Corporate Reporting

Lecturer-in-charge

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Corporate Reporting?

- Does a company need to follow some rules when preparing its FSs? Who sets up the rules? What types of financial reports should a company prepare for its users?
- If a company owns more than 50% shares in another company, should two company's FSs be consolidated (added up)? If so, how to do it?
- How about if a company owns less than 50% shares in other companies? Any different requirements regarding its FSs?

Coverage

- Week 1: The corporate reporting environment in Australia. What rules should follow? Who sets up rules? What are the consequences if a company fails to follow the rules?
- Week 2-3: How to prepare FS according to relevant Accounting standards?

- Week 4-5: Accounting for income tax, difference b/w income tax calculated for accounting profit and tax purpose
- Week 6: Accounting for business combination, revaluation, and goodwill
- Week 7: Mid-semester test
- Week 8: Anzac holiday

- Week 9, 10 and 11: Consolidated financial statements. How to combine FS for two more companies?
- Week 12: Accounting for equity accounting (Investments 20%-50% in another Co)
- Week 13: Accounting for Joint ventures (each participant has equal interest in another Co or operation) and Revision

Class Requirements

- 1 x two-hour lecture on Wednesdays
- 1 x one hour tutorial

- Enrolment for tutorials will be done Through **OASIS system**.
- For guidance contact Students Office

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Assessment

• **Assignment**	15%
(Due on 1st June 2012 at 17:00)	
• **Mid semester Examination**	15%
(18th April 2012)	
• **Final Examination**	<u>70%</u>
	100%

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Mid-Semester Examination

- On 18th April 2012, Wednesday, 1 ½ hours
- Preparing FSs along with notes in accordance with applicable accounting standards.
- Formats for the statements will be provided.
- You will **NOT** be permitted to bring the Accounting Handbook.
- Bring a calculator

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Final Examination

- 2 hours
- The Accounting Handbook is **not permitted** in the examination hall.
- Students need to pass the final exam (40%) in order to pass this subject

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LMS (Moodle)

- **LMS (Moodle) for this subject can be accessed from**
- **<u>https://www.latrobe.edu.au/lms/login/</u>**
- ***Use your own username and password***
- ***Issued by Student Center***

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Lecture Notes

- **Student Versions:**
  - **Have been put on the website;**
  - **Print, bring to the lectures and take notes**
  - **Some slides are deliberately left blank;**
  - **May be important issues;**
- **Complete versions of lecture notes, tutorial solutions will be posted one week after the class.**

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Corporate Reporting

Lecture 1:

An Overview of the Australian External Reporting Environment

Lecture Topics

- Definition of a company
- Characteristics of a company
- Classifications of companies

- The general functions of the Australian Securities and Investments Commission (ASIC), the Australian Accounting Standards Board (AASB) and Financial Reporting Council (FRC)
- They are responsible for setting up reporting and disclosure requirements

Lecture Topics

- The general functions of the International Accounting Standards Board (IASB) and its direct relevance to Australian accounting standard setting
- Conceptual Framework and its relevance to financial reporting

The Nature of A Company

- The Company has all the powers as set out in Section 124 (1) of *Corporations Act 2001.*

Powers of a company

(a) issue and cancel shares in the company

(b) issue debentures

(c) grant options over unissued shares in the company

(d) distribute any of the company’s property among members, in kind or otherwise

(e) give security by charging uncalled capital

(f) grant a floating charge over the company's property. (Mortgaging)

(g) arrange for the company to be registered or recognised as a body corporate in any place outside this jurisdiction

(h) do anything that it is authorised to do by any other law (including a law of a foreign country).

Note: A company limited by guarantee does not have the power to issue shares.

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Characteristics of a company

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Characteristics of a company

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Types of Companies

- Size of ownership
  - public company
  - large proprietary company
  - small proprietary company

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Public Company

- Can raise capital from general public.
- No upper limit on the number of shareholders.
- At least three directors.
- Wider distance b/w management and owners.
- More strictly regulated (reporting, disclosure and auditing requirement).

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Proprietary Company

- Must have a share capital, can only be limited by shares, not by guarantee.
- At least one shareholder, no more than 50.
- no restriction on the transfer of its shares
- must not engage in any fund raising activity in public
- must have the word "Proprietary' or the abbreviation 'Pty' as part of its name
- no obligation to hold a annual general meeting.
- But still need to prepare financial reports and have those reports audited if it is large.

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Public and large proprietary companies have to:

- prepare financial statements that comply with accounting standards
- have their financial statements audited
- have statements sent to shareholders if:
  - so requested by ASIC; or
  - so requested by shareholders holding at least 5% of the voting shares.

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The Small Proprietary Company

- Satisfy at least two of following conditions:
  - Employees < 50
  - Gross operating revenue < $25 m
  - Gross assets < $12.5m
- No need to prepare formal financial statements or to have them audited, unless required by
  - ASIC; or
  - shareholders holding at least 5% of the voting shares.

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Types of Companies

- Mode of participation
  - share company: owned by shareholders
  - guarantee company: owned by guarantors, in the event of liquidation, each member undertakes to pay up an agreed sum to meet the shortfall.

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- Extent of liability
  - limited liability. a member’s liability is no more than that owed to company itself, if shares full paid, no liability, partly paid, outstanding balance.
  - no liability. A member’s liability does not exceed the amount paid. Company name should have words No Liability, NL
  - unlimited liability. Shareholders are liable for all liability incurred in company.

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<u>Example</u>

- A company issues 100,000 shares, the issuing price is $1.00 and paid up to 80 c.
- In the event that A Ltd is liquidated:
  - Each shareholder needs to pay additional 20 c if A is a limited liability company.
  - Does not need to pay extra 20 c if A is a no liability company

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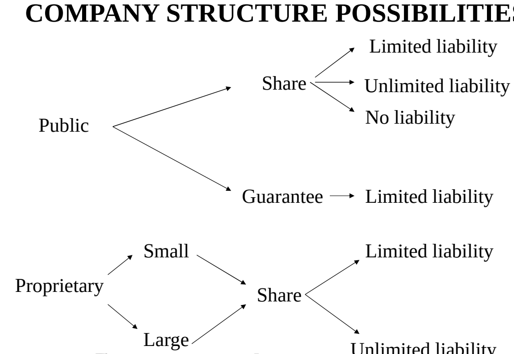
COMPANY STRUCTURE POSSIBILITIES



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Sources of external financial reporting regulation

Four main bodies that formulate and/or enforce accounting regulations in Australia

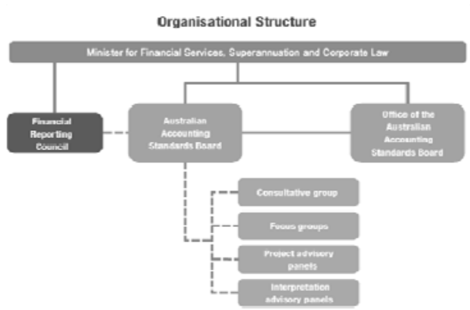
1. The Australian Accounting Standards Board (AASB)
2. The Financial Reporting Council (FRC)
3. The Australian Securities and Investments Commission (ASIC)
4. The Australian Securities Exchange (ASX)

Sources of external financial reporting regulation

Australian Accounting Standards:

- Adopt from International Accounting Standards
- Issued by The Australian Accounting Standards Board (AASB)
- Enforced by the Australian Securities and Investments Commission (ASIC)
- For listed public companies, also need to follow the listing rules issued by ASX

The Structure for Australian Accounting Standard Setting



http://www.aasb.gov.au/About-the-AASB/Organisational-structure.aspx

1. Australian Accounting Standards Board (AASB)

- Australia has adopted International accounting standards since 2005
- Developing accounting standards now is in the hands of IASB (international Accounting Standards Board).
- Minor changes can be made by AASB, such as removing some options, adding more explanatory materials.

Functions of AASB

- Functions (under s. 227 of *ASIC Act*) include:
  - developing a conceptual framework
  - making accounting standards that have force of law under s. 334 of the *Corporations Act*
  - formulate accounting standards for other purposes:
    - for entities not governed by The Corporations Law
  - participate in and contribute to the development of a single set of accounting standards for worldwide use

2. Functions and powers of the Financial Reporting Council (FRC)

- Provide broad oversight of the process for setting accounting standards
- Appoint members of the AASB
- Approve and monitor the AASB’s priorities, business plan, budget and staffing
- Give the AASB directions, advice or feedback on matters of general policy
- No power to direct AASB re-development of particular standards
- No power to veto a standard
- Powers expanded in 2003 to include overseeing the activities of AUASB—AUASB moved from the AARF

Interpretations

- Interpretations are issued by the AASB to provide requirements concerning urgent financial reporting issues
- The AASB will, from time to time, establish Interpretation Advisory Panels to address urgent issues. These panels will be comprised of experts in the relevant area of financial reporting
- Interpretations are not accounting standards but nevertheless are required to be followed pursuant to AASB 1048

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3. Australian Securities and Investments Commission (ASIC)

- Formerly the Australian Securities Commission (ASC)
- Responsible for administering corporation legislations, especially the enforcement of *Corporations Act*
- Independent of state ministers or state parliaments
- Reports to the Commonwealth Parliament and Treasurer

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Corporation Law

The Corporations Law

- Requires preparation of 'true and fair' financial statements by directors of public companies, large proprietary companies, organisations with securities listed on the ASX, and some small proprietary companies

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Financial statements

Defined in the *Corporations Act* (s. 295(2)) as:

- a statement of financial position as at the end of the period (previously referred to as the balance sheet)
- a statement of comprehensive income for the period
- a statement of changes in equity for the period
- a statement cash flows for the period
- notes, comprising a summary of significant accounting policies and other explanatory notes

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True and fair view

- No definition of 'true and fair' provided in the *Corporations Act*
- But if accounts *are* to be considered 'true and fair' they should include all information of a 'material' nature

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Definition of 'material' (AASB 1031, par. 4.1)

- Information is material if its omission, misstatement or non-disclosure has the potential, individually or collectively, to:
  - influence the economic decisions of users taken on the basis of the financial report; or
  - affect the discharge of accountability by the management or governing body of the entity.

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Disclosure requirements

- According to *Corporations Act*, directors of large and listed companies, as well as some other entities, are required to attach to financial statements:
  - –Directors' Declaration
  - –Directors' Report

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Directors' Declaration

Directors required (s. 295(4) of the *Corporations Act*) to:

- – state whether, in their opinion, the accounts are true and fair
- – give details of any significant after-balance-date events
- – state whether or not, in their opinion, there are any grounds to believe that the company will be unable to pay its debts as and when they fall due

- If declaration is made fraudulently, carelessly or recklessly they may be liable for outstanding debts of the company

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Directors' Report

According to ss. 298–300 of *Corporations Act, Director's Report* is to provide information concerning:

- – names of directors
- – details of directors' emoluments
- – principal activities of the company
- – review of operations during the year
- – significant changes in the state of affairs of the company
- – likely future developments
- – significant post-balance-date events
- – compliance with environmental laws

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ASIC (cont.)

Directors' Report (cont.)

From July 2004 the Directors' Report must include an 'operating and financial review'

- – A review contains information that shareholders of the company would reasonably require to make informed decisions regarding the operations, financial position, and future strategies of the organisation

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Declaration by chief executive officer and chief financial officer

- For entities listed on the ASX
- Reinforces the responsibility of the CEO and CFO in relation to the entity's financial statements

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ASIC (cont.)

- Also of relevance to the functioning of ASIC is the establishment of the Financial Reporting Panel in 2006
  - – Its purpose is to resolve disputes on a non-binding basis between ASIC and companies in respect of whether financial statements have been prepared in accordance with accounting standards and whether financial statements present a true and fair view
- ASIC also releases policy statements and guidelines on various issues, including financial reporting

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4. Australian Stock Exchange (ASX)

- One nationally operated stock exchange
- In November 1998 the ASX became a publicly listed company:
  - The Australian Stock Exchange Limited
- One set of listing rules for all trading floors
- Failure to comply may lead to removal from the Board
- Rules help ensure that information is disseminated in an efficient and timely manner

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Structure of the International Accounting Standards Setting

- International Accounting Standard Committee (IASC) was established in 1973, headquarter is in London, U.K.
- IASC was replaced by IASB in 2001. Now IASB comprises 14 individuals: 12 full time, 2 part time
- Each IASB member has one vote on technical and other matters

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Structure of the IASB (cont.)

- Publication of standard, exposure draft or final IFRIC interpretation requires approval by at least eight board members
- Other decisions, e.g. the issue of Draft Statements of Principles or Discussion Papers and agenda decisions, require a simple majority of Board members present at a meeting attended by 50% or more

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Structure of the IASB (cont.)

- Board has full control over technical agenda
- On publication of a standard, also publishes a 'Basis for Conclusions' to explain publicly how conclusions were reached, background information to assist application, and dissenting opinions

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- IASB has an International Financial Reporting Interpretations Committee

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Conceptual Framework and its relevance to financial reporting

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The Conceptual Framework

- A set of interrelated concepts which will define the nature, subject, purpose and broad contents of financial reporting
- To define the nature, scope and purpose by addressing:
  - who should report
  - What are the objectives of reports
  - what makes a good report
  - what should be reported
    - elements
    - recognition
    - measurement
- Building Blocks see Figure 2-1, pp.57, Graig Deegan *Australian Financial Accounting* 5th Edition.

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Benefits of the Conceptual Framework

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The Conceptual Framework in Australia

- **SAC 1 : Definition of the Reporting Entity**
- **SAC 2: Objectives of General Purpose Financial Reporting**
- **Framework for the Preparation and Presentation of Financial Statements**

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Structure of the Conceptual Framework

Until 2004, four Statements of Accounting Concepts (SACs) were issued
- Did not have legal force nor did they override or amend existing accounting standards

- From 2005 we have no longer been using the entire conceptual framework that was developed in Australia:
  - SAC3 and SAC 4 have been replaced by the 'Framework for the Preparation and Presentation of Financial Statements' (released July 2004)—the AASB Framework

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Structure of the Conceptual Framework (cont.)

- SAC1 and SAC2 are temporarily retained but their requirements are expected to be incorporated in later document
- Now, the AASB Framework, SAC1 and SAC2 are mandatory. They are are used in the development of accounting standards and also used by firms in the case if a particular accounting standards is absent.

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SAC 1: Reporting Entity

- All entities respect of which
- it is reasonable to expect the existence of users
- whose information needs have common elements
- and those users cannot command
- the preparation of information to satisfy their individual information needs

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- A reporting entity shall prepare
  - general purpose financial reports (GPFRs)
  - according to CFs and Accounting standards
- examples of reporting entities
  - listing corporations
  - borrowing corporations
  - subsidiaries of a listing foreign company
  - others

Criteria for deciding whether an entity is a reporting entity

- The existence of an accountability relationship b/w an entity and the outsiders
  - the separation of economic interest from management; (e.g. most listed public Co.)
  - the economic or political importance; (Coles, Myer, Woolworths BHP Billiton, Telstra)
  - the entity's financial characteristics (e.g. higher D/E ratio)
- users who are unable to command the preparation of reports tailored so as to satisfy, specifically, all of their information needs

General Purpose Financial Reports (GPFRs)/ Special Purpose Financial Reports

- General Purpose Financial Reports: Financial reports intended to meet the information needs common to users who are unable to command the preparation of reports tailored so as to satisfy, specifically, all of their information needs
- Special Purpose Financial Reports: To meet special requirements such as demand for information from Taxation Office

- Demand for GPFRs
  - Present and potential investors
  - employees;
  - lenders;
  - suppliers and other trade creditors
  - customers
  - governments and their agencies and public

SAC 2: Objectives of General Purpose Financial Reporting

- To provide information to users that is useful for making and evaluating decisions about the allocation of scarce resources.
- Discharge managements and governing bodies accountability to users.

Accountability

- The responsibility to provide information
- to enable users to make informed judgements about
- the performance, financial position, financing and investing, and compliance
- of the reporting entity

Types of Information Relevant to Users' Needs

- Performance
- Financial position
- Financing and investing
- Compliance

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Qualitative Characteristics of GPFRs (Framework)

- What kind of information should be selected in FRs?
- How should it be presented in FSs?
- How fast should such information be delivered to users?

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Qualitative Characteristics of GPFRs (Framework)

Selection

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Elements of Financial Statements (Framework)

- Assets
- Liabilities
- Equity
- Income
- Expenses

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Assets

– A resource controlled by the entity
– as a result of past events and
– from which future economic benefits are expected to flow to the entity

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Recognition Criteria

- An asset is to be recognised in the financial statements if (AASB Framework. par. 83):
  - it is probable that any future economic benefit associated with the asset will flow to the entity; and
  - the item has a cost or value that can be measured with reliability.

"Probable"?

- Not defined in AASB Framework
- But SAC 4 (par. 40) defines it as 'more likely rather than less likely'
- Peirson (1988) interpreted this to mean that the probability level exceed 0.5.

Liabilities

- Liabilities defined as (AASB Framework, par. 49):
  - A present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits.

Recognition Criteria

- Must be probable that the sacrifice of economic benefits will be required;
- The liability must be able to be reliably measured;
- When the above criteria are not satisfied may be disclosed in notes as contingent liabilities.

Equity

- Residual interest in the assets of the entity after deducting all of its liabilities
- Directly a function of the definitions given to assets and liabilities

Income (AASB Framework, par. 70)

- Increases in economic benefits during the accounting period in the form of inflows or enhancements of assets or decreases of liabilities that result in increases in equity, other than those relating to contributions from equity participants
- The definition is dependent on those of 'asset' and 'liability'

Recognition of income

- Income can be recognised in the financial statements when:
  - it is probable that the inflow or other enhancement or saving in outflows has occurred; and
  - the inflow or other enhancement or saving in outflows of economic benefits can be measured reliably

Components of Income

- Income encompasses both ‘Revenues’ and ‘gains’ (AASB Framework para 74):
  - Revenue arises in the course of the ordinary activities of an entity and includes: sales, fees, interest, dividends, royalties, and rent
  - Gains represent other items that meet the definition of income and might or might not arise in the ordinary activities of an entity, e.g. disposal of non-current assets
- Some professional judgment is required to determine whether a component of income should be classified as revenue or a gain

Expenses (AASB Framework, par. 70)

- Expenses are decreases in economic benefits during the accounting period in the form of outflows or depletions of assets or incurrence of liabilities that result in decreases in equity, other than those relating to equity participants

Recognition of expenses

- Expenses are recognised in the income statement when (AASB Framework, par. 94):
  - a decrease in future economic benefits related to a decrease in an asset or an increase in a liability has arisen that can be measured reliably.
- The definition of expenses includes losses as well as expenses that arise in the ordinary activities of an entity