ASIC findings from 31 December 2016 financial reports

What's the issue?

ASIC has announced the findings of its review of the 31 December 2016 financial reports of 90 Australian listed and other public interest entities. In a media release and accompanying report of its findings, ASIC stated it had contacted 23 entities to ask them to explain their accounting treatments across 28 matters. The majority of these matters continue to relate to "impairment of non-financial assets and inappropriate accounting treatments", with ASIC advising financial report preparers to continue focusing on values of assets and accounting policy choices when preparing reports.

ASIC stated that its surveillance of public interest entities' financial reports for the June 2010 to June 2015 period had led to material changes being made to 4% of the reports reviewed. The main changes related to impairment of assets, revenue recognition and expense deferral.

Public announcements of material changes

In line with its policy of publicly announcing when a company makes material changes to information already released to the market, ASIC flagged that since December 2015 it had issued media releases relating to eight companies that had made combined profit adjustments of $700 million.

Areas of focus

The areas of focus for ASIC are:

- asset values and impairment testing
- consolidation accounting
- amortisation of intangible assets
- revenue recognition
- tax accounting, and
- estimates and accounting policy judgements.

Asset values and impairment testing

Nearly half of ASIC's enquiries relate to asset values and impairment. These inquiries include problems with determining the carrying amount of cash generating units; the reasonableness of cash flows and assumptions; use of fair value; impairment indicators; and disclosures.

ASIC stressed the importance of disclosures to investors and other users of financial reports given the subjectivity of impairment calculations and assessments.

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ASIC has made enquiries of companies that have provided more granular information to investors than they include in their segment disclosures, as ASIC has taken this as an indication that the company may have identified too few operating segments and cash-generating units (CGUs). ASIC has also questioned companies' disclosures of their impairment tests where they have not provided specific information for each CGU. Where CGUs operate in different markets or provide different products or services, they would be exposed to different risks and the key assumptions, discount rates and growth rates would be expected to be different.

Consolidation accounting

ASIC made enquiries of five entities on the non-consolidation of entities. In one case, an entity had relied on the exemption from consolidation for investment entities, and ASIC questioned whether the entity met the definition of an investment entity.

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> An investment entity is exempted from consolidating controlled investees under AASB 10 *Consolidated Financial Statements* and accounts for controlled entities at fair value through profit or loss under AASB 9 *Financial Instruments*. Entities wishing to take advantage of this exemption must determine whether they meet the definition of an investment entity in AASB 10. Judgement may be needed to assess whether this definition is met, and AASB 10 provides guidance to assist entities in performing this assessment.

Amortisation of intangible assets

ASIC made enquiries of three entities on issues related to the non-amortisation of intangible assets or the period over which the assets are amortised.

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> Judgement may be needed to identify the useful life of an intangible asset. Entities should assess whether an intangible asset's useful life is finite or indefinite against the indicators provided in AASB 138 *Intangible assets* and be aware that an asset's life cannot be assumed to be indefinite merely because there is no legal or contractual limit. Entities are also required to reassess whether an indefinite life continues to be appropriate each year. Following a recent clarification by the IFRS Interpretation Committee, companies should also consider the deferred tax accounting for indefinite-lived intangible assets, in particular their assumptions about the expected manner of recovery of the assets.

Revenue recognition

ASIC stated that it is following up a matter around recognition of revenue that is related to the provision of services in the future.

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> Whilst ASIC is focused on entities' preparedness for the new revenue accounting standard, AASB 15, ASIC also continues to make enquiries of entities' revenue recognition policies under the existing standard, AASB 118. Whichever standard is applied, entities should carefully consider the timing of revenue recognition. Where entities receive payments from customers in advance of the provision of services, the criteria for recognition of revenue may not be met at the time the cash is received.

Tax accounting

ASIC made enquiries regarding how entities account for income tax related to situations where it appears that future taxable income might not be enough to recover deferred tax assets.

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> Tax accounting is a notoriously complex area and requires a detailed knowledge of both the tax legislation and accounting requirements. Companies that have incurred tax losses need to pay particular attention to the recoverability of deferred tax assets. Where a company has a track record of making losses, it needs "convincing evidence" that a deferred tax asset will be recoverable in the future and also needs to provide specific disclosure of the nature of the evidence supporting recognition.

Estimates and accounting policy judgements

ASIC stated that it has seen situations where entities needed to improve the quality and completeness of disclosures in relation to estimation uncertainties and significant judgements in applying the accounting policy. The regulator advised that the disclosures are principle-based and should include information necessary for investors and others to understand the impact of the estimates and judgements; for example, key assumptions, reasons for judgements, alternative treatments and appropriate quantification.

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Information should be provided in a way that helps users of the financial statements understand the judgements made by management. It should reflect the entity's individual circumstances and not 'boiler plate' narratives.

For more information or for a deeper discussion on how these issues might affect your business, contact your usual PwC advisor or:

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