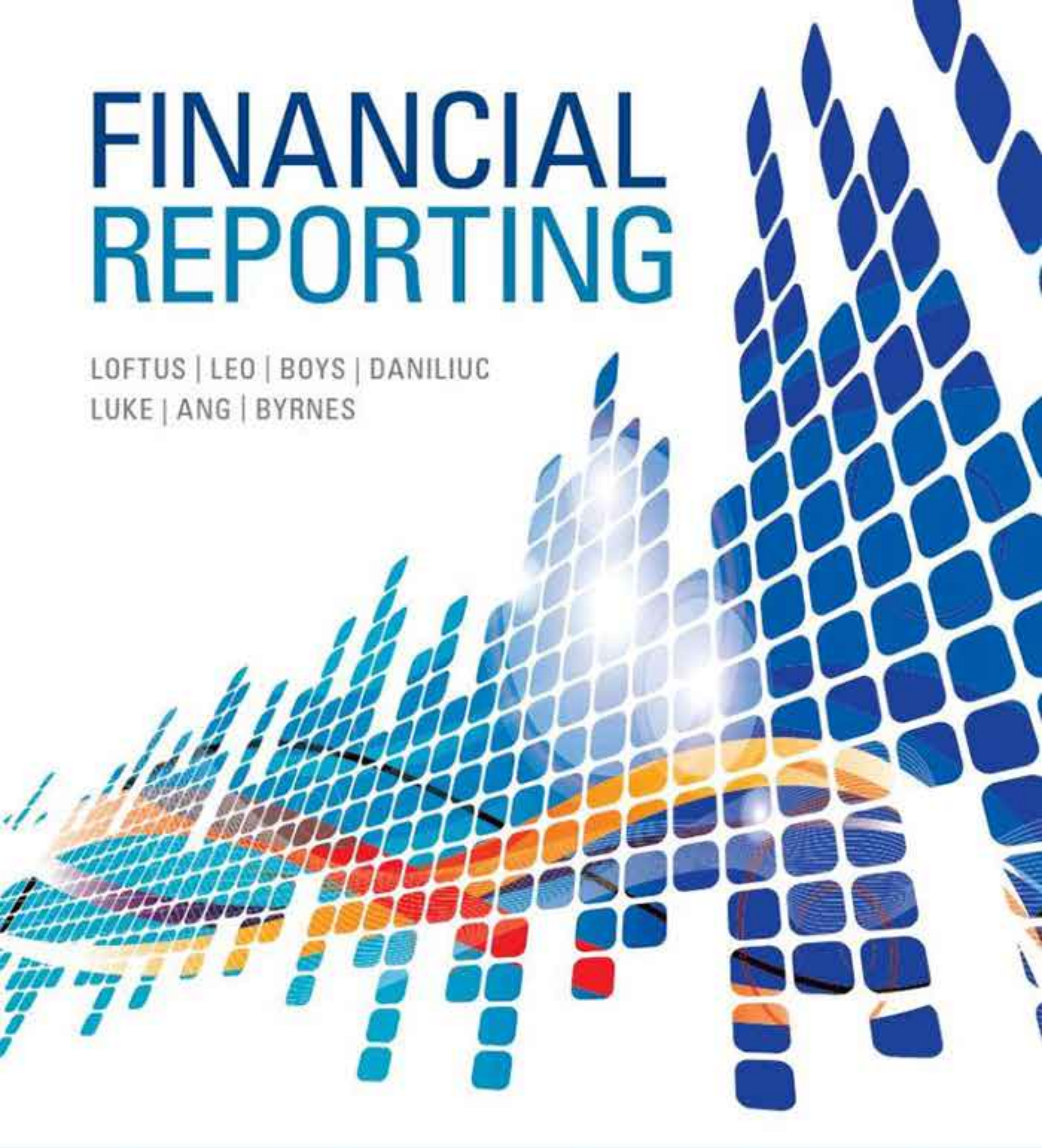


FINANCIAL REPORTING

LOFTUS | LEO | BOYS | DANILIUC
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WILEY

FINANCIAL REPORTING

1ST EDITION

JANICE LOFTUS

KEN LEO

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SORIN DANILIUC

BELINDA LUKE

HONG NEE ANG

KARYN BYRNES

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Preface

We are excited to present the first edition of *Financial Reporting*! This new text builds on the strengths of *Understanding Australian Accounting Standards* (Loftus) and *Company Accounting* (Leo), bringing the strongest elements of those two respected titles into one combined volume.

Financial Reporting is designed to be used in the second and third year financial accounting courses. It covers all the topics typically taught across two units, including company regulation, the conceptual framework, applying accounting standards, disclosures and consolidations.

Our aim was to produce a book that explained accounting principles and practice to students in a clear, understandable way. In endeavouring to make accounting more understandable to students we have not lost sight of the fact that Accounting Standards are principles-based. An understanding of the conceptual basis of accounting and the rationale behind the principles espoused in particular standards is crucial to their consistent application in a variety of practical contexts. The text then provides both a conceptual understanding as well as a practical application of accounting standards.

At the time of writing the International Accounting Standards Board had several major projects on its agenda that have implications for topics covered in this book, including financial instruments, revenue and leases. The following discussion explains how those projects and the ensuing changes to accounting standards have been treated in this book.

Accounting for financial instruments is regulated by AASB 132/IAS 32 *Financial Instruments: Presentations*, AASB 7/IFRS 7 *Financial Instruments: Disclosures* and either AASB 139/IAS 39 *Financial Instruments: Recognition and Measurement* or AASB 9/IFRS 9 *Financial Instruments*, which is effective from 1 January 2018 with early adoption permitted. Much of the coverage of recognition and measurement issues in the financial instruments chapter is based on AASB 9/IFRS 9 in anticipation of the Standard becoming effective from 1 January 2015, as per the scheduled operative date at the time of writing. However, impairment of financial instruments is based on AASB 139/IAS 39 due to the timing of revision to that section of AASB 9/IFRS 9. Occasional reference is also made to AASB 139/IAS 39 in explaining terms, such as transaction costs, where AASB 9/IFRS 9 defers to the earlier standard for definitions.

In May 2014, the IASB issued IFRS 15 *Revenue from Contracts with Customers*, with the AASB following suit with the issue of AASB 15 *Revenue from Contracts with Customers* in December 2014. When effective, that is, from 1 January 2017, AASB 15/IFRS 15 will replace the current suite of pronouncements that regulate accounting for revenue and other income — namely, AASB 111/IAS 11 *Construction Contracts*, AASB 118/IAS 18 *Revenue*, AASB Interpretation 13/IFRIC 13 *Customer Loyalty Programmes*, AASB Interpretation 15/IFRIC 15 *Agreements for the Construction of Real Estate*, AASB Interpretation 18/IFRIC 18 *Transfers of Assets from Customers* and AASB Interpretation 131/SIC-31 *Revenue — Barter Transactions Involving Advertising Services*. The chapter on revenue is based on the currently applicable standards and interpretations, with a section devoted to the principles of AASB 15/IFRS 15 and their application.

A new IFRS on leases has been scheduled for release in the second half of 2015. Accordingly, the approach adopted in this book is based on AASB 117/IAS 17 *Leases*, supplemented by comprehensive coverage of the approach adopted by the IASB in developing the proposed new standard. The section explains the principles embodied in the new approach and illustrates their application.

Learning design

We recognise that a university textbook should not be written for practising accountants, but for those who are learning accounting prior to entering the accounting profession. Besides making explanations as simple as possible, we have not tried to cover everything that an accounting practitioner needs to know. We recognise that university students will undertake further education and professional qualifications. Hence, we have provided students with the basis necessary for further study. We see it as important that the basic principles are clear and well understood before more difficult issues are discussed.

The author team has brought their collective teaching insights to bear on the learning design of the text — the hallmark features of which include: an optimised mix of basic, moderate and difficult illustrative examples; a similar graduation with the end-of-chapter questions; applications in the form of case studies; and end-of-section learning checks to assist students to understand what they should now know and/or be able to do.

Concepts for review. This feature lists the prerequisite knowledge students need in order to understand the chapter. It prompts students to revise those concepts should they need to.

Learning objectives. The learning objectives have been designed to articulate into the broader Accounting Threshold Learning Objectives. They reflect the level of knowledge and skill that an accounting major should have acquired after studying each section of the chapter.

Key terms. The important terminology introduced in the chapter is bolded and coloured. These key terms help students identify the most important concepts. They are also listed at the end of each chapter to help students assess their knowledge.

AASB standards. Quotes from the AASB standards and explanations are included throughout the text. The equivalent international standard is also noted.

Illustrative examples. In each chapter a range of illustrative examples are provided to model how accounting principles are applied. The aim is to enable students to gradually build their understanding and skills by providing lower level examples initially and then progressing to more detailed scenarios as the chapter progresses.

Learning checks. A list of the main points covered in the topic appears at the end of every section. This helps students to revise and assess whether they need to study the section more before proceeding to the next one.

Chapter summaries. Each chapter concludes with a succinct overview of the key concepts and processes discussed in the chapter.

Application and analysis exercises. End of chapter exercises allow students to test their progress and whether they have understood what they have read. These exercises require the student to apply their knowledge to specific problems and scenarios and are at graduated levels of difficulty, allowing students to build confidence by achieving success with basic problems before tackling the more complex tasks.

Case studies. The case studies require the students to write a report explaining the accounting concepts relevant to a particular example/scenario. As part of this, they may have to solve problems, but the focus is on explaining the concepts.

Comprehension questions. Comprehension questions require the student to discuss, explain or apply a concept rather than simply restate it.

Threshold Learning Outcomes. There is a growing demand for graduates with strong skills in communication, problem solving, critical thinking and judgement, and the need to provide assurance that graduates have developed these skills. To this end, Threshold Learning Outcomes for accounting bachelors and coursework masters degrees have been developed. This text supports the development of these learning outcomes by highlighting which skills are developed across the end-of-chapter application and analysis exercises

WileyPLUS. The text is accompanied by a WileyPLUS course featuring algorithmic versions of most of the end-of-chapter questions plus animated examples of the key demonstration problems from the text with additional explanatory content to facilitate student self-study.

Supplementary materials

Financial Reporting 1st Edition is supported with an extensive teaching and learning resources supplementary package.

- *WileyPLUS* is a research-based online environment for effective teaching and learning. With *WileyPLUS*, lecturers can prepare, assign and grade accounting activities simply and in a time-efficient manner. *WileyPLUS* increases student confidence through an innovative design that allows greater engagement, which leads to improved learning outcomes. For more information, contact your John Wiley & Sons sales consultant or visit www.wileyplus.com.
- A solutions manual containing worked solutions to all end-of-chapter discussion questions, exercises, problems, case studies and activities is available for lecturers who prescribe this text. The solutions manual has been thoroughly checked for accuracy and correctness.
- PowerPoint Presentations contain over 1000 slides with summaries of key concepts and processes presented in the chapter as well as key diagrams and worked examples from the text.
- A testbank contains over 1000 multiple-choice questions designed to test students' knowledge and understanding of the key concepts from the text.

WileyPLUS

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Part 1

THEORY AND PRACTICE

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1

Accounting regulation and the conceptual framework

CHAPTER AIM

This chapter introduces the regulatory framework that governs financial reporting in Australia, including the conceptual framework and accounting standards issued by the Australian Accounting Standards Board (AASB) and the International Accounting Standards Board (IASB), the *Corporations Act 2001* and the Australian Securities Exchange Listing Rules.

LEARNING OBJECTIVES

After studying this chapter, you should be able to:

- 1 assess whether an entity is a reporting entity in the context of the regulation of financial reporting
- 2 identify the roles of the key bodies involved in accounting regulation in Australia
- 3 explain the structure, role and processes of the International Accounting Standards Board (IASB) and the IFRS Interpretations Committee (IFRIC)
- 4 explain the key components of the conceptual framework
- 5 explain the qualitative characteristics that make information in financial statements useful
- 6 discuss the going concern assumption underlying the preparation of financial statements
- 7 define the basic elements in financial statements — assets, liabilities, equity, income and expenses
- 8 explain the principles for recognising the elements of financial statements
- 9 distinguish between alternative bases for measuring the elements of financial statements
- 10 outline concepts of capital maintenance.

CONCEPTS FOR REVIEW

Before studying this chapter, you should understand and, if necessary, revise:

- the basic accounting system used to record and classify transactions
- the rules of double-entry accounting and how to apply these rules in analysing transactions
- the purpose and basic format of accounting journals, ledger accounts and financial statements.

1.1 Key sources of regulation of financial reporting in Australia

The major sources of regulation of financial reporting in Australia are:

- the *Corporations Act 2001*
- Australian Accounting Standards
- the *Framework for the Preparation and Presentation of Financial Statements*
- the Australian Securities Exchange Listing Rules.

1.1.1 The Corporations Act

Australian companies must comply with the requirements of the *Corporations Act 2001* (the **Corporations Act**). The Corporations Act covers many aspects of the management of companies and the relationships between the company — as a legal person — and directors, shareholders and others. Our discussion of the Corporations Act will focus on its implications for the preparation of financial statements, which are contained in Part 2M.3 of Chapter 2M of the Act.

The Corporations Act requires certain types of entities to prepare financial reports. The categories described in the Corporations Act are as follows.

- *Disclosing entity*. With few exceptions, entities whose securities are listed on a securities exchange are disclosing entities (Corporations Act s. 111AC).
- *Proprietary company*. To qualify for registration as a proprietary company under s. 45A of the Corporations Act a company must:
 - be limited by shares or be an unlimited company with a share capital
 - have no more than 50 non-employee shareholders
 - not do anything that would require disclosure to investors under Chapter 6D (except in limited circumstances).

Section 45A of the Act further classifies proprietary companies as small or large, as follows.

- *Small proprietary company*. A small proprietary company is a proprietary company that satisfies at least two of the following criteria, specified in s. 45A(2).
 - (a) The consolidated revenue for the financial year of the company and the entities it controls is less than \$25 million.
 - (b) The value of the consolidated gross assets at the end of the financial year of the company and the entities it controls is less than \$12.5 million.
 - (c) The company and the entities it controls have fewer than 50 employees at the end of the financial year.
- *Large proprietary company*. A proprietary company is a large proprietary company if it does not satisfy the definition of a small proprietary company.
- *Public company*. A public company means any company other than a proprietary company.
- *Registered scheme*. A registered scheme refers to a managed investment scheme that is registered under s. 601EB of the Corporations Act.

Accountants face two related questions.

- *Is the entity required to prepare a financial report?*
- *If so, does the report need to comply with Australian accounting standards?*

The answers to these questions are found in the Corporations Act. In relation to the second question, we will also need to refer to the AASB conceptual framework (particularly Statement of Accounting Concepts *SAC 1: Definition of the Reporting Entity*) and AASB 1053 *Application of Tiers of Australian Accounting Standards* for further information about the extent of the application of accounting standards.

Section 292 of the Corporations Act requires the preparation of a financial report and directors' report each financial year. This requirement applies to:

- (a) all disclosing entities; and
- (b) all public companies; and
- (c) all large proprietary companies; and
- (d) all registered schemes.

For example, Commonwealth Bank of Australia (CBA) is a public company registered in Australia. It is also a disclosing entity because its shares are listed on the Australian Securities Exchange (ASX). In accordance with s. 292 of the Corporations Act, CBA prepares an annual financial report and a directors' report. The directors' report of CBA includes information about the directors of the company, the company's principal activities, company operations, dividends, and compliance with environmental regulations, as well as a remuneration report.

Note that small proprietary companies are not required to prepare a financial report or a directors' report under s. 292 of the Corporations Act. Does this mean shareholders of small proprietary companies cannot obtain financial reports on the financial position and performance of the company in which they have invested? No — shareholders holding at least 5% of the voting power may give the company a direction to prepare a financial report and directors' report under s. 293 or, in the case of a small proprietary company limited by guarantee, a members' direction in accordance with s. 294A. When shareholders and members make directions for the preparation of financial reports they may specify that the report does not have to comply with accounting standards or that some part of the report does not have to be prepared. They may also specify whether the financial report needs to be audited. In addition, the Australian Securities and Investments Commission (ASIC) may make a direction for a small proprietary company to prepare a financial report and a directors' report under s. 294 or s. 294B. Section 292(2)(b) requires foreign-controlled small proprietary companies to prepare a financial report if the parent did not lodge consolidated financial reports for that year with ASIC.

Table 1.1 details the reporting requirements for various types of entities under the Corporations Act.

ILLUSTRATIVE EXAMPLE 1.1 | Preparation of a financial report according to the Corporations Act

Nature Walk Resort Pty Ltd is a proprietary company that operates a resort in the Australian outback. It has 10 shareholders and 28 employees. According to internal accounting records, Nature Walk Resort Pty Ltd has total assets of \$14 million and total liabilities of \$5 million. Its revenue for the current year was \$27 million. Neither ASIC nor shareholders have made a direction for the preparation of a financial report.

Is Nature Walk Resort Pty Ltd required to prepare a financial report?

Nature Walk Resort Pty Ltd is required to prepare a financial report in accordance with s. 292 of the Corporations Act because it is a *large proprietary company*. Nature Walk Resort Pty Ltd fails to satisfy the definition of a small proprietary company because it does not meet the minimum of two of the three criteria specified in s. 45A(2) of the Corporations Act. The company has less than 50 employees, but its total revenue is more than \$25 million and total assets are more than \$12.5 million.



Table 1.1 Reporting requirements for various types of entities under the Corporations Act

Type of entity	Reporting requirements
Disclosing entity	Disclosing entities are required to comply with continuous disclosure requirements and prepare annual and half-year reports that include a directors' report and directors' declaration, financial statements as required by the Australian accounting standards, and notes to the financial statements. Disclosing entities must have the financial report audited in accordance with Division 3 of Part 2M.3 of the Corporations Act and lodge the financial report, together with the directors' report and auditor's report, with ASIC.
Small proprietary company	Small proprietary companies are not required to prepare annual financial reports in accordance with Chapter 2M of the Corporations Act unless directed by ASIC or shareholders with at least 5% of the voting rights.
Large proprietary company	Large proprietary companies are required to prepare annual financial reports in accordance with Chapter 2M of the Corporations Act, and have the annual reports audited and sent to members within 4 months of the end of the financial year.
Public company	Public companies are required to prepare annual financial reports in accordance with Chapter 2M, have them audited, and lodge them with ASIC within 4 months of the end of the financial year. The reports must be sent to members by the earlier of 4 months after year-end or 21 days before the next annual general meeting.
Registered scheme	Responsible entities of the registered scheme must prepare financial reports, a directors' report and an auditor's report each financial year and lodge them with ASIC within 3 months of the end of the financial year.

The financial statements, including the notes, for a financial year must provide a true and fair view of the financial position and performance of the entity (Corporations Act s. 297). This section does not affect the obligation under s. 296 to comply with accounting standards. In other words, companies cannot rely on presenting a

true and fair view as an excuse for non-compliance with accounting standards. So what should the directors of a company do if they believe that compliance with accounting standards would not produce a true and fair view? In these circumstances the Corporations Act requires compliance with accounting standards and the inclusion of additional information in the notes to the financial statements so as to give a true and fair view.

The term ‘true and fair’ is not defined in the Corporations Act. However, auditing standard ASA 200 *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Australian Auditing Standards* indicates that ‘gives a true and fair view’ and ‘presents fairly’ are equivalent in all material respects. According to paragraph 15 of AASB 101 *Presentation of Financial Statements*, fair presentation requires the:

faithful representation of the effects of transactions, other events and conditions in accordance with the definitions and recognition criteria for assets, liabilities, income and expenses set out in the *Framework*.

The requirements for additional disclosure in the notes when necessary to present a true and fair view are considered further in chapter 16.

1.1.2 Australian accounting standards

Section 296 of the Corporations Act requires compliance with accounting standards issued by the AASB. Under the direction of the Financial Reporting Council (FRC), the AASB adopted **International Financial Reporting Standards (IFRSs)**, effective for reporting periods commencing on or after 1 January 2005. To achieve this, the AASB issues Australian Accounting Standards with requirements that are the same as those of IFRSs for application by for-profit entities.

The requirements of IFRSs have a significant impact on financial reporting in Australia because the standards issued by the AASB are Australian equivalents of IFRSs. So what are IFRSs? International Financial Reporting Standards comprise the authoritative pronouncements issued by the International Accounting Standards Board (IASB). They include two series of accounting standards and two series of interpretations:

- standards that are labelled IFRS (e.g. IFRS 8 *Operating Segments*)
- standards that originated as part of the older series of International Accounting Standards, originally issued by the International Accounting Standards Committee and reissued or revised and reissued by the IASB (e.g. IAS 16 *Property, Plant and Equipment*)
- interpretations issued by the IFRS Interpretations Committee (e.g. IFRIC 13 *Customer Loyalty Programmes*)
- interpretations issued by the former Standing Interpretations Committee (e.g. SIC 32 *Intangible Assets — Web Site Costs*).

The Australian equivalents of the IASB’s ‘IFRS’ series are numbered from AASB 1. For example, the Australian equivalent of IFRS 8 *Operating Segments* is AASB 8 *Operating Segments*. The Australian equivalents of the IASB’s ‘IAS’ series are numbered from AASB 101. For example, the Australian equivalent of IAS 16 *Property, Plant and Equipment* is AASB 116 *Property, Plant and Equipment*.

The AASB also issues Australian accounting standards that are not an equivalent of a corresponding standard issued by the IASB. These standards typically cover specific local requirements, such as additional disclosure requirements, and requirements for not-for-profit and public sector entities; for example, AASB 1051 *Land Under Roads*, which applies to the financial statements of various public sector entities.

The Corporations Act requires compliance with Australian accounting standards, which, in turn, are consistent with IFRSs. IFRSs include both standards and interpretations issued by the IASB. Interpretations do not have the same status as accounting standards under the Corporations Act. The AASB has addressed this problem by bringing the content of interpretations into the ambit of accounting standards. This is achieved through AASB 1048 *Interpretation of Standards*.

As noted above, accounting standards issued by the AASB have legislative backing under s. 334 of the Corporations Act. An exception is provided for small proprietary companies that prepare financial reports under the direction of shareholders or members, where the direction specifies that the report does not have to comply with accounting standards.

The inclusion of the **reporting entity** concept in most Australian accounting standards establishes a form of **differential reporting** whereby certain entities are allowed to adopt substantially reduced disclosures while complying with the recognition, measurement and presentation requirements of accounting standards. Most Australian accounting standards apply only to:

- each entity that is required to prepare financial statements in accordance with Part 2M.3 of the Corporations Act and that is a *reporting entity*
- general purpose financial statements of each *reporting entity*
- financial statements that are, or are held out to be, general purpose financial statements (essentially capturing those entities which opt for the preparation of general purpose financial statements).

The reporting entity concept is used to determine whether entities are required to prepare general purpose financial statements. Paragraph 40 of SAC 1 *Definition of the Reporting Entity*, which forms part of the Australian conceptual framework, states:

Reporting entities are all entities (including economic entities) in respect of which it is reasonable to expect the existence of users dependent on general purpose financial reports for information which will be useful to them for making and evaluating decisions about the allocation of scarce resources.

Deciding whether an entity is a reporting entity requires professional judgement. The critical factor in identifying an entity as a reporting entity is the existence of users who depend on general purpose financial statements produced by that entity for resource allocation decisions. Where dependence is not readily apparent, SAC 1 suggests some factors that might indicate the existence of user dependence:

- 20 The greater the spread of ownership/membership and the greater the extent of the separation between management and owners/members or others with an economic interest in the entity, the more likely it is that there will exist users dependent on general purpose financial reports as a basis for making and evaluating resource allocation decisions.
- 21 Economic or political importance/influence refers to the ability of an entity to make a significant impact on the welfare of external parties. The greater the economic or political importance of an entity, the more likely it is that there will exist users dependent on general purpose financial reports as a basis for making and evaluating resource allocation decisions. Reporting entities identified on the basis of this factor are likely to include organisations which enjoy dominant positions in markets and those which are concerned with balancing the interests of significant groups, for example, employer/employee associations and public sector entities which have regulatory powers.
- 22 Financial characteristics that should be considered include the size (for example, value of sales or assets, or number of employees or customers) or indebtedness of an entity. In the case of non-business entities in particular, the amount of resources provided or allocated by governments or other parties to the activities conducted by the entities should be considered. The larger the size or the greater the indebtedness or resources allocated, the more likely it is that there will exist users dependent on general purpose financial reports as a basis for making and evaluating resource allocation decisions.

Note that the definition of reporting entity requires only that there be a reasonable expectation that users exist. Thus an entity cannot claim to be a non-reporting entity merely because it is not aware of the identity of particular users.

Users who are able to demand financial statements to meet their specific needs would not be considered dependent users. The specific needs of such users can be satisfied through the preparation of special purpose financial statements. For example, the information needs of taxation authorities can often be satisfied by the preparation of financial statements tailored to meet their specific needs.

Does this mean that a non-reporting entity that is required to prepare a financial report in accordance with Chapter 2M of the Corporations Act need not be concerned with Australian accounting standards (other than AASB 101, AASB 107, AASB 108 and AASB 1048)? Not exactly. The guidance issued by ASIC on the application of the reporting entity concept in 'Regulatory Guide 85: Reporting requirements for non-reporting entities' specifies that the definition and measurement requirements of other Australian accounting standards should also be applied by non-reporting entities. Figure 1.1 provides an extract from Regulatory Guide 85 that explains why non-reporting entities should apply the recognition and measurement requirements of Australian accounting standards when preparing financial reports in accordance with the Corporations Act.

Figure 1.1 Application of recognition and measurement requirements to non-reporting entities

Section 2: Accounting provisions applicable to non-reporting entities

- 2.1 The accounting standards provide a framework for determining a consistent meaning of 'financial position' and 'profit or loss' in financial reporting across entities.
- 2.2 In the absence of any such framework, the figures disclosed in financial statements would lose their meaning and could be determined completely at the whim of the directors of individual entities. The profit or loss reported by an individual entity would vary greatly depending upon which individuals were responsible for the preparation of its financial statements.
- 2.3 This would not be consistent with the requirements of the Act for financial reports to give a true and fair view (s. 297), prohibiting the giving of false and misleading information (s. 1308), and only permitting dividends to be paid out of profits (s. 254T).
- 2.4 The following requirements of accounting standards that apply to all entities reporting under Chapter 2M are also relevant:
 - (a) Paragraph 13 of accounting standard AASB 101 *Presentation of Financial Statements* requires the financial report to present fairly the financial position, financial performance and cash flows. Fair presentation requires 'the faithful representation of the effects of transactions, other events and conditions' in accordance with the definitions and recognition criteria for 'assets', 'liabilities', 'income' and 'expenses' set out in the *Framework for the Preparation and Presentation of Financial Statements (Framework)*.

(continued)

Figure 1.1 (continued)

- (b) Paragraph 25 of AASB 101 requires all entities reporting under Chapter 2M to apply the accrual basis of accounting.
- (c) Paragraphs 10 and 11 of AASB 108 *Accounting Policies, Changes in Accounting Estimates and Errors* provides that, in the absence of an Australian Accounting Standard that specifically applies to a transaction, other event or condition, management should refer to, and consider the applicability of, the following sources in descending order:
 - (i) the requirements and guidance in Australian Accounting Standards dealing with similar and related issues; and
 - (ii) the definitions, recognition criteria and measurement concepts for assets, liabilities, income and expenses in the *Framework*.
- 2.5 Hence, the recognition and measurement requirements of accounting standards must also be applied in order to determine the financial position and profit or loss of any entity preparing financial reports in accordance with the Act.
- 2.6 As noted earlier, the recognition and measurement requirements of the accounting standards include requirements relating to depreciation of non-current assets, tax effect accounting, lease accounting, measurement of inventories, and recognition and measurement of liabilities for employee entitlements.
- 2.7 The provisions of accounting standards dealing with the classification of items as assets, liabilities, equity, income and expenses also apply. This would include the provisions of AASB 132 *Financial Instruments: Disclosure and Presentation* concerning the classification of financial instruments issued as debt or equity.
- 2.8 Class Order [CO 05/639] *Application of accounting standards by non-reporting entities* allows non-reporting entities to take advantage of concessions to the measurement requirements of accounting standards. Examples of these concessions include the provisions of AASB 1 *First-time Adoption of Australian Equivalents to International Financial Reporting Standards* and transitional provisions in new accounting standards.
- 2.9 Directors of non-reporting entities must also consider carefully the need to make disclosures which are not directly prescribed by accounting standards, but which may be necessary in order for the financial statements to give a true and fair view. Such disclosures could include certain significant related party transactions.
- 2.10 ASIC will look closely at cases where non-reporting entities have not complied with the recognition and measurement requirements of accounting standards.
- 2.11 Non-reporting entities which hold out their financial reports to be general purpose financial reports must comply with all requirements of accounting standards.

Source: ASIC (2005, pp. 5–6).

In 2010, the AASB provided further guidance on differential reporting by issuing an accounting standard AASB 1053 *Application of Tiers of Australian Accounting Standards* which introduces a two-tiers reporting system for companies producing general purpose financial statements. Companies complying with Tier 1 requirements will comply with all relevant accounting standards, whereas Tier 2 comprises the recognition, measurement and presentation requirements of Tier 1 but has substantially reduced disclosure requirements in comparison with Tier 1. Each Australian accounting standard sets out the disclosure requirements from which Tier 2 entities are exempted. This differential reporting requirement applies to annual reporting periods beginning on or after 1 July 2013. In relation to which companies shall comply with Tier 1 reporting requirements, paragraph 11 of AASB 1053 states:

- Tier 1 reporting requirements shall apply to the general purpose financial statements of the following types of entities:
- (a) for-profit private sector entities that have public accountability; and
 - (b) the Australian Government and State, Territory and Local Governments.

Given that public accountability is central to the requirement, Appendix A of AASB 1053 provides the definition as follows.

Public accountability means 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.

A for-profit private sector entity has public accountability if:

- (a) its debt or equity instruments are traded in a public market or it is in the process of issuing such instruments for trading in a public market (a domestic or foreign stock exchange or an over-the-counter market, including local and regional markets); or
- (b) it holds assets in a fiduciary capacity for a broad group of outsiders as one of its primary businesses. This is typically the case for banks, credit unions, insurance companies, securities brokers/dealers, mutual funds and investment banks.

Paragraph B2 of Appendix B to AASB 1053 further states:

The following for-profit entities are deemed to have public accountability:

- (a) disclosing entities, even if their debt or equity instruments are not traded in a public market or are not in the process of being issued for trading in a public market;
- (b) co-operatives that issue debentures;
- (c) registered managed investment schemes;

- (d) superannuation plans regulated by the Australian Prudential Regulation Authority (APRA) other than Small APRA Funds as defined by APRA Superannuation Circular No. III.E.1 *Regulation of Small APRA Funds*, December 2000; and
- (e) authorised deposit-taking institutions.

In regards to the types of companies that shall at least apply Tier 2 reporting requirements in preparing general purpose financial statements, paragraph 13 of AASB 1053 lists:

- (a) for-profit private sector entities that do not have public accountability;
- (b) not-for-profit private sector entities; and
- (c) public sector entities, whether for-profit or not-for-profit, other than the Australian Government and State, Territory and Local Governments.

In sum, for example, a large proprietary company must at least prepare Tier 2 financial statements. Companies applying Tier 2 reporting requirements would not be able to state compliance with IFRSs unless they elect to also apply Tier 1 reporting requirements.

Paragraph BC6 of AASB 1053 states that all companies including those eligible for the Tier 2 reduced reporting burden must apply in full the following Australian accounting standards:

- AASB 101 *Presentation of Financial Statements* (refer to chapter 16)
- AASB 107 *Statement of Cash Flows* (refer to chapter 17)
- AASB 108 *Accounting Policies, Changes in Accounting Estimates and Errors* (refer to chapter 18)
- AASB 1048 *Interpretation of Standards*.

ILLUSTRATIVE EXAMPLE 1.2 | Application of Australian accounting standards

Seaside Resorts Pty Ltd is a proprietary company that operates a holiday resort in the Whitsundays. It has 10 shareholders, all of whom are involved in the management of the company. Seaside Resorts Pty Ltd has 33 employees. According to internal accounting records, Seaside Resorts Pty Ltd has total assets of \$28 million and total liabilities of \$10 million, most of which represents a secured bank loan. Seaside Resorts Pty Ltd must provide the bank with financial information each year as specified in the loan agreement. Seaside Resorts Pty Ltd's revenue for the current year was \$24 million. Neither ASIC nor shareholders have made a direction for the preparation of a financial report.

Does Seaside Resorts Pty Ltd need to prepare a financial report and apply Australian accounting standards?

To address this question, it is necessary to first consider whether the Corporations Act requires Seaside Resorts Pty Ltd to prepare a financial report. If so, then we must consider whether Seaside Resorts Pty Ltd is a reporting entity and the implications of being either a reporting entity or a non-reporting entity.

Seaside Resorts Pty Ltd is not required to prepare a financial report in accordance with s. 292 of the Corporations Act because it is a small proprietary company. Seaside Resorts Pty Ltd satisfies the definition of a small proprietary company because it meets two

of the three criteria specified in s. 45A(2) of the Corporations Act, by having fewer than 50 employees and revenue less than \$25 million even though the company's total assets exceed \$12.5 million.

Seaside Resorts Pty Ltd is unlikely to be considered a reporting entity. The shareholders are unlikely to be dependent upon general purpose financial statements for their information needs because they are able to access internal financial information through their involvement in management. The major creditor is a bank that is able to demand special purpose financial statements under the terms of the loan. While it could be argued that employees are potential users of general purpose financial statements, Seaside Resorts Pty Ltd does not have many employees. Thus, it is not reasonable to expect the existence of users dependent upon general purpose financial statements.

However, if Seaside Resorts Pty Ltd is directed by the shareholders with at least 5% voting power to prepare a financial report under s. 293 of the Corporations Act, the financial report must comply with AASB 101, AASB 107, AASB 108 and AASB 1048 in full and apply the recognition and measurement requirements of accounting standards. Given that the company does not have public accountability, it is allowed to provide reduced disclosure through a regime of partial or full exemptions from the relevant accounting standards.

1.1.3 A conceptual framework

The purpose of a conceptual framework is to provide a coherent set of principles:

- to assist standard setters to develop a consistent set of accounting standards for the preparation of financial statements
- to assist preparers of financial statements in the application of accounting standards and in dealing with topics that are not the subject of an existing applicable accounting standard
- to assist auditors in forming an opinion about compliance with accounting standards
- to assist users in the interpretation of information in financial statements.

In Australia, the conceptual framework includes the AASB's *Framework for the Preparation and Presentation of Financial Statements* (which incorporates the IASB's *Conceptual Framework for Financial Reporting*) and