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# FINANCIAL REPORTING REQUIREMENTS AND ACCOUNTING STANDARDS

## Institutional framework

Australia has a differential disclosure regime under which financial reporting requirements are set according to the type of entity, principally on the basis of the level of public interest in the entity. The types of entities can be classified as:

- (a) disclosing entities (mainly listed corporations and registered managed investment schemes/prescribed interest undertakings) that have listed securities or have issued shares and other securities as a result of the circulation of a prospectus;
- (b) unlisted public companies and large proprietary companies (that is, a proprietary company that meets at least two of the following criteria: gross operating revenue of \$10 million or more, gross assets of \$5 million or more and 50 or more employees); and
- (c) small proprietary companies.

Under the Corporations Law, all disclosing entities, companies and registered managed investment schemes are required to maintain records which accurately record their financial transactions and which would enable the preparation of financial statements and the audit of those financial statements.

Annual financial statements must be prepared by all entities except small proprietary companies. The annual financial statements consist of a balance sheet, a profit and loss statement and a cash flow statement. The matters to be disclosed in the financial statements are contained in accounting standards, which are made by the Australian Accounting Standards Board (AASB) and which have the force of law under the Corporations Law. The Corporations Law also provides that consolidated financial statements must be prepared where the preparation of such statements is required by an accounting standard. This normally occurs in circumstances where an entity controls one or more other entities. Annual financial statements must be circulated to members of the entity (for consideration at the annual general meeting

of the disclosing entity or company) and must be lodged with the Australian Securities and Investments Commission (ASIC).

In addition to meeting annual disclosure requirements, disclosing entities are required to prepare half-yearly financial statements. These are generally an abridged version of the annual financial statements. Half-yearly financial statements must be lodged with ASIC but do not have to be circulated to members.

Both the annual and half-yearly financial statements must be:

- (a) accompanied by a directors' report about the operations of the entity;
- (b) accompanied by a directors' declaration as to whether the accounts comply with the requirements of the accounting standards and give a true and fair view of the entity's financial position and whether the entity is solvent; and
- (c) audited (audited or reviewed in the case of half-yearly financial statements) by a registered company auditor who is independent of the entity.

Three important elements underpin Australia's financial reporting framework:

- (a) accounting standards that must be used by all entities that are required to prepare financial statements;
- (b) auditing standards that must be used for the purpose of auditing financial statements; and
- (c) appropriate levels of surveillance and enforcement to ensure that entities prepare their financial statements in accordance with the requirements of the Corporations Law and applicable accounting standards, and that those financial statements are audited in accordance with auditing standards issued by the accounting profession.

## Accounting standards

The accounting standards used by entities for preparing financial reports under the Corporations Law (commonly referred to as AASB-series standards) are made by the AASB, a body established under Part 12 of the *Australian Securities and Investments Commission Act 1989*. A list of these standards is at Attachment E.

The development of Australia's AASB-series standards is a multi-step process which includes a public consultation process and, where appropriate, supplementary discussions with key business groups. The public consultation process takes the form of the draft accounting standard (usually known as an exposure draft or ED) being released for comment, normally for a period of three months. At the end of the exposure period, the AASB considers public comments and decides upon any changes that it considers should be made to the document before it is issued as a final standard. A standard can be made by a majority vote of AASB members. Once a standard has been made, notice of the decision must be published in the *Commonwealth of Australia Gazette* and a copy of the standard must be tabled in each House of the Australian Parliament.

Each standard made by the AASB contains an application clause which specifies the entities to which the standard applies. The standard listing the basic information that must be included in a financial report (AASB 1034) applies to all companies and other entities that are required by the Corporations Law to prepare financial reports. However, other standards are more restricted in their application with the majority of standards being expressed to apply to reporting entities, a term defined to include listed corporations and borrowing corporations. Application of accounting standards in this manner ensures that listed corporations and other economically significant entities are subject to extensive disclosure requirements. At the same time, it minimises the regulatory burden imposed on other entities.

The AASB is currently undertaking a program to harmonise the requirements of Australian accounting standards with the requirements of accounting standards made by the International Accounting Standards Committee (IASC) (details of the standards that have been harmonised are contained in Attachment E). The differences between Australian standards and international accounting standards are generally ones of detail, the nature of which may differ from standard to standard. However, one important difference is that some international standards allow alternative accounting treatments or

disclosure methods, while Australian standards generally permit only one treatment or method.

One of the objectives of the harmonisation program is to ensure that compliance with Australian accounting standards will also ensure compliance with the equivalent requirement in the international standards. However, because many Australian standards contain requirements that go beyond the equivalent requirements in international standards, compliance with the international standards will not always result in compliance with Australian standards.

The Australian Government's Corporate Law Economic Reform Program (CLERP) envisages the continuation of the harmonisation program. However, the program also envisages that there could ultimately be a move by Australia to full adoption of international standards made by the IASC. A decision on the adoption of international standards would only be made by the Government following a report from the Financial Reporting Council (a new body to oversee the standard setting process) on the acceptance of international standards in overseas markets, on the progress in obtaining the International Organisation of Securities Commissions' (IOSCO's) acceptance of 20 core standards developed by the IASC for the purpose of cross-border listings and fundraising, and on whether such adoption would be in Australia's best interests.

Further information about the 20 core standards developed by the IASC can be obtained from its web site ([www.iasc.org.uk](http://www.iasc.org.uk)), while further information about the Australian harmonisation program can be obtained from the website of the Australian Accounting Research Foundation (AARF) ([www.aarf.asn.au](http://www.aarf.asn.au)).

Another feature of CLERP is the establishment of revised institutional arrangements for accounting standard setting. Under the legislation introduced into the Australian Parliament in December 1998, a Financial Reporting Council will be established with, among other things, overall responsibility for the accounting standard setting process while the AASB will be reconstituted as a body corporate. The proposals also envisage that the standard setting functions of the Public Sector Accounting Standards Board will be transferred to the AASB.

## **Auditing standards**

The Auditing and Assurance Standards Board (AuASB) of AARF is responsible for developing standards and other authoritative guidance on audits and audit-related services. The development and maintenance of these standards and guidelines establish the benchmarks for appropriate professional conduct by members of the Institute of Chartered Accountants in Australia (ICAA) and the Australian Society of Certified Practising Accountants (ASCPA).

As with accounting standards, the development of auditing standards and guidance statements is a multi-step process which includes a public consultation process. This process takes the form of an exposure draft being released for comment. At the end of the exposure period, the AuASB considers public comments and decides upon any changes that it considers should be made to the document before it is finalised. When the text of an auditing standard or guidance statement has been approved by the members of the AuASB, the document is submitted to the ICAA and the ASCPA for approval and is then issued by AARF on behalf of the two accounting bodies.

In 1995, the AuASB (then known as the Auditing Standards Board) completed a program to codify the Statement of Auditing Standards and the Statements of Auditing Practice then on issue. The new standards issued as a result of the codification program are listed in Attachment F.

The AuASB seeks, as a matter of policy, to implement statements issued by the International Auditing Practices Committee (IPAC) and the decision to undertake the codification program was prompted by a decision of IPAC to redesignate all International Auditing Guidelines as International Standards on Auditing (ISA) to more appropriately describe their authority.

Material published by the AuASB indicates that there are few differences between Australian Auditing Standards and ISA. Most of the differences that do exist reflect the consistent application by the AuASB of a high level/general principles approach to standard setting, and an 'audit risk' rather than the 'procedural' approach adopted in some ISA. This essentially means that the AuASB establishes a basic principle as the black letter requirement, provides guidance on relevant procedures, and requires the application of the auditor's judgement as to whether these or additional procedures may be necessary to gather sufficient, appropriate audit evidence. The ISA, on the other hand,

may prescribe, in black letter form, all the detailed procedures to be applied in certain situations.

Auditing standards made by the AuASB do not have the force of law. While both the accounting profession and regulatory agencies have, from time to time, called for auditing standards to be given legislative backing, successive Governments have not acceded to those requests. Auditing standards tend to be more qualitative than accounting standards in that (among other things) they require auditors to form judgements on a wide range of matters and, as a consequence, it is considered that it would be inappropriate to give such requirements force of law.

Nevertheless, the ethical rules of the ICAA and the ASCPA both require members to comply with standards issued by the AuASB when undertaking audit assignments. It is believed that most auditing work in Australia is carried out in accordance with auditing standards.

Where an auditor fails to comply with applicable auditing standards in performing an audit, the auditor could be subject to:

- (a) disciplinary action by his or her professional body; and/or
- (b) a damages action by a party that claims to have suffered loss as a result of the auditor's actions.

In the case of an auditor who is registered under the Corporations Law as a company auditor, the matter could also be referred to the Companies Auditors and Liquidators Disciplinary Board (CALDB) for appropriate disciplinary action.

## **ASIC surveillance and enforcement**

ASIC is responsible for the day-to-day administration of the Corporations Law, including ensuring compliance with the disclosure requirements. Where ASIC finds examples of non-compliance with accounting standards it seeks to have financial statements revised, either by negotiation with the company involved, or if necessary by use of its powers to enforce the law. ASIC registers company auditors and, where it becomes aware of registered company auditors who do not carry out their duties adequately and properly, may refer the matter to the CALDB for appropriate action.

ASIC also conducts a surveillance program on company financial reports. Surveillance targets are chosen using intelligence, complaints received by ASIC and matters noted by ASIC staff during other activities. Surveillance focuses on specific issues which past practice has indicated are areas of particular weakness. In 1998 ASIC conducted surveillance on 180 public companies. The level of compliance was generally high. Issues of concern arising from the surveillance were publicly reported. In addition ASIC conducted follow-up interviews with several companies and requested further information and explanation from others.

## Transparency

Financial statements are one of the principal sources of information used by investors, analysts, creditors and the entities themselves to make informed decisions about the allocation of resources. Consequently, a key objective of Australia's financial reporting requirements is the provision of relevant and reliable financial information for the users of financial statements.

The financial reporting requirements include a number of measures that have been taken over the last decade to ensure that deficiencies in financial reporting requirements that emerged during the corporate excesses of the late 1980s do not recur. These measures include:

- (a) removal of the true and fair override, which some companies used to avoid the use of otherwise applicable accounting standards, from the Corporations Law;
- (b) the introduction of enhanced disclosure requirements for economically important entities (usually listed corporations) (further information about these reforms is contained in the Corporate Governance section of this document); and
- (c) the transfer of detailed disclosure requirements from the Corporations Law and the Corporations Regulations to accounting standards, thus providing a more flexible environment for dealing with trends necessitating changes to disclosure and reporting requirements.

**Disclosure standard: Private sector compliance with independently established and high quality national accounting standards.**

This standard is in keeping with a recommendation of the G22 Working Group on Transparency and Accountability that “private firms adhere to national accounting standards and that national authorities remedy any deficiencies in their enforcement”. A list of accounting standards issued by the AASB is at Attachment E, along with a summary of the extent to which each standard is compatible with the equivalent international accounting standard.

**Disclosure standard: Compliance with international audit standards issued by the International Auditing Practices Committee of the International Federation of Accountants**

Attachment F lists auditing standards and auditing guidance releases issued by the AuASB, along with details of the equivalent ISA and a summary of any differences between the Australian standard and the ISA.