

ACC/ACF3100 Week 1 Tutorial Solutions
The Australian Accounting Environment

Henderson et al. Chapter 1

Questions

1. Outline the main sources of regulation governing accounting policies and financial reporting practices in Australia.

The three main sources of regulation governing accounting policies and financial reporting practices in Australia 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).

Government Legislation:

In the private sector, the most important legislation specifying financial reporting requirements is the *Corporations Act 2001*. In particular, the Corporations Act specifies general requirements that require the financial report to comply with accounting standards and to 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 issued by the Australian Accounting Standards Board (AASB) that are discussed in later chapters of this book.

ASX Listing Rules:

The listing rules of the ASX apply only to entities whose securities are listed on the ASX. 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 (e.g. various disclosures relating to the 20 largest holders of each class of quoted equity securities). If a listed company does not comply with the ASX Listing Rules, it may be delisted.

The ASX has also issued *Corporate Governance Principles and Recommendations* as amended in 2014 through its Corporate Governance Council. There are eight guidelines to which 29 recommendations are attached. The guidelines and associated recommendations are not mandatory. However, the listing rules include two mandatory requirements relating to the corporate governance guidelines. 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 S&P/All Ordinaries Index have an audit committee and that companies included in the S&P/ASX 300 Index have an audit committee that is constituted in accordance with the *Corporate Governance Principles and Recommendations*.

Accounting Standards and Other Pronouncements Issued by the AASB:

The third source of regulation governing financial reporting is accounting standards and interpretations prepared by the Australian Accounting Standards Board (AASB). Accounting standards and interpretations are concerned with both accounting measurement and disclosure. Authority is provided to AASB accounting standards by the Corporations Act. The Accounting Professional and Ethical Standards Board (APESB) provides similar authority for Australian accounting standards via *APES 205 'Conformity with Accounting Standards'* (para. 5).

3. Outline the contents of the professional and ethical standard APES 205 Conformity with Accounting Standards. Explain the relevance of APES 205 to professional accountants.

The Australian Professional and Ethical Standards Board (APESB) was established as an initiative of CPA Australia and the then ICAA (now CAANZ) primarily to develop and issue appropriate professional and ethical standards for their membership. (The IPA has subsequently become a member.)

The APESB has reviewed existing professional and ethical standards such as the old Code of Professional Conduct and Miscellaneous Professional Statements (APS series) and guidance notes (GN series). The subsequent APES series of ethical and professional standards approved by the APESB are mandatory for accountants who are members of CPA Australia, the ICAA and the IPA.

The specific professional standard and ethical standard **APES 205 ‘Conformity with accounting standards’** requires members to comply with accounting standards as follows:

4.3 Members who are involved in, or are responsible for, the preparation and/or presentation of Financial Statements of a Reporting Entity shall take all reasonable steps to ensure that the Reporting Entity prepares General Purpose Financial Statements.

5.1 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.

5.2 Where Members are unable to apply Australian Accounting Standards pursuant to paragraph 5.1, they shall take all reasonable steps to ensure that any departure from Australian Accounting Standards, the reasons for such departure, and its financial effects are properly disclosed and explained in the General Purpose Financial Statements.

5.5 Members in Public Practice shall take all reasonable steps to ensure that Clients have complied with Australian Accounting Standards when they perform an Audit or Review Engagement or a compilation Engagement of General Purpose Financial Statements which purport to comply with the Australian Financial Reporting Framework.

Compliance with *APES 205* is mandatory for members of the professional accounting bodies, and non-compliance represents a breach of the code of ethics issued by the Accounting Professional and Ethical Standards Board. Failure by members to comply with the requirements of *APES 205* could result in disciplinary proceedings being brought against them, which could result in the imposition of a fine or expulsion from the professional body.

4. Describe the present institutional arrangements for setting accounting standards in Australia. Your answer should include discussion of the role of the FRC and the AASB.

The present institutional arrangements for accounting standard-setting in Australia are summarised in Figure 1.1 in Chapter 1.

Financial Reporting Council:

The Financial Reporting Council (FRC) is a statutory body under the *Australian Securities and Investments Commission Act 2001*. It is the peak body responsible for the broad oversight of the accounting and auditing standard-setting process in Australia. 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).

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 Minister. 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 world-wide use and promoting the adoption of these standards.

Although the FRC has wide-ranging powers, the FRC cannot 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 direct the AASB in relation to the development or making of a particular standard.

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. <www.frc.gov.au>.

Australian Accounting Standards Board:

The Australian Accounting Standards Board (AASB) began operations in 1991, replacing the Australian Accounting Standards Review Board (ASRB). At this time, the ASRB was Australia's sole standard-setting body for the private sector and its activities were complimented by the Public Sector Accounting Standards Board (PSASB) which developed accounting standards applicable to all other reporting entities. The passage of CLERP in October 1999 resulted in the activities of the PSASB merging into 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 for entities in the public sector and the remainder of the non-corporate sector. The AASB's major functions are specified in section 227(1) of the Australian Securities and Investments Commission Act as follows:

- 1) to develop a conceptual framework, not having the force of an accounting standard, for the purpose of evaluating proposed accounting standards and international standards;
- 2) to make accounting standards under section 334 of the *Corporations Act 2001* for the purposes of the national scheme laws;
- 3) to formulate accounting standards for other purposes;
- 4) to participate in and contribute to the development of a single set of accounting standards for worldwide use; and
- 5) to advance and promote the main objectives of Part 12 of the Act as set down in section 224, which include reducing the cost of capital, enabling Australian entities to compete effectively overseas and maintaining investor confidence in the Australian economy.

The Minister appoints the chair of the AASB, and the chair is subsequently accountable to the Minister regarding the operations of the AASB. The AASB comprises nine part-time members

plus the full-time chair. Member appointments to the AASB are made by the FRC from nominations received from a number of bodies including CPA Australia, the ICAA, the Business Council of Australia and the ASX. In addition, the AASB presently has one observer – the member of the International Accounting Standards Board, the Australian representative of the IFRS Interpretations Committee. Meetings of the AASB are open to the public. <www.aasb.com.au>.

The Office of the AASB:

The *Governance Review Implementation (AASB and AUASB) Bill 2008* was passed by Parliament in June 2008. *Inter alia*, the Bill established the Office of the AASB to support the operations of the AASB through the provision of technical and administrative services, information and advice. The chief executive officer of the Office is the chair of the AASB, who is also responsible to the Minister for the financial management of the Office.

The Minister:

The Minister is one of three Treasury Ministers from the Federal Government.

6. (a) Briefly describe the procedures for preparing accounting standards in Australia.

The due process used to develop an accounting standard is summarised in Figure 1.2 in Chapter 1. The first step is *identification of a technical issue* to be added to the AASB's work program. This can happen in one of three ways:

- 1) Inclusion in the AASB's program of issues on the International Accounting Standards Board's (IASB) and the International Financial Reporting Interpretations Committee's (IFRIC) work programs;
- 2) Inclusion in the AASB's program of issues on the International Public Sector Accounting Board's (IPSASB) work program; and
- 3) Inclusion in the AASB's work program of issues identified by AASB Board members and staff, as well as Australian organisations and individuals. (Issues relating to for-profit entities are normally referred to the IASB or IFRIC for consideration, while issues relating to not-for-profit entities may be referred to the IPSASB or addressed domestically.)

The second step involves the development of a *project proposal* by the AASB. This contains an assessment of the potential benefits of the project, the potential costs of not undertaking it, resource availability and timing. After reviewing the proposal the AASB makes a decision on whether to place the project on its agenda (and therefore work program).

Once an issue is included on the AASB's agenda, the third step involves the preparation of *agenda papers* by AASB staff. Agenda papers consider the scope of issues, alternative approaches, and the timing of outputs. They are prepared using material drawn from the IASB, IPSASB, the New Zealand Accounting Standards Board, and other such organisations.

The fourth step involves the exposure of the results of the research conducted in step three to facilitate *public comment and discussion with stakeholders* in the form of:

- Discussion Papers (DP) outlining a wide range of possible accounting policies on a particular topic;
- Exposure Drafts (ED) of a proposed standard or amendment to a standard;
- Invitations to Comment (ITC) that seek feedback on broad proposals; or
- Draft Interpretations of a standard.

Feedback from the public and stakeholders may be obtained through round-table discussions with stakeholders, Focus Groups, Project Advisory Panels, Interpretation Advisory Panels, and the Academic Advisory Panel.

The fifth step involves Board discussion of the results of the feedback received on an agenda item. There are two possible outcomes from this discussion:

- 1) A standard is not issued. In this situation, the Board notes its view in the minutes of a meeting or in a formal Board agenda decision.
- 2) An accounting standard is issued.

(b) Find an example of an issue currently under consideration as a potential accounting standard from the AASB website <www.aasb.gov.au>.

Students should visit the Work in Progress page on the AASB website <www.aasb.gov.au>.

8. What is the purpose and scope of AASB Interpretations?

AASB Interpretations are designed to provide timely guidance to preparers of financial statements on various financial reporting issues. For example, sometimes after an accounting standard is issued, problems occur in its implementation where diversity in practice arises because financial statement preparers interpret the requirements of the standard in diverse ways. In addition, financial reporting problems may arise which do not warrant either amendments to an existing standard or the preparation of a new standard. In these cases, it may have been appropriate to resolve the problems by issuing an interpretation to clarify, explain or elaborate upon existing standards. Thus, interpretations have a much narrower scope than accounting standards. They do not introduce ‘new’ requirements, rather they clarify the application of the existing requirements in the relevant accounting standards.

12. Explain how accounting standards are enforced.

There are three groups responsible for enforcing the accounting standards issued by the AASB. They are: the accounting bodies; the Australian Securities and Investments Commission; and governments. The enforcement mechanisms employed by each of these groups are considered in turn.

Accounting Bodies:

The profession’s attitude towards accounting standards has changed from regarding them merely as recommendations during the 1960s to making them mandatory in the 1990s.

The Australian Professional and Ethical Standards Board (APESB) was established in 2006 as an initiative of CPA Australia and the then ICAA (now CAANZ) primarily to develop and issue appropriate professional and ethical standards for their membership. Of these professional standards and ethical standards, *APES 205* 'Conformity with accounting standards' requires members to comply with accounting standards as follows.

4.3 Members who are involved in, or are responsible for, the preparation and/or presentation of Financial Statements of a Reporting Entity shall take all reasonable steps to ensure that the Reporting Entity prepares General Purpose Financial Statements.

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5.5 Members in Public Practice shall take all reasonable steps to ensure that Clients have complied with Australian Accounting Standards when they perform an Audit or Review Engagement or a compilation Engagement of General Purpose Financial Statements which purport to comply with the Australian Financial Reporting Framework.

Compliance with *APES 205* is mandatory for members of CPA Australia and the ICAA, and non-compliance represents a breach of the *Code of Professional Conduct* of the accounting bodies. Failure by members to comply with the requirements of *APES 205* could result in disciplinary proceedings being brought against those members, which could result in a fine or expulsion from the professional body.

Australian Securities and Investments Commission:

Accounting standards issued by the AASB are supported by the *Corporations Act 2001*. This law applies only to those entities required to report under the *Corporations Act 2001*.

Under section 296 of the *Corporations Act 2001*, the governing board of a company is required to comply with AASB accounting standards in preparing financial reports. Failure to comply is an offence under the Corporations Act which could lead to prosecution by ASIC.

Governments:

A standard-setting board cannot issue accounting standards that are legally binding on governments. It is the responsibility of the relevant legislatures to require compliance with accounting standards. Various pieces of legislation require the use of accounting standards in the preparation of financial reports by reporting entities in the public sector. For example, Commonwealth statutory authorities and some Commonwealth departmental authorities are required to comply with accounting standards as a result of guidelines issued pursuant to the *Audit Act 1902*. The various Australian States and Territories have similar pieces of legislation.

14. (a) ASIC conducts regular reviews of reporting entities' financial statements to ensure that investors, creditors and other users of those statements are provided with relevant, reliable, and comparable decision useful information. The quality of financial reporting is evaluated by ASIC on the basis of reporting entities' compliance with Australian accounting standards. The reviews assist ASIC in meeting its legislative obligations and

signal to financial statement preparers and users that ASIC takes its responsibilities seriously. The reviews can also serve an educative purpose by assisting entities to understand the application and interpretation of reporting regulations.

(b) Accounting for the extractive industries is covered in Chapter 19. However, students can be encouraged to consider how the nature of the mining and renewable energy industries can impact on financial reporting practices. For example, most students are likely to understand that mining is highly risky because of factors such as the uncertainties associated with finding economically recoverable reserves and the fluctuations associated with the market prices for commodities. Consequently, the value of mining companies' assets can be highly sensitive to these risks and so issues of asset carrying value and potential impairment are of considerable importance to mining companies. For instance, during 2016, many Australian entities that mined iron ore and produced steel were forced to undertake significant impairment of their assets as a result of the collapse of the market price for iron.