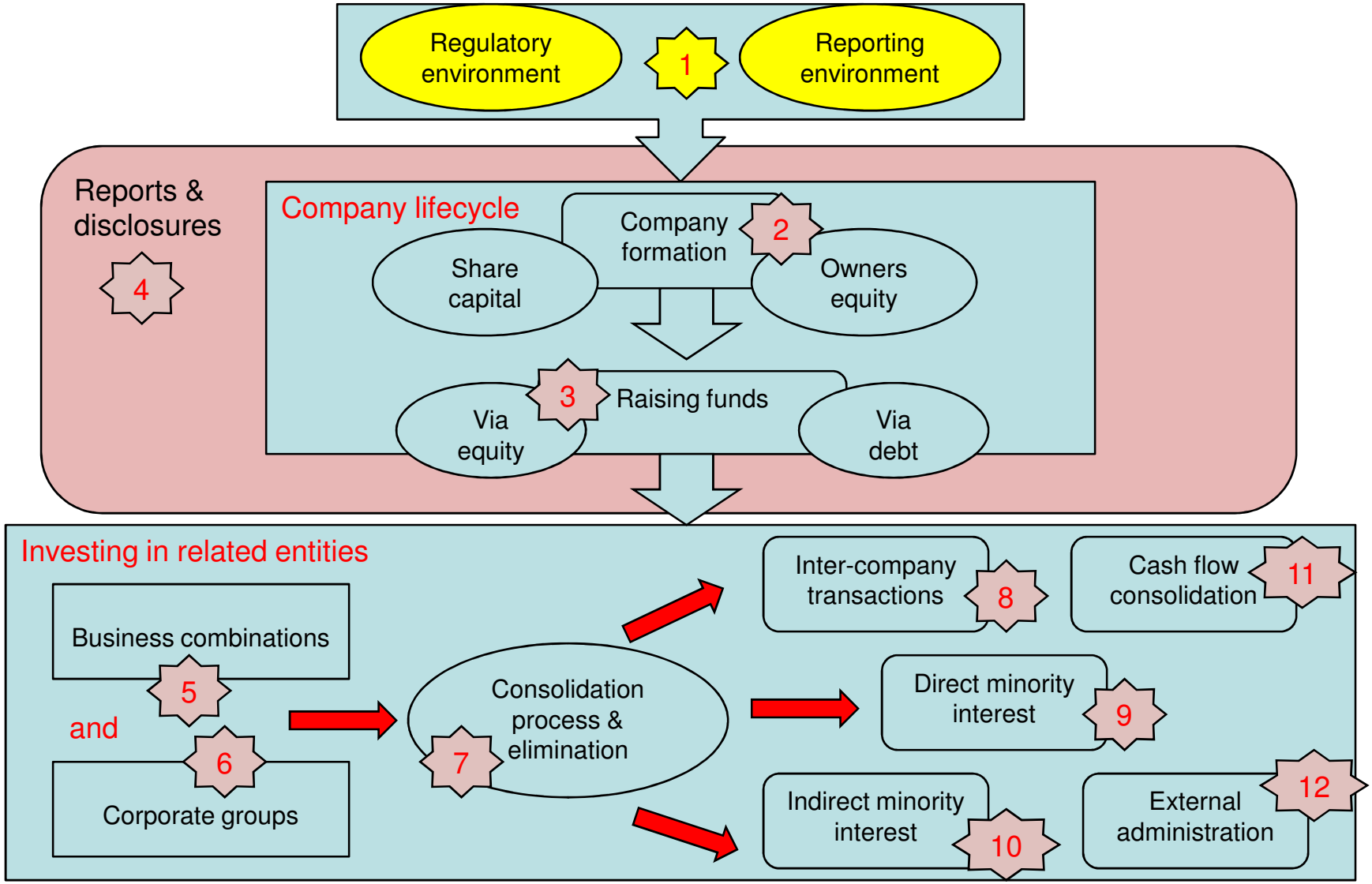
HA2032
Corporate Accounting

Topic 1
Corporate Regulation & Reporting

Studying Corporate Accounting



Characteristics of Companies

- Separate legal identity
- Limited liability
- Ownership by share
- Perpetual succession
- Ability to raise capital
- Professional management.

© Holmes Institute 2009

Types of Companies

- Allowable company structures in Australia:
  - public companies
  - small proprietary companies
  - Large proprietary companies
- Mode of participation
  - share company
  - guarantee company.
- Extent of liability
  - limited liability
  - no liability
  - unlimited liability.

© Holmes Institute 2009

Types of Companies (cont)

- Special types of companies
  - investment
  - banking
  - life insurance
  - foreign.

© Holmes Institute 2009

Historical evolution of regulation

- Companies were uncommon until the late 19th Century
- Based on British system
- Mainly restricted to government/quasi-government and religious organisations
- Early concern over fraud and manipulation
- Limited liability was applicable since 1855
- Australia
  - initially administered by states
    - no uniformity until 1960s
    - *Uniform Companies Act.*
  - National Cooperative Scheme (1981)
    - National Companies and Securities Commission.
  - *Corporations Act 1989* and the Corporations Law.

© Holmes Institute 2009

The Corporations Act and reporting

- Accounting requirements are generally of two types:
  1. requirements that relate to the way in which financial data are recorded in the company's accounting system
  2. requirements that relate to the drawing up of compulsory reports that are prepared for the benefit of company members and others.

.

© Holmes Institute 2009

The FRC and the AASB

- The Financial Reporting Council (FRC):
  - formed in 2000
  - its powers and responsibility are specified in s.225 of ASIC Act:
  - oversees the AASB and its activities
  - funds AASB
  - provides oversight of accounting standard-setting process.

© Holmes Institute 2009

The FRC and the AASB (cont)

- The Australian Accounting Standards Board (AASB)
- Replaced the ASRB in 1991
- Functions include:
  - develop a conceptual framework
  - make accounting standards
  - participate in, and contribute to, the development of a single set of accounting standards.

© Holmes Institute 2009

AASB accounting standards

- AASB accounting standards have the 'force of law' under s.334(1) of the *Corporations Act* in the following ways:
  - company directors must ensure the company's financial statements comply with accounting standards
  - auditors of companies are required to state whether accounts have been made out in accordance with accounting standards.

© Holmes Institute 2009

International standards and AASB

- In 2002, the FRC announced that Australia would adopt International Accounting Standards Board (IASB) standards in full from the 1st January 2005.
- Most AASB standards have been replaced with (IFRS).
- All of IFRSs have an AASB equivalent, three groups of AASB standards:
  1. three-digit numbers: corresponding to IAS series
  2. one-digit numbers: corresponding to IFRS series
  3. four-digit numbers: existing Australian standards with no corresponding IFRS.

© Holmes Institute 2009

Other accounting authorities

- Most important sources of authority for financial reporting:
  - The *Corporations Act*
  - AASB accounting standards
  - Other authorities:

1. Urgent Issues Group (UIG)
2. Accounting bulletins
3. ASX listing rules
   - An entity whose securities are listed must agree to abide by the rules of the exchange.
   - These rules do not conflict with the Corporations law or accounting standards, but are complementary or additional to those authorities.
4. ASIC practice notices

© Holmes Institute 2009

Enforcement of financial reporting reqmt

- ICAA and CPA Australia enforce financial reporting-related requirements through rules of professional conduct
- ASIC is responsible for enforcement of accounting standards
- Auditor must advise ASIC if the company does not comply with accounting standards.

© Holmes Institute 2009

Thrust of legislative reforms

- Streamlining reporting requirements
- Specification in accounting standards rather than the law
- Simplification of corporate administration
- Differential reporting requirements
- Re-organisation of legal provisions
- Changes to corporate governance
- 1st *Corporations Law Simplification Act 1995*
- *Company Law Review Act 1998*
- *Corporations Act 2001.*

© Holmes Institute 2009

Reasons for corporate disclosure

- Public interest
- Protection of members
- Predicting investment returns
- Stewardship
- Information useful for decision-making
- Arguments against compulsory reporting:
  - decision usefulness: too little or too much information
  - self-interest of profession
  - accountability: misleading published financial reports.

© Holmes Institute 2009

Objectives of Corporations Act

- The Act requires financial reports give a 'true and fair view' of the financial position and performance of the entity (s. 297)
  - Meaning that mere compliance with accounting standards may be insufficient (s.295(3))
  - 'True and fair' is not defined by the Act
  - However, it is based on reasoned judgment and ethical fair play
  - Flexibility and interpretation are integral to relevance and reliability of financial information.

© Holmes Institute 2009

Objectives of Corporations Act (cont)

- AASB 101 *Presentation of Financial Statements* states that:
  - ‘A financial report shall present fairly the financial position, financial performance and cash flow of an entity. Fair presentation requires the faithful representation of the effects of transactions, other events and conditions in accordance with definitions and recognition criteria for assets, liabilities, income and expenses set out in the *Framework*. The application of [accounting standards], with additional disclosure when necessary, is presumed to result in a financial report that achieves a fair presentation.’

© Holmes Institute 2009

The conceptual framework

- In the 1990s, a set of Statements of Accounting Concepts (SACs) started to develop. The four issued SACs are:
  - SAC 1: Definition of the Reporting Entity
  - SAC 2: Objectives of General Purpose Financial Reporting
  - SAC 3: Qualitative Characteristics of Financial Information
  - SAC 4: Definition and Recognition of the Elements of Financial Statement.

© Holmes Institute 2009

The conceptual framework (cont)

- SACs are benchmarks used in developing accounting standards and can be used to analyse and understand accounting standards requirements.
- The IASB *Framework* predates the SACs in 2005. However, it is not as comprehensive as the four Australian SACs.
- Thus, the AASB retains SACs 1 & 2 to fill in the gaps in the *Framework*. SACs 3 & 4 are withdrawn.

© Holmes Institute 2009

The reporting entity and its users

- Reporting entity concept – to help decide which entities must comply with accounting standards
- Each reporting entity is required to prepare financial reports in accordance with Part 2M.3 of the *Corp Act*
- Financial reports are general purpose financial reports
- Part 2M.3 requires financial report each year from:
  - all disclosing entities formed in Australia
  - all public companies
  - all large proprietary companies
  - all registered schemes
  - small proprietary companies under some circumstances e.g. controlled by a foreign company.
- However, they are not necessarily reporting entities.

© Holmes Institute 2009

The reporting entity and its users (cont)

- Most small proprietary companies are not reporting entities
- Most accounting standards only apply to reporting entities, except core accounting standards, AASB 101 & 107.

© Holmes Institute 2009

Characteristics of financial information

- All reports should be characterised by:
  - accrual basis
  - going concern.
- All reports should possess these desirable characteristics:
  - understandability
  - relevance
  - materiality
  - reliability
  - comparability.

© Holmes Institute 2009

Elements of financial statements

- Definition and recognition criteria of elements are now contained under the *Framework*, prior to 2005 they appear in SAC 4.
- Assets
  - Future economic benefits are expected to flow in to the entity
  - Resource controlled by the entity
  - Resulting form past transactions or other past events
- Liabilities
  - The entity is presently obliged
  - Resulting from past transactions or events
  - The settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits.

© Holmes Institute 2009

Classification related terms

- Current versus non-current
- Tangible versus intangible
- Monetary versus non-monetary
- Financial instruments (AASB 132)
  - Financial assets versus other assets
  - Financial liabilities versus other liabilities
  - Equity instruments.

© Holmes Institute 2009

Measurement related terms

- Historical cost
- Replacement cost
- Current cash equivalent
- Net present value
- Net realisable value
- Lower of cost and net realisable value
- Recoverable amount
- Fair value
- Marking to market.

© Holmes Institute 2009

Topic 1 tutorial questions

- Chapter 2

Qu 2.7, 2.11, 2.12

- Chapter 3

Qu 3.1, 3.8, 3.14

© Holmes Institute 2009