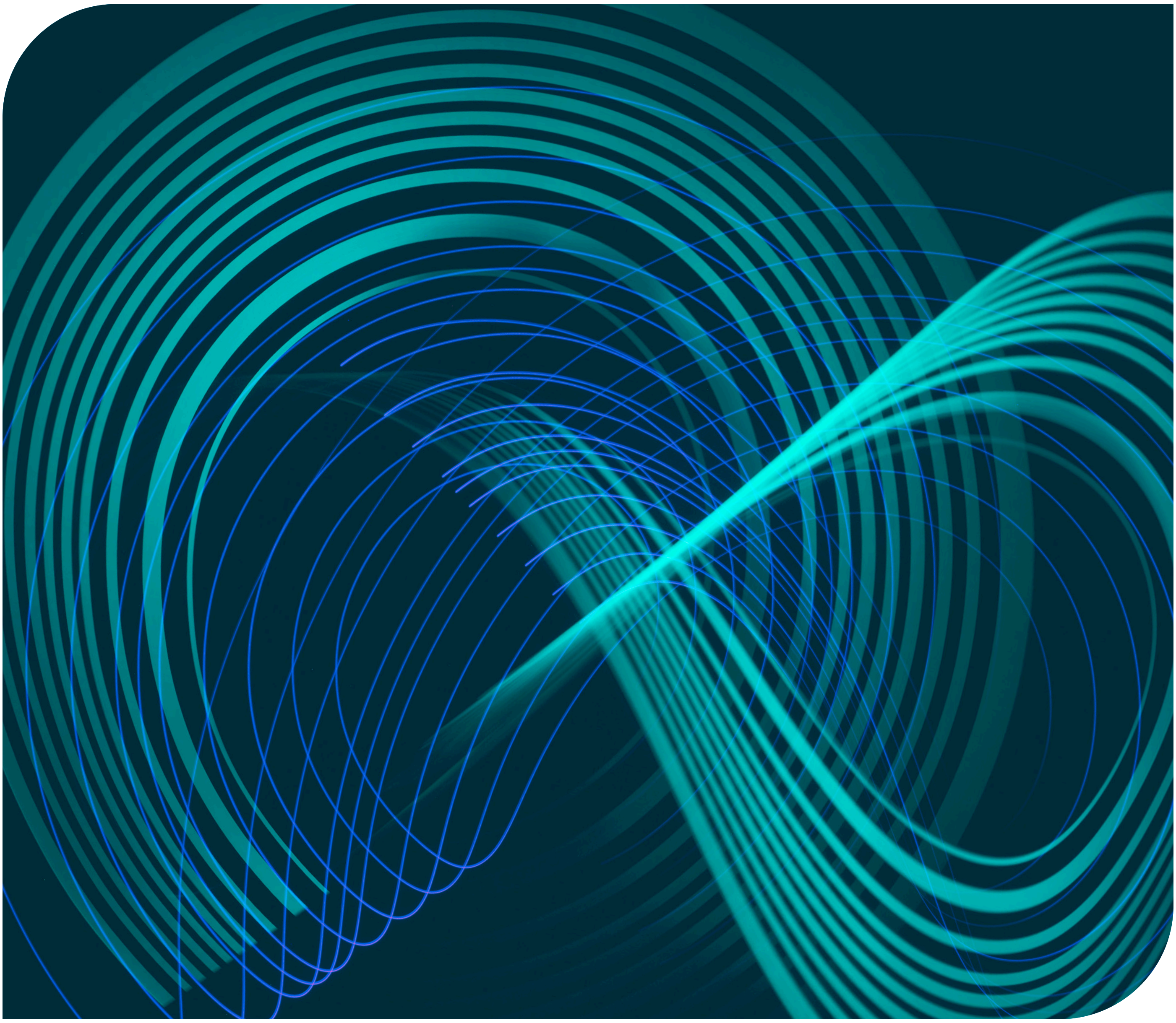
Nexia Australia

Year End Financial Reporting Health Check

2025



Year End Financial Reporting Health Check

Introduction

As another 30 June financial year approaches, Australian companies are busy preparing their financial and other information for disclosure in financial statements and tax returns, whether they be private or public, audited or unaudited. Recent and ongoing global events such as critical national elections, military conflicts and trade wars have resulted in significant disruption of and volatility in global equity and debt capital markets (refer chart below) and created ongoing uncertainty about previously established business models.

In this environment of ever-increasing complexity, volatility, disruption and uncertainty, which has real consequences for asset prices, it is timely to reflect on the key areas that may be contentious and/or require independent external technical input and advice.

CBOE Volatility Index ("VIX")

What are the key areas companies should be focussed on this reporting season?

1. Intangible Assets & Impairment

Intangible assets represent a significant component of many companies' balance sheets. These assets, which lack physical substance, include intellectual property (eg software, patents, designs, etc), customer contracts and relationships and brands. Proper financial reporting of intangible assets is essential for transparency, regulatory compliance, and accurate reflection of a company's value.

The financial reporting requirements for intangible assets are governed by the Australian Accounting Standards Board ("AASB") and the relevant standards include *AASB 138: Intangible Assets* and *AASB 136: Impairment of Assets*. These standards provide guidance on the recognition, measurement, amortisation, and impairment of intangible assets.

AASB 136 provides guidance on the procedures that companies must follow to ensure that their intangible assets are not carried at more than their recoverable amount. At each reporting date, companies must assess whether there is any indication that an intangible asset may be impaired. If such indications exist, an impairment test must be conducted. Some or all of the global events identified above may be indicators of impairment.

The recoverable amount of an asset is the higher of its fair value less costs of disposal ("FVLCOD") and its value in use ("VIU"). If the carrying amount of an asset exceeds its recoverable amount, an impairment loss is recognised.

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Year End Financial Reporting Health Check

Why is this a key area and how is it relevant to my company/business?

1.1 Ongoing Focus Area for ASIC and Auditors

The Australian Securities and Investments Commission ("ASIC") regularly issues media releases highlighting their focus areas for financial reporting and auditing and asset valuations are an enduring focus are for both ASIC and company auditors. Media Release 25-079MR published on 19 May 2025 confirms this enduring focus of ASIC.

1.2 Valuation Difficulties

Intangible assets, such as brands and goodwill, can be challenging to value accurately. Companies and valuers generally use a combination of market-based and income-based approaches to estimate the fair value of these assets.

Income-based approaches such as discounted cash flow ("DCF") analysis, which is commonly used in both FVLCOD and VIU impairment models, can be particularly technical and tricky to deal with for many companies with limited experience of building and updating such models.

In our experience, many technology and other high-growth companies must make an active choice between using a FVLCOD approach or a VIU approach and we are able to provide practical commercial advice together with our deep technical expertise to help businesses navigate this path and produce a robust impairment model in a timely and efficient manner.

The involvement of specialist independent valuers in the impairment modelling process also greatly assists in taking some of the burden off businesses, their management teams and their Boards and providing greater assurance to auditors and stakeholders.

1.3 Rapid Technological Changes

In industries experiencing rapid technological advancements, the useful lives of intangible assets may be shorter than initially anticipated. Companies must regularly reassess and adjust the useful lives and amortisation schedules of their intangible assets to reflect these changes.

1.4 Regulatory Changes

The regulatory environment for financial reporting is constantly evolving. Companies must stay informed about any updates or changes to AASB standards that may impact the recognition, measurement, and disclosure of intangible assets.

2. Business Combinations & Purchase Price Allocation ("PPA")

AASB 3: Business Combinations prescribes how companies should account for transactions and events that meet the definition of a business combination. AASB 3 aims to ensure that the acquiring entity recognises and measures the assets acquired, the liabilities assumed, and any non-controlling interest in the acquiree at their fair values as of the acquisition date. This process involves identifying and valuing the identifiable assets acquired, liabilities assumed, and any contingent consideration.

Why is this a key area and how is it relevant to my company/business?

2.1 Valuation of Acquired Intangible Assets

Similar to AASB 136 and AASB 138, AASB 3 often presents challenges in the valuation of intangible assets such as patents, trademarks, and customer relationships. These assets typically do not have active markets, necessitating the use of complex valuation techniques and assumptions.

2.2 Determining the Fair Value of the Purchase Price Itself

Whilst it might seem like a non-issue to the uninitiated, in many business combinations determining the starting point for the PPA (ie the purchase price itself) is harder than it looks, particularly in scrip-based deals or where deferred or contingent consideration such as earnouts is a key component of the overall purchase price. It is hard to allocate a purchase price if you don't know how much to allocate!

Year End Financial Reporting Health Check

AASB 3 addresses the accounting for contingent consideration, which involves future payments contingent on the acquiree's future performance. Estimating the fair value of such consideration requires careful judgment and analysis and in certain cases the application of complex option valuation methodologies.

Where scrip-based payments are made to vendor founders and other key management personnel in the acquired business who are remaining with the acquiror, *AASB 2: Share-based Payment*, often comes into play and it is necessary to split the total purchase price between the fair value component under AASB 3 and the fair value component under AASB 2 before the overall PPA process proceeds. This can be a highly technical area where valuation specialists are required.

2.3 Allocation of Goodwill and Gain from Bargain Purchase

Allocating the purchase price to the acquired assets and liabilities, including goodwill, can be a contentious issue. Goodwill is often a significant component of the purchase price, and its allocation requires a thorough understanding of the acquired business's operations and potential synergies. Disagreements can arise between the buyer and seller, as well as with auditors and regulators, over the appropriate allocation method.

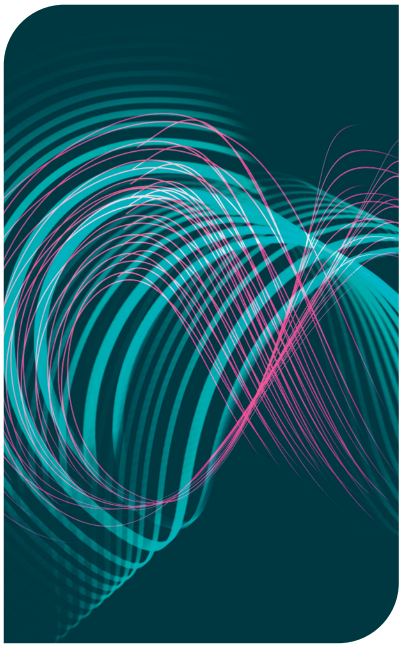
Another one of the crucial aspects of AASB 3 is the treatment of gains from bargain purchases. Goodwill represents the future economic benefits arising from assets that are not individually identifiable and separately recognised. When the fair value of the net assets acquired exceeds the consideration transferred, a gain from a bargain purchase is recognised in profit or loss.

2.4 Tax Considerations

Business combinations can have substantial tax implications, including the impact on deferred tax assets and liabilities. Certain intangible assets may be eligible for tax amortisation (eg software, patents, designs) as well as accounting amortisation. Companies must carefully consider the tax consequences of the acquisition and plan accordingly to optimise their tax position and avoid potential pitfalls.

2.5 Regulatory Compliance

Compliance with AASB 3 can be complex and resource-intensive, especially for companies that engage in frequent business combinations. It requires a thorough understanding of the standard's requirements and the ability to apply them to various business scenarios.



Year End Financial Reporting Health Check

3. Employee Share and Option Plans and Other Scrip Based Incentive Schemes

Why is this a key area and how is it relevant to my company/business?

Valuing Employee Share and Option Plans ("ESOPs") and other scrip-based incentive schemes can be fraught with challenges that require meticulous analysis and specialised expertise. These schemes are typically designed to align the interests of employees and management with those of shareholders by providing them with ownership stakes in the company. However, their valuation poses several issues as follows.

3.1 Fair Value Determination under AASB 2 using Valuation Models and Assumptions

AASB 2: Share-based Payment sets out the guidelines for the fair value determination of share-based payments. Valuation of ESOPs and scrip-based schemes often involves the use of complex financial models, such as the Black-Scholes model, Monte Carlo analysis or the binomial option pricing model. The accuracy of these models heavily relies on a range of assumptions, including:

- Volatility of the company's stock price
- Expected dividends
- Risk-free interest rate
- Employee exercise behaviour
- Expected life of the options

Small changes in any of these assumptions can lead to significant variations in the valuation, making it an area of contention and scrutiny. As noted above, the recent spike in volatility has a direct impact on asset prices, including derivative instruments such as options.

3.2 Market Conditions and Performance Metrics

The fair value of share options and incentives can be influenced by prevailing market conditions and the company's performance metrics. Fluctuations in market prices, interest rates, and overall economic environment can impact the perceived value of these schemes. Furthermore, performance-related vesting conditions, such as achieving certain revenue or profit targets, add an additional layer of complexity to the valuation process.

3.3 Employee Behaviour and Attrition

Predicting employee behaviour, including the likelihood of option exercise and attrition rates, is critical in valuing these schemes. Employee turnover can affect the number of options that will ultimately vest and be exercised, impacting the overall cost of the incentive scheme. Companies need to factor in historical data and industry trends to make informed assumptions about employee behaviour.

3.4 Tax Implications

ESOPs and scrip-based schemes can have significant tax implications for both the company and the employees. The tax treatment of these schemes may vary depending on the jurisdiction and specific circumstances, which impacts the overall valuation. Companies must carefully consider the tax outcomes and plan accordingly to optimise their tax position and avoid potential pitfalls.

3.5 Regulatory and Disclosure Requirements

Compliance with regulatory and disclosure requirements is another critical issue in the valuation of ESOPs and other incentive schemes. Companies must adhere to the strict guidelines set forth by accounting standards and regulatory bodies, ensuring that all assumptions and methodologies used in the valuation are transparent and justifiable. Failure to meet these requirements can lead to legal and reputational risks.

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Who do I contact to discuss these key areas in more depth?

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Brent has worked as a specialist in corporate finance for over 20 years. Brent gained his experience as a Corporate Finance Partner in one of the world's largest accounting firms where he spent 10 years in the London office before returning to their Sydney office. Brent has also worked on the client side, working in the corporate development and strategy team in an ASX 20 company.

Brent works on a range of corporate finance transactions including valuations and expert reports, M&A buy and sell side, IPOs, valuations, private fundraising and due diligence for corporate, private equity and bank pre-lending. Brent is a Fellow of Chartered Accountants Australia & New Zealand, a Business Valuation Specialist of Chartered Accountants Australia & New Zealand, a Fellow of the Financial Services Institute of Australasia, an AFSL Authorised Representative and a Graduate of the Institute of Company Directors.

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Stephen is a highly experienced Corporate Advisory specialist with more than 30 years of M&A and commercial expertise developed in both professional and financial services. This has provided Stephen with insights as to the importance of both organic and inorganic growth options, and how these can be combined to fulfil the growth agenda of the organisation whilst appropriately managing all significant risk aspects.

Stephen spent more than 25 years with one of the largest professional services firms in the world focusing on strategy & business plan assessment, understanding the competitive landscape, target identification, due diligence, negotiation, valuation, assessment of synergies and risks, project management and execution and is an acknowledged expert in the fields of corporate valuation & IERs, due diligence, IPOs, and financial modelling.

Stephen is a Member of Chartered Accountants Australia & New Zealand, a Fellow of the Financial Services Institute of Australasia, an AFSL Authorised Representative and a Graduate of the Institute of Company Directors.

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Lydia joined the Nexia Sydney Corporate Advisory team in 2019 and has over 12 years of experience in corporate advisory, and professional accounting experience gained in both medium tier and big fours.

Lydia works on a range of corporate advisory transactions including valuations and Independent Expert's Reports, Due Diligence, Investigating Accountants' Reports, M&A buy and sell side advisory within the healthcare, education, technology, manufacturing, retail, real estate/property and agriculture sectors. Lydia is a member of Chartered Accountants Australia & New Zealand and she holds a Masters Degree of Applied Finance from Macquarie University.