimate fair value where the calculations are dependent on a large number of management inputs. Where it is not possible to reliably estimate the value that would be received to sell an asset in an orderly transaction between market participants, the entity may need to use the asset's value in use as its recoverable amount.

Impairment indicators

Some entities are not having sufficient regard to impairment indicators, such as significant adverse changes in market conditions, and reported net assets exceeding market capitalisation.

Disclosures

ASIC still finds a number of entities not making necessary disclosure of:

- sensitivity analysis where there is limited excess of an asset's recoverable amount over the carrying amount and where a reasonably possible change in one or more assumptions could lead to impairment;
- key assumptions, including discount rates and growth rates; and
- for fair values, the valuation techniques and inputs used.

ASIC notes that 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.

Accounting policy choices

2 Revenue recognition

ASIC has followed up 12 matters concerning the recognition of revenue, particularly contracts that involve multiple performance obligations (e.g. sale of goods and provision of services) where one of more obligation is still to be met. In one instance, it appeared that the tax effect of a change in revenue recognition had not been taken into account.

It also identified instances where revenue was not disaggregated with regard to how the nature, amount, timing and uncertainty of revenue and cash flows are affected by economic factors, as is required for both full year and half year reports.

3 Tax accounting

ASIC has made enquiries of three entities concerning their accounting for income tax, including the adequacy of tax expense and whether it is probable that future taxable income will be sufficient to enable the recovery of deferred tax assets relating to tax losses.

Key disclosures

4 Consolidation accounting

ASIC has made enquiries of two entities on the non-consolidation of other entities, including an entity that holds a significant interest in an investee.

5 New accounting standards

ASIC observed that some entities could have provided a better explanation of the impact of adopting new accounting standards on revenue recognition (AASB 15 *Revenue from Contracts with Customers*) and financial instruments (AASB 9 *Financial Instruments*), particularly in 31 December 2018 half-year financial reports (which was the first reporting period June year-end entities have had to apply these standards), including the nature and cause of any changes.

6 Non-IFRS financial information

ASIC has made enquiries of four entities where the use of non-IFRS financial information may have the potential to be misleading due to the prominence of the information compared to the equivalent statutory measure or lack of clarity on how the non-IFRS information was determined.

7 Operating and financial review (OFR)

There were some cases where it appeared that companies could have provided better analysis of the underlying drivers of results and explanation of the impact of relevant business risks on future strategies and prospects.

8 Estimates and accounting policy judgements

ASIC observed instances where entities needed to improve the quality and completeness of disclosures in relation to estimation uncertainties, and significant judgments in applying accounting policies. The disclosure requirements are principle-based and should include all information necessary for investors and others to understand the judgements made and their effect. This may include key assumptions, reasons for judgements, alternative treatments, and appropriate quantification.

Other matters

ASIC also reminds directors that they are primarily responsible for the quality of the financial report. This includes ensuring that management produces quality financial information on a timely basis. Companies must have appropriate processes, records and analysis to support information in the financial report. Companies should also apply appropriate experience and expertise, particularly in more difficult and complex areas such as accounting estimates (including impairment of non-financial assets), accounting policies (such as revenue recognition) and taxation.

Further information can be found in ASIC Information Sheet 183 *Directors and financial reporting* and ASIC Information Sheet 203 *Impairment of non-financial assets: Materials for directors*.

Further information

If you wish to discuss any of the information included in this Technical Accounting Alert, please get in touch with your local Grant Thornton Australia contact or a member of the National Assurance Quality Team at national.assurance.quality@au.gt.com.