



# Technical Accounting Alert

## ASIC focus areas for 31 December 2012 financial reports

### Introduction

The purpose of this Alert is to draw attention to the Australian Securities and Investments Commission's (ASIC) Media Release 12-292MR [\*ASIC's areas of focus for 31 December 2012 financial reports\*](#), which commented on the results of ASIC reviews of financial reports for the year ended 30 June 2012 and announced its areas of focus for 31 December 2012 financial reports.

A copy of the Media Release is available at:

<http://www.asic.gov.au/asic/asic.nsf/byHeadline/12-292MR%20ASICs%20areas%20of%20focus%20for%2031%20December%202012%20-%20Financial%20reports?opendocument>

### Overview

The Media Release highlights ASIC's concerns in the areas of revenue recognition, expense deferral, asset values, off-balance sheet arrangements, going concern, non-IFRS financial information disclosures, current vs non-current classifications, estimates and accounting policy judgements, financial instruments and new accounting standards. These areas are identical to the ASIC areas of focus for 30 June 2012 financial year ([Media Release 12-140MR](#)), except that operating and financial review (OFR) is no longer listed as an area of concern.

Specific commentary is provided on the following areas:

### Performance and uncertain economic conditions

#### 1. Revenue recognition

ASIC is particularly concerned about the recognition of a right to future income as 'up-front' revenue by recognising that right as a financial asset at fair value rather than as an intangible asset measured at amortised cost.

So as 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:

- a Ensuring that services to which the revenue relates have been performed;
- b That control of relevant goods has passed to the buyer;

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- c Where revenue relates to both the sale of goods and the provision of related services that revenue is appropriately allocated to the components and recognised accordingly;
- d Ensuring proper classification of assets between financial and non-financial assets; and
- e Recognising revenue on financial instruments on the basis appropriate for the class of instrument under accounting standards.

## 2. Expense deferral

Expenses should only be deferred where there is an asset. This includes:

- a Ensuring that where expenses are deferred, the amount recognised on the balance sheet meets the definition of an “asset” under accounting standards and that there is a resource controlled by the entity as a result of past events from which future economic benefits are expected to flow to the entity;
- b It is probable that future economic benefits will arise; and
- c The requirements of the intangibles accounting standard are met, including expensing start up, training, relocation and research costs, as well as ensuring that any amounts deferred meet the requirements concerning reliable measurement.

ASIC believes that 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 appropriately allocated between the profit and other comprehensive income.

## 3. Asset values

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

As a result of ASIC enquiries:

- Entities have made significant impairment write-downs of assets or improved their disclosures concerning impairment testing and fair values of assets.
- Entities are making greater disclosure of key assumptions underlying asset impairment calculations. These disclosures are important to investors and other users of financial reports given the subjectivity of any calculations.

ASIC is currently in discussions with an entity regarding its value in use calculation for impairment testing of goodwill, including the consistent application of assumptions used to calculate recoverable amounts.

On that basis ASIC argues that Directors should carefully consider asset values and the appropriateness of underlying assumptions, particularly in the context of current economic conditions. ASIC will continue to focus on companies with substantial assets held in emerging

economies. Disclosure of the key assumptions and associated sensitivity analysis enables users of the financial report to make their own assessments about the carrying values of the entity's assets given the subjective nature of many asset valuations.

ASIC states that entities impacted by the introduction of the carbon tax from 1 July 2012 will need to take this into account when performing their impairment testing of non-current assets. However, as Grant Thornton sees it, given the imprecision and arbitrary estimate of if and how a carbon tax will apply given the political uncertainties, and level of government funding, it is expected that many companies will just not be in a position to identify the carbon tax impact.

The minerals resource rent tax will also impact a number of entities from 1 July 2012, but again from Grant Thornton's analysis the degree of subjective of the MRRT and political uncertainties will make it difficult for many of those companies that may be impacted by the MRRT, to be able to arrive at a detailed assessment. Interesting that ASIC states that entities affected will need to ensure they obtain the necessary asset valuations if they adopt the market approach to the starting base allowance. Entities adopting this approach will also need to ensure they correctly account for any resultant changes in their deferred tax balances.

#### **4. Off-balance sheet arrangements**

ASIC continues to make enquiries of entities in relation to the non-consolidation of special purpose entities that appear to have been established for the entity's benefit. It is also making enquiries in relation to the investments that have been equity accounted where the investor holds a majority interest.

ASIC argues that directors should carefully review the treatment of off-balance sheet arrangements, investments in associates and joint venture arrangements, particularly where the entity is presumed to control that entity or has the majority interest, has the right to obtain the majority of the benefits of any special purpose entity's activities or any assets transferred to another entity. Consideration should also be given to who is exposed to the majority of risks.

Where arrangements remain off balance sheet, the details of the arrangements and any exposures should be disclosed, together with the reasons why they are not on balance sheet.

#### **5. Going concern**

Nothing new here with ASIC noting the number of audit reports drawing attention to uncertainty surrounding going concern, and there continues to be a significant number of entities experiencing liquidity and financing difficulties.

Directors need to be realistic in their assumptions about the entity's future prospects. 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 their company's ability to refinance maturing debt and compliance with loan covenants.

Auditors should carefully consider their reporting obligations to ASIC where they issue a qualified audit opinion regarding going concern.

### **Useful and meaningful information for investors**

#### **6. Non-IFRS financial information disclosures**

Following the release of Regulatory Guide RG 230 [\*Disclosing non-IFRS financial information\*](#) (RG 230) in December 2011, ASIC reviewed the financial reports, market announcements, investor and analyst presentations and related media releases of over 150 listed entities. Approximately 40% of these entities disclosed a non-IFRS profit number in at least one of the documents reviewed.

There has been a significant reduction in the number of entities reporting a non-IFRS profit measure in their income statement.

There has also been a substantial improvement in the manner in which entities have disclosed non-IFRS financial information in other documents. This includes giving equal or greater prominence to the corresponding IFRS information, more clearly labelling and explaining the information, and providing reconciliations to the IFRS information.

In the very small number of cases where entities are presenting a non-IFRS profit in their income statement, or giving more prominence to the non-IFRS financial information compared to the IFRS information in other documents, entities contacted have agreed to improve their disclosures.

At 31 December 2012, directors should continue to review non-IFRS financial information disclosures against RG 230.

#### **7. Current vs non-current classifications**

Again as detailed in Grant Thornton's December 2011 TA Alert 2011-23, given the Centro decision and the subsequent \$200M settlement by Centro and its former auditors, ASIC sees the correct classification of liabilities and assets between current and non-current as important to an understanding of the financial position of an entity.

ASIC continues to identify cases where current liabilities have been incorrectly classified as non-current and adjustments have been required. In some cases, directors have not ensured that there is a contractual right to defer settlement for more than 12 months.

As a result of ASIC enquiries:

- The accommodation bonds held by two aged care operators were reclassified to current.
- An entity reclassified a material component of its inventory from current to non-current.

Directors should focus on the classification of the entity's assets and liabilities between current and non-current. They should ensure that appropriate systems are in place, have regard to loan maturities, lending covenant breaches, their legal rights to defer an obligation, and ensure that the classification is consistent with accounting standards and their understanding of the business. For assets, directors should consider the normal operating cycle and, where the normal operating cycle is not clearly identifiable, it should be assumed to be twelve months.

#### **8. Estimates and accounting policy judgements**

ASIC continues to find that some entities did not make material disclosures of sources of estimation uncertainty and significant judgements 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 and necessary information. Directors should review the disclosures in the 31 December 2012 financial report to ensure the necessary disclosures are made and are specific to the assets, liabilities, income and expenses of the entity.

#### **9. Financial instruments**

ASIC found that a number of entities failed to disclose the methods and significant assumptions used to value financial assets for which there is no observable market data.

ASIC believes that directors should focus on financial instrument disclosures at 31 December 2012, however the real issue is the lack of a simplified and realistic replacement for the ageing Financial Instruments accounting standard, and the need for the International Accounting Standards Board and the US Financial Accounting Standards Board to get on with producing a better globally consistent accounting standard in this area.

#### **10. New accounting standards**

This is a reminder of the requirement to provide disclosure of new standards issued but not yet effective, and AASB 10 *Consolidated Financial Statements*, AASB 11 *Joint Arrangements*, and AASB 12 *Disclosure of Interests in Other Entities* are specifically mentioned. However ASIC is likely to be disappointed about the lack of disclosures given that most companies and auditors are still working their way through what the new requirements which apply in 2013 really mean in practice.

ASIC notes that these three new accounting standards will apply for the first time to financial reporting periods beginning on or after 1 January 2013. For entities with a 31 December year end, the balance sheet as of 31 December 2012 is the end of the first comparative period and the commencement of the first full year to which these standards will apply. Hence, entities should be well advanced in determining the impact of these standards and are required to disclose these impacts in their 31 December 2012 financial reports in accordance with AASB 101 *Presentation of Financial Statements*.

**Further information**

For further information on any of the information included in this TA alert, please contact your local Grant Thornton Australia contact member or a member of the National Audit Support team.

Further information is also available from Keith Reilly (Grant Thornton's National Head of Professional Standards) at [keith.reilly@au.gt.com](mailto:keith.reilly@au.gt.com), Peter Kidd (National IFRS Technical Director) at [peter.kidd@au.gt.com](mailto:peter.kidd@au.gt.com) and Siva Sivanantham (IFRS Manager – National Audit Support) at [siva.sivanantham@au.gt.com](mailto:siva.sivanantham@au.gt.com).