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Technical Accounting Alert

ASIC findings from 30 June 2013 financial reports

Introduction

The purpose of this Alert is to draw attention to the Australian Securities and Investments Commission's (ASIC) Media Release 13-341MR *Findings from 30 June 2013 financial reports*, which commented on the results of ASIC reviews of 30 June 2013 financial reports that covered 280 listed and other public interest entities.

Overview

The Medial Release highlights ASIC's findings and inquiries in the areas of:

1. disclosure in the operating and financial review
2. off-balance sheet arrangements and new standards
3. asset values and impairment testing
4. going concern
5. revenue recognition and expense deferral
6. financial instrument values
7. estimates and accounting policy judgements
8. non-IFRS financial information
9. related party disclosures
10. amortisation of intangible assets
11. segment reporting
12. other material disclosures (such as post balance date events)
13. other areas (such as business combination accounting)

More information about ASIC's findings on each of these areas is provided below:

1. Disclosure in the Operating and financial review (OFR)

On 27 March 2013, ASIC issued RG 247 *Effective disclosure in an operating and financial review* which sets out ASIC's expectation regarding the level of disclosures that listed entities will need to provide in an OFR in order to comply with section 299A(1) of *Corporations Act 2001*.

RG 247 also provides ASIC's view on when/how the 'unreasonable prejudice' exemption should be applied.

ASIC's reviews reveal significant improvements in the quality of OFRs. Previous ASIC reviews found that half of listed entities sought to rely on an exemption for information that could cause unreasonable prejudice and did not disclose any information on business strategies and prospects for future financial years. This included cases where relevant information was already publicly available. In the OFRs reviewed at 30 June 2013, there was a substantial reduction in the use of the exemption.

ASIC has written to, or will be writing to, a number of entities regarding omitted or inadequate disclosures of:

- the entity's business model(s);
- business strategies which are relevant to the entity's future financial position and performance;
- material business risks that could adversely affect the achievement of the future financial performance or financial outcomes of the entity;
- underlying drivers of financial performance; and
- explanation of significant changes in balances.

Entities are encouraged to refer to RG 247 and review how to best articulate their business model, strategies, and underlying drivers of financial performance.

ASIC notes that some entities make relevant disclosures in investor presentations and analyst briefings rather than in the OFR. However, these disclosures are often in the form of slide presentations, lack supporting explanation and are not in a readily understandable narrative form.

For further information on RG 247, refer to our TA Alert 2013-04 *ASIC Regulatory Guide 247: Effective disclosure in an operating and financial review*.

2. Off-balance sheet arrangements and new standards

Accounting standards AASB 10 *Consolidated Financial Statements*, AASB 11 *Joint Arrangements*, AASB 12 *Disclosure of Interests in Other Entities* and AASB 13 *Fair Value Measurement* applied to 30 June 2013 half -year financial reports for the first time. AASB 10 and AASB 11 can significantly change the identification of controlled entities and accounting for joint arrangements. AASB 13 can affect aspects of the determination of fair values of financial instruments or other assets.

In light of these new standards, ASIC is making inquiries on the non-consolidation of some entities (including some majority owned entities) and the appropriateness of accounting for a joint arrangement.

ASIC also notes that a number of entities affected by the new accounting standards did not make the necessary disclosures of the impact of those standards.

For further guidance on applyng of these new standards, refer to the December 2013 edition of Grant Thornton's CLEARR Example Financial Statements which incorporate the requirements in these standards.

3. Asset values and impairment testing

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

As a result of ASIC inquiries, entities have made significant impairment write-downs of assets or will improve their disclosures on matters such as key assumptions.

The table below summarises ASIC's particular findings in this area:

Area of finding	ASIC comment
Determining the carrying amount of cash generating units (CGU)	There are cases where entities: • appear to have identified CGUs at too high a level or used single CGUs where cash inflows for individual assets are 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; • did not include all assets that generate the cash inflows in the carrying amount of a cash generating unit (CGU), such as inventories and trade receivables; • incorrectly included the benefit of tax losses in determining the recoverable amount of a CGU; and • incorrectly deducted liabilities from the carrying amount of a CGU.
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, the manner in which an entity is funded and market conditions. In particular, ASIC found cases where: • cash flows for value in use calculations included estimated future cash inflows or outflows expected to arise from future restructuring or development plans; • assumptions derived from external sources were not

Area of finding	ASIC comment
	assessed for consistency and relevance; and • forecasts extended beyond five years for value in use calculations even though the entity had a poor history of making forecasts.
Fair value assessments of recoverable amounts	In their fair value assessment some entities are using to discounted cash flow techniques that are dependent on a large number of management inputs without considering recoverable amounts for comparable transactions. Where it is not possible to determine fair value because there is no basis for making a reliable estimate of the amount obtainable from the sale of the asset in an arm's length transaction between knowledgeable and willing parties, the entity may need to attribute the asset's value in use as its recoverable amount.
Impairment indicators	Some entities are not attaching appropriate weight to impairment indicators, such as obsolescence and market capitalisation relative to reported net assets.
Disclosures	A number of entities are 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 an assumption(s) could lead to impairment; • key assumptions including discount rates and growth rates; and • periods covered by forecasts. 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.

4. Going concern

ASIC is currently making inquiries of one entity concerning the appropriateness of applying the going concern assumption.

Directors need to be realistic with their assumptions about an entity's future prospects, particularly in the current environment or where the entity has continuing losses. Where an entity is assessed to be a going concern, but significant uncertainty exists, the entity must ensure that its financial report adequately discloses the uncertainty and why the directors consider the entity to be a going concern. Directors should continue to review the entity's ability to refinance maturing debt and ongoing compliance with loan covenants.

5. Revenue recognition and expense deferral

ASIC has made inquiries with entities to clarify the recognition of revenue in relation to sales of goods, provision of services, investments, consignment stock, cash received in advance and other contractual arrangements. Material adjustments have been made by some entities that had prematurely recognised revenue.

Concerns include recognition of revenue prior to:

- the performance of services to which the revenue relates;
- control of relevant goods passing to the buyer; and
- services being provided under contracts that involve both the sale of goods and the provision of related services. Revenue should be appropriately allocated to the components and recognised accordingly.

ASIC also found that the disclosure of revenue recognition policies by many entities was not sufficiently specific to the entity, its business and sources of revenue. Boilerplate accounting policies do not assist users of a financial report to understand the basis of revenue recognition.

Expenses should only be deferred where there is an asset as defined in the accounting standards and it is probable that future economic benefits will arise. ASIC is making inquiries of three entities in relation to the control of assets.

6. Financial instrument values

ASIC has made inquiries of some entities in relation to the valuation of financial instruments not traded in an active market, including the adequacy of provisions against loans made by entities.

A number of entities needed to improve disclosures to enable users to assess the significance of and the nature and extent of risks under financial instruments. In particular, ASIC noted:

- some entities did not provide information of the assumptions and technique/ methodology applied when valuing financial instruments;
- inconsistent information in the financial report; and
- a number of entities that had disclosed that they had pledged assets as security for liabilities did not provide explicit information on the items pledged.

7. Estimates and accounting policy judgements

ASIC observed opportunities for entities to improve the quality and completeness of disclosures in relation to judgements, key assumptions, estimation uncertainties, and significant judgments in applying accounting policies.

Disclosures in this area are important to allow users of the financial report to assess the reported financial position and performance of an entity with all relevant information.

8. Non-IFRS financial information

ASIC reviewed financial reports, market announcements, investor and analyst presentations, and related media releases of selected listed entities having regard to the use of non-IFRS financial information.

While the vast majority of entities reviewed by ASIC had followed the guidance in Regulatory Guide RG 230 *Disclosing non-IFRS financial information*, ASIC continues to find some entities that:

- inappropriately disclose non-IFRS information in the financial report;
- describe items of expense as 'one-off' or 'non-recurring', even though they are inherent to the entity's business and occur every year or can be reasonably expected to recur;
- give greater prominence to non-IFRS financial information in market announcements, investor and analyst presentations, and/or related media releases;
- do not provide a reconciliation between non-IFRS and IFRS financial information in all relevant documents; and/or
- do not disclose whether the non-IFRS financial information had been subject to audit or review.

ASIC has contacted a number of companies in relation to their use of non-IFRS financial information.

9. Related party disclosures

A number of entities did not disclose the terms and conditions of related party transactions or appear to have incorrectly described transactions as being on arm's length terms and conditions.

ASIC has also made inquiries with entities regarding the adequacy of related party disclosures and compliance with Part 2E of *Corporations Act 2001* in relation to the approval of certain transactions.

10. Amortisation of intangible assets

ASIC is making inquiries of entities concerning the appropriateness of their assessment of indefinite useful life and/or the amortisation periods attributed to intangible assets.

Amortisation should take place as the benefits of an intangible asset are consumed by the entity. Where the useful life of an intangible asset arises from contractual or legal rights, the amortisation period must not exceed the period of the contractual or legal rights. Useful life extends to the contract term, including renewal periods where renewal is expected to occur and renewal costs are not significant.

11. Segment reporting

A number of entities did not appear to meet the core principle in the AASB 8 *Operating segments* and disclose segment information that may be important to investors. This included some entities that provided select segment information in market announcements and other documents but did not disclose segment information in their financial reports.

12. Other material disclosures

Some entities did not disclose:

- significant post balance date events that were known prior to the signing of the financial report; or
- the nature of non-audit services provided by their auditors.

13. Other areas

ASIC is also making inquiries of entities in relation to:

- the appropriateness of business combination accounting, including recognition of amounts as goodwill rather than a prepayment for services;
- recognition of deferred tax assets where it may not be probable that future taxable income will be sufficient to enable its recovery;
- the classification of financial instruments as equity rather than liabilities;
- treatment of mine stripping costs;
- the grossing up of assets and liabilities; and
- recognition of employee provisions.

A company that had not corrected material errors in its 30 June 2013 financial report in relation to revenue, expenditure and asset recognition has now addressed those issues following ASIC inquiries. The auditor had issued a qualified audit report.

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.