

Accounting Alert

Analysis of the latest accounting developments delivered to you via e-mail

The AASB issues Pending Framework for the Preparation and Presentation of Financial Statements

A copy of the Pending Framework can be downloaded from the AASB web site: www.aasb.com.au

The Australian Accounting Standards Board (AASB) has released the *Pending Framework for the Preparation and Presentation of Financial Statements* (the 'Framework').

This *Accounting Alert* provides an overview of the Pending Framework and highlights some of the main issues arising from the key changes.

Overview

The Pending Framework supersedes SAC 3 *Qualitative Characteristics of Financial Information* ('SAC 3') and SAC 4 *Definition and Recognition of the Elements of Financial Statements* ('SAC 4'). The AASB plans to retain SAC 1 *Definition of the Reporting Entity* ('SAC 1') and SAC 2 *Objective of General Purpose Financial Reporting* ('SAC 2') in some form¹.

One of the main differences between the Pending Framework and existing Australian accounting pronouncements is that the Pending Framework contains a different notion of income and revenue from that contained in SAC 4.

In addition, in the final Pending Framework, 'reporting entity' is defined in terms of SAC 1 *Definition of a Reporting Entity*. It is our understanding that this definition will be updated to be consistent with the definition proposed by ED 124, which is consistent with the definition contained in AASB 3 *Business Combinations*.

Concept of Income

SAC 4 defines revenue as 'inflows or other enhancements, or savings in outflows, of future economic benefits in the form of increases in assets or reductions in liabilities of the entity'. The equivalent concept in the Pending Framework is income. This is defined as 'both revenue and gains'.

'Revenue' is defined as arising in the course of the ordinary activities of an entity, and 'gains' are determined on a net basis and represent other items that meet the definition of income and 'may, or may not, arise in the course of the ordinary activities of an entity'.

As a result of this change, the current requirement to report proceeds on the sale of assets will no longer form part of revenue, rather the net gain or loss will be appropriately classified.

The broad impact of the definition of income as 'revenue and gains' means that some items will be reported on a net basis and others will be reported on a gross basis.

A similar issue arises in respect of expenses, which are defined to encompass both 'losses as well as those expenses that arise in the course of the ordinary activities of the entity'.

SAC 1 and SAC 2 to be retained in some form.

Net profit, rather than proceeds on sale of a non-current asset, reported as revenue.

¹ At the time of writing this Accounting Alert the AASB had not confirmed its treatment of SAC 1 and SAC 2. However, in its plans for adopting IASB Standards by 2005 it is noted that 'The IASB has no equivalent to SAC 1 Definition of the Reporting Entity, and the reporting entity concept is embedded in Australian GAAP. The concept of general purpose financial reports in SAC 2 Objective of General Purpose Financial Reporting is also essential to the application of AASB Standards.' www.aasb.com.au

Change in the definition of a reporting entity.

The Reporting Entity Concept

The original ED 124 proposal was for Australia to adopt the IAS concept of a reporting entity. Specifically, as part of the ED the AASB proposed to amend the definition of 'reporting entity' to:

'An entity in respect of which it is reasonable to expect the existence of users who rely on the entity's general purpose financial report for information that will be useful to them for making and evaluating decisions about the allocation of resources. A reporting entity can be a single entity or a group comprising a parent and all of its subsidiaries.'

AASB 3 *Business Combinations* defines reporting entity consistent with the proposal in ED 124.

In the final Pending *Framework* 'reporting entity' is defined in terms of SAC 1 *Definition of a Reporting Entity*. It is our understanding that the SAC 1 definition will be updated to be consistent with AASB 3.

Therefore, under Australian equivalents to International Financial Reporting Standards the definition of a reporting entity will change from that currently contained in the existing AASB standards. The definition in the existing AASB standards is:

'an entity (including an economic entity) 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, and includes but is not limited to the following:

- (a) a disclosing entity; and*
- (b) a company which is not a subsidiary of a holding company incorporated in Australia and which is a subsidiary of a foreign company where that foreign company has its securities listed for quotation on a stock market or those securities are traded on a stock market'.*

A major impact of the change in definition is that subsidiaries of overseas listed entities will no longer automatically fall within the definition of a reporting entity.

Other differences

There are a number of other differences between the Pending *Framework* and SAC 3 and SAC 4 that are not expected to have a significant impact for practical application. These differences include:

- The Pending *Framework* includes prudence as a qualitative characteristic, whereas SAC 3 has an emphasis on neutrality. There is some potential for accounting policies to be adopted that are more conservative than was previously the case.
- SAC 3 includes the qualitative characteristics of relevance and reliability as characteristics with primary importance, whereas the Pending *Framework* apportions equal weighting to all qualitative characteristics discussed.
- The definition of an asset and liability refers to the 'resource' controlled by the entity, whereas SAC 4 refers to 'future economic benefits'. The items that previously satisfied the definition of assets and liabilities may differ due to this change in terminology. The AASB have noted in ED 124 that in practice this is unlikely as the probability requirement would be failed for those assets that satisfy the Pending *Framework* definition, but not the SAC 4 definition.

Feedback and Assistance

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