

HENDERSON
PEIRSON
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HOWIESON

16 EDITION

Issues in Financial Accounting





Issues in Financial
Accounting

Dedicated to

Margaret, Chris, John, John and Christopher

HENDERSON
PEIRSON
HERBOHN
ARTIACH
HOWIESON

16 EDITION

Issues in Financial Accounting

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Preface to the sixteenth edition

This edition of the book is based on the Australian Accounting Standards Board (AASB) standards and interpretations that have been issued up to the end of September 2016. As a result, there have been widespread changes to this edition – some of them based on changes to the accounting standards and some on the feedback we have received. The main changes to this edition are as follows:

- Part 1 has been restructured to reduce the number of chapters on the conceptual framework (from three to two). However, there is a new chapter on fair value measurement to enhance the discussion of measurement in accounting.
- The structure of Part 2 is largely unchanged. All chapters have been revised to take account of developments since the fifteenth edition – in particular, Chapter 11 has been revised to incorporate the effects of the new standard on leases (*AASB 116*). The chapter on financial instruments was contributed by Professor Phil Hancock; we are indebted to him for agreeing to revise this chapter.
- The highlight of Part 3 is the introduction of a new chapter on revenue to incorporate the significant changes wrought by the new standard on revenue (*AASB 15*).
- Part 4 has been rationalised into four chapters, covering the extractive industries, agricultural activity, superannuation entities and insurance. Where relevant, material from the deleted chapters has been revised and reassigned to other chapters for this edition.
- The structure of Parts 5 and 6 remains the same as for the fifteenth edition. All chapters have been updated.

As for previous editions, our partners have our profound gratitude for their support during the preparation of this edition.

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POWERPOINT LECTURE SLIDES

A comprehensive set of PowerPoint slides can be used by educators for class presentations or by students for lecture preview or review. They include key figures and tables, as well as a summary of key concepts and examples from the text.



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The authors and publisher would like to acknowledge the contributions of many academics during the development of this new edition. Their in-depth feedback on both the previous edition and draft chapters of the new sixteenth edition has helped the authors to align the book more closely than ever before to contemporary teaching and learning needs.

These academics include:

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PART 1

Institutional setting and the conceptual framework

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Institutional arrangements for setting accounting standards in Australia

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 - 1.1.1 Government legislation
 - 1.1.2 Australian Securities Exchange Ltd Listing Rules
 - 1.1.3 Accounting standards and interpretations
 - 1.2 Accounting standard setting in Australia
 - 1.2.1 Present standard-setting arrangements
 - 1.3 The preparation and enforcement of AASB Accounting Standards and AASB Interpretations
 - 1.3.1 The development of accounting standards and concepts statements
 - 1.3.2 The development of AASB Interpretations
 - 1.3.3 Authority and enforcement of AASB Accounting Standards and Interpretations
- Appendix 1.1
The development of institutional arrangements for standard setting in Australia

LEARNING OBJECTIVES

After studying this chapter you should be able to:

- 1 identify the main sources of regulation of financial reporting;
- 2 identify the major developments in the institutional arrangements for accounting standard setting;
- 3 explain the present accounting standard-setting arrangements;
- 4 explain the process of developing accounting standards and concepts statements in Australia;
- 5 explain the process of developing interpretations; and
- 6 explain the process of enforcing accounting standards and interpretations.

1.1 Introduction

In this book, we consider some of the controversial issues in financial accounting that have been debated over time by the preparers, users, auditors and regulators of general purpose financial statements (GPFS). The preparation of GPFS requires accountants to make decisions as to which accounting policies are the ‘best’ for any given entity and situation. For example, should a company use a straight-line or an accelerated method of depreciating its property, plant and equipment? Accountants must exercise professional judgement in making a choice, because determining the most appropriate accounting policy is often not simple. For instance, when choosing the accounting policy for depreciating machinery, an accountant needs to estimate both the useful life of that machinery and the pattern of future economic benefits that is likely to be generated by it. As both of these characteristics are unknown at the start of the life of the machinery, the accountant can only make an educated but uncertain judgement about how to depreciate the machinery.

Accountants are not free to make any accounting policy choice they like, because their behaviour is governed by some form of regulation, including government and non-government regulation, accounting concepts and standards, and professional ethics. The three main sources of regulation governing accounting policies and financial reporting practices are: government legislation, the Australian Securities Exchange Ltd (ASX) Listing Rules, and accounting standards and other pronouncements issued by the Australian Accounting Standards Board (AASB). This chapter also outlines the processes by which these sources of regulation are developed and how they are enforced. The accounting conceptual framework is explored in Chapters 2 and 3, and professional ethics is discussed in Chapter 26.

1.1.1 Government legislation

In the private sector, the most important legislation specifying financial reporting requirements is the *Corporations Act 2001*, which replaced the *Corporations Act 1989*. This legislation may be found at www.legislation.gov.au. The Corporate Law Economic Reform Program (CLERP) was commenced in 1998 as part of the Commonwealth Government’s ongoing program to modernise business regulation in Australia. As part of this program, the Corporations Act was simplified through substantial amendments made in 1998, some of which affected financial reporting. Section 292 of the Corporations Act requires the preparation of financial statements for each financial year by all disclosing entities, all public companies, all large proprietary companies and all registered schemes.¹ Broadly speaking, the financial reporting and audit provisions of the Corporations Act require that:

- 1 proper financial records are kept;
- 2 a financial report is prepared each half-year (for disclosing entities only) and at the end of the financial year;
- 3 the financial report consists of:
 - (a) the financial statements, comprising a statement of comprehensive income, a statement of financial position, a statement of changes in equity and a statement of cash flows;
 - (b) the notes to the financial statements; and
 - (c) the directors’ declaration about the financial statements and notes;

LEARNING OBJECTIVE

1 Identify the main sources of regulation of financial reporting.

- 4 the financial statements give a ‘true and fair view’ of the financial position and performance of the entity;
- 5 the financial statements comply with accounting standards;
- 6 if the financial statements and notes prepared in compliance with accounting standards would not give a true and fair view, then additional information necessary to give a true and fair view is included in the notes to the financial statements. This means that entities must comply with accounting standards in the preparation of their financial statements even if, in the opinion of the governing board, this does not result in a true and fair view; and
- 7 the financial statements include an auditor’s report. Auditors have to report, *inter alia*, whether in their opinion the financial statements are prepared in compliance with accounting standards and provide a true and fair view. If not of that opinion, the auditor’s report must state why. In those cases where there has not been compliance with an accounting standard, the auditors also have to provide an opinion on the quantified effect of non-compliance on the financial statements.

The Corporations Act, therefore, specifies general requirements that the financial statements comply with accounting standards and present a true and fair view. The form and content of the statement of comprehensive income, statement of financial position, statement of changes in equity and statement of cash flows are considered in accounting standards discussed later in this book.

As noted previously, the financial statements of entities reporting under the Corporations Act must comply with accounting standards issued by the AASB. Section 226 of the *Australian Securities and Investments Commission Act 2001* provides for the establishment of the AASB, and accounting standards issued by the Board are deemed to be part of the Corporations Act. This aspect of the legislation is considered in section 1.2.1.

The Corporations Act applies to companies and other types of entities, such as listed trusts, that are identified in the legislation. Financial reporting by most entities in the public sector is regulated by other legislation. For example, legislation such as the *Financial Management Amendment Act 1994* in Victoria, the *Financial Accountability Act 2009* in Queensland and the *Public Finance and Audit Act 1987* in South Australia establishes the financial reporting obligations of state public sector bodies. These Acts are commonly supplemented with regulations entitled ‘Treasurer’s Instructions’, which are designed to ensure uniform and detailed financial reporting. The legislation generally requires the financial statements to be prepared in accordance with accounting standards and interpretations issued by the AASB.

1.1.2 Australian Securities Exchange Ltd Listing Rules

The second source of regulation governing financial reporting is the listing rules of the ASX. These rules apply only to entities whose securities are listed on the ASX and are designed to ensure that capital markets receive timely and relevant information. The disclosure requirements of the ASX are contained in Chapter 3 (continuous disclosure), Chapter 4 (periodic disclosure) and Chapter 5 (additional reporting on mining and exploration activities) of the listing rules. The listing rules specify the detailed disclosure of financial information and require the disclosure of some information not required by the Corporations Act. For example, the ASX requires listed entities to disclose, in returns filed with it, the names of the 20 largest holders of each class of quoted equity securities, the number of equity securities each holds and the percentage of capital this represents (see ASX Listing Rule 4.10.9). If a listed company does not comply with the ASX Listing Rules, it may be delisted. In addition to the listing rules, which are mandatory, on 27 March 2014 the ASX

Corporate Governance Council released the document *Corporate Governance Principles and Recommendations*. The aim of these corporate governance guidelines is to promote investor confidence and to assist companies in meeting investors' expectations. This is the third edition of the *Corporate Governance Principles and Recommendations* since 2003 and provides evidence for the view expressed in 2003 by the ASX Corporate Governance Council that it is 'committed to a continuing review of these principles and best practice recommendations to ensure that they remain relevant, take account of local and international developments, and continue to reflect international best practice' (p. 7). The following text from *Corporate Governance Principles and Recommendations* provides an overview of the eight principles to which 29 recommendations are attached. For example, one of the recommendations for principle 1, 'Lay solid foundations for management and oversight', is for a listed entity to 'disclose the respective roles and responsibilities of its board and management'.

CORPORATE GOVERNANCE PRINCIPLES AND RECOMMENDATIONS (2014, 3RD EDITION)

Principle 1: Lay solid foundations for management and oversight

A listed entity should establish and disclose the respective roles and responsibilities of its board and management and how their performance is monitored and evaluated.

Recommendation 1.1: A listed entity should disclose:

- (a) the respective roles and responsibilities of its board and management; and
- (b) those matters expressly reserved to the board and those delegated to management.

Recommendation 1.2: A listed entity should:

- (a) undertake appropriate checks before appointing a person, or putting forward to security holders a candidate for election, as a director; and
- (b) provide security holders with all material information in its possession relevant to a decision on whether or not to elect or re-elect a director.

Recommendation 1.3: A listed entity should have a written agreement with each director and senior executive setting out the terms of their appointment.

Recommendation 1.4: The company secretary of a listed entity should be accountable directly to the board, through the chair, on all matters to do with the proper functioning of the board.

Recommendation 1.5: A listed entity should:

- (a) have a diversity policy which includes requirements for the board or a relevant committee of the board to set measurable objectives for achieving gender diversity and to assess annually both the objectives and the entity's progress in achieving them;
- (b) disclose that policy or a summary of it; and
- (c) disclose as at the end of each reporting period the measurable objectives for achieving gender diversity set by the board or a relevant committee of the board in accordance with the entity's diversity policy and its progress towards achieving them and either:
 - 1 the respective proportions of men and women on the board, in senior executive positions and across the whole organisation (including how the entity has defined 'senior executive' for these purposes); or
 - 2 if the entity is a 'relevant employer' under the *Workplace Gender Equality Act 2012*, the entity's most recent 'Gender Equality Indicators', as defined in and published under the Act.

(Continued)

Recommendation 1.6: A listed entity should:

- (a) have and disclose a process for periodically evaluating the performance of the board, its committees and individual directors; and
- (b) disclose, in relation to each reporting period, whether a performance evaluation was undertaken in the reporting period in accordance with that process.

Recommendation 1.7: A listed entity should:

- (a) have and disclose a process for periodically evaluating the performance of its senior executives; and
- (b) disclose, in relation to each reporting period, whether a performance evaluation was undertaken in the reporting period in accordance with that process.

Principle 2: Structure the board to add value

A listed entity should have a board of an appropriate size, composition, skills and commitment to enable it to discharge its duties effectively.

Recommendation 2.1: The board of a listed entity should:

- (a) have a nomination committee which:
 - 1 has at least three members, a majority of whom are independent directors; and
 - 2 is chaired by an independent director; and disclose
 - 3 the charter of the committee;
 - 4 the members of the committee; and
 - 5 as at the end of each reporting period, the number of times the committee met throughout the period and the individual attendances of the members at those meetings; or
- (b) if it does not have a nomination committee, disclose that fact and the processes it employs to address board succession issues and to ensure that the board has the appropriate balance of skills, knowledge, experience, independence and diversity to enable it to discharge its duties and responsibilities effectively.

Recommendation 2.2: A listed entity should have and disclose a board skills matrix setting out the mix of skills and diversity that the board currently has or is looking to achieve in its membership.

Recommendation 2.3: A listed entity should disclose:

- (a) the names of the directors considered by the board to be independent directors;
- (b) if a director has an interest, position, association or relationship of the type [that would suggest the director is not independent] but the board is of the opinion that it does not compromise the independence of the director, the nature of the interest, position, association or relationship in question and an explanation of why the board is of that opinion; and
- (c) the length of service of each director.

Recommendation 2.4: A majority of the board of a listed entity should be independent directors.

Recommendation 2.5: The chair of the board of a listed entity should be an independent director and, in particular, should not be the same person as the chief executive officer (CEO) of the entity.

Recommendation 2.6: A listed entity should have a program for inducting new directors and provide appropriate professional development opportunities for directors to develop and maintain the skills and knowledge needed to perform their role as directors effectively.

Principle 3: Act ethically and responsibly

A listed entity should act ethically and responsibly.

Recommendation 3.1: A listed entity should:

- (a) have a code of conduct for its directors, senior executives and employees; and
- (b) disclose that code or a summary of it.

Principle 4: Safeguard integrity in corporate reporting

A listed entity should have formal and rigorous processes that independently verify and safeguard the integrity of its corporate reporting.

Recommendation 4.1: The board of a listed entity should:

- (a) have an audit committee which:
 - 1 has at least three members, all of whom are non-executive directors and a majority of whom are independent directors; and
 - 2 is chaired by an independent director, who is not the chair of the board; and disclose
 - 3 the charter of the committee;
 - 4 the relevant qualifications and experience of the members of the committee; and
 - 5 in relation to each reporting period, the number of times the committee met throughout the period and the individual attendances of the members at those meetings; or
- (b) if it does not have an audit committee, disclose that fact and the processes it employs that independently verify and safeguard the integrity of its corporate reporting, including the processes for the appointment and removal of the external auditor and the rotation of the audit engagement partner.

Recommendation 4.2: The board of a listed entity should, before it approves the entity's financial statements for a financial period, receive from its CEO and chief financial officer (CFO) a declaration that, in their opinion, the financial records of the entity have been properly maintained and that the financial statements comply with the appropriate accounting standards and give a true and fair view of the financial position and performance of the entity and that the opinion has been formed on the basis of a sound system of risk management and internal control which is operating effectively.

Recommendation 4.3: A listed entity that has an annual general meeting (AGM) should ensure that its external auditor attends its AGM and is available to answer questions from security holders relevant to the audit.

Principle 5: Make timely and balanced disclosure

A listed entity should make timely and balanced disclosure of all matters concerning it that a reasonable person would expect to have a material effect on the price or value of its securities.

Recommendation 5.1: A listed entity should:

- (a) have a written policy for complying with its continuous disclosure obligations under the listing rules; and
- (b) disclose that policy or a summary of it.

Principle 6: Respect the rights of security holders

A listed entity should respect the rights of its security holders by providing them with appropriate information and facilities to allow them to exercise those rights effectively.

Recommendation 6.1: A listed entity should provide information about itself and its governance to investors via its website.

Recommendation 6.2: A listed entity should design and implement an investor relations program to facilitate effective two-way communication with investors.

Recommendation 6.3: A listed entity should disclose the policies and processes it has in place to facilitate and encourage participation at meetings of security holders.

Recommendation 6.4: A listed entity should give security holders the option to receive communications from, and send communications to, the entity and its security registry electronically.

Principle 7: Recognise and manage risk

A listed entity should establish a sound risk management framework and periodically review the effectiveness of that framework.

Recommendation 7.1: The board of a listed entity should:

- (a) have a committee or committees to oversee risk, each of which:
 - 1 has at least three members, a majority of whom are independent directors; and
 - 2 is chaired by an independent director; and disclose:

(Continued)

- 3 the charter of the committee;
 - 4 the members of the committee; and
 - 5 as at the end of each reporting period, the number of times the committee met throughout the period and the individual attendances of the members at those meetings; or
- (b) if it does not have a risk committee or committees that satisfy (a) above, disclose that fact and the processes it employs for overseeing the entity's risk management framework.

Recommendation 7.2: The board, or a committee of the board, should:

- (a) review the entity's risk management framework at least annually to satisfy itself that it continues to be sound; and
- (b) disclose, in relation to each reporting period, whether such a review has taken place.

Recommendation 7.3: A listed entity should disclose:

- (a) if it has an internal audit function, how the function is structured and what role it performs; or
- (b) if it does not have an internal audit function, that fact and the processes it employs for evaluating and continually improving the effectiveness of its risk management and internal control processes.

Recommendation 7.4: A listed entity should disclose whether it has any material exposure to economic, environmental and social sustainability risks and, if it does, how it manages, or intends to manage, those risks.

Principle 8: Remunerate fairly and responsibly

A listed entity should pay director remuneration sufficient to attract and retain high-quality directors and design its executive remuneration to attract, retain and motivate high-quality senior executives and to align their interests with the creation of value for security holders.

Recommendation 8.1: The board of a listed entity should:

- (a) have a remuneration committee which:
 - 1 has at least three members, a majority of whom are independent directors; and
 - 2 is chaired by an independent director; and disclose:
 - 3 the charter of the committee;
 - 4 the members of the committee; and
 - 5 as at the end of each reporting period, the number of times the committee met throughout the period and the individual attendances of the members at those meetings; or
- (b) if it does not have a remuneration committee, disclose that fact and the processes it employs for setting the level and composition of remuneration for directors and senior executives and ensuring that such remuneration is appropriate and not excessive.

Recommendation 8.2: A listed entity should separately disclose its policies and practices regarding the remuneration of non-executive directors and the remuneration of executive directors and other senior executives.

Recommendation 8.3: A listed entity which has an equity-based remuneration scheme should:

- (a) have a policy on whether participants are permitted to enter into transactions (whether through the use of derivatives or otherwise) which limit the economic risk of participating in the scheme; and
- (b) disclose that policy or a summary of it.

Source: ASX Corporate Governance Council, *Corporate Governance Principles and Recommendations*, 3rd edition, Australian Securities Exchange, Sydney, 2014, pp. 8–34. © Copyright 2016 ASX Corporate Governance Council.

The principles and associated recommendations are not mandatory, although listed entities that do not adopt an ASX Corporate Governance Council recommendation must explain why they have not done so (the 'if not, why not?' approach). However, the ASX Listing Rules include two mandatory requirements relating to the Corporate Governance Principles. First, ASX Listing Rule

4.10.3 requires listed entities to disclose in their annual reports the extent to which they have followed the guidelines during the reporting period. Second, ASX Listing Rule 12.7 requires that companies included in the Standard & Poor's (S&P) All Ordinaries Index have an audit committee, and that companies included in the S&P/ASX 300 Index comply with the corporate governance guidelines in relation to composition, operation and responsibility of the audit committee.

At the time of writing, we are unaware of any research studies that have explored the impact of the third edition of the Corporate Governance Principles. However, there is some evidence available for previous editions. A study by Brown and Gorgens investigated, *inter alia*, compliance by the top 300 Australian listed companies with the ASX Corporate Governance Council's *principles* over the period 2004 to 2006.² Table 1.1 provides an overview of the main compliance results. From the table, there is evidence that for each of the three years, on average, ASX 300 companies were compliant with more than eight of the then 10 principles. Principles two, four and nine were the least complied with by companies during this period.³

TABLE 1.1 Compliance of the top 300 Australian companies listed on the ASX with the ASX Corporate Governance Council's Principles of Good Corporate Governance and Best Practice Recommendations between 2004 and 2006

	2004	2005	2006
Principle 1	99%	99.7%	99.7%
Principle 2	40%	45%	46%
Principle 3	90%	93%	93%
Principle 4	69%	78%	83%
Principle 5	93%	95%	96%
Principle 6	93%	94%	95%
Principle 7	89%	92%	92%
Principle 8	89%	92%	92%
Principle 9	72%	76%	77%
Principle 10	92%	95%	95%
Number of companies fully compliant with 10 principles	92	108	113
Average compliance with 10 principles	8.28	8.61	8.7
Minimum number of principles complied with by any company	0	1	1
Maximum number of principles complied with by any company	10	10	10
Standard deviation	1.93	1.68	1.61
Number of companies	304	304	304

Source: R. Brown and T. Gorgens, 'Corporate Governance and Financial Performance in an Australian Context', *Treasury Working Paper*, 2009-02, Table 4.2, Australian Treasury, Canberra, March 2009, p. 17. © Commonwealth of Australia, reproduced by permission.

Other more recent studies have explored whether the introduction of the Corporate Governance Principles has more generally improved the level of corporate governance practices. Matolcsy, Tyler and Wells (2011), Psaros and Seamer (2015), and Beekes, Brown and Zhang (2015) all provide evidence that, relative to the years immediately before the introduction of the Corporate Governance Principles in 2003, corporate governance in Australia's listed companies had improved by 2012 with higher levels of disclosures, greater independence of corporate boards and increased use of independent board sub-committees such as remuneration committees and audit committees. The findings of the study by Matolcsy, Tyler and Wells (2011) suggest that the

improvements in corporate governance have been greatest among smaller listed companies – that is, those outside the ASX 300.

1.1.3 Accounting standards and interpretations

The third source of regulation governing financial reporting is accounting standards and interpretations prepared by the AASB. Accounting standards and interpretations are concerned with accounting definition, recognition, measurement and disclosure.

As noted in section 1.1.1, authority is provided to AASB accounting standards by the Corporations Act. The Accounting Professional and Ethical Standards Board (APESB) <www.apesb.org.au>, formed in 2006, provides similar authority for Australian accounting standards – that is, AASB accounting standards. Specifically, paragraph 5.1 of *APES 205* 'Conformity with Accounting Standards' states that:

Members shall take all reasonable steps to apply Australian Accounting Standards when they prepare and/or present General Purpose Financial Statements that purport to comply with the Australian Financial Reporting Framework.

Members are defined as 'a member of a professional body that has adopted this Standard as applicable to their membership as defined by a professional body' (*APES 205*, para. 2), and the Australian Financial Reporting Framework comprises accounting standards, concepts and interpretations. To date, professional bodies adopting *APES 205* include CPA Australia (CPAA), Chartered Accountants Australia and New Zealand (CAANZ) and the Institute of Public Accountants (IPA). More detail on the APESB is provided in section 1.3.3.

In addition to preparing accounting standards and interpretations, the AASB has been developing a conceptual framework for general purpose financial reporting. The conceptual framework is used by the AASB in the development (and revision) of accounting standards and interpretations. It is also used by preparers, auditors and regulators of financial statements to assist them in resolving financial reporting problems that are not covered by an accounting standard.

The institutional framework for accounting standard setting in Australia, and the preparation and enforcement of accounting standards and interpretations, are discussed next, in sections 1.2 and 1.3. The concepts statements and other conceptual framework documents are discussed in Chapters 2 and 3.

1.2 Accounting standard setting in Australia

An overview of the early developments in institutional arrangements for setting accounting standards in Australia is provided in Appendix 1.1. The current standard-setting arrangements are outlined in section 1.2.1.

1.2.1 Present standard-setting arrangements

The passage of the Corporate Law Economic Reform Program in October 1999 introduced fundamental changes to the structure and arrangements for accounting standard setting. The *Australian Securities and Investments Commission Act 2001* was amended, replacing the previous Part 12 with a new Part 12. The amendments established the Financial Reporting Council (FRC) and provided for the establishment of a reconstituted AASB. Each of these bodies is discussed in turn. Figure 1.1 provides an overview of the standard-setting organisational structure in Australia.

LEARNING OBJECTIVE

2

Identify the major developments in the institutional arrangements for accounting standard setting.

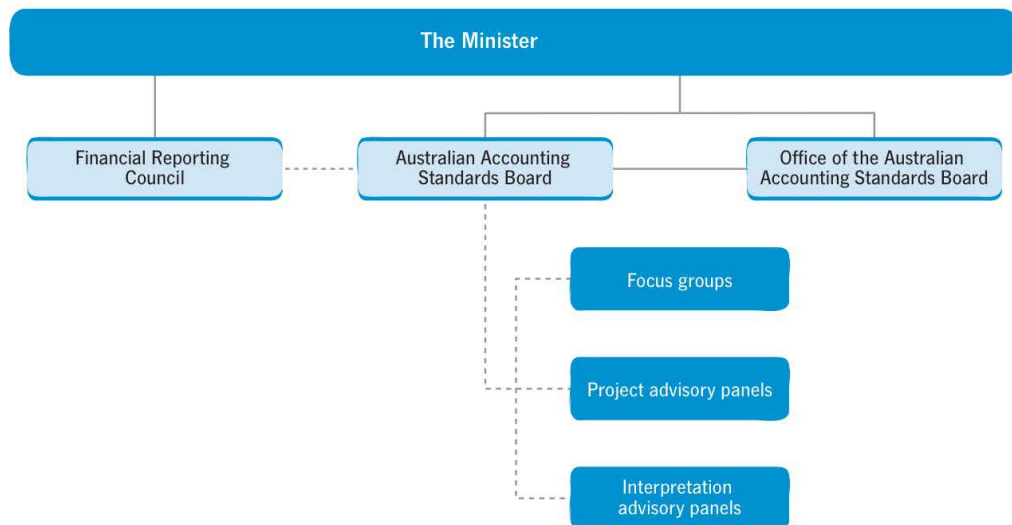


FIGURE 1.1 AASB organisational structure

Source: AASB, *Annual Report 2014–2015*, p. 22. © Australian Accounting Standards Board, 2016.

THE FINANCIAL REPORTING COUNCIL

The FRC is a statutory body under the *Australian Securities and Investments Commission Act 2001*. Its current structure came into place with the CLERP reforms (*Audit Reform and Corporate Disclosure Act 2004*). Figure 1.1 shows its role as the peak body responsible for the broad oversight of the accounting and auditing standard-setting process in Australia.

In general, the FRC has responsibility for oversight of the AASB and for presenting reports and advice on the Australian accounting standard-setting process to the Commonwealth Government via the relevant Minister at the time. The role of the FRC includes:

- appointment of the members of the AASB (except for the full-time Chair, who is appointed by the Minister);
- approving and monitoring the AASB's priorities, business plan, budget and staffing arrangements;
- determining the AASB's broad strategic direction;
- giving the AASB directions, advice or feedback on matters of general policy and the AASB's procedures; and
- monitoring the development of international accounting and auditing standards, working to further the development of a single set of accounting and auditing standards for worldwide use and promoting the adoption of these standards.

Although the FRC has wide-ranging powers, the Australian Securities and Investments Commission Act expressly limits the FRC's ability to become involved in the technical deliberations of the AASB. For example, the FRC does not have the power to veto a standard formulated or recommended by the AASB, nor to direct the AASB in relation to the development or making of a particular standard. However, the FRC has in the past made two 'directives' to the AASB that have influenced the technical agenda of the AASB. The first of these was in 2002 when the FRC required the adoption in Australia of international financial reporting standards (IFRSs) with effect

LEARNING OBJECTIVE

3

Explain the present accounting standard-setting arrangements.

from 1 January 2005. This directive required the AASB to replace Australian accounting standards with their international equivalents and effectively ended the ability of the AASB to set its own standards for entities in the private sector. In the same year, the FRC issued a second directive to the AASB that had an impact on public sector accounting in Australia. Essentially, the directive required the AASB to combine two types of accounting systems – generally accepted accounting principles (GAAP) reporting with Government Finance Statistics (GFS) reporting, which is a form of reporting rules used by governments around the world. As a result of this directive, the AASB had to add a special and resource-intensive project to its technical agenda, which in October 2007 resulted in the release of *AASB 1049* ‘Whole of Government and General Government Sector Financial Reporting’.

The FRC is also responsible for monitoring the effectiveness of auditor independence requirements in Australia and has an oversight function of the Auditing and Assurance Standards Board (AuASB).⁴

Under section 235A of the *Australian Securities and Investments Commission Act 2001*, members of the FRC are appointed by the Minister and hold office on terms and conditions determined by the Minister. Members of the FRC include the Chair, appointees of the Commonwealth and members drawn from the business community, the professional accounting bodies, the investing community, governments and regulatory agencies. For example, in 2016, FRC members included the chairs of the AASB and the AuASB, the Chair of the External Reporting Board of New Zealand, a representative of CAANZ and the Chief Compliance Officer of the ASX. Information on the FRC may be found at www.frc.gov.au.

THE AUSTRALIAN ACCOUNTING STANDARDS BOARD

The AASB was established under section 226(1) of the *Australian Securities and Investments Commission Act 1989* and presently operates under section 261 of the *Australian Securities and Investments Commission Act 2001*. The AASB began operations in 1991, replacing the Australian Accounting Standards Review Board (ASRB). At that time, the ASRB was Australia’s sole standard-setting body for the private sector and its activities were complemented by the Public Sector Accounting Standards Board (PSASB), which developed accounting standards applicable to all other reporting entities.⁵ The passage of CLERP in October 1999 resulted in the activities of the PSASB being merged with those of the AASB.

The reconstituted AASB is an Australian government agency under the Australian Securities and Investments Commission Act. It has responsibility for making accounting standards applicable not only to entities coming under the jurisdiction of the Corporations Act but also to entities in the public sector and the non-corporate sector.

The AASB has issued two interrelated packages of standards.

- 1 Australian accounting standards not derived from international pronouncements. They are organised as follows:
 - *AASB 1000+* series, which covers former Australian standards revised and retained pending finalisation of International Accounting Standards Board (IASB) projects, issues specific to not-for-profit entities and Australian-specific issues; and
 - *Omnibus series* (*AASB 2010–7* to *AASB 2015–10*), which covers amendments to Australian accounting standards numbered in a series using the year of issue.