ACCT3102 COMPLETE REVISION

Topic 1: Regulating External Reporting

Key sources of Regulation

- Major sources of financial reporting regulation in Australia
  - Corporations Act 2001
  - Australian Accounting Standards (AASB)
  - The Conceptual Framework
  - ASX Listing Rules
- Most countries have
  - Securities regulation
  - Accounting standards
  - Securities exchange rules for listed entities

Key Regulators in Australia

- The Corporations Act = Australian Securities and Investments Commission (ASIC)
- Australian Accounting Standards = Australian Accounting Standards Board (AASB)
- The Conceptual Framework = AASB/IASB
- ASX Listing Rules = Australian Securities Exchange (ASX)

The Corporations Act

- Australian companies must comply with the requirements of the Corporations Act 2001
- The Corporations Act requires the preparation of financial reports for all (reporting entities):
  - 1. Disclosing entities (e.g. listed entities)
  - 2. Public companies
  - 3. Large proprietary companies
  - 4. Registered schemes

Australian Accounting Standards

- All entities required to prepare financial statements in accordance with the Corporations Act must apply the following standards:
  - AASB 101 – Presentation of Financial Statements
  - AASB 107 – Statement of Cash Flows
  - AASB 108 – Accounting Policies
  - AASB 1048 – Interpretation and Application of Standards
- The reporting entity concept is used to determine whether entities are required to present GPFRs (General Purpose Financial Reports)
  - Requires professional judgement

Reporting Entities

- OLD Statement of Accounting Concepts 1 (SAC 1)
  - Australian Conceptual Framework limits the application of concepts statements and accounting standards to 'reporting entities':
    - A reporting entity has financial statement users who cannot force the entity to prepare financial information to meet their specific needs, even though they have a right to be kept informed
    - Non-reporting entities prepare special purpose financial statements

Large proprietary companies

- Large proprietary companies satisfy at least two of the following requirements
  - Consolidated gross operating revenue for the financial year of the company and the entities it controls is $25 million or more

    - The value of the consolidated gross assets at the end of the financial year of the company and the entities it controls is $12.5 million or more
    - The company and the entities it controls have 50 or more employees at the end of the financial year

Differential reporting

- Some entities can be excused from compliance with (some) accounting standards
- Justifications:
    - 1. Cost of an accounting information system is likely to be more significant for smaller entities
    - 2. Information needs of users of financial statements of small entities are likely to be different
    - 3. Users of financial statements of small entities are usually able to obtain special purpose statements to meet their particular needs for financial information

Reduced reporting requirements

- Australia has introduced a differential reporting regime: RDR – Reduced Disclosure Regime
- AASB 13 July 2010 Update – Full IFRS Tier 1 Reporting
    - For-profit private sector entities that have public accountability
    - Australian Governments and State, Territory and Local Governments
- AASB 13 July 2010 Update – Reduced IFRS (Tier 2) reporting
    - For-profit private sector entities that do not have public accountability
    - All not-for-profit private sector entities
    - Public sector entities not included above
- Entities must still comply with the recognition and measurement principles but have relief from some of the extensive disclosure requirements
- Many AASBs have RDR provision
- IASB has also initiated a small and medium sized enterprises (SME) project which considers differential reporting using the notion of 'public accountability'
- Public accountability = accountability to those existing and potential resource providers and others external to the entity who make economic decisions but are not in a position to demand reports tailored to meet their particular information needs

Update on differential reporting – July 2014

- 30 June 2010 = Stage 1 – RDR for Tier 2 entities
- AASB is currently monitoring the work of various regulators
- Stage 2 involves further research on the remaining AASB proposals in ED 192, in particular, the use of the reporting entity concept for differential reporting purposes

Accounting Standards

- Prepared by the AASB (authority provided by the Corporations Act), adopted from IASB
- AASB has been developing a conceptual framework (in conjunction with the IASB) used in the development and revision of accounting standards and interpretations

Institutional arrangement for Accounting Standard setting

- Financial Reporting Council (FRC) responsible to the Treasurer (minister for financial services, superannuation and corporate law
    - Primary role is to oversee the AASB
- Australian Accounting Standards Board (AASB) has power to set accounting standards under *Corporations Act 1989*, s32
- Functions are to develop a conceptual framework and sponsor, develop and review accounting standards for the private and public sectors

AASB

- Established under s226(1) of the ASIC Act 2001
- Functions are to develop a conceptual framework and sponsor, develop and review accounting standards for the private and public sectors
- Three formal avenues for constituent entities and organisations to have input to the standard-setting process:
    - Focus groups – resource in formulating standard-setting priorities advising on agenda projects
    - Project advisory panels - develop agenda material relating to specific standard-setting projects
    - Interpretation advisory panels – preparing alternate views on a specific issue

FRC

- Statutory body under the Australian Securities and Investment Act (ASIC) Act 2001.
- Oversees and is the advisory body of Australian Accounting Standards Board (AASB)
- Appoints members of AASB – except Chair appointed by Federal Treasurer
- Approves/monitors AASB's priorities, business plan, budget and staffing
- Promotes use of international standards in Australia
- The FRC is within the Federal Portfolio of Treasury

AASB Standard Setting Process

- Identify technical issue
- Add issue to the agenda
- Research and consider issue
- Consult with stakeholders
- Issue standard or other pronouncement

IASB

- Independent private sector board responsible for setting International Financial Reporting Standards (IFRS)
- The IASB is supported by the Standards Advisory Council and the International Financial Reporting Interpretations Committee (IFRC) who offer guidance where there is a divergence
- The IASC Foundation (a geographically diverse group of trustees) has oversight of IASB and is accountable to the public interest
- Committed to the development of a single set of high quality, understandable, enforceable and globally accepted accounting standards

Global Influences on IASB

- U.S. removal of reconciliation requirement for foreign private issuers that adopt IFRS
- Continuing pressure from regional organisations (European, Asian, Latin American, etc. standard setters)
- Counties currently considering adopting IFRS: US, Japan, India, Russia, Malaysia, Columbia

Adoption of Australian equivalents of IFRS (AIFRS)

- FRC Announcement on 3 July 2002
    - Formalised support for adoption by Australia of International Accounting Standards by 1 January 2005 (now called IFRS)
    - AASB adopted policy of 'international convergence and harmonisation'
    - Australia an 'early adopter'
    - Date for adoption determined by EU date for adoption of IFRS by consolidated entities
- Currently nearly 120 countries have adopted IFRS

Motivation for IFRS adoption

- Pressure was applied by big business (and the ASX) to the Federal Government to adopt AIRFS which lead to the formation of FRC and the restructuring of the AASB
- More generally, the common arguments for adoption of AIFRS are: (Chua and Taylor 2008)

    - Provide timely information for investors (cross-country evaluation)
    - Results in better quality accounting
    - Improves comparability
    - Developing counties gain expert interpretation advice through IASB through IFRS
- All of the above would theoretically contribute to benefits such as improving access to international capital markets, reducing cost of capital

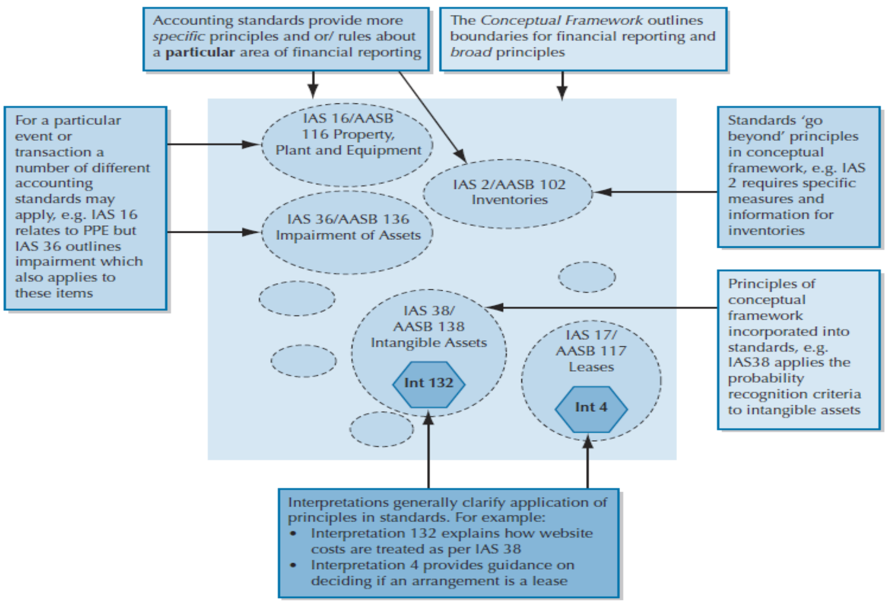
The Conceptual Framework (issued by the AASB)

- The purpose is to provide a coherent set of principles; assists:
    - Issued by the AASB
        - standard consistency
        - preparers deal with issues not addressed by a standard
        - auditors in forming an opinion on compliance
        - users to interpret statements
- Currently in Australia
    - The Framework for the Preparation and Presentation of Financial Statements (AASB Framework 2009) and as amended in 2013 (AASB CF 2013-1)
- IASB is currently undergoing a project to revise the Conceptual Framework
    - Started as joint project with FASB, suspended in 2010
    - 2013 IASB issued a Discussion Paper: Review of Conceptual Framework
- The IASB's Conceptual Framework for FR 2010 comprises
    - Ch 1 – the objective of general purpose financial reporting
    - Ch 2 - the reporting entity (TO BE ADDED)
    - Ch 3 – the qualitative characteristics of useful financial reporting
    - The Framework (1989): the remaining text (definition of the elements, recognition and measurement principles)

Conceptual Framework vs. Accounting Standards

- The Conceptual Framework
    - Designed to provide guidance and apply to a wide range of decisions (purpose of FS, users, assumptions when preparing, elements of FS, etc.)
- Accounting Standards
    - Specific requirements for a particular area
    - May go beyond the framework
    - Are mandatory
    - Sometimes conflict with the framework

The relationship between the conceptual framework and the accounting standards



Qualitative Characteristics of Useful Financial Information

- There is a hierarchy of qualitative characteristics
  - **Fundamental** (AASB CF 2013-1 Appendix QC5)
    - 1. Relevance (AASB CF 2013-1 QC6-10)
      - Aims to ensure that only useful information is included
      - An important part of this concept is materiality
    - 2. Faithful Representation (AASB CF 2013-1 QC12-16)
      - What is shown corresponds to the actual events and transactions that are being represented
      - Three key elements
        - Complete Depiction
        - Neutrality
        - Freedom from Error
  - **Enhancing** (AASB CF 2013-1 Appendix QC19)
    - 1. Comparability (AASB CF 2013-1 QC20-25)
      - Achieved with consistent measurement and presentation of items over time and between entities
    - 2. Verifiability (AASB CF 2013-1 QC26-28)
      - Information can be supported or confirmed so that users are confident in relying on it
    - 3. Timeliness (AASB CF 2013-1 QC29)
      - Users need information on a timely basis
    - 4. Understandability (AASB CF 2013-1 QC30-32)
      - Financial reports are prepared for users who
        - Have reasonable knowledge of business and economic activities; and
        - Will conduct a diligent review and analysis of the information
- To be useful for decision making
  - Information must have BOTH of the two fundamental characteristics
  - The enhancing characteristics are not essential (but can improve usefulness)

Determining the relative importance of Qualitative Characteristics

- Ideally information will have all characteristics
- In reality there are often trade-offs (AASB CF 2013-1 QC33-34)
  - Timeliness versus faithful representation
  - Relevance versus verifiability
  - Relevance versus understandability
- Cost constraint on financial information (AASB CF 2013-1 QC235-39)
  - Cost versus benefit

Definitions of Elements of Financial Statements

- Assets
  - A resource controlled by the entity as a result of past events and from which future economic benefits are expected to flow to the entity – Framework 2009 para. 49(a)
  - Proposed: A present economic resource controlled by the entity as a result of past events – 2013 IASB DP – para.2.11 (removes probability aspect)
- Liabilities
  - A present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits – Framework 2009 para. 49(b)
  - Proposed: A present obligation of the entity to transfer an economic resource as a result of past events – 2013 IASB DP – para.2.11
- Equity (definition remains unchanged in IASB DP)
  - The residual interest in the assets of the entity after deducting all its liabilities – Framework 2009 para.49(c)