

Some of the issues regulators will be focusing on in December 2009 reports

What is the issue?

In the next reporting season, regulators around the world will be focusing on a number of the financial reporting issues that have surfaced as a result of the changed economic conditions.

This edition of *IFRS in brief* addresses six of the likely areas of focus and shares PwC's insight on each.

Impact on profit and loss	✓
Impact on balance sheet	✓
Impact on disclosures	✓
Impact on stakeholder communication	✓

Who does it impact?

All entities that submit financial statements to a regulator, particularly those currently preparing December 2009 reports.

What are likely areas of focus?

Issue: Going concern

Directors should be mindful of the entity's 'going concern' assumption and whether it remains appropriate at reporting date. Issues of liquidity and debt restructuring, and the ability of the entity to raise new funds should be considered when making this assumption. Consideration should also be given to future compliance with debt covenants.

PwC insight: Explain how 'significant uncertainties' will be mitigated

A number of entities disclosed significant uncertainty over their ability to continue as a going concern in the June 2009 reporting season. To help users of the financial statements understand the financial position, management should disclose how it plans to mitigate the circumstances surrounding the significant uncertainty. For example, an entity that is uncertain about its ability to refinance might disclose that it is currently renegotiating its banking covenants in order to maintain its existing line of credit.

Issue: Impairment of assets

Regulators continue to emphasise that an entity's impairment review process should be robust and transparent to ensure that investors can be confident in the reported value of assets.

In particular, entities should ensure that:

- The discount rates and growth rates used in the value-in-use calculation are realistic and supportable;
- Forecast periods of greater than five years are adequately explained; and
- A sensitivity analysis is disclosed, which includes any changes in management's key assumptions.

PwC insight: Impairment remains an issue at December

Economic indicators may appear more favourable now than at June 2009, but management should still be mindful of impairment indicators in the December 2009 period. For example, in Australia the continuing strength of the Australian dollar may give rise to an impairment indicator for entities with foreign currency cash flows. When translating foreign currency cash flows, management should ensure the foreign exchange rate is appropriate. Where the value-in-use calculation is the basis to determine the recoverable amount, the foreign exchange rate should be the 'spot rate' at reporting date. In contrast, a forward rate that is based on market evidence should be used where a discounted cash flow calculation has been applied to estimate the fair value of an asset.

Issues regulators will focus on in December 2009 reports... cont'd

Issue: Determining fair value

Regulators are likely to focus on how fair value is being determined for a range of assets. For example, some regulators have indicated that in the June 2009 reporting season a number of entities that held investment property didn't disclose the methods and assumptions that management used to determine their fair value. Further, some entities operating in inactive markets that carried their financial assets at fair value did not determine the fair value using the maximum amount of market information available. Entities should also be clear about when it is and isn't appropriate to carry intangible assets at fair value.

PwC insight: Intangible assets should rarely be carried at fair value

Accounting standards are strict in this area. Intangible assets can only be re-valued where there is an active market for the assets, such that there are willing buyers and sellers for the asset and those assets are homogenous with prices available to the public. It is rare for intangible assets to meet this criteria in our experience. To justify why intangible assets have been carried at fair value, some entities cite the presence of broker quotes and prices in trade journals as evidence that prices are available to the market. However, these prices are often open to negotiation (in contrast to stock market prices, which are non-negotiable), making them a negotiated price rather than the market price.

Issue: Off-balance sheet arrangements

Regulators around the world have indicated that financial reports imply off-balance sheet arrangements, but these arrangements are not being adequately disclosed in financial reports.

PwC insight: Consider consolidation of special purpose entities

Although an entity may not be a subsidiary under the provisions of IAS 27, 'Consolidated and separate financial statements', it may be a controlled special purpose entity (SPE), which should be consolidated under SIC 12, 'Consolidation – Special purpose entities'. To help determine which party has control over an SPE, management should consider the substance of the SPE and its relationship to the various parties that participate in it. For example, on which party's behalf are the SPE's activities conducted?; which entity controls the decision-making process?; and which entity has the right to obtain the risks and benefits of the SPE's activities?

Issue: New financial instruments disclosures

Regulators will expect to see entities fully disclose the extent of their financial instruments in line with IFRS 7. For example, that disclosure will include:

- Full explanation of the risks associated with financial instruments.
- A comprehensive sensitivity analysis to market risks.
- An ageing analysis of financial assets that are past due but not impaired.
- An analysis of impaired financial assets.

PwC insight. New fair value hierarchy

Entities preparing annual financial statements at December 2009 should be aware of the revised requirements under IFRS 7. For example, all financial instruments measured at fair value in the balance sheet should be classified into a new three-level fair value hierarchy. We expect the new hierarchy to increase the disclosure requirements for those entities with instruments in the level 3 category, which are measured primarily using management's estimates and assumptions. For more information, download PwC's 'Fair's fair' publication from www.pwcinform.pwc.com