



Technical Accounting Alert

ASIC Report on its focus areas for 30 June 2012 financial reports

Introduction

The purpose of this alert is to draw attention to the Australian Securities and Investments Commission's (ASIC) Media Release 'Improved financial information for investors and others', which commented on the results of its reviews of financial reports for the year ended 31 December 2011 and announced its areas of focus for 30 June 2012 financial reports.

A copy of the Media Release is available at:

<http://www.asic.gov.au/asic/asic.nsf/byheadline/Attachment+to+12-140MR%3A+ASIC's+areas+of+focus+for+30+June+2012++financial+reports?openDocument>

Overview

ASIC's Media Release 12-140 MR highlights a new key area of focus being: revenue recognition and expense deferral policies, as well as the usual: asset values and the disclosure of associated assumptions; off-balance sheet arrangements; going concern assessments, and a reminder on excluding non-IFRS financial information from the financial statements, but allowable in directors' reports and media releases in accordance with ASIC Regulatory Guide 230 Disclosing non-IFRS financial information (RG 230)

Specific commentary is provided on the following areas:

Performance and uncertain economic conditions

1. Revenue recognition, expense deferral and other comprehensive income

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 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.

Similarly, 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.

2. 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:

- A number of entities have made significant impairment write-downs of assets or improved their disclosures concerning impairment testing and fair values of assets.
- Many 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.

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. A particular focus for ASIC will be 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 form 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.

3. Off-balance sheet arrangements

Nothing new here as 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.

ASIC argues that directors should carefully review the treatment of off-balance sheet arrangements, particularly where the entity has the right to obtain the majority of the benefits of any special purpose entity's activities or any assets transferred to another entity, and 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.

4. Going concern

Again 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. In a number of cases, the disclosures in the financial report did not appear to give a balanced reflection of the seriousness of the situation.

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

5. 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 65% 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. Managed schemes are generally disclosing distribution information in the notes to the financial statements.

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 a small number of cases, entities are still giving more prominence to the non-IFRS financial information compared to the IFRS information. ASIC has contacted these entities to discuss their disclosures further, and most entities contacted have already agreed to improve their disclosures. Entities have been contacted in relation to the disclosure of 'constant currency' profit in a potentially misleading manner, disclosing a non-IFRS profit measure on the face of the income statement, using multiple non-IFRS profit measures in a confusing manner, and failing to disclose a clear reconciliation of IFRS profit to non-IFRS profit in the company's profit announcement.

Some entities have questioned whether the guidance in RG 230 that entities state whether their non-IFRS financial information is audited or reviewed, implies that the information must be audited. ASIC is only seeking a statement as to whether or not the information is audited. We recognise that there is currently no framework for the calculation of non-IFRS financial information, and that the auditor forms an opinion on the financial report as a whole rather than on individual components.

At 30 June 2012, directors should continue to review non-IFRS financial information disclosures against RG 230.

6. Operating and financial review (OFR)

As detailed in Grant Thornton's December 2011 TA Alert 2011-23 this is a particularly contentious area given that there is a 'prejudicial' exemption from disclosing 'likely future developments' if in the directors' opinion it would result in unreasonable prejudice to the company. ASIC is not impressed with the level of exemptions, however the reality is that this is an area of Corporations Law reform as amendments to the Directors' Report for limited by guarantee companies' significantly increased detailed disclosures of objectives, strategy, and how the company measures performance, without a prejudicial let out.

ASIC will be issuing a draft Regulatory Guide on this issue but probably not till September 2012 and a final Regulatory Guide will be issued in 2013, however directors have been warned as follows: Directors should also ensure that the OFR complies with the law. The director's report of a listed entity must contain information that members of the entity would reasonably require to make an informed assessment of the operations and financial position of the entity, and, except where likely to result in unreasonable prejudice to the entity, business strategies and prospects for future financial years.

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. ASIC is also making enquiries of the classification of assets as current by an entity.

One of the more common issues relates to resident bonds held by retirement or nursing homes. These bonds are commonly repayable immediately in circumstances outside the holder's control. In these cases, the bonds should be classified as current liabilities.

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 and lending covenant breaches, and ensure that the classification is consistent with accounting standards and their understanding of the business.

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 30 June 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 continues to find that a number of entities have failed to disclose an ageing analysis of financial assets that are past due but not impaired and/or an analysis of impaired financial assets. Other disclosure deficiencies included the methods and significant assumptions used to value financial assets for which there was no observable market data.

ASCIC believes that directors should focus on financial instrument disclosures at 30 June 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 IASB and the US 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 IFRS/AASB 10 Consolidations, IFRS/AASB 11 Joint Arrangements, and IFR/AASB 12 Disclosures 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 3 new accounting standards will apply for the first time to financial reporting periods beginning on or after 1 January 2013. For entities with a 30 June year end, the balance sheet at 30 June 2012 will form the opening balances of the first comparative period to which these standards will apply. Entities should be well advanced in determining the impact of these standards and are required to disclose these impacts in their 30 June 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, and Peter Kidd Head of IFRS at peter.kidd@au.gt.com