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Technical Accounting Alert

ASIC focus areas for 31 December 2014 financial reports

Introduction

The purpose of this Alert is to draw attention to the Australian Securities and Investments Commission's (ASIC) Media Release 14-294MR *Focuses for 31 December 2014 financial reports*, which outlines ASIC's areas of focus for 31 December 2014 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. 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
8. Impact of new revenue standard

These areas are identical to the ASIC areas of focus for 30 June 2014 financial year (TA Alert 2014-05), except that the impact of new revenue standard has been added as a new area of focus for the 31 December 2014 reporting season.

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 carefully consider the need to impair goodwill and other assets and ensure that:

(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. 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 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

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.

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

Accounting policy choices

3. Off-balance sheet arrangements and new standards

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*, AASB 12 *Disclosure of Interests in Other Entities* which became effective to for profit entities on 1 January 2013.

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) 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

5. Expense deferral

Directors and auditors are urged 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.

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

Key disclosures

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 31 December 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.

8. Impact of new revenue standard

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 31 December 2014 financial reports disclose the impact of IFRS 15 *Revenue from Contracts with Customers* which was issued by the International Accounitng Standards Board (IASB) in May 2014 and is applicable to annual periods begiing on or after 1 January 2017. In the Australian context, the Australian Accounting Standards Board (AASB) is expected to release the equivalent Australian Standard (AASB 15 *Revenue from Contracts with Customers*) by the end of 2014. The AASB is also expected to issue a new Exposure Draft on income from transactions of not-for-profit entities in quarter 1 of 2015, proposing to replace the income recognition requirements of AASB 1004 *Contributions*.

Where a more detailed assessment of the new revenue standard is not possible, Grant Thornton encourages entities to perform at least a high level assessment and disclose the impact in December 2014 financial reports given the ASIC's specific focus on this disclosure.

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.