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Bachelor of Commerce (B2001) | Level 2 • Part B Major | Monash University

Financial accounting

Course Code: ACC2100 • Module 1 Notes

Module 1: Regulatory Framework, Corporate Reporting, Sustainability & Income Taxes

1. The Australian Financial Reporting and Regulatory Framework

1.1 Statutory Mandate Under the Corporations Act 2001 (Cth)

Corporate financial reporting in Australia is anchored in Chapter 2M of the *Corporations Act 2001 (Cth)*, which establishes mandatory record-keeping, financial statement preparation, audit, and lodgement obligations for registered entities. Section 286 requires every company, registered scheme, and disclosing entity to keep written financial records that correctly record and explain its transactions, financial position, and performance, and that would enable true and fair financial statements to be prepared and audited. Financial records must be retained for seven years after the transactions covered by the records are completed.

Under Part 2M.3, entities classified as disclosing entities, public companies, large proprietary companies, and registered managed investment schemes must prepare an annual financial report and a directors' report for each financial year. Under section 45A(3), a proprietary company is classified as **large** for a financial year if it satisfies at least two of three statutory thresholds: consolidated revenue of A$50 million or more, consolidated gross assets of A$25 million or more at the end of the financial year, or 100 or more employees at the end of the financial year. Small proprietary companies are generally exempt from statutory financial report preparation and audit unless directed by ASIC or shareholders holding at least 5% of voting shares, or unless they are controlled by a foreign company and not consolidated in financial statements lodged with ASIC.

Section 295 specifies that the annual financial report comprises the financial statements for the year, the notes to the financial statements, and the directors' declaration. Under section 296, the financial report must comply with the accounting standards issued by the Australian Accounting Standards Board (AASB), unless an applicable statutory relief order applies. Section 297 imposes an overriding qualitative requirement that the financial statements and notes give a **true and fair view** of the financial position and performance of the company or consolidated group. If compliance with an AASB standard would not give a true and fair view, section 295(3)(c) requires additional information to be included in the notes, and section 295(4) requires the directors to declare whether, in their opinion, there are reasonable grounds to believe that the company will be able to pay its debts as and when they become due and payable (the solvency declaration).

Entity Classification (Corporations Act 2001)	Statutory Financial Reporting & Audit Duties	ASIC / ASX Lodgement Deadlines
Disclosing Entities (including ASX-listed companies)	Full-year and half-year GPFS (Tier 1); mandatory independent external audit (half-year review or audit); Remuneration Report under s 300A; continuous disclosure under s 674.	Half-year: 75 days (ASX Appendix 4D within 2 months); Full-year: 3 months (ASX Appendix 4E within 2 months).
Unlisted Public Companies	Annual GPFS (Tier 1 if publicly accountable, otherwise Tier 2 Simplified Disclosures under *AASB 1060*); mandatory external audit unless limited by guarantee thresholds (s 285A).	Within 4 months after financial year end (ASIC Form 388).
Large Proprietary Companies (s 45A)	Annual GPFS (Tier 2 Simplified Disclosures minimum, or Tier 1); mandatory external audit (subject to narrow grandfathered exemptions repealed for most entities).	Within 4 months after financial year end (ASIC Form 388).
Small Proprietary Companies	Written financial records required (s 286); exempt from preparing/lodging financial reports unless directed by 5% shareholders, ASIC, or foreign-controlled without consolidation.	Not required unless specifically directed under s 293, s 294, or s 292(2)(b).

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1.2 Institutional Standard-Setting and Enforcement Architecture

Australia's corporate reporting regime operates through a coordinated institutional framework designed to maintain capital market integrity, investor confidence, and alignment with International Financial Reporting Standards (IFRS).

Regulatory Body	Statutory Mandate & Authority	Core Functions in Financial Reporting
Financial Reporting Council (FRC)	Established under the *Australian Securities and Investments Commission Act 2001 (Cth)* (ASIC Act).	Provides broad strategic oversight of the accounting and auditing standard-setting process in Australia; advises the Commonwealth Treasurer; appoints members of the AASB and AUASB; monitors international IFRS adoption and sustainability reporting developments.
Australian Accounting Standards Board (AASB)	Commonwealth statutory agency under the *ASIC Act 2001*; standards have force of law under s 334 of the *Corporations Act 2001*.	Develops, issues, and maintains Australian Accounting Standards (AASB standards) and Australian Sustainability Reporting Standards (ASRS / AASB S1 & S2); incorporates IFRS into Australian law for for-profit entities while providing transaction-neutral adaptations for not-for-profit and public sector entities.
Australian Securities and Investments Commission (ASIC)	Independent Commonwealth corporate, markets, and financial services regulator under the *ASIC Act 2001*.	Administers the *Corporations Act 2001*; conducts proactive financial reporting and audit surveillance; issues Regulatory Guides and Legislative Instruments (relief orders); enforces compliance through corrective restatements, enforceable undertakings, and civil or criminal proceedings.
Australian Securities Exchange (ASX)	Licensed market operator supervised by ASIC and the Reserve Bank of Australia (RBA).	Enforces ASX Listing Rules, notably Chapter 3 (continuous disclosure under Listing Rule 3.1, reinforced by s 674 of the *Corporations Act*) and Chapter 4 (periodic half-year Appendix 4D and full-year Appendix 4E reporting); publishes ASX Corporate Governance Council *Principles and Recommendations*.

1.3 Differential Reporting Framework: Tier 1 vs Tier 2

Because imposing full IFRS disclosure burdens on non-publicly accountable entities creates compliance costs disproportionate to user benefits, the AASB maintains a two-tier general purpose financial statement (GPFS) framework under *AASB 1053 Application of Tiers of Australian Accounting Standards*. Following the issuance of *AASB 2020-2*, the ability of most for-profit private sector entities required by legislation (such as the *Corporations Act 2001*) to lodge Special Purpose Financial Statements (SPFS) was removed for reporting periods beginning on or after 1 July 2021.

- **Tier 1 (Australian Accounting Standards):** Applies to all for-profit private sector entities that have **public accountability** (such as entities whose debt or equity instruments are traded on the ASX, or banks, credit unions, and insurers holding assets in a fiduciary capacity for a broad group of outsiders under APRA supervision) and to Commonwealth, State, and Territory governments. Tier 1 entities must comply fully with all recognition, measurement, presentation, and disclosure requirements of AASB standards, enabling an explicit and unreserved statement of compliance with IFRS.
- **Tier 2 (Simplified Disclosures):** Applies to for-profit private sector entities without public accountability (such as large proprietary companies and unlisted public companies) and eligible not-for-profit entities. Tier 2 entities apply the exact same recognition and measurement rules as Tier 1 entities (for example, *AASB 112* deferred tax, *AASB 116* revaluation, *AASB 16* leases, and *AASB 15* revenue), but provide substantially streamlined note disclosures under *AASB 1060 General Purpose Financial Statements – Simplified Disclosures for For-Profit and Not-for-Profit Tier 2 Entities*.

1.4 Conceptual Framework, Business Ethics, and Professional Judgement

The *AASB Conceptual Framework for Financial Reporting* underpins standard-setting and guides preparers when exercising professional judgement. Its fundamental qualitative characteristics are **relevance** (information capable of making a difference in user decisions via predictive or confirmatory value, bounded by entity-specific materiality) and **faithful representation** (complete, neutral, and free from error). Enhancing qualitative characteristics—comparability, verifiability, timeliness, and understandability—reinforce decision usefulness subject to the pervasive cost constraint.

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Because accounting standards frequently require estimates, valuation assumptions, and policy choices—such as determining useful lives, assessing impairment discount rates, or evaluating revenue contingencies—technical competence alone cannot safeguard reporting quality. Professional accountants in Australia are bound by *APES 110 Code of Ethics for Professional Accountants (including Independence Standards)*, issued by the Accounting Professional & Ethical Standards Board (APESB). APES 110 establishes five fundamental ethical principles:

1. **Integrity:** Being straightforward and honest in all professional and business relationships, never knowingly associating with materially false or misleading financial disclosures.
2. **Objectivity:** Exercising professional judgement free from bias, conflict of interest, or undue influence from executive management seeking bonus-linked earnings targets or debt-covenant relief.
3. **Professional Competence and Due Care:** Maintaining current mastery of AASB standards, tax legislation, and sustainability rules, and acting diligently when preparing financial models and audit schedules.
4. **Confidentiality:** Respecting the confidentiality of client or employer financial data acquired through professional relationships, unless legal or statutory disclosure duties apply.
5. **Professional Behaviour:** Complying with relevant laws and regulations and avoiding conduct that discredits the accounting profession.

Ethical tensions frequently arise around aggressive earnings management, where managers exploit accounting discretion (such as delaying asset write-downs under *AASB 136* or understating provisions under *AASB 137*) to smooth reported profits or conceal liquidity stress. Directors and preparers who succumb to such pressures risk breaching fiduciary duties under sections 180–184 of the *Corporations Act 2001* and section 1308 (making false or misleading statements).

2. Presentation of Financial Statements (AASB 101) and Accounting Policies (AASB 108)

2.1 Complete Set of Financial Statements and Core Presentation Principles (AASB 101)

AASB 101 Presentation of Financial Statements prescribes the structure and minimum content of Tier 1 general purpose financial statements to ensure comparability across periods and across entities. A complete set of financial statements comprises: (1) a Statement of Financial Position as at the end of the period; (2) a Statement of Profit or Loss and Other Comprehensive Income for the period; (3) a Statement of Changes in Equity for the period; (4) a Statement of Cash Flows for the period (prepared under *AASB 107*); (5) Notes comprising material accounting policy information and explanatory disclosures; and (6) a third 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 or reclassification of items.

Preparers must apply seven foundational presentation concepts under *AASB 101*:

- **Fair Presentation and Compliance with Standards:** Financial statements must present fairly the financial position, financial performance, and cash flows, with an explicit note stating unreserved compliance with IFRS (for Tier 1 for-profit entities).
- **Going Concern:** Management must assess the entity's ability to continue as a going concern for at least twelve months from the reporting date. Material uncertainties must be explicitly disclosed; if management intends to liquidate or cease trading, the financial statements must be prepared on an alternative basis (such as liquidation value).
- **Accrual Basis of Accounting:** Except for cash flow information, all transactions and events are recognised when they occur rather than when cash is received or paid.
- **Materiality and Aggregation:** Each material class of similar items is presented separately. Information is material if omitting, misstating, or obscuring it could reasonably be expected to influence decisions that primary users make on the basis of those financial statements.
- **Offsetting Prohibition:** Assets and liabilities, and income and expenses, shall not be offset unless required or permitted by an AASB standard (for example, net presentation of deferred tax assets and liabilities under strict *AASB 112* criteria, or contract assets/liabilities under *AASB 15*).
- **Frequency and Comparative Information:** Financial statements are presented at least annually, with comparative figures for the preceding period for all amounts reported in the current financial statements and narrative disclosures where relevant.

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- **Consistency of Presentation:** The presentation and classification of items must be retained from one period to the next unless a significant change in operations or a new AASB standard mandates a more appropriate presentation.

2.2 Current vs Non-Current Classification and Other Comprehensive Income

In the Statement of Financial Position, an entity must present current and non-current assets and liabilities as separate classifications unless a liquidity presentation provides more reliable and relevant information (typical for APRA-regulated banks). An asset is classified as **current** if it is expected to be realised, sold, or consumed in the entity's normal operating cycle; held primarily for trading; expected to be realised within twelve months after the reporting period; or consists of cash or cash equivalents not restricted from exchange or use for at least twelve months. A liability is classified as **current** if it is expected to be settled in the normal operating cycle, held primarily for trading, due to be settled within twelve months after the reporting period, or if the entity does not have a right at the end of the reporting period to defer settlement for at least twelve months.

In the Statement of Profit or Loss and Other Comprehensive Income, *AASB 101* requires strict separation between **Profit or Loss** and **Other Comprehensive Income (OCI)**. OCI comprises items of income and expense (including reclassification adjustments) that specific AASB standards require or permit to be excluded from profit or loss. Crucially, OCI line items must be grouped into two categories:

1. **Items that will NOT be reclassified subsequently to profit or loss:** Examples include changes in asset revaluation surplus under *AASB 116* or *AASB 138*, remeasurements of defined benefit superannuation plans under *AASB 119*, and fair value changes on equity investments irrevocably designated at FVOCI under *AASB 9*.
2. **Items that MAY be reclassified (recycled) subsequently to profit or loss when specific conditions are met:** Examples include exchange differences on translating foreign operations under *AASB 121*, effective cash flow hedge gains or losses under *AASB 9*, and fair value changes on debt instruments measured at FVOCI under *AASB 9*.

2.3 Accounting Policies, Estimates, and Prior-Period Errors (AASB 108)

AASB 108 Accounting Policies, Changes in Accounting Estimates and Errors governs how entities select, modify, and correct accounting treatments to preserve comparability over time.

Category Under AASB 108	Definition & Trigger	Accounting Treatment & Financial Statement Impact
Change in Accounting Policy	Specific principles, bases, conventions, rules, and practices applied in preparing financial statements. Changed only if required by a new AASB standard or if a voluntary change provides reliable and more relevant information (e.g., changing inventory cost formula from FIFO to weighted average).	**Retrospective application:** Adjust the opening balance of each affected component of equity (typically Retained Earnings) for the earliest prior period presented, and restate comparative figures as if the new policy had always been applied (unless impracticable). Note: transitioning from cost to revaluation under *AASB 116* is treated prospectively as a revaluation, not a retrospective policy change.
Change in Accounting Estimate	Adjustment of the carrying amount of an asset or liability, or the pattern of periodic consumption of an asset, resulting from new information or developments (e.g., revising PPE useful life, residual value, warranty claim rate, or expected credit loss matrix).	**Prospective recognition:** Recognised in profit or loss in the period of the change (if it affects that period only) or in the period of the change and future periods (if it affects both). Prior periods are never restated.
Prior-Period Material Error	Omissions from, and misstatements in, prior-period financial statements arising from a failure to use, or misuse of, reliable information that was available when those statements were authorised for issue (e.g., arithmetic errors, misapplication of AASB rules, fraud, or overlooked accruals).	**Retrospective restatement:** Restate the comparative amounts for the prior period(s) in which the error occurred, or adjust the opening balances of assets, liabilities, and equity for the earliest prior period presented if the error occurred earlier.

Worked Numerical Example: Policy Change vs Estimate Revision vs Error Restatement

Southern Cross Logistics Pty Ltd (a Tier 1 reporting entity subject to a 30% corporate tax rate) prepares its financial statements for the year ended 30 June 2027, with comparative figures for 30 June 2026. Consider two independent events discovered during the 2027 close:

- **Event A (Prior-Period Error):** A review of inventory records revealed that inventory at 30 June 2026 was overstated by A$120,000 because consigned goods belonging to a supplier were erroneously included in closing stock.
- **Event B (Change in Accounting Estimate):** On 1 July 2026, management revised the remaining useful life of warehouse automated sorting equipment (purchased on 1 July 2023 for A$500,000, zero residual value, previously depreciated straight-line over 10 years at A$50,000 per year) to 4 remaining years (total life of 7 years).

Step-by-Step Resolution:

Event A (Retrospective Restatement under AASB 108): Overstating closing inventory at 30 June 2026 understated Cost of Goods Sold (COGS) in FY2026 by A$120,000 and overstated FY2026 pre-tax profit by A$120,000. Assuming tax returns were filed accurately excluding the consigned stock (or adjusting current tax payable/deferred tax), the after-tax overstatement of 2026 profit and Retained Earnings at 30 June 2026 is:

$$\Delta\text{Retained Earnings}_{30\text{ Jun }2026} = -120{,}000 \times (1 - 0.30) = -\text{AUD } 84{,}000$$

Where: –120,000 is the pre-tax overstatement of closing inventory at 30 June 2026, and $0.30 $is the applicable Australian corporate income tax rate. Because opening inventory for FY 2027 was also overstated by A$ 120,000, the 2026 comparative Cost of Sales increases by A$120,000, comparative Income Tax Expense decreases by A$36,000, and comparative Closing Inventory and Retained Earnings at 30 June 2026 decrease by A$120,000 and A$84,000 respectively. The adjusting entry recorded in FY2027 against opening balances is:

- Dr Retained Earnings (opening, 1 July 2026): A$84,000; Dr Current/Deferred Tax Liability (or Tax Receivable): A$36,000; Cr Opening Inventory (reducing FY2027 COGS): A$120,000.

Event B (Prospective Application under AASB 108): By 30 June 2026 (after 3 years of depreciation at A$50,000 per year), accumulated depreciation is A$150,000 and the carrying amount is A$500,000 – A$150,000 = A$350,000. No prior-period figures are restated. Revised annual depreciation from FY2027 onward is calculated prospectively over the remaining 4 years:

$$\begin{aligned}\text{Revised Annual Depreciation} &= \frac{\text{CA}_{1\text{ Jul }2026} - \text{RV}}{\text{Remaining Useful Life}} \\ &= \frac{350{,}000 - 0}{4} = \text{AUD } 87{,}500 \text{ per annum}\end{aligned}$$

Where: $\text{CA}_{1\text{ Jul }2026}$ is the carrying amount at the beginning of the revision period (A$350,000), RV is the residual value (A$0), and the remaining useful life is 4 years. In FY2027, the company records Dr Depreciation Expense A$87,500 / Cr Accumulated Depreciation A$87,500 and discloses the nature and dollar impact of the estimate change (an increase of A$37,500 in FY2027 depreciation expense) in the notes.

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3. Sustainability, Social and Environmental Reporting Frameworks (AASB S1 & AASB S2)

3.1 Mandatory Australian Climate-Related Financial Disclosures

Historically, corporate sustainability reporting in Australia evolved through voluntary frameworks—most notably the Global Reporting Initiative (GRI) Standards, the Task Force on Climate-related Financial Disclosures (TCFD), and the International Integrated Reporting Framework (<IR>). While those voluntary frameworks promoted broad stakeholder accountability across environmental, social, and governance (ESG) dimensions, inconsistency across disclosures limited comparability for capital providers. Following the establishment of the International Sustainability Standards Board (ISSB), the Australian Parliament enacted the *Treasury Laws Amendment (Financial Market Infrastructure and Other Measures) Act 2024 (Cth)*, amending the *Corporations Act 2001* to mandate climate-related financial disclosures inside a dedicated Sustainability Report within the annual report.

In September 2024, the AASB issued two Australian Sustainability Reporting Standards:

- **AASB S1 *General Requirements for Disclosure of Sustainability-related Financial Information*:** A voluntary framework covering all sustainability-related risks and opportunities (environmental, social, workforce, supply-chain, and governance matters) that could reasonably be expected to affect an entity's cash flows, access to finance, or cost of capital over the short, medium, or long term.
- **AASB S2 *Climate-related Disclosures*:** A mandatory standard for entities meeting phased statutory thresholds under Chapter 2M of the *Corporations Act 2001* (Group 1 large entities commencing financial years from 1 January 2025, Group 2 from 1 July 2026, and Group 3 from 1 July 2027, based on consolidated revenue, gross assets, employee counts, or NGER reporting obligations).

3.2 Four-Pillar Architecture and Financial Statement Connectivity

Both *AASB S1* and *AASB S2* adopt the four-pillar structure established by the ISSB and TCFD, ensuring tight conceptual alignment between narrative sustainability disclosures and quantitative AASB financial statements:

Disclosure Pillar	Core Reporting Requirements Under AASB S2	Connectivity to Financial Statements (AASB Standards)
1. Governance	Board and management oversight bodies responsible for climate-related risks and opportunities, competencies, reporting frequency, and linkage to executive remuneration.	Relates to related-party and key management personnel remuneration disclosures (*AASB 124*) and directors' governance statements.
2. Strategy	Physical risks (acute extreme weather events and chronic climate shifts) and transition risks (policy, carbon pricing, technology shifts, market preferences); climate resilience assessment using scenario analysis (including a 1.5°C pathway and a high-emissions pathway under Australian legislation).	Directly affects asset useful lives and residual values (*AASB 116*), cash flow projections in Value in Use impairment tests (*AASB 136*), and early site rehabilitation or onerous contract provisions (*AASB 137*).
3. Risk Management	Processes used to identify, assess, prioritise, and monitor climate-related risks and opportunities, and integration into the entity's overall enterprise risk management framework.	Informs sensitivity disclosures for key sources of estimation uncertainty (*AASB 101* para 125) and financial risk management disclosures (*AASB 7*).
4. Metrics & Targets	Gross Scope 1 (direct operational), Scope 2 (purchased electricity/steam), and Scope 3 (upstream and downstream value chain) greenhouse gas (GHG) emissions measured in tonnes of CO_2-equivalent; internal carbon prices; transition targets and progress.	Impacts recognition and measurement of Australian Carbon Credit Units (ACCUs), Safeguard Mechanism liabilities, and green sustainability-linked loan margin adjustments (*AASB 9*).

3.3 Accountability, Greenwashing Risks, and Inclusive Reporting

Evaluating sustainability and social disclosures requires distinguishing substantive, decision-useful reporting from superficial public relations rhetoric. Both ASIC and the Australian Competition and Consumer Commission (ACCC) actively prosecute **greenwashing**—misleading or deceptive representations regarding environmental credentials, net-zero

pledges, or sustainable investment products under the *ASIC Act 2001* and the *Australian Consumer Law*. High-quality reporting demands verifiable baselines, transparent disclosure of Scope 3 estimation boundaries, explicit reconciliation of transition capital expenditure with asset carrying amounts, and clarity on whether targets rely on operational abatement or purchased carbon offsets.

Furthermore, contemporary Australian social and governance reporting encompasses workforce equity, diversity, inclusion, and human rights accountability—such as reporting under the *Workplace Gender Equality Act 2012 (Cth)* and the *Modern Slavery Act 2018 (Cth)*. Presenting transparent, accessible financial and sustainability narratives for diverse stakeholders—employees, First Nations communities, regional suppliers, lenders, and retail shareholders—enhances institutional trust and demonstrates responsible corporate stewardship.

Australian Mandatory Reporting Cohort	Commencement Date	Statutory Thresholds (Two of Three Criteria, or NGER)
Group 1 Entities	Financial years starting on or after 1 January 2025	Consolidated revenue ≥ A$500m, gross assets ≥ A$1b, or ≥ 500 employees (plus controlling corporations exceeding NGER publication thresholds).
Group 2 Entities	Financial years starting on or after 1 July 2026	Consolidated revenue ≥ A$200m, gross assets ≥ A$500m, or ≥ 250 employees (plus asset owners with ≥ A$5b assets under management).
Group 3 Entities	Financial years starting on or after 1 July 2027	Consolidated revenue ≥ A$50m, gross assets ≥ A$25m, or ≥ 100 employees (aligned with Chapter 2M large proprietary company thresholds).

4. Accounting for Income Taxes (AASB 112)

4.1 Accounting Profit vs Taxable Profit and Permanent Differences

AASB 112 Income Taxes establishes how entities account for the current and future tax consequences of transactions and events recognised in the financial statements. In Australia, corporate income tax is levied under the *Income Tax Assessment Act 1997 (Cth)* (ITAA 1997) and administered by the Australian Taxation Office (ATO). The standard Australian corporate tax rate is 30%, while eligible base rate entities (aggregated turnover below A$50 million and no more than 80% base rate entity passive income) are taxed at 25%.

Accounting profit before tax (determined under AASB standards) rarely equals taxable profit (determined under tax legislation) because tax rules pursue fiscal policy objectives rather than accrual matching. Differences between accounting profit and taxable profit fall into two distinct categories:

- **Permanent Differences:** Items of revenue or expense included in accounting profit that will *never* be assessable or deductible for tax purposes, or tax deductions/exemptions that never appear in accounting profit. Examples in Australia include non-deductible entertainment expenses (ITAA 1997 s 32-5), statutory fines and penalties (s 26-5), goodwill impairment expense (which is never tax-deductible), non-assessable government grants, and exempt foreign branch income. Permanent differences affect **current tax expense** and the effective tax rate, but **never** create deferred tax assets or deferred tax liabilities.
- **Temporary Differences:** Differences between the carrying amount of an asset or liability in the Statement of Financial Position and its tax base. Temporary differences originate in one period and reverse in one or more subsequent periods, shifting the timing of tax cash flows without changing total cumulative taxable profit over the asset or liability's full life.

4.2 The Balance Sheet Liability Method and Tax Bases

AASB 112 mandates the **balance sheet liability method**, which computes deferred tax balances by comparing the accounting **Carrying Amount (CA)** of every asset and liability against its **Tax Base (TB)** at the reporting date.

For an **asset**, the tax base (TB_A) is the amount that will be deductible for tax purposes against any taxable economic benefits that will flow to the entity when it recovers the carrying amount of the asset. If those economic benefits will not be taxable, the tax base of the asset equals its carrying amount. Typical examples include:

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- **Depreciable Equipment:** Tax base equals tax written-down value (original cost minus cumulative ATO tax depreciation claimed to date).
- **Accounts Receivable:** Carrying amount is net of the Allowance for Expected Credit Losses; because bad debts are only tax-deductible when formally written off (not when an allowance is estimated), the tax base equals gross receivables.
- **Prepaid Expenses (e.g., Prepaid Insurance):** Under Australian tax law, prepayments immediately deductible on payment have a tax base of zero ($TB_A = 0$), even though the accounting asset remains on the balance sheet until the coverage period expires.

For a **liability**, the tax base (TB_L) is defined formulaically as:

$$TB_L = CA_L - \text{Future Deductible Amounts}$$

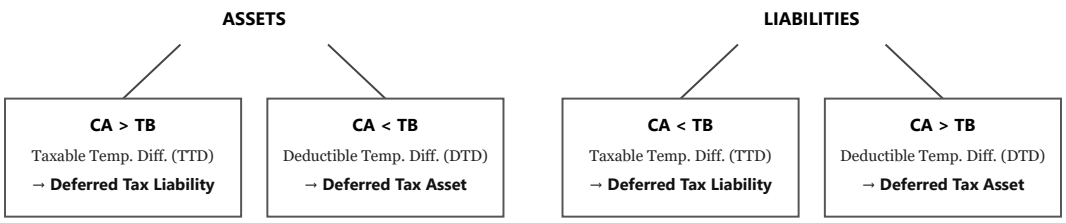
Where: TB_L is the tax base of the liability, CA_L is the carrying amount of the liability in the Statement of Financial Position, and $\text{Future Deductible Amounts}$ represents amounts relating to that liability that will be deductible for tax purposes in future periods. In the special case of revenue received in advance (Unearned Revenue), $TB_L = CA_L - \text{Revenue Not Taxable in Future Periods}$: if cash receipts are taxed by the ATO upon receipt rather than when earned, future revenue recognition is not taxable again, so $TB_L = 0$. Conversely, if an accrued liability such as Warranty Provision or Annual Leave Provision is only tax-deductible when paid in cash, all of CA_L will be deductible in future periods, giving $TB_L = CA_L - CA_L = 0$.

Comparing CA and TB classifies every temporary difference into either a **Taxable Temporary Difference (TTD)** or a **Deductible Temporary Difference (DTD)**, multiplied by the substantively enacted future tax rate *t*:

$$\text{DTL} = \text{TTD} \times t \qquad \text{and} \qquad \text{DTA} = \text{DTD} \times t$$

Where: DTL is the closing Deferred Tax Liability, DTA is the closing Deferred Tax Asset, TTD is the sum of taxable temporary differences (arising when $CA_A > TB_A$ or $CA_L < TB_L$), DTD is the sum of deductible temporary differences (arising when $CA_A < TB_A$ or $CA_L > TB_L$), and t is the corporate income tax rate expected to apply when the asset is realised or the liability is settled.

Compare Carrying Amount (CA) vs Tax Base (TB)



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4.3 Recognition Criteria, Tax Losses, and Rate Changes

Under *AASB 112*, all deferred tax liabilities must be recognised unless an explicit initial-recognition exception applies (notably, DTLs are never recognised on the initial recognition of goodwill, nor on an asset/liability in a transaction that is not a business combination and affects neither accounting profit nor taxable profit at the time of the transaction). By contrast, a deferred tax asset—whether arising from deductible temporary differences or unused tax losses—may only be recognised to the extent that it is **probable** that future taxable profit will be available against which the deductible temporary difference or tax loss can be utilised.

When the Commonwealth Parliament passes legislation changing the corporate tax rate (for example, when a growing company transitions from the 25% base rate entity rate to the 30% standard corporate rate, or vice versa), existing opening DTA and DTL balances must be remeasured at the newly applicable rate. The resulting adjustment is recognised in profit or loss, except to the extent that it relates to items previously recognised in OCI (such as a property revaluation surplus under *AASB 116*) or directly in equity. Similarly, current and deferred tax assets and liabilities are offset in the Statement of Financial Position only when the entity has a legally enforceable right to set off current tax amounts and intends to settle on a net basis, and the deferred tax balances relate to income taxes levied by the same taxation authority (such as the ATO) on the same taxable entity.

4.4 Comprehensive Worked Tax-Effect Accounting Example in AUD

Yarra Valley Manufacturing Ltd (a Tier 1 Australian company subject to the 30% corporate tax rate) reported accounting profit before income tax of A$950,000 for the year ended 30 June 2027. The following additional data apply for FY2027:

1. **Permanent items included in accounting profit:** Entertainment expense of A$24,000 (non-deductible under ITAA 1997); ASIC administrative penalty of A$16,000 (non-deductible); exempt dividend income from a foreign subsidiary of A$50,000 (non-assessable non-exempt under s 768-5 ITAA 1997).
2. **Machinery:** Cost A$1,200,000 acquired on 1 July 2025. Accounting depreciation is 15% straight-line (A$180,000/year); ATO tax depreciation is 25% straight-line (A$300,000/year). At 30 June 2026, accounting carrying amount was A$1,020,000 and tax written-down value was A$900,000. At 30 June 2027, accounting carrying amount is A$840,000 and tax written-down value is A$600,000.
3. **Accounts Receivable & Allowance for Doubtful Debts:** Gross receivables were A$410,000 at 30 June 2026 (Allowance A$30,000; Net A$380,000) and A$480,000 at 30 June 2027 (Allowance A$45,000; Net A$435,000). During FY2027, bad debts of A$20,000 were physically written off against the allowance, and Doubtful Debts Expense of A$35,000 was recognised in profit or loss.
4. **Provision for Employee Annual Leave:** Balance at 30 June 2026 was A$110,000; balance at 30 June 2027 is A$140,000. During FY2027, employee leave expense accrued was A$95,000 and cash leave paid to employees was A$65,000.
5. **Prepaid Insurance:** Asset balance at 30 June 2026 was A$32,000; balance at 30 June 2027 is A$44,000. Insurance expense recorded in FY2027 was A$70,000, while cash premiums paid (fully tax-deductible when paid) were A$82,000.
6. **Unearned Subscription Revenue:** Liability balance at 30 June 2026 was A$60,000; balance at 30 June 2027 is A$85,000. Under ATO rules, subscription receipts are assessable when cash is received.

Step 1: Current Tax Worksheet (Reconciliation to Taxable Profit and Current Tax Liability)

We begin with accounting profit before tax, eliminate permanent differences, and adjust for timing differences between accounting accruals and cash/tax rules:

Current Tax Calculation Item	Amount (AUD)	Tax Treatment Rationale
Accounting Profit Before Income Tax	**950,000**	Starting accrual profit under AASB standards
Add: Non-deductible entertainment expense	24,000	Permanent difference (add back)
Add: Non-deductible ASIC penalty	16,000	Permanent difference (add back)
Less: Exempt foreign dividend income	(50,000)	Permanent difference (deduct)

Current Tax Calculation Item	Amount (AUD)	Tax Treatment Rationale
Accounting Profit Adjusted for Permanent Differences	**940,000**	Basis for statutory effective tax check (940,000 × 30% = 282,000)
Add: Accounting depreciation on machinery	180,000	Non-deductible accounting charge
Less: ATO tax depreciation on machinery	(300,000)	Allowable tax deduction
Add: Doubtful debts expense (allowance movement)	35,000	Estimated allowance not deductible
Less: Bad debts actually written off	(20,000)	Deductible on formal write-off
Add: Annual leave expense accrued	95,000	Accrual not deductible until paid
Less: Annual leave paid in cash	(65,000)	Deductible when paid
Add: Insurance expense (accounting)	70,000	Accrual amortisation of prepayment
Less: Insurance cash premiums paid	(82,000)	Deductible upon cash payment
Add: Increase in unearned revenue (85,000 – 60,000)	25,000	Excess cash receipts taxed on receipt
Taxable Profit (FY2027)	**878,000**	Net taxable income assessed by ATO
Current Tax Liability (878,000 × 30%)	**263,400**	Recognised as Income Tax Payable

Step 2: Deferred Tax Worksheet at 30 June 2027 (Balance Sheet Liability Method)

First establish the opening deferred tax balances at 30 June 2026: Machinery TTD was A$1,020,000 – A$900,000 = A$120,000; Prepaid Insurance TTD was A$32,000 – A$0 = A$32,000; Total opening TTD = A$152,000, giving Opening DTL = 152,000 × 30% = A$45,600. Opening DTDs comprised Doubtful Debts Allowance (A$30,000), Annual Leave Provision (A$110,000), and Unearned Revenue (A$60,000), totalling A$200,000, giving Opening DTA = 200,000 × 30% = A$60,000.

Now prepare the closing deferred tax schedule at 30 June 2027:

Statement of Financial Position Item	Carrying Amount (AUD)	Tax Base (AUD)	TTD (AUD)	DTD (AUD)
Assets				
Machinery (net)	840,000	600,000	240,000	—
Accounts Receivable (net)	435,000	480,000	—	45,000
Prepaid Insurance	44,000	0	44,000	—
Liabilities				
Provision for Annual Leave	140,000	0	—	140,000
Unearned Subscription Revenue	85,000	0	—	85,000
Total Temporary Differences (30 June 2027)			**284,000**	**270,000**
Closing Deferred Tax Balances at 30%			**DTL: 85,200**	**DTA: 81,000**
Less: Opening Balances (30 June 2026)			(45,600)	(60,000)

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Statement of Financial Position Item	Carrying Amount (AUD)	Tax Base (AUD)	TTD (AUD)	DTD (AUD)
Net Movement Charged / (Credited) to Tax Expense			**+39,600 (Cr DTL)**	**+21,000 (Dr DTA)**

Step 3: Journal Entries and Reconciliation Check

The net deferred tax expense for FY2027 is the increase in DTL (A$39,600) minus the increase in DTA (A$21,000), equalling A$18,600. Combining current tax expense and deferred tax expense yields total income tax expense:

$$\begin{aligned}\text{Total Income Tax Expense} &= \text{Current Tax} + \Delta\text{DTL} - \Delta\text{DTA} \\ &= 263{,}400 + 39{,}600 - 21{,}000 = \text{AUD } 282{,}000\end{aligned}$$

Where: Current Tax is the ATO tax payable on FY2027 taxable profit (A$263,400), ΔDTL is the net increase in Deferred Tax Liability (A$39,600), and ΔDTA is the net increase in Deferred Tax Asset (A$21,000). Observe the exact proof: A$282,000 equals 30% of the A$940,000 accounting profit adjusted for permanent differences (950,000 × 30% + 24,000 × 30% + 16,000 × 30% − 50,000 × 30% = 285,000 + 7,200 + 4,800 − 15,000 = 282,000), confirming zero arithmetic discrepancy.

Date	Account Description	Debit (AUD)	Credit (AUD)
30 Jun 2027	Income Tax Expense (Current)	263,400	
	Current Tax Liability		263,400
30 Jun 2027	Income Tax Expense (Deferred)	18,600	
	Deferred Tax Asset	21,000	
	Deferred Tax Liability		39,600

In the Statement of Financial Position at 30 June 2027, assuming Yarra Valley Manufacturing Ltd operates solely within the Australian federal tax jurisdiction with a legally enforceable right to offset ATO income tax balances, the closing DTA (A$81,000) and closing DTL (A$85,200) are offset to report a net non-current Deferred Tax Liability of A$4,200 alongside a Current Tax Liability of A$263,400 (less any PAYG tax instalments already remitted to the ATO during the year).

4.5 Unused Tax Losses, Base-Rate Entity Rate Changes & Tax Reconciliation Note

When an Australian entity incurs a tax loss in a given year under the ITAA 1997 (after satisfying the continuity of ownership test or business continuity test), no current tax is payable; instead, the tax loss may be carried forward indefinitely to offset future taxable profits. Under *AASB 112* paragraph 34, a Deferred Tax Asset is recognised for unused tax losses only to the extent that it is probable that future taxable profit will be available against which the unused tax losses can be utilised. Because a history of recent tax losses provides strong evidence that future taxable profit may not arise, paragraph 35 requires convincing other evidence (such as binding long-term sales contracts, sufficient existing taxable temporary differences reversing in the same period, or disposal of appreciated non-core assets) before recognising a DTA on tax losses. Unrecognised tax losses are disclosed in the notes and reassessed at each reporting date.

Additionally, Australian corporate entities frequently cross the A$50 million aggregated turnover threshold separating **base rate entities** (taxed at 25%) from general corporate entities (taxed at 30%). Under *AASB 112* paragraph 47, deferred tax assets and liabilities must be measured at the tax rates expected to apply to the period when the asset is realised or the liability is settled, based on tax rates substantively enacted by the end of the reporting period. When an entity's expected future tax rate changes from 25% to 30%, opening DTA and DTL balances must be remeasured by multiplying existing

temporary differences by the rate differential (Δ t = +5%). The resulting adjustment flows through Income Tax Expense (Deferred) in profit or loss, except for the portion relating to items originally recognised in OCI (such as an Asset Revaluation Surplus), which is charged directly to OCI.

Worked Example: Tax-Rate Change & Tax Loss Recognition (AUD)

Suppose Bendigo Precision Tools Pty Ltd held opening temporary differences at 1 July 2026 (when taxed at the 25% base rate) comprising TTDs of A$200,000 (Opening DTL = 200,000 × 25% = A$50,000, of which A$80,000 of TTD arose from a land revaluation credited to OCI) and DTDs of A$120,000 (Opening DTA = 120,000 × 25% = A$30,000). During FY2027, Bendigo's turnover exceeds A$50 million, making the 30% corporate rate applicable for FY2027 and future years. Simultaneously, Bendigo incurs an operating tax loss of A$100,000 in FY2027 due to a one-off factory relocation, and management provides convincing evidence of signed FY2028–FY2029 government defence contracts ensuring probable future taxable profits. At 30 June 2027, closing TTDs remain A$200,000 and closing DTDs remain A$120,000 (excluding the tax loss).

- **DTL Remeasurement (25% → 30%):** Total DTL rises from A$50,000 to 200,000 × 30% = A$60,000 (+A$10,000). Of this A$10,000 increase, the portion attributable to the land revaluation reserve is 80,000 × (30% – 25%) = A$4,000 (Dr Income Tax Expense – OCI A$4,000 / Cr DTL A$4,000), while the remaining 120,000 × 5% = A$6,000 is charged to Profit or Loss (Dr Income Tax Expense – P&L A$6,000 / Cr DTL A$6,000).
- **DTA Remeasurement & Tax Loss Recognition:** Existing DTA rises from A$30,000 to 120,000 × 30% = A$36,000 (+A$6,000, credited to Income Tax Expense in P&L). In addition, the A$100,000 carry-forward tax loss creates a new DTA of 100,000 × 30% = A$30,000 (Dr DTA A$30,000 / Cr Income Tax Benefit – P&L A$30,000).

Finally, *AASB 112* paragraph 81(c) requires an explicit numerical reconciliation in the notes linking accounting profit multiplied by the statutory corporate tax rate to reported income tax expense. Returning to Yarra Valley Manufacturing Ltd's FY2027 results (Accounting Profit A$950,000, Tax Expense A$282,000), the statutory note disclosure reconciles the 29.68% effective tax rate to the 30.00% Australian corporate rate as follows:

Income Tax Expense Reconciliation Note (AASB 112 para 81(c))	Amount (AUD)	Effective Rate (%)
Accounting profit before income tax	950,000	—
Prima facie income tax expense at Australian statutory rate (30%)	285,000	30.00%
Add tax effect of non-deductible entertainment (24,000 × 30%)	7,200	0.76%
Add tax effect of non-deductible ASIC penalty (16,000 × 30%)	4,800	0.51%
Less tax effect of exempt foreign dividend (50,000 × 30%)	(15,000)	(1.58%)
Total Income Tax Expense Reported in Profit or Loss	**282,000**	**29.68%**

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