ATTACHMENT TO 14-294MR: FOCUSES FOR 31 DECEMBER 2014 FINANCIAL REPORTS

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 focus.

It is important for directors and auditors to ensure:

(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 to sell where forecasts and assumptions are not reliable. Fair value less costs to sell 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, 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; and

(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 should 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

Directors and auditors should review the 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, including periods must be covered by contractual rights and renewal must not be not subject to significant cost; and

(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 should carefully review the treatment of off-balance sheet arrangements, the accounting for joint arrangements and disclosures relating to structured entities.

4. Revenue recognition

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 transactions. 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 properly classified as financial or non-financial assets; and

(e) Revenue is recognised on financial instruments on the basis appropriate for the class of instrument.

The appropriate timing of revenue recognition may also need careful consideration in industries with complex sale and licensing arrangements that may include continuing obligations, such as software providers.

5. Expense deferral

Directors and auditors should ensure that expenses are only deferred where:

(a) There is an asset as defined in the accounting standards;

(b) It is probable that future economic benefits will arise; and

(c) The requirements of the intangibles accounting standard are met, including

  (i) expensing start-up, training, relocation and research costs;

  (ii) ensuring that any amounts deferred meet the requirements concerning reliable measurement; and

  (iii) development costs meet the six strict tests for deferral.

To assist users of financial reports to understand the results of an entity, items of income and expense should only be included in other comprehensive income rather than profit/loss where specifically permitted by the accounting standards.

6. Tax accounting

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; and

(c) The recoverability of any deferred tax asset is appropriately reviewed.

Key disclosures

7. Estimates and accounting policy judgements

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. Directors and auditors should ensure disclosures are made and are specific to the assets, liabilities, income and expenses of the entity.

Disclosure of key assumptions and a 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

Directors and auditors should ensure that financial reports disclose the impact of upcoming requirements for recognising revenue.

Earlier this year the International Accounting Standards Board issued a new accounting standard on revenue under contracts. This standard may significantly affect how and when revenue can be recognised. It is expected that a corresponding Australian accounting standard will be issued before the end of 2014 for application in coming years.

Accounting standard require financial reports to disclose the impact of these new requirements on future financial position and results. Disclosure of the future impact of the international standard and any new Australian standard will apply for 31 December 2014 financial reports.