

## AUDIT & ASSURANCE

The Australian Securities & Investments Commission (ASIC) is has recently investigating 350 listed and unlisted financial reports for the year ended 30 June 2009, and focusing on the following areas

### 1. Going Concern

The appropriateness of the going concern assumption in the preparation of financial reports continues to be a significant issue in current market conditions.

Of the 30 June 2009 reviews undertaken by ASIC, 18 per cent of audit reports contained an emphasis of matter paragraph, relating to the ability to continue as a going concern. An emphasis of matter paragraph is a section which highlights and draws attention to a matter affecting the financial report.

This percentile applied across both listed and unlisted entities. The 18 per cent rate (from the 30 June 2009 reviews) compares to 25 per cent of listed entities at 31 December 2008, and 15 per cent of listed entities at 30 June 2008. Common reasons for the emphasis of matter paragraphs were:

- negative or minimal net assets or net current assets;
- uncertainty over the recoverability of the value of assets; and
- debt refinancing requirement.

While accounting standards require the going concern assessment to take into account a minimum of 12 months from the reporting date, they also require consideration of all available information about the future. Where refinancing is required outside the 12 month window, entities are still required to consider their prospects of obtaining necessary funding for the entity to continue as a going concern.

Entities should continue to focus on reduced liquidity and ability to refinance debt, and on compliance with lending covenants. Where the ability of a listed entity to continue as a going concern is subject to refinancing, the entity must keep the market informed about the status of finance negotiations.

### 2. Asset Impairment

Based on the financial reports reviewed, ASIC found that writedowns were 11 per cent of the total value of indefinite life intangible assets (including goodwill) for the 12 months to 30 June 2009. For the six months to 31 December 2008, the writedowns were 6 per cent, and less than 1 per cent for the 12 months to 30 June 2008. Further writedowns may be expected, and directors should continue to focus on asset values at 31 December 2009.

Common issues identified in our review were:

- unrealistically optimistic discount and growth rates. The rates used should reflect the risks and uncertainties associated with the assets being tested;
- cash flows were projected for more than five years in value in use calculations without any explanation justifying the longer period. Periods of more than five years should only be used if the

forecasts are detailed and explicit, management is confident that the projections are reliable, and there is past evidence supporting the ability of management to forecast accurately over the longer period;

- cash generating units (CGUs) used for testing goodwill impairment, were not chosen at a sufficiently low level. For example, some CGUs were larger than the primary or secondary segments disclosed in the entity's segment reporting note. Accounting standards require CGUs to be identified at a low level so that cash flows from assets in one unit do not support asset values in other units;
- the failure to disclose carrying amounts allocated to each CGU and the basis for determining recoverable amount;
- flawed discounted cash flow (DCF) calculations, including pre-tax discount rates being applied to post-tax cash flows or vice versa;
- no sensitivity analysis disclosed for changes in key assumptions; and
- a lack of disclosure of assumptions used in DCF calculations, particularly growth rates and discount rates. Disclosure of these assumptions has always been required for 'value in use' and is also required for fair values based on DCF projections from 31 December 2009 year ends.

Accounting standards specify disclosure requirements for full year financial reports. Entities should also be mindful of disclosures in relation to impairment of assets that may assist users of half-year financial reports.

Directors should ensure that there is a reasonable basis for cash flows and assumptions used, that impairment is considered at CGUs at the lowest levels, and that appropriate internal or external expertise is used. Cash flows should be relevant to the assets being assessed and the same cash flows should not be used to support different assets covered by different calculations.

### 3. Fair value of assets

#### *Investment properties*

During ASIC's review of entities with June 30 year ends, they found that writedowns of investment properties accounted for 12 per cent of the carrying value of the properties, compared to 6 per cent in the half year to 31 December 2008.

Values of properties need to reflect current market conditions. ASIC is contacting some entities to better understand the basis for the extent of their writedowns. Some entities carrying investment properties at fair value failed to appropriately disclose the methods and significant assumptions applied in determining the fair values.

#### *Financial Assets*

Financial assets at fair value should be valued by reference to quoted prices in active markets, including most ASX-listed securities. A careful assessment should be made as to whether or not there is an active market. In the instance where there is an inactive market, fair values should be determined with the maximum use of market inputs and key assumptions should be disclosed.

ASIC's review highlighted wide variations in interpretations of when an 'available for sale (AFS) asset' is impaired.

AFS financial instruments are reported at fair value. If the market price of an AFS investment is significantly below cost, or has been below cost for a prolonged period of time, the investment is considered impaired and the writedown is recognised in the income statement rather than a reserve account.

While the requirement is principle-based and it is not appropriate to apply blanket criteria for all investments, the quantitative criteria for the significant or prolonged test used by some entities may not comply with accounting standards.

While not having legal force, a rejection statement from the International Financial Reporting Interpretations Committee (IFRIC) highlights that an investment may be impaired even though a decline in its values is consistent with the relevant market or there are forecasts of market recovery.

Pending any new standards that come into place, entities must comply with the requirements of the existing standard.

### ***Intangible Assets***

The review indicated some entities were carrying intangible assets at fair value in circumstances where it may not have been appropriate to do so.

Accounting standards only allow certain identifiable intangible assets to be revalued and then only where there is an active market for the intangible asset. The criteria for an active market in accounting standards are strict, and ASIC has not yet seen intangible assets in Australia that would meet those criteria.

ASIC recently asked some companies to revert back to using amortised cost rather than fair values for their intangible assets. Entities that are carrying intangibles at fair value should review the basis for that treatment.

## **4. Off balance sheet exposures**

ASIC recently identified a couple of cases where entities should have consolidated other entities. Directors should carefully review any off balance sheet arrangements to ensure that they are correctly treated. Where arrangements remain off balance sheet, the nature and scale of the arrangements should be disclosed, together with the reasons why they are not on the balance sheet.

## **5. Financial instrument disclosures**

ASIC expects companies to provide full disclosure of the significance of financial instruments, the associated risks, and how the entity manages those risks, notwithstanding the complexity of the

financial instrument. Disclosures should be meaningful to users, and boilerplate disclosures should be avoided. Common shortcomings identified by ASIC's review were:

- insufficient disclosure to enable users of financial reports to evaluate the nature and extent of risks arising from financial instruments;
- failure to disclose sensitivity analysis to market risks;
- lack of ageing analysis of financial assets past due but not impaired, and analysis of impaired financial assets; and
- failure to separately disclose material gains and losses arising from a group of similar transactions, as required by AASB 101 *Presentation of Financial Statements*.

## 6. Other issues related to current market conditions

These include:

- failure to disclose significant judgements in applying accounting policies;
- failure to disclose key assumptions and sources of estimation uncertainty;
- incorrect classification of debt as non-current when it should be current; and
- balance sheets presenting assets and liabilities on a liquidity basis, with no separate note disclosure of the current and non-current split of assets and liabilities (disclosure of this information would assist users to assess an entity's ability to meet its obligations over the next 12 months).

Entities should also focus on appropriate revenue recognition, expense recognition and debt versus equity classification, as well as related party disclosures and disclosure of subsequent events.

## 7. Revised accounting standards

ASIC's review of 31 December 2009 financial reports will also include a focus on compliance with revised accounting standards, including those concerning segment reporting, business combinations, consolidated financial statements, and the presentation of financial statements.

### **Disclaimers**

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