Focus on Financial Reporting

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Crowe Horwath

Preparers of financial statements continue to face a steady stream of developments in financial reporting.

In this report, we explore a few of the more important considerations for the 2015 financial reporting season including quality of financial information, regulatory requirements, and current vs non-current liabilities.

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1. Quality of financial information

Financial reports are often criticised for their incomprehensibility. In particular, their "disclosure overload", where relevant information is buried within a mass of compliance-driven disclosures. The trend now is to focus attention on the quality of financial information by producing reports that are relevant, understandable and transparent.

The standard-setters have gone some way to assist in "cutting the clutter". As an example, it has been clarified by the AASB that specific disclosures need not be made if the financial information resulting from the disclosure is not material, even if an accounting standard states that the disclosure is a minimum requirement. However, the materiality concept cannot be applied without understanding who the users of the financial report are.

In Australia, the 'Reporting Entity' concept is still the primary mechanism for understanding the dependent users, and deciding whether general or special purpose financial reports should be prepared. This distinction continues to be an area of focus for regulators.

Unless the financial reporting framework is prescribed, the responsibility for determining whether an entity should prepare general or special purpose financial reports lies with the entity's governing body (e.g. the board).

All entities are encouraged to revisit this aspect of financial reporting and to clearly document the considerations and decision before commencing drafting of their financial reports.

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2. Regulatory requirements

Preparers must have a thorough understanding of any specific regulatory requirements that may impact the entity's financial report.

For example, ASIC's Regulatory Guide 85 infers that the recognition and measurement requirements of accounting standards must be applied by a company, even if a special purpose financial report is prepared.

Companies limited by guarantee that are also registered charities are reminded that they no longer prepare financial reports in accordance with the Corporations Act, 2001. All registered charities must prepare their financial reports in compliance with Australian Charities and Not-for-Profits Commission (ACNC) requirements. A good starting point is to refer to the ACNC's Top Ten Tips for financial reporting.

Medium and large charities that prepare financial reports for a state or territory regulator may use these reports as their ACNC report in 2015.

Companies and charities must apply, as a minimum, the following six accounting standards to the extent they are relevant:

- AASB 101, Presentation of Financial Statements
- AASB 107, Statement of Cash Flows
- AASB 108, Accounting Policies, Changes in Accounting Estimates and Errors
- AASB 1031, Materiality
- AASB 1048, Interpretation of Standards
- AASB 1054, Australian Additional Disclosures.

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3. Impairment

Preparers should give special attention to the recoverability of the carrying amounts of assets such as goodwill, other intangibles and property, plant and equipment. In particular, entities should avoid these common errors when preparing impairment calculations:

a. Cash flows and assumptions that are inconsistent with current or expected trading conditions, and often reflect an overly confident position with no realistic prospect of being achieved.
b. 'Fair value less costs of disposal' is inappropriately used as a measure of recoverable amount when there is little or no ability to obtain reliable observable inputs for the calculation.
c. 'Value-in use' calculations apply projections that are based on budgets/forecasts for a period of more than 5 years, or that assume increasing growth rates thereafter, without justification.
d. CGU's are identified using a 'top-down' approach, instead of a 'bottom-up' approach.
e. No difference between discount rates applied across cash generating units (CGUs) with differing risk profiles.

In its role as regulator, the Australian Securities and Investments Commission (ASIC) continues to focus on asset values as one of its key financial reporting focus areas, and has issued specific guidance for directors on this topic.

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4. Employee benefits

Recent research conducted by the actuarial firm Milliman Australia has concluded that there is a sufficiently deep market in high quality corporate bonds in Australia. This means that entities might conclude that a corporate bond rate is appropriate to use when calculating the amount of long term employee benefit obligations (e.g. long service leave) under AASB 119 Employee Benefits. Until now, entities have applied the government bond rate.

Entities should discuss these developments with their advisors and their auditors as soon as possible to identify any impact. Any change in the measurement of the liability will be accounted for prospectively.

These changes do not apply to public sector not-for-profit entities.

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5. Current vs. non-current liabilities

The classification of liabilities as 'current' or 'non-current' continues to be an area of focus. Often, an entity's intention is to hold a liability for an extended period of time (i.e. more than one year after balance sheet date), but the rights attached to the facility give the other party the right to collect repayment in the short term. This may be the case, for example, where a bank loan is subject to an annual review clause, or where the entity is renegotiating its banking facilities near the year end.

Preparers are advised to reconsider these situations and determine the appropriate classification of their liabilities by referring to our news article.

Speak to your Crowe Horwath advisor today about these financial reporting considerations and how they may impact you and your financial situation.