

# Financial reporting for ASIC

November 2019 | Tips, traps and pitfalls

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- ▶ Nevertheless, this presentation has been carefully prepared based on the information available at the time of the presentation.

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- ▶ Alastair takes a special interest in financial reporting, accounting standards and their application to various entities.
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- ▶ In his spare time, he chairs the Perth Audit discussion group, and is honorary treasurer for a local charity.

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## Session Outline

- ▶ The easy part first
  - ▶ Definitions
  - ▶ Who has to lodge with ASIC / be audited
- ▶ What are compliant financials
- ▶ Common errors
- ▶ Looking to the future

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## Definitions

- ▶ Recognition and Measurement
- ▶ RG85
- ▶ Types of reports
  - ▶ Super Special Purpose
  - ▶ SPFR
  - ▶ RDR
  - ▶ GPFR

## Who has to lodge with ASIC?

- ▶ All disclosing entities (generally >100 shareholders)
- ▶ Public companies
- ▶ AFSL holders
- ▶ Companies limited by guarantee (except small Ltd)
- ▶ Large Pty Ltd (note changing thresholds)
- ▶ Registered managed investment schemes
- ▶ Small foreign controlled (and not exempt)
- ▶ Small with crowd sourced funding
- ▶ Small Pty Ltd and directed by ASIC or shareholders

## Who has to be audited?

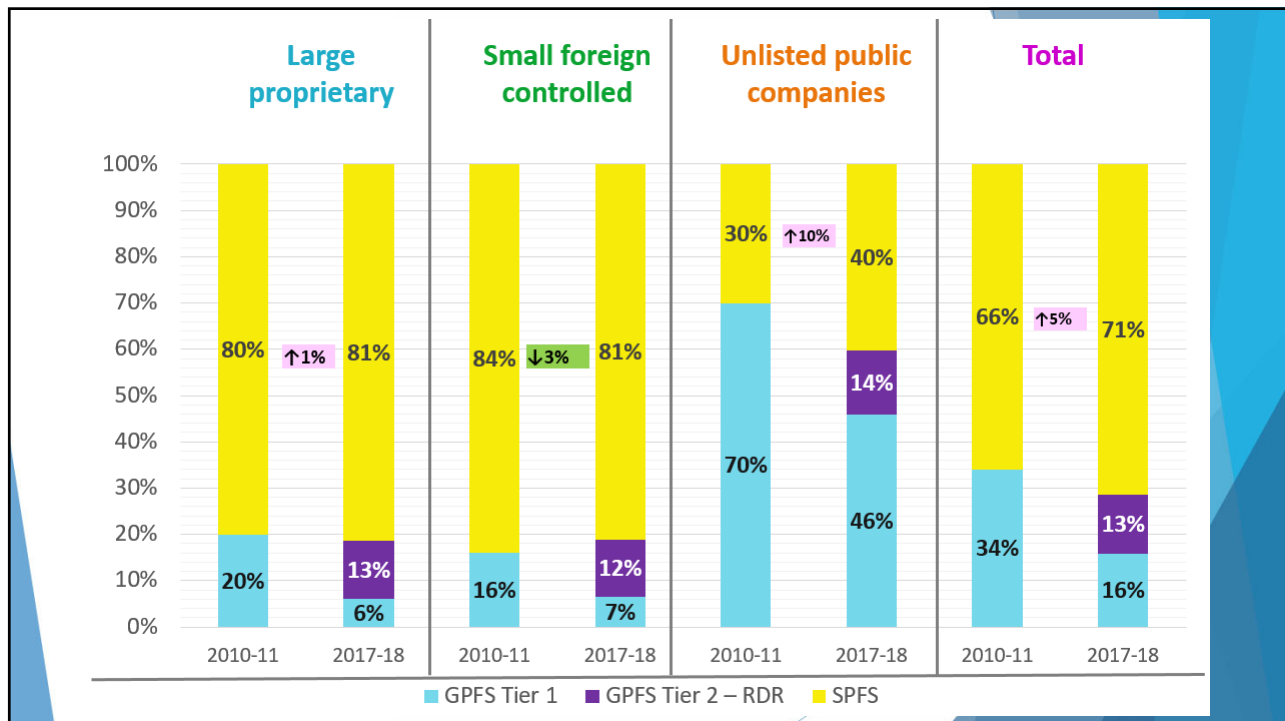
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## Financials vs Financials?

Not all special purpose financials are equal

## Why is there confusion?

- ▶ AASB Research Report 10 (legislative reporting requirements – Sep 2019)
  - ▶ 11 different types of for profit reporting from legislation. E.g.
    - ▶ (1) Preparation of financial statements according to Accounting Standards (as issued by the AASB)
    - ▶ (4) Preparation of financial statements providing a true and fair view of financial operations
    - ▶ (11) Financial records/other
- ▶ AASB Research Report 12 (for profit lodging SPFR – Aug 2019)
  - ▶ Use of SPFR remains extensive, Quality of SPFR remains poor
  - ▶ Evidence shows there are users
  - ▶ 34% of entities extent of R&M compliance was unclear
- ▶ The reporting entity concept is neither well-understood nor always applied as intended



## What are compliant financial reports?

- ▶ Satisfies the legislative or regulatory or constitutional requirements for financial reporting
- ▶ Identifies the **applicable reporting framework**
- ▶ Presents a **true and fair view** of financial position and performance

## Where are the relevant requirements?

- ▶ Corporations Act 2001
- ▶ The Conceptual framework
- ▶ APES 315 Compilation Reports
- ▶ The organisation's governing document (constitution)

## Corporations Act 2001

- ▶ Financial reporting required under Chapter 2M
  - ▶ S295 – contents of annual financial report
  - ▶ S296 – compliance with accounting standards and regulations
  - ▶ S297 – true and fair view
- ▶ A distinction between reporting and non reporting entities
- ▶ **RG 85 Reporting requirements for non-reporting entities**
  - ▶ *Issued July 2005*

## What is a reporting entity?

Reporting entities are described in Statement of Accounting Concepts SAC 1 – Definition of the Reporting Entity

- ▶ 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.
- ▶ A reporting entity must produce a **General Purpose Financial Report** applying all relevant Accounting Standards either International or Australian

## RG 85 Reporting requirements for non-reporting entities

- ▶ The **accounting standards** provide a framework for determining a **consistent meaning** of 'financial position' and 'profit or loss' in financial reporting across entities.
- ▶ **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.
- ▶ **This would not be consistent** with the requirements of the Act for financial reports to give a **true and fair view** (s297)

## RG 85 Reporting requirements for non-reporting entities

- ▶ 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**.



## RG85 Reporting requirements for non-reporting entities

A non-reporting entity should as a minimum produce a special purpose financial report satisfying RG85:

- ▶ Complies with the **recognition and measurement requirements** of the Accounting standards and the disclosure requirements of
  - ▶ AASB 101 'Presentation of Financial Statements';
  - ▶ AASB 107 '**Cash Flow Statements**';
  - ▶ AASB 108 'Accounting Policies, Changes in Accounting Estimates and Errors'; and
  - ▶ AASB 1048 'Interpretation and Application of Standards'.
  - ▶ AASB 1054 'Australian Additional Disclosures'
- ▶ Small Pty Ltd companies do not have to comply with RG85 unless required to do so by shareholders or the governing document

## APES 315 – Duties as a preparer

- ▶ **Apply expertise** in accounting and financial reporting
- ▶ Assist client to **determine appropriate** financial reporting **framework**
  - ▶ Consider acceptance / continuance if appropriate framework not used
- ▶ Comply with APES 205 (conformity with Accounting Standards)
- ▶ Issue a compilation report (not required for audited accounts)

## APES 205 – comply with accounting standards

- ▶ Members should take all reasonable steps to apply the principles and guidance provided in the **Statements of Accounting Concepts** and the **Framework** for the preparation and presentation of Financial Statements issued by the AASB when assessing whether an entity is a Reporting Entity.
- ▶ For SPFR, ensure report clearly identifies:
  - ▶ That financials are special purpose
  - ▶ The purpose that accounts were prepared for
  - ▶ The significant accounting policies adopted

## Legislative requirements for True & Fair

- ▶ Corporations Act section 297 (true and fair view);
  - ▶ The financial statements and notes for a financial year must give a true and fair view of the financial position and performance of the company

## What is a True & Fair View?

- ▶ There is much written on the topic
- ▶ The prevalent view is that at a minimum
  - ▶ The Financial report must comply **with the recognition and measurement principles** of Australian Accounting Standards
  - ▶ The Conceptual Framework
  - ▶ AASB 101 the Presentation of Financial Statements

## Examples of True & Fair Issues

- ▶ Creating a Reserve for Redundancy
- ▶ Then posting redundancy expense transactions direct to the reserve instead of to the normal expenses on the Income Statement
- ▶ The expenses incurred in the Financial Year have been understated because they appear in the reserve and not on the Income Statement
- ▶ Thus this is NOT a True and Fair View.

## Examples of True & Fair Issues

- ▶ Creating a Provision for Maintenance Liability
- ▶ And recording Maintenance expenses on the Income Statement
- ▶ This represents maintenance that must be completed but has not been.
- ▶ The PROBLEM is that maintenance cost has not yet been incurred and no obligating event can be demonstrated
- ▶ There is no liability – no legitimate expense
- ▶ The surplus is then understated.
- ▶ This is NOT a True and Fair View

What should be included in a SPFR?

## Special Purpose Financial Statements

- ▶ Mandatory disclosures are limited to those required by the five standards (must be applied in full)
- ▶ Any other disclosure that is relevant to a True and Fair View
- ▶ **Specific** accounting policies must have sufficient detail to explain departures from accounting standards
- ▶ The auditor or reviewer has to assess whether or not these specific accounting policies give a True and Fair View
- ▶ The criteria of only being understandable to the members is not sufficient

## AASB 101 Presentation of Financial Statements

- ▶ Financial statements **shall present fairly** the financial position, financial performance and cash flows of an entity.
- ▶ 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 application of Australian Accounting Standards, with additional disclosure when necessary, is presumed to result in financial statements that achieve a fair presentation

## A complete set of financial statements comprises (AASB101):

- ▶ a **statement of financial position** as at the end of the period;
- ▶ a **statement of profit or loss and other comprehensive income** for the period;
- ▶ a **statement of changes in equity** for the period;
- ▶ a **statement of cash flows** for the period;
- ▶ **notes**, comprising significant accounting policies and other explanatory information;
- ▶ comparative information in respect of the preceding period; and
- ▶ a statement of financial position as at the beginning of the preceding period **when an entity applies an accounting policy retrospectively** or makes a retrospective **restatement** of items in its financial statements

## Other Titles for the statements (AASB101)

- ▶ An entity may use titles for the statements other than those used in this Standard.
- ▶ For example, an entity may use the title 'statement of comprehensive income' instead of 'statement of profit or loss and other comprehensive income'.

## Accounting policies (AASB101)

- ▶ An entity **cannot rectify inappropriate accounting policies** either by disclosure of the accounting policies used or by notes or explanatory material
- ▶ Aus19.1 – entities preparing under 2M shall not depart from a requirement in an Australian Accounting Standard

## Accrual basis of accounting (AASB101)

- ▶ An entity shall prepare its financial statements, except for cash flow information, using the accrual basis of accounting.
- ▶ an entity recognises items as assets, liabilities, equity, income and expenses (the elements of financial statements) when they satisfy the definitions and recognition criteria for those elements in the *Framework*

## Materiality, aggregation & offsetting (AASB101)

- ▶ An entity shall present **separately each material class** of similar items.
- ▶ Materiality applies to disclosures also
- ▶ An entity shall present **separately items of a dissimilar nature** or function unless they are immaterial.
- ▶ An entity **shall not offset assets and liabilities or income and expenses**, unless required or permitted by an Australian Accounting Standard.
- ▶ Exceptions
  - ▶ Gains & loss on disposal of assets
  - ▶ expenditure related to a Provision

## AASB101 – other requirements

- ▶ Some lines items are mandatory (s54)
- ▶ P&L by nature or function is acceptable
- ▶ Current / non-current distinction is important
- ▶ The presentation currency
- ▶ The level of rounding
- ▶ Number of shares on issue and reconciliation
- ▶ Description of nature and purpose of each reserve



## Statement of cash flows (AASB107)

### ▶ Operating cash flows

- ▶ Receipts from operations ( you may split between type of receipt)
- ▶ Payments to employees
- ▶ Payments to suppliers

### ▶ Investing cash flows

- ▶ Interest received( may be operating)
- ▶ Dividends & distributions
- ▶ Payments for investments (including Plant & Equipment)
- ▶ Proceeds from sale

### ▶ Financing cash flows

- ▶ Interest paid
- ▶ Funds received from loans
- ▶ Funds paid on loans

### ▶ Net increase or decrease in cash

## Australian Additional Disclosures (AASB1054)

- ▶ Audit Fees
- ▶ Imputation credits
- ▶ Cash flow reconciliation

## Consolidation – measurement or disclosure?

- ▶ SAC 1 – reference to economic entity
- ▶ RG85 – consolidation required for reporting entities
- ▶ ASIC INFO31 – lodgement of financial reports
  - ▶ Consolidate where required by accounting standards
- ▶ Different interpretations has lead to variance in practice

## SPFR – in summary

- ▶ Management accounts for purpose of tax return only
  - ▶ Prepare accounts that are useful for owners
  - ▶ Super special purpose still allowed
- ▶ SPFR if lodged with ASIC
  - ▶ Must comply with minimum requirements

## Common Errors in SPFR

## Common Errors

- ▶ **AASB 101 Presentation of Financial statements**
  - ▶ RDR - No requirement to disclose the impact of new Accounting standards
  - ▶ But Full General Purpose and Special Purpose reports require disclosure
- ▶ **AASB 119 Employee Benefits**
  - ▶ Calculating the Net present value of Long service leave entitlement
- ▶ **AASB 13 Fair Value Measurement**
  - ▶ Assessing the fair value of assets in a changing environment

## Common Errors

- ▶ **AASB 116 Property Plant & Equipment**
  - ▶ The standard allows cost or revaluation
  - ▶ But requires depreciation on revalued assets
  - ▶ And assessment of impairment
- ▶ **AASB 124 Related party disclosures**
  - ▶ RDR allows aggregation of Key management personnel.
  - ▶ GPFR and Special Purpose do not
- ▶ **AASB 138 Intangible assets**
  - ▶ Recognising Goodwill on merger or acquisition
  - ▶ Excluding internally generated Goodwill
  - ▶ When to capitalise development costs

## Common Errors

- ▶ **AASB 1054 Australian Additional Disclosures**
  - ▶ Require disclosure of audit fees, franking credits, reconciliation of Net operating cash flow to net profit
  - ▶ Not required for General Purpose RDR
- ▶ **AASB 1053 Application of Tiers of Australian Accounting Standards**
  - ▶ Who can use General Purpose Reduced Disclosure Requirements
  - ▶ Cannot be Tier 1 – for profit private sector & Government entities who have Public accountability
- ▶ **AASB 108 Accounting Policies, Changes in Accounting Estimates and Errors**
  - ▶ Change to policy may lead to a restatement of the prior two years balance sheets
  - ▶ A note explaining the impact of the policy change

## Common Errors

- ▶ **AASB 137 Provisions, Contingent Liabilities and Contingent Assets**
  - ▶ When can you take up a provision – must be an obligating event
  - ▶ When do you have to disclose contingent assets & liabilities
    - ▶ Such as possible costs arising from legal actions & how much detail
- ▶ **AASB 102 Inventories**
  - ▶ How do you value inventory
- ▶ **AASB 10 Consolidated Financial Statements**
  - ▶ Special Purpose do not have to apply?
  - ▶ General Purpose and RDR do have to apply when “control” of other entities is established

## More Common Errors

- ▶ Current portion of long term debt not separated out
- ▶ Tax effect accounting not calculated
- ▶ Annual leave not on balance sheet
- ▶ Cash flow / changes in equity missing
- ▶ Note 1 isn't relevant
- ▶ Inaccurate information in note 1
- ▶ No prepayments
- ▶ No depreciation
- ▶ No recent revaluations

## ASIC Inspection Findings

Findings from ASIC inspections – listed items rarely change

- ▶ Impairment and other asset values
- ▶ Revenue recognition
- ▶ Tax effect accounting
- ▶ Consolidation
- ▶ Business combinations
- ▶ Amortisation of intangibles
- ▶ Disclosure of estimates and judgments

## Use of templates (still require thinking)

- ▶ Templates are great ... but ... you still have to apply your expertise!
- ▶ Only include policies and notes that relate to items in the financial statements
- ▶ For example
  - ▶ There should not be a policy on leases if there no leases in place.



Looking to the future ...

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## Software and templates

- ▶ IFRSSystem (<https://ifrssystem.com/>)
- ▶ Caseware (<https://www.caseware.com.au/>)
- ▶ Xero (<https://www.xero.com/au/>)
- ▶ Thomson Reuters – XYZ Model accounts  
(<https://tax.thomsonreuters.com.au/checkpoint/xyz>)
- ▶ Big 4 / Mid tier model financial statements

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## Changes currently in process

- ▶ **Comparability, transparency, comprehensibility and consistency** are all paramount (93% users of SPFR from survey)
- ▶ A modified, more user-friendly GPFS-RDR was the preferred Tier 2 framework (AASB Survey)
- ▶ ED 295 – **Simplified Disclosures as a replacement for RDR**
  - ▶ Single stand alone standard, based on IFRS for SME
  - ▶ Ready for 20/21 FY
- ▶ ED 297 – **Removal of SPFR** for some For Profit
  - ▶ Must use GPFR or SD
- ▶ ED293 – disclose **extent of R&M compliance**
  - ▶ Will be NFP only – originally considered applying to For Profit

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## ED 297 – Removal of SPFR

### Who is affected?

	Number of entities expected to be affected:			
	Increase in R&M requirements in AAS and GPFS disclosures	Increase in disclosures only	Increase in consolidation and equity accounting requirements for the first time	Maximum number of entities currently preparing SPFS expected to be affected by these proposals
For-profit companies lodging under the <i>Corporations Act 2001</i> , principally:				
✓ large proprietary companies;	351 – 901	2,765	?	3,666
✓ unlisted public companies;	84 – 313	939	?	1,252
✓ small foreign-controlled companies;	183 – 492	1,885	?	2,377
✓ financial services licensees; and	?	?	?	?
✓ small proprietary companies with crowd-sourced funding.	?	?	?	?
	<b>618 – 1,706</b>	<b>5,589</b>	<b>?</b>	<b>7,295</b>

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## References / Further Reading

- ▶ Dec 2018 – AASB For-profit User and Preparer Survey Results
- ▶ Aug 2019 – AASB Financial Reporting Practices of For-Profit Entities Lodging Special Purpose Financial Statements
- ▶ Sep 2019 – AASB Legislative and Regulatory Financial Reporting Requirements
- ▶ <https://asic.gov.au/regulatory-resources/financial-reporting-and-audit/preparers-of-financial-reports/lodgement-of-financial-reports/>
- ▶ AASB ED295 – SD to replace RDR
- ▶ AASB ED297 – Removal of SPFR for some entities
- ▶ ASIC 19-206MR – findings from 2018 inspections

Questions?

## Australian Audit

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