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Technical Accounting Alert

ASIC focus areas for 30 June 2014 financial reports

Introduction

The purpose of this Alert is to draw attention to the Australian Securities and Investments Commission's (ASIC) Media Release 14-120MR *Focuses for 30 June 2014 financial reports*, which outlines ASIC's areas of focus for 30 June 2014 financial reports of listed entities and other entities of public interest with a large number of stakeholders.

Overview

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

1. impairment testing and asset values
2. amortisation of intangible assets
3. off-balance sheet arrangements and new standards
4. revenue recognition
5. expense deferral
6. tax accounting
7. estimates and accounting policy judgements

These areas are broadly similar to the ASIC areas of focus for 31 December 2013 financial year (Media Release 13-297MR), except the following differences:

Deleted items	Newly added item
• Disclosure in the operating and financial review • Going concern • Non-IFRS financial information • Related party disclosures	• Amortisation of intangible assets

While 'financial instrument values' is no longer listed as a key area of focus, it is mentioned in the context of 'impairment testing and asset values'.

Specific commentary is provided on the following areas:

1. Impairment testing and asset values

ASIC continues to focus on the recoverability of the carrying amounts of assets such as goodwill, other intangibles and property, plant and equipment.

Directors and auditors are urged to carefully consider the need to impair goodwill and other assets and challenge the appropriateness of assumptions underlying impairment calculations, particularly where prior period financial forecasts have not been met over several reporting periods.

In particular, ASIC stresses the importance of ensuring:

(a) cash flows and assumptions are reasonable having regard to matters such as historical cash flows, how an entity is funded, and economic and market conditions. Significant variances between prior period cash flow projections and actual results are likely to raise doubt as to whether assumptions are reasonable and supportable

(b) discounted cash flows are not used to determine fair value less costs of disposal where forecasts and assumptions are not reliable. Fair value less costs of disposal should not be viewed as a means to use unreliable estimates that could not be used under a value in use model. In the absence of a reliable fair value, value in use must be applied which also requires reliable best estimates and, for example, does not allow increasing cash flows after 5 years (unless it can be justified), or cash flows from restructurings and improving or enhancing asset performance

(c) cash flows used are matched to carrying values of all assets that generate those cash flows, including inventories, receivables and tax balances

(d) cash generating units (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

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.

2. Amortisation of intangible assets

ASIC advises directors and auditors to review amortisation periods and methods applied for intangible assets, including:

(a) amortising time based intangible assets that are available for use even if they have not yet generated revenue

(b) having regard to the significant constraints on taking into account renewal periods for intangible assets, which includes only including periods covered by contractual rights and where renewal is not subject to significant cost

(c) challenging the basis for any assertion that assets have an indefinite life

3. 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* apply to for-profit entities for reporting periods beginning on or after 1 January 2013.

As AASB 10 can significantly change the identification of controlled entities, directors and auditors are advised to carefully review the treatment of off-balance sheet arrangements under the new standard. AASB 11 can change the accounting for joint arrangements, AASB 12 includes disclosures on unconsolidated structured entities, and AASB 13 affects aspects of the determination of fair values of financial instruments and other assets.

4. 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) revenue is recognised on financial instruments on the basis appropriate for the class of instrument

5. Expense deferral

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

(a) there is an asset as defined in the accounting standards

(b) it is probable that future economic benefits will arise

(c) the requirements of the intangibles accounting standard 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 *Intangible Assets*

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 profit/loss where specifically permitted by accounting standards.

6. 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

7. 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 advised to review the disclosures in 30 June 2014 financial reports 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.

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 nationalaudit.support@au.gt.com.