CHARTERED SECRETARIES
AUSTRALIA

Leaders in governance

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Dear Bede

Improving Australia's corporate reporting framework: Exposure Draft of Corporations Amendment (Corporate Reporting Reform) Bill 2010

Chartered Secretaries Australia (CSA) is the independent leader in governance and risk management. As the peak professional body delivering accredited education and the most practical and authoritative training and information in the field, it is focused on improving organisational performance and transparency. Our members are all involved in governance, corporate administration and compliance with the Corporations Act (the Act). Our members work in both public listed and public unlisted companies, and many serve as officers of not-for-profit organisations, or manage the affairs of subsidiary companies of public listed companies, which are frequently public unlisted companies. We have drawn on their experience in the formulation of each submission on the matters contained in the Exposure Draft of Corporations Amendment (Corporate Reporting Reform) Bill 2010 (the Exposure Draft).

We welcome the opportunity to comment on the Exposure Draft and commend the government for introducing these proposed reforms.

1 Companies limited by guarantee

a) A differential financial reporting framework

CSA welcomes the focus in the Exposure Draft on ameliorating the regulatory burden for companies limited by guarantee, particularly as this corporate form is utilised by many not-for-profit organisations. CSA had commented on the discussion paper *Financial reporting by public unlisted companies* when it was released in 2007 and is very glad to see that the reforms contained in the Exposure Draft address the issues highlighted at the time of that consultation.

CSA fully supports the proposal to introduce a three-tiered differential reporting regime based on size for companies limited by guarantee, as follows:

- under the first tier, companies limited by guarantee with annual revenue less than $250,000 which do not have deductible gift status will be exempt from preparing the financial report and the directors' report

- under the second tier, companies limited by guarantee with an annual revenue of less than $250,000 that are a deductible gift recipient and companies with an annual revenue of $250,000 or more but less than $1 million, irrespective of whether the company is a deductible gift recipient, will prepare financial reports but can elect to have them reviewed rather than audited; prepare a streamlined directors' report, rather than a full directors' report; and be subject to a streamlined process for distributing annual reports to members
- under the third tier, companies limited by guarantee with an annual revenue of $1 million or more, irrespective of whether the company is a deductible gift recipient, will continue to prepare an audited financial report; prepare a streamlined directors' report, rather than a full directors' report; and be subject to a streamlined process for distributing the annual report to members.

CSA notes that the essence of good governance is accountability, transparency and stewardship, and that any reform of the financial reporting framework for companies limited by guarantee must ensure that stakeholders continue to have confidence in the governance of such companies. Members of not-for-profit companies are not investors seeking to examine the accounts to ascertain the deployment of and return on their investment, but they nonetheless have a strong interest in being able to review the financial position of the company and that the company is being managed well.

In the past, CSA has stated that it believes that companies limited by guarantee not be differentiated by the nature of their operations rather than just by size, pointing out that companies raising funds through donations from the public, for which greater transparency may be required, can still be accounted for under the size test. However, CSA supports the proposal in the Exposure Draft to use classification as a deductible gift recipient for the purposes of the *Income Tax Assessment Act 1997* as the basis for clarifying whether a company limited by guarantee will be exempt from reporting obligations or required to provide streamlined reporting.

Revenue

CSA notes that one issue that may arise for companies where tiers are applied based on revenue is that companies may fall in and out of different tiers and, therefore, have different requirements year-to-year. The requirements in relation to corporate reporting may be uncertain until the very end of the financial year.

CSA recommends that, in order to avoid such a potentially confusing and perhaps costly situation, the revenue figure to be used should be an average of the previous three years' annual revenue figures, this definition would have to take account of companies with less than a three-year life.

Exception where direction by ASIC or members

CSA supports the provision that companies limited by guarantee must prepare a financial report or a directors' report if they are directed to by ASIC or by a percentage of members. However, CSA has concerns with the proposal that five per cent of members may require a financial report or directors' report to be prepared.

The Explanatory Material notes that this requirement is similar to the existing requirements applying to small proprietary companies under corporations legislation. CSA notes, however, that the existing requirements in s 293 of the Corporations Act provide that:

> Shareholders with at least 5% of the votes in a small proprietary company may give the company direction to:
> (a) prepare a financial report and directors' report for a financial year; and
> (b) send them to all shareholders.

CSA notes that there is a substantial difference between the requirements to have five per cent of members give direction for financial reports and a directors' report to be prepared and five per cent of the votes giving such direction. For example, if a company limited by guarantee has 20 members (as do some small sporting clubs) only one member need require the preparation of audited financial reports and a directors' report, the cost of which could be prohibitively expensive.

CSA considers that other options need to be canvassed, in order to avoid the potential for large and unjustifiable costs to companies being imposed by one or two members. We accept that there is no ready solution, and propose various suggestions below for consideration, while recognising that each has its limitations.

One possibility is that legislation could provide that any member can ask that a resolution be put to the annual general meeting requesting the preparation of financial statements and an audit of those statements. If the resolution is passed the board must comply. This preserves members' rights, but avoids the potential for one or two members to potentially put the company to great cost for little benefit.

Another possibility is that the percentage of members required to request financial statements could be set at a higher level, such as 20 per cent. However, our concerns with this approach is that in larger companies limited by guarantee, this percentage could set the bar too high, so that it is impossible for members to request financial statements.

A third possibility is to provide for ASIC alone to require the preparation of financial statements upon request by members. This would follow a request from five per cent of members to the board for the preparation of financial statements, which request is refused by the board. However, we have concerns with this approach as it denies members the right to request financial statements directly.

Audits and reviews

CSA supports the proposal that companies falling within the second tier would be given the option of having their annual report subject to a review, rather than an audit. CSA agrees that expanding the category of individuals that are permitted to undertake a review will provide greater flexibility and reduce unnecessary compliance burdens on companies limited by guarantee.

Streamlined directors' report

CSA supports companies falling within the second and third tiers of financial reporting obligations being exempt from complying with the existing directors' report disclosure requirements and being obliged to prepare a simplified directors' report that would include:

- a description of the short and long-term objectives of the entity
- the entity's strategy for achieving those objectives
- the entity's principal activities during the year
- how those activities assisted in achieving the entity's objectives
- how the entity measures its performance, including any key performance indicators
- the name of each person who has been a director of the company at any time during or since the end of the year and the period for which the person was a director
- each director's qualifications, experience and special responsibilities
- the number of meetings of the board of directors held during the year and each director's attendance at those meetings
- for each class of membership in the company, the amount for which a member of that class is liable to contribute if the company is wound up
- the total amount that members of the company are liable to contribute if the company is wound up.

CSA has been on the record as recommending mandatory, short-form report for all not-for-profit organisations, which would be publicly available, that would cover the disclosures listed above. However**, CSA recommends** the inclusion of a further three essential governance elements that are currently missing from this list of disclosures, as follows:

- whether there are any board committees or equivalent, how many board committee meetings have been held during the year and directors' attendance at those committee meetings
- the remuneration, if any, paid to directors and the principle executive officer if that person is not a director, and the secretary (including information on whether non-executive board members are paid)
- disclosure of all related-party interests.

CSA believes it is essential for members to have access to information concerning the processes that are in place to ensure the personal interests of directors do not override the interests of the organisation.

b) Distribution of annual reports

CSA supports the proposal that companies falling within the second and third tiers would be required to write to members informing them that an annual report has been prepared and how they can obtain a copy (including by directing members to the company website where available), and that members wishing to obtain a hard copy or an electronic copy of the company's latest annual report can make a standing election to obtain this from the company free of charge.

c) Prohibition on paying dividends

CSA supports the introduction of a prohibition on companies limited by guarantee from distributing profits to members in the form of dividends. CSA notes that a company limited by guarantee cannot currently be registered with ASIC unless the constitution states that it will not pay dividends, but believes that a statutory obligation clarifies and streamlines this process.

However, CSA notes that neither the Exposure Draft nor the Explanatory Material discuss the particular group of companies which are both companies limited by guarantee and companies limited by shares. While perhaps few in number, such companies nonetheless need to be considered in any process of reform. Most recently this group would include financial organisations, which came under the jurisdiction of the corporations law in 1999. The group of companies that were both limited by guarantee and shares (for example, friendly societies) took the once-off opportunity to elect this form of incorporation in order to provide them with the option, at a later date, of undertaking a process of demutualisation with diminished difficulty.

CSA notes that a prohibition on companies limited by guarantee from distributing profits to members in the form of dividends would pose difficulties for the group of companies that are both companies limited by guarantee and companies limited by shares. **CSA recommends** that the proposed legislation accommodate the specific needs of this group of companies.

2 Parent-entity financial statements

CSA supports the repeal of subsections 295(2) and 303(2) of the Corporations Act and the introduction of new provisions that provide that, where the accounting standards require an entity to prepare financial statements in relation to a consolidated entity, separate financial statements do not have to be prepared in relation to the entity itself.

CSA notes that many large companies are structured in a manner whereby the parent company is a holding company, with most of the business activities being undertaken by the subsidiaries. The parent company has few assets apart from the shares in the subsidiary. As a result, the financial statements of the parent company tend to be stripped of any real meaning, with the

value of operations sitting in the financial statements of the subsidiary. CSA therefore believes that the proposed reform to replace full parent entity financial statements with summary information will reduce the burden on business, reduce business costs and remove unnecessary disclosures from an entity's annual report.

With respect to the repeal of ss 295(2) and 303(2), there should only be relief from the requirement to prepare stand-alone accounts where an appropriate deed of cross-guarantee is in place. The relief that is available to wholly-owned entities from filing accounts is to allow a group structure to be viewed as one economic entity. The mechanism to achieve this outcome is a deed of cross guarantee between a parent company and one or more of its wholly-owned subsidiaries.

Therefore, any summary information as proposed should refer to the deed of cross guarantee that would need to be in place between the parent and subsidiary if a parent entity is only to be required to prepare consolidated accounts.

However, another question at stake is whether or not wholly-owned subsidiaries in corporate groups should be required to file separate accounts. CSA believes that the policy position and principle is, if the consolidated group files its own accounts and a deed of cross guarantee is in place, then there should be no need for the subsidiary companies that are party to the deed of cross guarantee to file separate accounts, because customers, creditors, suppliers etc can deal with the corporate group as one entity. The public policy objective relates to the filing of accounts, which for wholly-owned subsidiaries is dealt with when the parent company files its accounts and the directors provide the sign-off that members of the extended group can meet their obligations. CSA therefore queries why subsidiaries should be required to lodge stand-alone accounts if it is acceptable for the parent company to only lodge consolidated accounts.

3 Requirements for paying dividends

CSA supports the repeal of the 'profits test' and its replacement with a more flexible requirement allowing a company to pay dividends if:

- the company's assets exceed its liabilities and the excess is sufficient for the payment of the dividend
- it is fair and reasonable to the company's shareholders as a whole
- it does not materially prejudice the company's ability to pay its creditors.

Taxation legislation

CSA notes that the proposed reform has tax implications, and **recommends** that the government amend the taxation legislation as a matter of urgency in order to implement the proposed reform.

International Financial Reporting Standards (IFRS)

While CSA welcomes the proposed reform, we note that the reform is required to address issues raised by IFRS, and that the source of the difficulty itself is not being addressed. However, CSA believes that the reform, which will allow companies to pay dividends in periods where they would not otherwise have been able to do so, will assist companies.

4 Changing reporting periods

CSA supports the proposed amendment of s 323D to allow a financial year of an entity subsequent to the first year to last for a period other than 12 months provided that the period is not longer than 18 months; there has not been a period during the last five financial years in which there was a financial year of other than 12 months; and the change to the subsequent financial year is made in good faith in the best interests of the entity.

However, **CSA recommends** that, if a reporting period is amended to 18 months to take advantage of the capacity to synchronise the financial years of an entity and its controlled entities (to facilitate the preparation of consolidated financial statements), consequential legislative amendment may be required to ensure that entities are not in breach of their obligations under the Corporations Act to hold an annual general meeting (AGM) within the calendar year.

5 Extending s 299A of the Corporations Act

CSA supports the extension of the application of s 299A of the Corporations Act to all listed entities. CSA believes this will enhance the governance framework, by providing more information to shareholders to enable them to understand the performance of a company and the factors underlying its results and financial position.

6 Solicitors' representation letters

CSA supports solicitors' representation letters and associated communication being protected from disclosure to another person or court.

CSA supports ASIC, APRA and the Companies and Liquidators Board (CALDB) being able to continue to access these communications for the purpose of performing their functions. However, **CSA recommends** that, where litigation involves one of these regulators, the exception should not apply. Legal professional privilege should apply to advice concerning that litigation, as in the normal course of events.

7 IFRS declaration

CSA is in principle supportive of the proposed reform that would require the directors' declaration in a company's annual report to include a statement of whether, in the directors' opinion, the company's financial statements and the notes to its financial statements are prepared in compliance with IFRS.

However, CSA notes that this is a fairly circuitous approach to resolving the perception problem in other jurisdictions that Australian companies and other reporting entities are not compliant with IFRS, given that accounting standards in Australia are referred to as 'Australian-equivalent International Financial Reporting Standards (AIFRS)'. CSA queries why accounting standards in Australia need to be referred to in this manner and suggests that the problem that the reform is attempting to solve could be more easily solved if accounting standards in Australia were referred to as IFRS.

8 Lost capital reductions

CSA leaves it to the accounting bodies to comment on this issue.

9 FCR functions and funding

CSA leaves it to the accounting bodies to comment on this issue.

10 CALDB processes

CSA supports:

- modification of the membership requirements of the CALDB by repealing the current selection process and providing for the Minister to appoint six members as accounting members

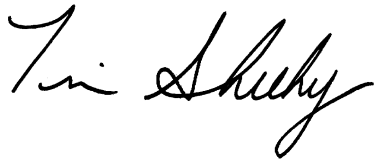
- extension of the protection and immunity provisions to include a conference convened by the Chairperson of CALDB.

Conclusion

In preparing this submission, CSA has drawn on the expertise of the members of two of our national policy committees, the Legislation Review Committee and the Corporate and Legal Issues Committee.

CSA would welcome further contact during the consultation process and the opportunity to be involved in further deliberations.

Yours sincerely



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