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THE PARLIAMENT OF THE COMMONWEALTH OF AUSTRALIA

HOUSE OF REPRESENTATIVES

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# CORPORATIONS AMENDMENT (CORPORATE REPORTING REFORM) BILL 2010

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EXPLANATORY MEMORANDUM

(Circulated by the authority of the
Minister for Financial Services, Superannuation, Corporate Law and Human Services,
the Hon Chris Bowen)

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# Glossary

The following abbreviations and acronyms are used throughout this explanatory memorandum.

| ***Abbreviation*** | ***Definition*** |
|---|---|
| AASB | Australian Accounting Standards Board |
| APRA | Australian Prudential Regulation Authority |
| ASIC | Australian Securities and Investments Commission |
| ASIC Act | *Australian Securities and Investments Commission Act 2001* |
| AUASB | Auditing and Assurance Standards Board |
| CAC Act | *Commonwealth Authorities and Companies Act 1997* |
| CALDB | Company Auditors and Liquidators Disciplinary Board |
| Corporations Act | *Corporations Act 2001* |
| CPAA | CPA Australia |
| FMA Act | *Financial Management and Accountability Act 1997* |
| FRC | Financial Reporting Council |
| GRI Act | *Governance Review Implementation (AASB and AUASB) Act 2008* |
| IASB | International Accounting Standards Board |
| ICAA | Institute of Chartered Accountants in Australia |
| IFRS | International Financial Reporting Standards |
| IPAA | Insolvency Practitioners Association of Australia |
| NIA | National Institute of Accountants |
| RIS | Regulation Impact Statement |

# General outline and financial impact

## General outline

A robust financial reporting framework is an essential component of an efficient market. The Corporations Amendment (Corporate Reporting Reform) Bill 2010 will improve Australia's corporate reporting framework by reducing unnecessary red-tape and regulatory burden on companies, improving disclosure requirements and implementing a number of other important refinements to the corporate regulatory framework.

***Date of effect***: The Act commences on the day it receives the Royal Assent.

## Summary of regulation impact statement

### Regulation impact on business

***Impact***: A Regulation Impact Statement (RIS) has been prepared in accordance with the Government's best practice regulation requirements. The RIS was released publicly as part of the consultation process.

# Chapter 1
# Companies limited by guarantee

## Context of amendments

1.1 Under the existing reporting framework, all companies limited by guarantee are required to prepare an audited financial report in accordance with the Australian accounting standards and a directors' report in accordance with the *Corporations Act 2001* (Corporations Act), regardless of their size.

1.2 The company limited by guarantee structure is used predominantly by not-for-profit entities to incorporate their operations. Research conducted by The University of Melbourne found that approximately 21 per cent of companies limited by guarantee were sports and recreation related organisations, 19 per cent were community service organisations, 15 per cent were education-related institutions and 10 per cent were religious organisations.

1.3 The vast majority of companies limited by guarantee are relatively small. The table below outlines the relative size of companies limited by guarantee based on a sample of companies that lodged financial reports with Australian Securities and Investments Commission (ASIC). The small size of companies limited by guarantee means that they may not have the capacity to comply with extensive reporting requirements. However, as discussed below, it is recognised that reporting by companies limited by guarantee is an important governance and transparency mechanism given the public nature of these companies.

**Table 1.1: Size of companies limited by guarantee**[1]

| | ***Revenue (%)*** | ***Cumulative Total: Revenue (%)*** | ***Assets (%)*** | ***Cumulative Total: Assets (%)*** |
|---|---|---|---|---|
| **Less than $20,000** | 14 | 14 | 12 | 12 |
| **Between $20,000 and $50,000** | 9 | 23 | 9 | 21 |
| **Between $50,001 and $250,000** | 24 | 47 | 16 | 37 |
| **Between $250,001 and $500,000** | 7 | 54 | 8 | 45 |
| **Between $500,001 and $1,000,000** | 14 | 68 | 18 | 63 |
| **Between $1,000,000 and $12,500,000** | 28 | 96 | 30 | 93 |
| **Greater than $12,500,000** | 4 | 100 | 5 | 100 |

1.4 In June 2007, Treasury released a discussion paper on financial reporting by unlisted public companies. The paper sought comments on whether the existing reporting framework was appropriate for the 11,000 companies limited by guarantee and the 7,000 unlisted public companies limited by shares preparing financial reports under the Corporations Act.

1.5 The majority of respondents to the discussion paper indicated that for reporting purposes, companies limited by guarantee could be differentiated on the basis of the size of their operating revenue. Tests based on assets or number of employees may not be accurate indicators of the ‘size’ of the company. For example, a company limited by guarantee may have a large number of assets, but there may be restrictions on the company disposing of these assets. In addition, indicators based on employee numbers are likely to be distorted by the large number of volunteers that generally participate in not-for-profit entities.

1.6 The submissions also noted that some types of companies limited by guarantee will have a higher level of public interest due to the nature of their activities. Charities, for instance, were identified as being in this category because of their public fundraising activities (for example, donation drives) and significant community involvement. In contrast, member-focused companies limited by guarantee (for example, sporting clubs) may have a significantly lower level of public interest. Such factors need to be considered when differentiating between companies limited by guarantee for reporting purposes.

1 Based on sample data provided by ASIC on 3 November 2006.

1.7 Any differentiation between companies limited by guarantee on the basis of the nature of their activities needs to be sufficiently clear to ensure that companies are certain of their reporting obligations. For this reason, it is proposed that classification as a deductible gift recipient for the purposes of the *Income Tax Assessment Act 1997* be used to differentiate between companies limited by guarantee in terms of the nature of their activities. Deductible gift recipients may receive tax deductible donations from the public. As such, it is considered to be indicative of a high degree of public interest in the activities of the company.

## Summary of new law

1.8 A three tiered differential reporting framework will be introduced exempting small companies limited by guarantee from reporting and auditing requirements and providing other companies limited by guarantee with streamlined assurance requirements and simplified disclosures in the directors' report. In addition, the process for companies to distribute the annual report to their members will be streamlined.

1.9 Companies limited by guarantee will be prohibited from paying a dividend, as the corporate structure of companies limited by guarantee means that they are not suited for conducting for-profit activities which could legitimately warrant the payment of dividends to members.

1.10 This proposal is aimed at introducing a tailored financial reporting regime for companies limited by guarantee that will reduce the regulatory burden on these entities while ensuring that appropriate levels of financial transparency and governance are maintained.

## Comparison of key features of new law and current law

| ***New law*** | ***Current law*** |
|---|---|
| A three tiered differential reporting framework will be introduced exempting small companies limited by guarantee from reporting and auditing requirements and providing other companies limited by guarantee with streamlined assurance requirements and simplified disclosures in the directors' report. | Companies limited by guarantee must prepare a full audited financial report in accordance with accounting standards and a directors' report in accordance with the Corporations Act. |

| ***New law*** | ***Current law*** |
| --- | --- |
| The process for companies to distribute the annual report to their members will be streamlined, by allowing companies limited by guarantee to write to members informing them that an annual report has been prepared and how they can obtain a copy. | Companies limited by guarantee must comply with section 314 of the Corporations Act, which allows companies to distribute their annual report to members via the Internet, and if the company does not maintain a website, it must send members a hard copy report. |
| Companies limited by guarantee will be prohibited from paying a dividend. | The Corporations Act does not prohibit companies limited by guarantee from paying dividends. |

## Detailed explanation of new law

### Differential reporting framework

1.11 Under the proposed new law, a three tiered differential reporting framework would be introduced for companies limited by guarantee.

1.12 Under the first tier, companies would be exempt from preparing the financial report and the directors' report. As a result, companies in this tier would not be required to have the annual report audited, or be required to appoint an auditor. This tier comprises of companies limited by guarantee with annual revenue less than $250,000 which do not have deductible gift recipient status.

1.13 Under the second tier, companies would:

- prepare a financial report, which they could elect to have reviewed rather than audited;
- prepare a streamlined directors' report, rather than a full director's report; and
- be subject to a streamlined process for distributing the annual report to members.

The second tier comprises of the following companies limited by guarantee:

- companies 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.

1.14 Under the third tier, companies would:

- continue to prepare an audited financial report;
- prepare a streamlined directors' report, rather than a full director's report; and
- be subject to a streamlined process for distributing the annual report to members.

The third tier comprises of companies limited by guarantee with an annual revenue of $1 million or more, irrespective of whether the company is a deductible gift recipient.

1.15 The Bill provides a regulation making power to vary the amount of the threshold, to ensure that the threshold can be easily updated over time. In addition, the Bill provides that the revenue and consolidated revenue are to be calculated in accordance with accounting standards.

***[Schedule 1, Part 1, item 14, section 285A]***

### *Exception where direction by ASIC or members*

1.16 Appropriate safeguards would be put in place requiring companies limited by guarantee to prepare a financial report or a directors' report if they are directed to by ASIC or by at least five per cent of members. ***[Schedule 1, Part 1, item 16, sections 294A and 294B]*** The requirements relating to a direction from ASIC or at least five per cent of members are similar to the existing requirements applying to small proprietary companies in sections 293 and 294 of the Corporations Act.

1.17 The Bill provides a strict liability offence where a company fails to comply with a direction given by ASIC. ***[Schedule 1, Part 1, item 16, subsection 294B(2)]*** This will facilitate effective enforcement and compliance of this requirement.

1.18 A direction by ASIC under subsection 294B(1) is not a legislative instrument within the meaning of section 5 of the *Legislative Instruments Act 2003*. ***[Schedule 1, Part 1, item 16, subsection 294B(6)]***

***Exception for Commonwealth companies or subsidiaries of Commonwealth companies and Commonwealth authorities***

1.19 The following entities are excluded from the proposed reforms applying to companies limited by guarantee:

- a Commonwealth company;
- a subsidiary of a Commonwealth company; or
- a subsidiary of a Commonwealth authority.

***[Schedule 1, Part 1, items 4 and 30, paragraphs 45B(1)(d) and 301(3)(a)]***

1.20 The directors of a Commonwealth company (a company subject to the Corporations Act that the Commonwealth controls, whether they are companies limited by shares or companies limited by guarantee) are required to comply with the annual reporting requirements in the *Commonwealth Authorities and Companies Act 1997* (CAC Act).

1.21 The annual reporting requirements in the CAC Act currently require the directors of a Commonwealth company to provide to their responsible Minister the company's financial report, directors' report and auditor's report required by the Corporations Act for a financial year, as if the company were a public company under the Corporations Act.

1.22 The CAC Act also requires the directors of Commonwealth authorities and companies to ensure that certain information regarding subsidiaries is included in their reports and that the financial statements of those subsidiaries are audited by the Auditor-General.

1.23 By excluding Commonwealth companies and subsidiaries of Commonwealth companies and Commonwealth authorities from the coverage of these reforms, such entities will continue to maintain the higher level of reporting that is appropriate given that the entity is controlled by the Commonwealth, and their reports are tabled in Parliament.

***Exception for certain bodies corporate***

1.24 The following entities are excluded from the proposed reforms applying to companies limited by guarantee:

- a transferring financial institution of a State or Territory; or

- a company that is permitted to use the expression 'building society', 'credit society' or 'credit union' under section 66 of the *Banking Act 1959*.

***[Schedule 1, Part 1, item 4, paragraph 45B(1)]***

1.25 These entities are currently subject to a tailored financial reporting regime under Part 12.6 of the *Corporations Regulations 2001*, and as such, the proposed reforms will not apply to such entities.

## Audits and reviews

1.26 The current framework requires companies limited by guarantee to have their financial reports audited by a registered company auditor in accordance with Australian auditing standards. Stakeholders have suggested that many small companies limited by guarantee are currently spending a disproportionate amount on audit fees. This reduces the resources that the company has available for member services.

1.27 Under the new law, companies falling within the second tier would be given the option of having their annual report subject to a review, rather than an audit. ***[Schedule 1, Part 1, item 30, subsection 301(3)]***

1.28 A review, in contrast to an audit, is not designed to obtain reasonable assurance that the financial information reported by the company is free from material misstatement. A review consists of making enquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. A review may bring significant matters affecting the financial information to the assurance practitioner's attention, but it does not provide all of the evidence that would be required in an audit.

1.29 This measure is intended to reduce the time and costs associated with having the financial statements audited, whilst ensuring that the financial information is still subject to an appropriate degree of assurance.

1.30 The review would be conducted in accordance with a standard on review engagements developed (and modified as appropriate) by the Auditing and Assurance Standards Board (AUASB).

1.31 The review could be undertaken by either a registered company auditor, or a member of a professional accounting body that holds a prescribed practising certificate. ***[Schedule 1, Part 1, item 45, section 324BE]***

1.32 The associated regulations prescribe the following practising certificates:

- the Certificate of Public Practice issued by the Institute of Chartered Accountants in Australia (ICAA);
- the Public Practice Certificate issued by CPA Australia Ltd or the National Institute of Accountants (NIA).

1.33 This measure will expand the category of individuals that are permitted to undertake a review, which will provide greater flexibility and reduce unnecessary burden on companies limited by guarantee and their auditors, particularly during peak periods.

## Streamlined directors' report

1.34 Currently, all companies limited by guarantee are required to prepare a directors' report. The existing directors' report disclosure requirements for companies include a large number of provisions that are not relevant for not-for-profit companies. These include disclosures relating to the payment of dividends and options issued to directors as remuneration. In addition, not-for-profit companies are generally purpose or objective driven. As such, stakeholders in not-for-profit companies are likely to be particularly interested in the objectives of the organisation and how the activities conducted during the period contributed to achieving those objectives.

1.35 Under the new law, companies falling within the second and third tiers would be exempt from complying with the existing directors' report disclosure requirements, and would instead prepare a simplified directors' report. ***[Schedule 1, Part 1, item 14, section 285A]***

1.36 The simplified directors' report would contain the following disclosures:

- 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; and
- how the entity measures its performance, including any key performance indicators used by the entity.

***[Schedule 1, Part 1, item 29, subsections 300B(1) and (2)]***

1.37 In addition, the simplified directors report would contain details of:

- 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 which a member of that class is liable to contribute if the company is wound up; and
- the total amount that members of the company are liable to contribute if the company is wound up.

***[Schedule 1, Part 1, item 29, subsection 300B(3)]***

1.38 By creating a set of tailored, non-financial disclosure requirements for companies limited by guarantee that recognises the not-for-profit nature of these entities, the measure will result in more relevant information being provided to stakeholders. In addition, it will reduce the range of reporting requirements currently imposed on companies limited by guarantee.

### Distribution of annual reports

1.39 The Corporations Act currently allows companies limited by guarantee to distribute their annual reports to members via the Internet. However, small companies limited by guarantee may not have sufficient resources to maintain a website. In these circumstances, companies are required to send members a hard copy of the annual report. This can be a considerable burden if the company limited by guarantee has a large number of members.

1.40 Under the new law, members wishing to obtain a hard copy or an electronic copy of the company's latest annual report can elect to obtain this from the company free of charge, and the company limited by guarantee must comply with this request. This will minimise the regulatory burden on companies limited by guarantee by ensuring that they do not need to write to members each year informing them that the report has been prepared. ***[Schedule 1, Part 1, item 40, section 316A]***

1.41 An election made by members to either receive a hard copy or an electronic copy is a standing election for subsequent financial years until the member changes the election. ***[Schedule 1, Part 1, item 40, subsection 316A(3)]*** This will ensure that members do not need to repeat their requests for a copy of the report each year.

1.42 The Bill provides a strict liability offence where a company fails to send a member a copy of the report in accordance with subsections 316A(3) and (4). ***[Schedule 1, Part 1, item 40, subsection 316A(5)]*** This will facilitate effective enforcement and compliance of this requirement, and will safeguard member's rights to access financial information relating to the company.

## Payment of dividends

1.43 Currently, the Corporations Act does not prohibit companies limited by guarantee from paying dividends. Despite this, the corporate structure of companies limited by guarantee means that they are not suited for conducting for-profit activities which could legitimately warrant the payment of dividends to members. Some companies limited by guarantee have already remedied this situation by providing in their constitution a prohibition on the payment of dividends.

1.44 In order to address this situation for all companies limited by guarantee, the new law prohibits companies limited by guarantee from paying dividends to members. ***[Schedule 1, Part 1, item 6, section 254SA]***

1.45 This prohibition does not apply to entities that have been exempt from this reform, such as transferring financial institutions, building societies, credit societies or credit unions.

# Chapter 2
# Parent-entity financial statements

## Context of amendments

2.1 Under the Corporations Act, each public company, large proprietary company, registered scheme and disclosing entity (subsequently referred to as 'entity') is required to prepare a financial statement in relation to the entity reported on for each financial year. In addition, where an entity is a parent entity it is required to prepare financial statements in relation to the consolidated entity if the preparation of such statements is required by the accounting standards. The Act also contains equivalent requirements in respect of the half-year financial statements of a disclosing entity.

2.2 This results in parent entities having to include a minimum of four columns in their financial statements (that is, figures for the current financial year and the preceding financial year for both the parent entity and the consolidated entity).

2.3 The issue of the usefulness of separate parent entity financial statements has been debated in Australia for a number of years. In 2003, the Australian Accounting Standards Board (AASB) commissioned a research project on the relevance of parent entity financial reports and issued a discussion paper titled *The Relevance of Parent Entity Financial Reports*. The AASB believes that there is a need for revision in respect of parent entity reporting.

2.4 An industry group, the Group of 100 (comprising the Chief Financial Officers of Australia's largest entities) has also noted, in a submission to Treasury, that the replacement of full parent entity financial statements with summary information would reduce the burden of regulation on business, reduce business costs and remove unnecessary disclosures from an entity's annual report.

## Summary of new law

2.5 It is proposed that subsections 295(2) and 303(2) of the Corporations Act be repealed and replaced by 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.

2.6 It is also proposed that regulations will be made for the purposes of paragraph 295(3)(a) of the Corporations Act requiring the inclusion of a note in the consolidated financial statements containing the following supplementary information about the parent entity:

- current and total assets;
- current and total liabilities;
- shareholders' equity, showing separately issued capital and each reserve;
- profit or loss;
- total comprehensive income;
- details of any guarantees entered into by the parent entity in relation to the debts of its subsidiaries;
- details of any contingent liabilities; and
- details of any contractual commitments for the acquisition of property, plant or equipment.

2.7 The proposed regulations will also provide that the supplementary information is to be calculated in accordance with accounting standards in force in the financial year to which the disclosure relates.

## Comparison of key features of new law and current law

| ***New law*** | ***Current law*** |
|---|---|
| Under the new law, an entity would be required to prepare financial statements either: in relation to itself (if the accounting standards did not require the preparation of consolidated financial statements); or in relation to the consolidated entity (if the preparation of such statements is required by the accounting standards). | Under the current law, an entity is required to prepare a financial statement in relation to itself. In addition, where an entity is a parent entity it is required to prepare financial statements in relation to the consolidated entity if the preparation of such statements is required by the accounting standards. |
| Where the entity is required to prepare financial statements in relation to the consolidated entity, the Corporations Regulations will specify supplementary information about the parent entity that is to be included in a note to the consolidated financial statements. | |

## Detailed explanation of new law

2.8 Subsection 295(2) will be replaced by a new provision that provides that the financial statements of the entity for the year are either the financial statements in relation to the entity or, where the accounting standards require the preparation of financial statements in relation to the consolidated entity, the financial statements in relation to the consolidated entity.

2.9 An equivalent amendment will be made to subsection 303(2) in respect of the half-year financial statements of a disclosing entity. ***[Schedule 1, Part 1, items 17 and 31]***

2.10 In addition, regulations made for the purposes of paragraphs 295(3)(a) and 303(3)(a) will specify supplementary information about the parent entity to be included in the notes to the financial statements for the consolidated entity prepared under proposed paragraphs 295(2)(b) and 303(2)(b).

## Application and transitional provisions

2.11 Proposed subsections 1510B(5) and 1515(5) provide that the proposed amendment to subsection 295(2) will apply to a financial report of an entity for financial years of the entity ending on or after 30 June 2010.

2.12 Similarly, proposed subsections 1510B(8) and 1515(8) provide that the proposed amendment to subsection 303(2) will apply to a financial report of a disclosing entity for half-years of the disclosing entity ending on or after 30 June 2010.

2.13 Proposed subsections 1510B and 1515 (4) and (7) are savings provisions that provide that the substitution of subsections 295(2) and 303(2) respectively do not affect the operation of the accounting standards made for the purposes of those subsections. ***[Schedule 1, Parts 2 and 3, items 52 and 54]***

# Chapter 3
# Requirements for paying dividends

## Context of amendments

3.1 Currently, section 254T of the Corporations Act provides that a dividend may only be paid out of company profits. This is commonly referred to as the 'profits test'.

3.2 Industry has raised the following concerns with the profits test:

- the Corporations Act does not provide guidance about, or a definition of, the term 'profits'. In addition, the legal precedents on this issue are outdated and complex and not in line with current accounting principles. This makes it difficult for directors to understand the legal requirements when paying dividends;
- the nature of accounting principles for the calculation of profits has changed over time. Australian accounting standards, particularly following the adoption of International Financial Reporting Standards (IFRS), are increasingly linked to the fair value (whether realised or unrealised) impacting on the profitability of the company. This makes the profitability of Australian companies increasingly volatile with a large number of non-cash expenses being included in the net result. In these circumstances a company may have sufficient cash to pay a dividend to shareholders but is unable to do so because the accounting profits of the company have been eliminated by non-cash expenses; and
- the requirement for companies to pay dividends only out of profits is inconsistent with the trend to lessen the capital maintenance doctrine in Australia.

3.3 In 2002, the Australian Accounting Research Foundation released a discussion paper recommending that Australia move away from the current profits test.

## Summary of new law

3.4 The profits test will be repealed and replaced with a more flexible requirement that allows a company to pay dividends if:

- the company's assets exceed its liabilities immediately before the dividend is declared 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.
  - Where the payment results in the company becoming insolvent, it will clearly prejudice the company's ability to pay its creditors.

***[Schedule 1, Part 1, item 7, section 254T]***

3.5 The existing directors' duty to prevent insolvent trading in section 588G of the Corporations Act will continue to apply.

3.6 The Bill provides that the assets and liabilities referred to in the first limb of the test are to be calculated in accordance with accounting standards.

3.7 See 'detailed explanation of new law' below for an overview of the taxation issues relating to this proposal.

## Comparison of key features of new law and current law

| ***New law*** | ***Current law*** |
|---|---|
| A company may pay a dividend if:<br>• the company's assets exceed its liabilities immediately before the dividend is declared and the excess is sufficient for the payment of the dividend;<br>• it is fair and reasonable to the company's shareholders as a whole; and | A company may pay a dividend only from profit.<br>In addition, section 588G sets out the directors' duty to prevent insolvent trading. |

| *New law* | *Current law* |
|---|---|
| • it does not materially prejudice the company's ability to pay its creditors.<br>The existing directors' duty to prevent insolvent trading in section 588G will continue to apply. | |

## Detailed explanation of new law

3.8 The first limb of the new test establishes an important safeguard by requiring companies to have sufficient assets in excess of their liabilities in order to pay the dividend. This is similar to the balance sheet tests currently in operation in New Zealand and Canada.

3.9 The second and third limbs of the new test align with the requirements imposed on companies in relation to conducting share capital reductions and share buy-backs under Part 2J of the Corporations Act.

3.10 The new test is designed to ensure that creditors and shareholders who are not entitled to dividends are sufficiently protected.

3.11 In addition to the limbs outlined above, companies may also be subject to additional regulatory requirements. For example, prudentially regulated entities must comply with regulatory requirements governing the payment of a dividend or reduction in capital. The proposal outlined above will in no way impact upon these requirements.

### Companies not required to prepare an audited financial report

3.12 If a company is not required to prepare an audited financial report (for example, because it is a small proprietary company), then the first component of the test which requires the company to be balance sheet solvent can be determined by reference to the accounting records which are required to be kept under section 286 of the Corporations Act.

## Consequential amendments

General consequential amendments

3.13 Consequential amendments to other provisions that currently refer to profits are made to Part 1.5 of the Corporations Act and other statutes such as the *Medibank Private Sale Act 2006* and the *Financial*

*Sector (Business Transfer and Group Restructure) Act 1999*. ***[Schedule 1, Parts 1 and 4, items 5, 55, 58 and 59]***

3.14 Importantly, the share capital concept will remain in the Corporations Act for other purposes, such as the provisions dealing with share buy-backs in Part 2J of the Act.

Consequential amendments to the income tax law

3.15 For income tax purposes, a dividend is defined to mean, broadly, any distribution made by a company to its shareholders, other than an amount that is debited against the company's share capital account (subsection 6(1) of the *Income Tax Assessment Act 1936*). Therefore, distributions made as a result of the amendments to section 254T of the Corporations Act will generally be dividends for income tax purposes.

3.16 Dividends paid to shareholders are included in assessable income provided that the dividends are paid by the company out of its profits (section 44 of the *Income Tax Assessment Act 1936*). As a result of these amendments, some corporate distributions that are dividends for Corporations Act purposes may not be paid by the company out of its profits.

3.17 Therefore, a consequential amendment to section 44 will deem these distributions to be paid by a company out of profits for the purposes of the income tax law. This will ensure that shareholders include these distributions in assessable income. ***[Schedule 1, Part 4, item 56]***

3.18 Subject to the operation of the current imputation integrity rules, these distributions will be frankable under section 202-40 of the *Income Tax Assessment Act 1997*.

# Chapter 4
# Changing reporting periods

## Context of amendments

4.1 In Australia, close to 33,000 companies, registered schemes and disclosing entities (entities) have financial reporting obligations as outlined in Chapter 2M of the Corporations Act.

4.2 Under section 323D of the Act, a financial year is 12 months long (plus or minus seven days). The balance date can normally only be changed by up to seven days each year to accommodate entities with week-based internal reporting. The restrictions on changing financial years were introduced by the *Company Law Review Act 1988*, which came into effect on 1 July 1998.

4.3 The existing arrangements in Australia make it difficult for entities to change their year-end date for reasons other than those contained in the Corporations Act — generally, to synchronise the financial years of an entity and its controlled entities to facilitate the preparation of consolidated financial statements. In this regard, the Australian requirements are more stringent than the requirements of comparable jurisdictions.

## Summary of new law

4.4 It is proposed that section 323D be amended 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 12 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.

## Comparison of key features of new law and current law

| *New law* | *Current law* |
|---|---|
| The amended law will retain the existing requirements. | Under the current law, the financial year of an entity is to be 12 months long (plus or minus seven days).<br>An entity that is required to prepare consolidated financial statements is to ensure that the financial years of its consolidated entities are synchronised with its own financial year. |
| Under the amended law, an entity will be permitted to vary the length of a financial year subsequent to its first financial year provided that: the financial year is not longer than 12 months, the previous five financial years have all been of 12 months duration, and the change in the length of the subsequent financial year is made in good faith in the best interests of the entity. | There is no equivalent provision in the current law. |

## Detailed explanation of new law

4.5 The Bill provides for the insertion of a proposed subsection 323D(2A) which provides a more flexible regime for changing an entity's financial year. Subsection 323D(2) will also be amended to provide a cross-reference to proposed subsection 323D(2A). ***[Schedule 1, Part 1, items 43 and 44]***

4.6 Proposed subsection 323D(2A) provides that a subsequent financial year of an entity may last for a period other than 12 months provided the following requirements are satisfied:

- the financial year commences at the end of the previous financial year and it not longer than 12 months;
- during the previous five financial years each financial year has been of 12 months duration; and
- the change in length of the subsequent financial year is made in good faith in the best interests of the entity.

## Application and transitional provisions

4.7 Proposed subsections 1510B(9) and 1515(9) provide that the proposed amendments to section 323D apply where the previous financial year of the entity ends on or after 30 June 2010 (that is, the amendments apply to subsequent financial years commencing on or after 1 July 2010). ***[Schedule 1, Parts 2 and 3, items 52 and 54]***

# Chapter 5
# Extending section 299A of the Corporations Act

## Context of amendments

5.1 Under section 299A of the Corporations Act, a listed public company is required to provide, in its director's report, all information reasonably required to allow an informed assessment of its operations, financial conditional and business strategies and prospects for future financial years. Guidance on this requirement refers to it as a review of operations and financial condition.

5.2 The requirement for companies to disclose a review of operations and financial condition was introduced as a result of the recommendations of the HIH Royal Commission. The rationale for its introduction was to address a lack of contextual information which explained the results set out in a company's financial statements. Accordingly, the review of operations and financial condition was introduced to provide stakeholders with an overview which would enable users to understand a business' performance and the factors underlying its results and financial position.

5.3 Extending the application of section 299A to all listed entities was a recommendation of the Corporations and Markets Advisory Committee (CAMAC)'s 2006 report *The social responsibility of corporations*.

## Summary of new law

5.4 All listed entities, that is both listed registered schemes and listed companies will be required to report under section 299A.

## Comparison of key features of new law and current law

| *New law* | *Current law* |
|---|---|
| All listed entities will be required to report under section 299A. | Only listed public companies are required to report under section 299A. Listed registered schemes are not. |

## Detailed explanation of new law

5.5 The Bill amends subsection 299A(1) and paragraph 299A(2)(a) to provide that listed registered schemes, in addition to listed companies, are required to disclose the information that members would reasonably require to make an informed assessment of the operations, financial position and business strategies and prospects for future financial years of the entity reported on. ***[Schedule 1, Part 1, items 24 and 27]***

5.6 The Bill amends paragraphs 299A(1)(b)(c) to make the phrasing consistent with that which is used paragraph 299A(1)(a) and subsection 299A(2) with respect to using the term 'entity reported on' rather than the term entity. ***[Schedule 1, Part 1, items 25 and 26]***

5.7 The Bill amends subsection 299(3) to provide that listed registered schemes, in addition to listed companies, may omit material that would otherwise need to be disclosed under paragraph 299A(1)(c) if it is likely to result in unreasonable prejudice to the listed registered scheme or listed company or if consolidated financial statements are required, the consolidated entity or entity (including the company, registered scheme or disclosing entity) that is part of the consolidated entity. ***[Schedule 1, Part 1, item 28]***

# Chapter 6
# IFRS declaration

## Context of amendments

6.1 Some feedback from foreign jurisdictions has suggested there is a lack of awareness that the financial statements of Australian companies and other reporting entities are compliant with IFRS made by the International Accounting Standards Board (IASB). In particular, as accounting standards in Australia are commonly referred to as 'Australian-equivalent International Financial Reporting Standards (AIFRS)', there is a perception that they are not identical to IFRS.

6.2 Lack of international recognition of Australia's IFRS adoption prevents Australia from realising the full benefits of IFRS in relation to the facilitation of foreign investment.

6.3 Companies are already required by the accounting standards to make a statement of IFRS compliance in the notes to their financial statements. Auditing standards also require auditors to make a declaration of IFRS compliance in the audit report. However, there is no corresponding requirement in the directors' declaration and this may create some confusion.

## Summary of new law

6.4 Where a company, disclosing entity or registered scheme has included in the notes to the financial statements, in compliance with the accounting standards, an explicit and unreserved statement of compliance with IFRS, the directors' declaration included in the annual report must indicate that this statement has been included in the notes to the financial statements.

## Comparison of key features of new law and current law

| *New law* | *Current law* |
|---|---|
| Under the new law, where the notes to the financial statements include an explicit and unreserved statement of compliance with IFRS, the directors' declaration included in the annual report must indicate that this statement has been included in the notes to the financial statements. | Under the current law, no such statement has to be included in the directors' declaration. However, companies are required by accounting standards to make a statement of IFRS compliance in the notes to their financial statements. Auditing standards also require auditors to make a declaration of IFRS compliance in the audit report. |

## Detailed explanation of new law

6.5 The Bill requires that a new paragraph, 295(4)(ca) be inserted to require the directors' declaration to include, where the notes to the financial statements include an explicit and unreserved statement of compliance with IFRS, advice that this statement has been included in the notes to the financial statements. ***[Schedule 1, Part 1, item 18]***

6.6 Subsection 295(1) of the Act provides that a company's financial report for a financial year includes the directors' declaration about the statements and notes. The details required in the directors' declaration are provided under subsection 295(4).

6.7 The purpose of this amendment is to ensure international recognition of Australia's adoption of IFRS. This will also create consistency between the auditor's report, directors' declaration and the notes to the financial statements.

# Chapter 7
# Lost capital reductions

## Context of amendments

7.1 Under section 258F of the Corporations Act, companies are allowed to cancel paid-up capital that is lost or not represented by available assets of the company. The provision is intended to allow companies to write down the value of the company's capital in situations where a company incurs certain types of losses. This is done by writing-off past accumulated losses against the share capital of the company.

7.2 However, concerns have been expressed that companies may be able to use section 258F to overstate the profitability of the company by taking expenses directly to share capital rather than recognising them in the statement of financial performance. Such action would be in breach of Australian accounting standards.

## Summary of new law

7.3 It is proposed that section 258F be amended to make it clear that a company can only cancel share capital in circumstances where it is not inconsistent with the requirements in Australian accounting standards. The proposed amendment will still allow companies to write off accumulated losses to share capital but will not allow companies to take expenses directly to share capital.

7.4 The proposed amendment is of a technical nature and is designed to clarify the manner in which section 258F is intended to operate.

## Comparison of key features of new law and current law

| ***New law*** | ***Current law*** |
|---|---|
| Under the new law, a company may not reduce its share capital by cancelling any paid-up capital that is lost or not represented by available assets if the cancellation is inconsistent with the requirements of any accounting standard. | Under the current law, a company may reduce its share capital by cancelling any paid-up capital that is lost or not represented by available assets. |

## Detailed explanation of new law

7.5 The Bill provides for section 258F to be recast, with a proposed paragraph 258F(2)(b) providing that a company's ability to reduce its share capital by cancelling any paid-up share capital that is lost or is not represented by available assets will not apply if the cancellation is inconsistent with the requirements of any accounting standard. ***[Schedule 1, Part 1, items 8, 9 and 10]***

## Application and transitional provisions

7.6 Proposed subsections 1510B(3) and 1515(3) provide that the proposed amendments to section 258F apply in relation to the cancellations of paid-up share capital that occur on or after the commencement of items 8, 9 and 10 of Schedule 1. ***[Schedule 1, Parts 2 and 3, items 52 and 54]***

# Chapter 8
# FRC functions and funding

## Context of amendments

8.1 Prior to the enactment of the *Governance Review Implementation (AASB and AUASB) Act 2008* (GRI Act), the AASB and the AUASB were statutory bodies governed by the CAC Act. The GRI Act has transferred the AASB and the AUASB from the CAC Act to the *Financial Management and Accountability Act 1997* (FMA Act) framework.

8.2 As a consequence of the enactment of the GRI Act, the specific accounting and auditing standards functions given to the Financial Reporting Council (FRC) under paragraphs 225(2)(i) and (j) and 225A(2)(i) and (j) of the ASIC Act are now obsolete and unnecessary. These provisions require the FRC to:

- seek contributions towards the costs of the Australian accounting standard and auditing standard setting processes; and
- monitor the level of funding, and the funding arrangements, for those processes.

## Summary of new law

8.3 The Bill repeals paragraphs 225(2)(i) and (j) and 225(2A)(2)(i) and (j) of the ASIC Act.

## Comparison of key features of new law and current law

| *New law* | *Current law* |
|---|---|
| Paragraphs 225(2)(i) and (j) and 225(2A)(i) and (j) will be repealed. | Paragraphs 225(2)(i) and (j) and 225(2A)(i) and (j) set out the FRC's functions in relation to the funding arrangements for the AASB and the AUASB. |

## Detailed explanation of new law

8.4 Paragraphs 225(2)(i) and (j) and 225(2A)(2)(i) and(j) of the ASIC Act will be repealed as they are no longer necessary or appropriate having regard to the fact that the AASB and the AUASB are now financial management and accountability agencies for purpose of the FMA Act. ***[Schedule 2, Part 1, items 9 to 12]***

# Chapter 9
# CALDB processes

## Context of amendments

9.1 The CALDB is a disciplinary body which receives and reviews applications made to it by the ASIC or the Australian Prudential Regulation Authority (APRA) in respect of the conduct of either registered company auditors or liquidators.

9.2 Membership of the CALDB consists of:

- a Chairperson and a Deputy Chairperson, each of whom must be enrolled as a barrister and/or a solicitor or a legal practitioner in Australia;
- three members selected from a panel of seven nominated by the Board of the ICAA;
- three members selected from a panel of seven nominated by the Board of CPA Australia (CPAA); and
- six business members. Business members need not be nominated by any particular body. The Minister must be satisfied that a business representative has knowledge or qualifications in a business or law-related discipline.

9.3 There are three professional accounting bodies in Australia, the ICAA, CPAA and the NIA. Additionally, there is also a recognised professional body representing insolvency practitioners, the Insolvency Practitioners Association of Australia (IPAA). Under the current framework, the NIA and other professional and interested parties are unable to nominate members for CALDB.

9.4 Under section 221 of the ASIC Act, immunity consistent with that of a Justice of the High Court is conferred on Panel Members of the CALDB when exercising powers in relation to a hearing. Witness and legal and other representatives receive immunity equivalent to that which they would receive in appearing before the High Court.

9.5 However, section 1294A of the Corporations Act also allows the Chairperson and Deputy Chairperson to conduct pre-hearing conferences. This was introduced to streamline the hearing process.

9.6 Under the current framework, the immunity under section 221 of the ASIC Act is not available for pre-hearing conferences conducted by the Chairperson of the CALDB. It is only available if the full Panel conducts the pre-hearing conference.

9.7 The Bill introduces amendments to the ASIC Act to improve both the membership process and pre-hearing conferences immunities for the CALDB. These modifications will provide efficiency in the functioning of the CALDB.

## Summary of new law

9.8 The Bill modifies the membership requirements of the CALDB by repealing the requirement for three members to be selected from a panel of seven nominated by the Board of the ICAA and for three members to be selected from a panel of seven nominated by the Board of the CPAA. Under the new arrangements, the Minister appoints six members as accounting members of the CALDB.

9.9 The new arrangements will not apply retrospectively to existing members of the CALDB. The new arrangements will apply to members appointed once the provisions commences.

9.10 In addition, the Bill extends the protection and immunities provisions in section 221 of the ASIC Act to include a pre-hearing conference convened by the Chairperson of the CALDB.

9.11 This arrangement will apply both retrospectively and on or after the commencement of the provisions.

## Comparison of key features of new law and current law

| *New law* | *Current law* |
|---|---|
| Six members selected by the Minister who are eligible for appointment as accounting members of the CALDB. | Three members to be selected from a panel of seven nominated by the Board of the ICAA and three members to be selected from a panel of seven nominated by the Board of CPAA. |
| Immunity under section 221 of the ASIC Act is extended to include pre-hearing conferences convened by the Chairperson of the CALDB. | Immunity under section 221 of the ASIC Act is not available for pre-hearing conferences conducted by the Chairperson. |

## Detailed explanation of new law

### Definitions

9.12 The Bill repeals some terms used in Schedule 2. ***[Schedule 2, Part 1, items 1 and 2]***

### Modifying the membership requirements

9.13 Section 203 of the ASIC Act prescribed the membership conditions of the CALDB. The Bill repeals the existing requirements for the appointment of ICAA and CPAA members and introduces a new provision for the Minister to select 6 members who are eligible for appointment as accounting members of the CALDB. ***[Schedule 2, Part 1, items 3 and 4, paragraphs 203(1)(c) and (d), subsection 203(1A)]*** The new arrangement will mean that accounting members are appointed to the CALDB in the same manner in which business members are appointed.

9.14 The Bill sets out the conditions that must be met for a person to be eligible for appointment as an accounting member in subsection 203(1B). ***[Schedule 2, Part 1, item 5, subsection 203(1B)]*** This includes a person who is a resident of Australia and a member of a professional accounting body. The ICAA, CPAA and NIA are taken to be professional accounting bodies in Australia.

9.15 Additionally, the Bill contains a regulation making power to create regulations which prescribe bodies to which a person can be a member of and considered eligible for appointment as an accounting member. ***[Schedule 2, Part 1, item 5, subparagraph 203(1B)(b)(ii)]*** This is to ensure

that all relevant professional bodies, for example, the IPAA, are able nominate members for appointment to the CALDB.

9.16 Consequential changes to existing references to ICAA member and CPAA member are made in this Bill. ***[Schedule 2, Part 1, item 6, subsection 210A(5)]***

### Protection and immunity for pre-hearing conferences

9.17 Section 221 of the ASIC Act confers immunity consistent with that of a Justice of the High Court onto Panel Members of the CALDB when exercising powers in relation to a hearing. Also, witness and legal and other representatives receive immunity equivalent to that which they would receive in appearing before the High Court.

9.18 The Bill extends the scope of the provisions to apply to pre-hearing conferences convened by the Chairperson of the CALDB under section 1294A of the Corporations Act. ***[Schedule 2, Part 1, item 7, subsection 221(1A)]*** This arrangement will make the legislation more complete as the current immunity relies on a full Panel conducting a pre-hearing conference rather than just the Chairperson.

9.19 The Bill also extends the protection and immunity to include a barrister, solicitor or other person appearing on behalf of a person at a pre-hearing conference. ***[Schedule 2, Part 1, item 8, subsection 221(2A)]***

## Application and transitional provisions

9.20 Schedule 2, Part 2 of the Bill prescribes the application, saving and transitional provisions relevant to the new arrangements. ***[Schedule 2, Part 2, item 13]***

9.21 The Bill defines several terms used in Schedule 2, Part 2. ***[Schedule 2, Part 2, item 13, section 289]***

### Application of membership amendments

9.22 The new membership arrangements will not apply retrospectively to existing members of the CALDB. Rather, the Bill provides for a transition period whereby a member appointed after the commencement of the new provisions must be eligible as an accounting member. At the same time, however, a person already appointed as an ICAA or CPAA member prior to the commencement of the new provisions continues to hold the position for the remainder of their term. ***[Schedule 2, Part 1, item 13, section 290]***

## Application of pre-conference amendments

9.23 The provisions extending immunity to pre-hearing conferences convened by the Chairperson of the CALDB will apply to hearings conducted before, on or after the commencement. ***[Schedule 2, Part 2, item 13, section 291]***

9.24 This arrangement will apply retrospectively to ensure that the protections and immunities available for the Chairperson, witness and legal and other representatives cover any hearings that have been convened prior to the commencement of the provisions.

# Chapter 10
# Regulation Impact Statement

## Corporations Amendment (Corporate Reporting Reform) Bill 2010

## Regulatory Impact Statement

### Background

10.1 A robust financial reporting framework is an essential component of an efficient market. Appropriate financial reporting and auditing requirements enhance the accuracy of financial information, ensure transparency and comparability and promote confidence.

10.2 The proposed reforms seek to reduce red-tape, improve accountability and transparency of disclosures, and implement a number of other important refinements to the corporate regulatory framework. This work would also ensure that Australia's financial reporting framework remains strong and in line with or ahead of world's best practice. An overview of each of the recommended options is set out below.

***Reducing red-tape***

10.3 The proposals that are designed to cut red-tape in financial reporting with a view to reducing the regulatory burden on business include:

- simplifying financial reporting requirements for smaller companies limited by guarantee (which predominantly have a not-for-profit focus);
- relieving companies that are parent entities of the requirement to prepare financial statements for both the parent entity and the consolidated group;
- relaxing the statutory requirement that companies may only pay dividends from profits; and
- facilitating a change of balance date by a company.

***Improving accountability***

10.4 The proposals enhance the transparency and utility of disclosures contained in the directors' report include extending the requirement to disclose a review of operations and financial condition to all listed entities (currently, these requirements apply to listed public companies).

***Refining the framework***

10.5 The proposal for refining aspects of the financial reporting framework include amending the directors' declaration to refer to compliance with International Financial Reporting Standards (IFRS).

## Identification of options, impact analysis, conclusions and recommendations

***Impact assessment methodology***

10.6 Impacts can be divided between three impact groups (consumers, business and government). Typical impacts of an option on consumers might be changes in access to a market, the level of information and disclosure provided, or prices of goods or services. Typical impacts of an option on business would be the changes in the costs of compliance with a regulatory requirement. Typical impacts on government might be the costs of administering a regulatory requirement. Some impacts, such as changes in overall confidence in a market, may impact on more than one impact group.

10.7 The assessment of impacts in this regulation statement is based on a seven-point scale (-3 to +3). The impacts of each option are compared with the equivalent impact of the 'do nothing' option. If an impact on the impact group would, relative to doing nothing, be beneficial, the impact is allocated a positive rating of +1 to +3, depending on the magnitude of the relative benefit. On the other hand, if the impact imposes an additional cost on the impact group relative to the status quo, the impact is allocated a negative rating of -1 to -3, depending on the magnitude of the relative cost. If the impact is the same as that imposed under the current situation, a zero score would be given, although usually the impact would not be listed in such a case.

10.8 The magnitude of the rating of a particular impact associated with an option has been assigned taking into account the overall potential impact on the impact group. The reference point is always the status quo (or 'do nothing' option). Whether the cost or benefit is one-off or

recurring, and whether it would fall on a small or large proportion of the impact group (in the case of business and consumers), is factored into the rating. For example, a cost or benefit, even though large for the persons concerned, may not result in the maximum rating (+/-3) if it is a one-off event that only falls on a few individuals. Conversely, a small increase in costs or benefits might be given a moderate or high rating if it would be likely to recur or if it falls on a large proportion of the impact group. The rating scale for individual impacts is explained in the table below.

**Rating an individual impact**

| *+3* | *+2* | *+1* | *0* | *-1* | *-2* | *-3* |
|---|---|---|---|---|---|---|
| Large benefit/ advantage compared to 'do nothing' | Moderate benefit/ advantage compared to 'do nothing' | Small benefit/ advantage compared to 'do nothing' | No substantial change from 'do nothing' | Small cost/ disadvantage compared to 'do nothing' | Moderate cost/ disadvantage compared to 'do nothing' | Large cost/ disadvantage compared to 'do nothing' |

10.9 The ratings for the individual impacts compared to the status quo are then tallied to produce an overall outcome for the option. If it is positive, it indicates that the option is likely to produce a more favourable cost/benefit ratio than the status quo. If it is zero there would be no overall benefit from adopting the option, and if negative the option would provide overall a less favourable cost/benefit ratio than the 'do nothing' option. Ordinarily, options that have the highest positive score would be the favoured courses of action.

10.10 What is classed as a 'large', 'moderate' or 'small' cost or benefit depends on the nature of the problem and options being considered. Of course, the costs and benefits associated with options to address a problem costing billions of dollars per year are likely to be of a much greater absolute magnitude than the costs and benefits of options for dealing with a rather modest issue that affects only a handful of persons. However, as all the ratings are made relative to the status quo/ do nothing option for a particular problem, the absolute value of 'large' or 'moderate' or 'small' is not really important. All that matters is that within a problem assessment, the impacts of each option are given appropriate ratings relative to the status quo and each other. If that occurs, it will be sufficient for the methodology to yield an overall rating that assists in assessing the relative merits of options, from a cost/benefit perspective, to address the particular problem.

10.11 An example of the rating calculation for an option, using the seven-point scale ratings of impacts, is in the table below. The example is based on a purely hypothetical scenario that a new type of long-wearing vehicle tyre is being sold and marketed, but it has become apparent that the new style of tyres have a higher risk of exploding while in motion than

conventional tyres. The example is designed merely to illustrate how the rating scale might be used to compare a proposal's costs and benefits option to the 'do nothing' option — it is not intended to be a comprehensive or realistic assessment of options to address such a problem.

**Illustrative rating for the problem of a long-wearing tyre that may fail**

***Option A: Do nothing***

| | ***Benefits*** | ***Costs*** |
|---|---|---|
| Consumers | Access to a cheaper solution for vehicle tyres. | Risk of tyre failure that can result in personal and property damage as a result of collision. Damage can be severe but cases are rare. |
| Industry | | Some compensation payments to persons as a result of collisions caused by the tyre. |
| Government | Advantages for waste management perspective. | |

***Option B: Ban on sale of the new tyre***

| | ***Benefits*** | ***Costs*** |
|---|---|---|
| Consumers | No persons will be affected by tyre failure and resultant damage. (+3) | Lack of access by consumers to long-wearing vehicle tyres, increasing the cost of vehicle maintenance. [-2] |
| Industry | No compensation payments for accident victims. [+1] | Transitional costs involved with switching back all manufacturing/marketing operations to conventional tyres [-3] |
| Government | | Conventional tyres produce more waste which is costly to deal with. [-1] |
| Sub-rating | +4 | -6 |
| Overall rating | -2 | |

***Option C: Industry-developed quality control standards***

| | ***Benefits*** | ***Costs*** |
|---|---|---|
| Consumers | Much lower risk of tyre failure and resultant damage than status quo. [+2] | |
| Industry | Significantly less compensation payments for accident victims. [+1] | Developing and monitoring industry-wide quality control standards. [-2] |
| Government | | |
| Sub-rating | +3 | -2 |
| Overall rating | +1 | |

In the above hypothetical example, Option C appears to have a better impact for consumers and a better overall cost/benefit rating than Option B.

## Simplifying the reporting and auditing requirements of companies limited by guarantee

### Problem

10.12 Currently, all public companies, disclosing entities, large proprietary companies and registered schemes are required to prepare a full audited annual report in accordance with Australian accounting standards. As a result, the requirement to prepare a full audited annual report also applies to all public companies limited by guarantee, regardless of their size. Consequently, companies limited by guarantee are required to comply with the same level of reporting and auditing requirements as a large listed company.

10.13 The company limited by guarantee structure is used predominantly by not-for-profit entities to incorporate their operations. There are approximately 11,000 companies limited by guarantee, the majority of which are relatively small. Research conducted by The University of Melbourne found that 21 per cent of companies limited by guarantee were sports and recreation related organisations, 19 per cent were community service organisations, 15 per cent were education-related institutions and 10 per cent were religious organisations.

10.14 Given that companies limited by guarantee are mostly small not-for-profit entities, the current financial reporting requirements can impose onerous costs and regulatory burden in the form of preparation costs, audit costs, printing and distribution costs. Quantifying such costs can be difficult, as they vary significantly depending the size and complexity of the report. It is estimated that the average cost of preparing and auditing an annual report is $60,000 per company. This figure is based on approximate costs obtained in relation to large proprietary companies.

10.15 The table below outlines the relative size of companies limited by guarantee based on a sample of companies that lodged financial reports with the Australian Securities and Investments Commission (ASIC). The small size of companies limited by guarantee means that the costs of extensive reporting requirements are disproportionate to the size of the entity. However, reporting by such companies is also an important governance and transparency mechanism, particularly for larger companies or companies that seek donations from the public, as it provides users with information on how their donations have been spent, how the company is performing and how it is being managed.

**Table 10.1: Size of companies limited by guarantee**[2]

| | ***Revenue (%)*** | ***Cumulative Total: Revenue (%)*** | ***Assets (%)*** | ***Cumulative Total: Assets (%)*** |
|---|---|---|---|---|
| Less than \$20,000 | 14 | 14 | 12 | 12 |
| Between \$20,000 and \$50,000 | 9 | 23 | 9 | 21 |
| Between \$50,001 and \$250,000 | 24 | 47 | 16 | 37 |
| Between \$250,001 and \$500,000 | 7 | 54 | 8 | 45 |
| Between \$500,001 and \$1,000,000 | 14 | 68 | 18 | 63 |
| Between \$1,000,000 and \$12,500,000 | 28 | 96 | 30 | 93 |
| Greater than \$12,500,000 | 4 | 100 | 5 | 100 |

## Objective

10.16 The objective is to reduce the regulatory burden and administration costs for small companies limited by guarantee to allow greater resources to be devoted to their not-for-profit work, whilst ensuring that large companies limited by guarantee or companies that seek tax deductible donations from the public remain accountable and transparent.

## Options

***Option A: Do nothing***

10.17 Under this option, all companies limited by guarantee would continue to prepare a full audited annual report in accordance with Australian accounting standards regardless of their size.

2 Based on sample data provided by ASIC on 3 November 2006.

10.18 This would require a company limited by guarantee to provide the same level of annual reporting as companies listed on the Australian Stock Exchange. As noted above, it is estimated that the average cost of preparing and auditing an annual report is $60,000 per company, although this would vary depending on the size and complexity of the report.

10.19 A significant proportion of companies limited by guarantee (almost half) have consolidated revenue of less than $250,000, resulting in the compliance costs that are disproportionate to the size of the organisation.

***Option B: Establish a differential reporting and auditing framework and streamline requirements***

10.20 Under this option, small companies limited by guarantee would be exempt from preparing audited financial reports and directors' reports under Chapter 2M of the Corporations Act. Large companies limited by guarantee, or companies that seek tax deductible donations from the public, will continue to prepare financial reports with simplified auditing and directors' report requirements.

10.21 It is proposed that the threshold be determined by reference to the company's consolidated revenue. Tests based on assets or number of employees may not be accurate indicators of the "size" of the company. For example, a company limited by guarantee may have a large number of assets, but there may be restrictions on the company disposing of these assets. In addition, indicators based on employee numbers are likely to be distorted by the large number of volunteers that generally participate in not-for-profit entities. This is also consistent with the recommendations of the recent Senate Economics Committee report on the disclosure regimes for not-for-profit organisations, which recommended the introduction of a tiered reporting system based on revenue thresholds.

10.22 In addition, it is proposed that the threshold be set at $250,000 of consolidated revenue. Companies below this threshold would be exempt from the reporting and auditing requirements of Chapter 2M of the Corporations Act, unless they are a deductible gift recipient. As indicated in Table 1 above, 47 per cent (or approximately one half) of companies limited by guarantee would fall below the $250,000 threshold. On balance, this is considered to be an appropriate threshold, as it would ensure that the remaining half is still required to prepare financial reports. Appropriate safeguards will be put in place by requiring companies below this threshold to prepare a financial report if they are directed to by ASIC or by 5 per cent of members (similar to the requirements applying to small proprietary companies in sections 293 and 294 of the Corporations Act).

10.23 Some types of companies limited by guarantee will have a higher level of public interest due to the nature of their activities. Charities, for instance, generally fall within this category because of their public fundraising activities (for example, donation drives) and significant community involvement. In contrast, member-focused companies limited by guarantee (for example, sporting clubs) may have a significantly lower level of public interest. Such factors need to be considered when differentiating between companies limited by guarantee for reporting purposes. As such, it is proposed that all deductible gift recipients (that is, companies which seek tax deductible donations from the public) continue to prepare a financial report, irrespective of whether they fall above or below the threshold.

10.24 Companies above the threshold, or companies that seek tax deductible donations from the public, would continue to prepare financial reports in accordance with Australian Accounting Standards. However, these companies will have simplified directors' report requirements, as they will prepare a summarised directors' report containing approximately five key qualitative disclosures (rather than a full directors' report which would typically require compliance with sections 299 and 300). The existing directors' report disclosure requirements for companies include a large number of provisions that are not relevant for not-for-profit companies. These include disclosures relating to the payment of dividends and options issued to directors as remuneration. In addition, it is noted that not-for-profit companies are generally purpose or objective driven. As such, stakeholders in not-for-profit companies are likely to be particularly interested in the objectives of the organisation and how the activities conducted during the period contributed achieving those objectives. By creating a set of tailored, non-financial disclosure requirements for companies limited by guarantee that recognises the not-for-profit nature of these entities, the proposal will result in more relevant information being provided to stakeholders whilst reducing the range of reporting requirements currently imposed on companies limited by guarantee.

10.25 Companies above the threshold will also have simplified auditing requirements if their consolidated revenue is below $1 million. Such companies would have the option of having either a full audit or a review of the financial report conducted by a registered company auditor or by a member of a professional accounting body with a practising certificate. This will streamline the auditing requirements for a further 21 per cent of companies limited by guarantee. Companies with a consolidated revenue greater than $1 million will continue to be required to undertake a full audit of the financial report by a registered company auditor.

10.26 In addition, other minor and technical amendments would be implemented, such as providing streamlined methods for companies limited by guarantee to distribute the annual report to their members and

removing the ability of companies limited by guarantee to pay dividends as their corporate structure means they are not suited for conducting for-profit activities which could legitimately warrant the payment of dividends to members.

***Option C: Exempt all companies limited by guarantee from reporting and auditing requirements irrespective of size***

10.27 Under this option, all companies limited by guarantee, regardless of their size, would be exempt from preparing audited financial reports under Chapter 2M of the Corporations Act.

10.28 This option is not considered ideal, as it would diminish accountability and transparency for companies which ought to be subject to reporting requirements given the public nature of the company and the fact that it seeks donations from the public.

## Impact analysis

***Impact group identification***

10.29 Affected groups:

- users of financial reports (such as employees, donators) etc;
- companies limited by guarantee; and
- Government and regulators.

***Assessment of costs and benefits***

***Option A: Do nothing***

| | ***Benefits*** | ***Costs*** |
|---|---|---|
| Users | Financial details of all companies limited by guarantee are available to users.<br>All financial reports are required to be audited resulting in confidence that the figures are transparent and accurate. | |

| | ***Benefits*** | ***Costs*** |
|---|---|---|
| Companies limited by guarantee | | There are significant compliance costs for small companies limited by guarantee associated with producing financial reports<br>Compliance costs in the form of preparation costs, audit fees, printing costs and distribution costs can be significant for small companies limited by guarantee. |
| Government/regulators | | |

***Option B: Establish a differential reporting and auditing framework and streamline requirements***

| | ***Benefits*** | ***Costs*** |
|---|---|---|
| Users | Users will have access to more tailored disclosures, which are better suited to the not-for-profit nature of the company. [+3] | Decrease in availability of financial information in relation to small companies limited by guarantee. [-1] |
| Companies limited by guarantee | Significantly reduced compliance costs for small companies limited by guarantee. [+2] | |
| Government/regulators | | |
| Sub-rating | +5 | -1 |
| Overall rating | +4 | |

***Option C: Exempt all companies limited by guarantee from reporting and auditing requirements***

| | ***Benefits*** | ***Costs*** |
|---|---|---|
| Users | | Decrease in transparency and accountability for all companies limited by guarantee. [-3] |
| Companies limited by guarantee | Significantly reduced compliance costs relating to reporting and auditing. [+3] | |
| Government/regulators | | |
| Sub-rating | +3 | -3 |
| Overall rating | 0 | |

## Consultation

10.30 In June 2007, Treasury released a discussion paper on financial reporting by unlisted public companies. The paper sought comments on whether the existing reporting framework was appropriate for the 11,000 companies limited by guarantee and the 7,000 unlisted public companies limited by shares preparing financial reports under the Corporations Act.

10.31 The discussion paper elicited submissions from a broad range of stakeholders including preparers and auditors of unlisted public company financial reports as well as industry groups and other interested parties.

10.32 As part of the consultation process, there was broad support for the introduction of a differential reporting framework for companies limited by guarantee, consistent with Option B above.

## Conclusion and recommended option

10.33 Option A is not preferred, as it requires a company limited by guarantee to provide the same level of annual reporting as companies listed on the Australian Stock Exchange. A significant proportion of companies limited by guarantee are relatively small, resulting in the compliance costs that are disproportionate to the size of the organisation.

10.34 Option B is the preferred option as the introduction of a differential reporting and auditing framework will ease the regulatory burden on smaller companies limited by guarantee, while ensuring that the larger companies limited by guarantee remain transparent and accountable. Also, by creating a set of tailored, non-financial disclosure requirements for companies limited by guarantee that recognises the not-for-profit nature of these entities, this option will result in more relevant information

being provided to stakeholders whilst reducing the range of unnecessary reporting requirements currently imposed on companies limited by guarantee. The costs of this approach are expected to be minimal and outweighed by the benefits to users and companies limited by guarantee. In addition, this option is consistent with the recommendations of the recent Senate Economics Committee report on the disclosure regimes for not-for-profit organisations. The committee recommended the introduction of a tiered reporting system based on revenue thresholds.

10.35 Option C is not preferred, as it would weaken the existing framework for companies limited by guarantee that ought to be subject to greater accountability given their size or public fundraising activities. This option would weaken existing corporate governance arrangements and would result in users (such as donators) no longer having access to information about the financial performance and position of the company. The costs to users are likely to outweigh the benefits to companies as a result of this approach.

## Parent entity financial statements

### *Problem*

10.36 The Corporations Act requires companies to prepare audited financial statements for both the consolidated entity and the parent entity. This results in companies having to include a minimum of four columns in their financial statements ie figures for the current financial year and the preceding financial year for both the parent entity and the consolidated entity.

10.37 The presentation of full parent entity financial statements together with the consolidated financial statements clutters the annual report with unnecessary detail and is potentially confusing to users. The Group of 100 (comprising the Chief Financial Officers of Australia's largest entities) in a submission to Treasury noted that the replacement of full parent entity financial statements with summary information would reduce the burden of regulation on business, reduce business costs and remove unnecessary disclosures from an entity's annual report.

10.38 The issue of the usefulness and value of separate parent entity financial statements has been debated in Australia for a number of years. In 2003, the Australian Accounting Standards Board (AASB) commissioned a research project on the relevance of parent entity financial reports and issued a discussion paper titled *The Relevance of Parent Entity Financial Reports*. The AASB believes that there is a need for revision in respect of parent entity reporting.

10.39 The costs associated with the preparation and audit of full parent entity financial statements will be dependent on the size and complexity of the entity and relativities around the size of the parent as opposed to the consolidated entity. The Group of 100 have indicated that the removal of the requirement to prepare parent entity financial statements would result in significant cost savings in external audit alone with the incremental audit costs for parent entity financial statements being in the vicinity of $20,000 to $25,000 for the top 150 ASX companies.

10.40 While a number of stakeholders have indicated that full parent entity financial statements do not provide useful and relevant information to most users of financial information, they have noted that there would be value in the presentation of key financial information on the parent entity in a summarised form.

### *Objective*

10.41 The objectives are: to ensure that all stakeholders have access to an appropriate level of parent entity financial information; and, at the same time, to reduce the compliance burden on entities that produce full parent entity financial statements.

### *Options*

***Option A: Do nothing***

10.42 The current requirement to prepare and have audited full parent entity financial statements would be retained under this option.

***Option B: Allow companies to prepare summary financial information in relation to the parent entity***

10.43 Under this option, full parent entity financial statements would be replaced by summary data for the parent entity consisting of: the parent entity's current and total assets; current and total liabilities and total shareholders' equity; the parent entity's net profit after tax and total retained earnings; details of any guarantees entered into by the parent entity in relation to the debts of its subsidiaries; and details of any contingent liabilities applicable to the parent entity and the parent entity's capital commitments.

***Option C: Allow companies to not report any financial information in relation to the parent entity***

10.44 This option proposes that the parent entity would not include any separate parent entity financial information in its financial statements.

## *Impact analysis*

### *Impact group identification*

10.45 Affected groups:

- users of financial statements;
- preparers of financial statements; and
- regulatory Government agencies that rely on financial statements to conduct their supervisory duties.

***Assessment of costs and benefits***

***Option A: Do nothing***

| | ***Benefits*** | ***Costs*** |
|---|---|---|
| Users | Users of company financial statements would continue to have the access to a full range of information on the parent entity and the consolidated entity. | Retains an added level of complexity in the presentation of the financial reports for those users who may not understand the correlation, if any, between the operations of the company and the parent entity. |
| Preparers | | Significant resource and time costs would continue to be incurred in preparing and auditing parent entity information. |
| Government/regulators | | |

***Option B: Allow companies to prepare summary financial information in relation to the parent entity***

| | ***Benefits*** | ***Costs*** |
|---|---|---|
| Users | Reduced complexity for users of company financial statements. [+1] | Decrease in the level of information available to users of company financial statements. [-1] |
| Preparers | Substantial decrease in compliance costs resulting from a reduction in the level of resources needed to prepare and audit parent entity data. [+2] | A reduction in potential savings through having to maintain separate parent entity financial statements for prudential purposes. [-1] |
| Government/regulators | | |
| Sub-rating | +3 | -2 |
| Overall rating | +1 | |

***Option C: Allow companies to not report any financial information in relation to the parent entity***

| | ***Benefits*** | ***Costs*** |
|---|---|---|
| Users | Reduced complexity for users of company financial reports. [+1] | Decrease in the level of information available to users of company financial reports. [-3] |
| Preparers | Significant decrease in compliance costs resulting from a reduction in the level of resources needed to prepare and audit parent entity data. [+3] | A reduction in potential savings through having to produce parent entity financial statements on request for specific shareholders and creditors as well as APRA. [-2] |
| Government/regulators | | |
| Sub-rating | +4 | -5 |
| Overall rating | -1 | |

### Consultation

10.46 Targeted consultation occurred on this proposal in August 2008.

10.47 A number of stakeholders have called for the removal of the requirement to prepare (and audit) separate parent entity financial statements to be replaced by summarised information. Stakeholders include the Group of 100, the professional accounting bodies (The Institute of Chartered Accountants Australia, CPA Australia and the National Institute of Accountants), a number of audit firms and individual companies.

### Conclusion and recommended option

10.48 Option A is not preferred. While the current requirements provide significant information to stakeholders, questions have been raised as to whether stakeholders require or understand the financial statements as presented. As compliance costs associated with preparing and auditing parent entity financial statements are significant, the value of this information appears to be disproportionate to its cost.

10.49 Option B is the preferred option. This option strikes a more effective balance between the needs of users of parent entity financial information and the cost of preparing such information. Users of parent entity financial statements, including shareholders would still retain access to relevant financial information relating to the parent entity through the summary report. While some information on the parent entity would no

longer be reported, stakeholders have indicated that this information is not widely used and only adds to the complexity of the financial statements. The costs to prepare and audit of summary financial information will be significantly lower than the costs to prepare and audit separate parent entity financial statements — the extent of these costs savings will be dependent on the size and complexity of the entity and the relativities around the size of the parent as opposed to the consolidated entity. The Group of 100 estimates that the incremental savings from audit alone would be in the vicinity of $20,000 to $25,000 for large listed companies.

10.50 Option C is not preferred because the trade-off in reduced preparation expenses for industry is likely to be offset by the need to produce parent entity financial statements, or some form of summary parent entity information, on request for specific stakeholders. The impact of producing this information may be compounded by the fact that different data would be requested by different stakeholders, meaning that information may need to be customised. The impact on those stakeholders who do not have the capacity to request this information is also increased, as these users would then have no way of accessing financial information on the parent entity.

## Dividends from profits

### Problem

10.51 The Corporations Act provides that dividends can only be paid from profits. There are a number of difficulties with this requirement, including:

- the fact that the Corporations Act does not provide guidance or a definition for the term ‘profits’, making the legal requirements of dividend distribution unclear. In addition, the legal precedents on this issue are outdated, complex and not in line with current accounting principles. This makes it difficult for directors to understand the legal requirements when paying dividends;
- the nature of accounting principles for the calculation of profits has changed over time. Australian accounting standards, particularly following the adoption of IFRS, are increasingly linked to the fair value of the company’s assets with changes in the fair value (whether realised or unrealised) impacting on the profitability of the company. This makes the profitability of Australian companies increasingly volatile with a larger number of non-cash expenses being included in the net result. In these circumstances a company may have sufficient cash to pay a dividend to shareholders but is unable to do so because the accounting profits of the company have been eliminated by non-cash expenses; and
- the requirement for companies to pay dividends only out of profits is inconsistent with the trend to lessen the outdated capital maintenance doctrine in Australia. The capital maintenance doctrine is no longer supported by other provisions of the Corporations Act, such as the requirements relating to capital reconstructions and share buy-backs.

The concerns support recommendations made in a discussion paper by the Australian Accounting Research Foundation in 2002 that Australia move away from the current profits test for the payment of dividends.

### Objective

10.52 The objective is to ensure that companies have the ability to distribute dividends if they have the ability to do so without causing detriment to ongoing operation. Given the current reporting framework

focusing on fair valuation, this will allow companies to distribute a dividend even though profit may be impacted by non-cash revaluations.

### Options

***Option A: Do nothing***

10.53 Under this option companies would still be limited in the amount of dividend that can be distributed to accounting profit; known as the profits test.

***Option B: Broaden the ability of companies to pay dividends ensuring safeguards to protect shareholders and creditors are in place***

Under this option companies would be allowed to pay a dividend if it:

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

This would replace the existing profits test.

- If a company is not required to prepare an audited financial report (for example, because it is a small proprietary company), then the last component of the test which requires the company to be balance sheet solvent will be determined by reference to the accounting records which are required to be kept under section 286 of the *Corporations Act 2001*.

10.54 Share buy-backs would continue to be governed by the requirements in Part 2J of the Corporations Act. Some consequential amendments may be required to the income tax law to ensure that there is no change in taxing arrangements as a result of this reform.

***Option C: Broaden the ability of companies to pay dividends without ensuring safeguards to protect shareholders and creditors are in place***

10.55 This option allows companies to distribute dividends without applying any safeguards such as the balance sheet test.

## *Impact analysis*

### *Impact group identification*

10.56 Affected groups:

- shareholders;
- companies paying dividends; and
- regulatory Government agencies responsible for corporations and taxation.

### *Assessment of costs and benefits*

### *Option A: Do nothing*

| | *Benefits* | *Costs* |
|---|---|---|
| Shareholders | Prevents companies from distributing amounts that would be detrimental to the share value. | Shareholders of solvent companies that have mark downs to profit resulting from valuation changes are limited in their ability to receive dividends. Shareholders who have a preference for cash flow but cannot receive dividends will need to sell their shares which will incur transaction costs and may have tax implications. |
| Companies | Prevents companies from distributing amounts that would be detrimental to the share value. | Solvent companies that have mark downs to profit resulting from valuation changes are limited in their ability to distribute dividends. |
| Government/regulators | | |

***Option B: Broaden the ability of companies to pay dividends ensuring safeguards to protect shareholders and creditors are in place***

| | ***Benefits*** | ***Costs*** |
|---|---|---|
| Shareholders / creditors | Shareholders of solvent companies that have mark downs to profit resulting from valuation changes can receive dividends which will facilitate cash flow to the investor and potentially make the investment more attractive. [+2]<br>Greater protection for shareholders arising from the introduction of the balance sheet test [+1] | |
| Companies | Solvent companies that have mark downs to profit resulting from valuation changes can pay dividends if not detrimental to the creditors and shareholders. This provides greater flexibility to pay dividends which may increase their attractiveness as an investment and provide greater ability to attract and raise capital. [+2]. | Potential increase in monitoring costs for companies that are not required to prepare a financial report (in assessing whether they satisfy the balance sheet test). [-1] |
| Government/regulators | | |
| Sub-rating | +5 | -1 |
| Overall rating | +4 | |

***Option C: Broaden the ability of companies to pay dividends without ensuring safeguards to protect shareholders and creditors are in place***

| | ***Benefits*** | ***Costs*** |
|---|---|---|
| Shareholders/ creditors | Shareholders of solvent companies that have mark downs to profit resulting from valuation changes can receive dividends. [+2] | Shareholders could have the value of their shares significantly reduced if the ongoing operation of the company are damaged by a dividend payment. [-3]<br>Creditors of companies could have their debts reneged on if the company distributes a dividend that results in default. [-3] |
| Companies | Solvent companies that have mark downs to profit resulting from valuation changes can pay dividends if not detrimental to the creditors and shareholders. [+2] | |
| Government/regulators | | |
| Sub-rating | +4 | -6 |
| Overall rating | -2 | |

### Consultation

10.57 In August 2008, Treasury undertook targeted consultation on this issue with key stakeholders including representatives of industry, business, professional accounting bodies and other interested parties.

10.58 Overall, stakeholders were generally supportive of providing greater flexibility for paying dividends while maintaining appropriate safeguards, consistent with Option B above.

### Conclusion and recommended option

10.59 Option A is not preferred as the environment that companies operate in has significantly changed since the creation of the ‘profit test’. The adoption of IFRS has resulted in accounting practices that involve significant movements in the income statement that affect profit, but have no impact on the liquidity or ongoing operations of the company. This results in instances where a company is unable to distribute a dividend when it has the ability to do so.

10.60 Option B is the preferred option as it provides companies with the ability to distribute dividends greater than accounting profit, whilst ensuring that appropriate safeguards are in place to protect the shareholders and creditors of the company. The proposed new safeguards will also significantly improve the existing safeguards contained in the Corporations Act. The benefits of this approach are expected to outweigh the costs.

10.61 Option C is not preferred because of the significant risk to shareholders and creditors that would be exist if there were no safeguards in place relating to the payment of a dividend. Under this option a company would be able to distribute a dividend that could result in the company not being able to pay it's debts as and when they fall due. These are large and unacceptable risks.

## Changing reporting periods

### *Problem*

10.62 In Australia, close to 33,000 companies, registered schemes and disclosing entities have financial reporting obligations as outlined in Chapter 2M of the Corporations Act. Under the provisions of the Act, a financial year is 12 months long (plus or minus seven days). The balance date can normally only be changed by up to seven days each year to accommodate entities with week-based internal reporting. The restrictions on changing financial years were introduced by the *Company Law Review Act 199*8, which came into effect on 1 July 1998.

10.63 The existing arrangements in Australia make it difficult for companies to change their year-end date for reasons other than those contained in the Corporations Act. In this regard, the Australian requirements are more stringent than the requirements of comparable jurisdictions. This inflexibility has the potential to unnecessarily burden companies and their auditors, particularly during peak reporting periods.

10.64 An added issue that could arise through the adoption by companies of a new financial reporting period is an increase in compliance costs as it could result in a lack of alignment between a company's income years for financial reporting and tax purposes. While a taxpayer can apply to the Commissioner of Taxation to adopt a substituted accounting period for income tax purposes, the Commissioner will not allow the adoption of a substituted accounting period merely for convenience, such as to align with a taxpayer's financial reporting obligations.

### Objective

10.65 In principle, there is no reason why a company should not be free to change its year-end date, provided that any change is made in good faith, investors and other users of company information are not disadvantaged and the change does not conflict with the requirements of other legislation. However, entities may need to be made aware that such a change could result in increased compliance costs in respect of their taxation and other reporting obligations.

### Options

#### *Option A: Do nothing*

10.66 Under this option the requirement that an entity's reporting date be within seven days of its current reporting date would remain. In practical terms, this would mean that the majority of entities would have a reporting date of 30 June.

#### *Option B: Allow companies flexibility to change their reporting periods*

10.67 Under this option the restrictions on reporting date for a company would be eased to allow reasonable movement. Any changes would have to be made in good faith in the best interests of the company to ensure that companies are not changing their reporting date to alter the appearance of their financial information. Companies would also face potential compliance costs as they would still be required to lodge figures with the Australian Taxation Office, for taxation purposes, under the current timeframe.

### Impact analysis

#### *Impact group identification*

Affected groups:

- users;
- companies;
- preparers and auditors of financial statements; and
- Government agencies.

***Assessment of costs and benefits***

***Option A: Do nothing***

| | *Benefits* | *Costs* |
|---|---|---|
| Users | | |
| Companies | | Significant impact on availability of accounting and auditing resources for the preparation of financial reports due to companies and other members of the community being required to prepare and submit taxation returns at the same time. |
| Preparers and auditors | | |
| Government/regulators | Annual reporting timeframes for most companies align with the ATO cycle. | |

***Option B: Allow companies flexibility to change their reporting periods***

| | *Benefits* | *Costs* |
|---|---|---|
| Users | | Users could face slight delays in accessing financial information about the company. [-1] |
| Companies | Companies would have greater access to accounting and auditing services. [+2] | Companies could face additional costs in complying with the ATO tax cycle if a reporting date other than 30 June is chosen. [-2] |
| Preparers and auditors | Accounting and auditing firms would have the ability to spread their work more evenly throughout the year. [+2] | |
| Government/regulators | | |
| Sub-rating | +4 | -3 |
| Overall rating | +1 | |

### *Consultation*

10.68 Targeted consultation on this proposal occurred in August 2008.

10.69 A number of stakeholders have called for additional flexibility in this area. Stakeholders include audit firms and preparers, the Group of 100 and the professional accounting bodies (The Institute of Chartered Accountants Australia, CPA Australia and the National Institute of Accountants).

### *Conclusion and recommended option*

10.70 Option A is not preferred, primarily because of the restrictions it places on an entity's ability to program accounting and auditing work to minimise the cost and resource pressures on the entity. Maintaining the status quo will also result in the potentially inefficient use of resources within accounting and other professional firms being continued.

10.71 Option B is the preferred option. Greater flexibility around year-end reporting dates, would result in benefits to auditing and accounting firms which would in-turn flow through to cost savings for companies. With protections in place to ensure that changes are made in good faith in the best interests of the company there should be minimal costs for users of reports. There would be some costs to companies that have different reporting and taxation years but this would be optional and it is expected that companies would weigh up these costs when choosing alternative reporting dates. This option achieves an appropriate balance between minimising the costs incurred by entities for accounting and auditing work (including more efficient use of resources by professional accounting and auditing firms) and any additional compliance costs incurred in complying with the taxation reporting requirements.

## Extend the requirement to disclose a review of operations and financial condition to all listed entities

### Problem

10.72 Under section 299A of the Corporations Act, a listed public company is required to provide, in its director's report, all information reasonably required to allow an informed assessment of its operations, financial condition and business strategies and prospects for future financial years. Guidance on this requirement refers to it as a review of operations and financial condition.

10.73 The requirement for companies to disclose a review of operations and financial condition was introduced as a result of the recommendations of the HIH Royal Commission. The rationale for its introduction was to address a lack of contextual information which explained the results set out in a company's financial statements. Accordingly, the review of operations and financial condition was introduced to provide stakeholders with an overview which would enable users to understand a business' performance and the factors underlying its results and financial position.

10.74 However, the requirement to disclose a review of operations and financial condition only applies to listed public companies (of which there are approximately 2200) does not apply to listed managed investment schemes (of which there are approximately 200).

10.75 Managed investment schemes were not involvement in the HIH Collapse and as such were not considered in Commission's recommendations. Nonetheless, the size and degree of public investment in these listed managed is analogous to the degree of public investment in listed companies. The complexity and potential for confusion in the financial statements of managed investment schemes is also similar to that of companies.

10.76 As such, the same reasons which suggested a need to introduce additional narrative reporting for listed companies also suggest a need to introduce additional narrative reporting for listed managed investment schemes.

10.77 Extending 299A to all listed entities was a recommendation of the Corporations and Markets Advisory Committee (CAMAC) in 2006.

### Objective

10.78 To improve decision making by investors and oversight by regulators in relation listed managed investment schemes.

## Options

### *Option A: Do nothing*

10.79 Under this option listed entities would continue to have different reporting requirements, depending on whether they were companies or managed investment schemes.

### *Option B: Consistent requirements*

10.80 Under this option, all listed entities would have consistent reporting requirements in relation to disclosure of a review of the entity's operations and financial condition.

## Impact analysis

### *Impact group identification*

Affected groups:

- investors and other users of annual reports;
- listed managed investment schemes; and
- Government/regulators.

### *Assessment of costs and benefits*

### *Option A: Do nothing*

| | *Benefits* | *Costs* |
|---|---|---|
| Investors and other users of annual reports | | Users of listed managed investment schemes' annual reports do not have access to a narrative discussion which would help them understand a business' performance and the factors underlying its results and financial position. |
| Listed managed investment schemes | Preparers of listed managed investment schemes do not have to expend resources preparing a review of operations and financial condition. | |
| Government/regulators | | |

***Option B: Consistent requirements***

| | ***Benefits*** | ***Costs*** |
|---|---|---|
| Investors and other users of annual reports | The information which listed managed investment schemes would be required to disclose would allow investors and other users of financial reports to make better decisions. In particular, this should mean fewer losses as a result of poor information and more efficient allocation of capital. [+2] | |
| Listed managed investment schemes | | There would be some compliance costs for listed managed investment schemes associated with preparing the additional disclosures. However, these costs are expected to be minimal. Much of the information required under section 299A is similar to the information already required under section 299. Additionally, the disclosures required by section 299 rarely constitute more than a few pages; even BHP only devoted 1000 words to these disclosures in its 2008 Annual Report. Further, these disclosures do not need to be audited. The issues which must be reported on are also those which the responsible entity of a managed investment scheme (or any entity) should be aware of in any case. [-1] |
| Sub-rating | +2 | -1 |
| Overall rating | +1 | |

## Consultation

10.81 Consultation was undertaken as part of the CAMAC review and was taken into account by CAMAC in forming its recommendation. Groups who made submissions to the CAMAC inquiry included major businesses and business associations, accounting firms and shareholder representative.

10.82 Submissions which dealt with the issue of who should report generally focused on size and/or ownership. One submission which did deal with reporting obligations for companies other than corporations commented that any entity with a significant impact on society should be required to report.

## Conclusion and recommended option

10.83 Option B is the preferred option. It is difficult to quantify the costs and benefits of requiring companies to disclose a review of operations and financial condition. However, the costs appear likely to be minimal for the reasons outlined above. The disclosure of this information is also generally viewed as beneficial for listed companies and was considered by the HIH Royal Commission to be important in helping users understand the issues underlying the figures reported in a company's financial statements.

10.84 As the benefits of providing this information are generally considered to outweigh the costs when this information is provided by listed companies, it seems likely that the benefits will also outweigh the costs when this information is prepared by listed managed investment schemes.

## Other minor and technical amendments

## Declaration of IFRS Compliance

### Problem

10.85 Some feedback from foreign jurisdictions has suggested there is a lack of awareness that the financial statements of Australian companies are compliant with IFRS. In particular, as accounting standards in Australia are commonly referred to as 'Australian-equivalent International Financial Reporting Standards (AIFRS)', there is a perception that they are not identical to IFRS.

10.86 Lack of international recognition of Australia's IFRS adoption prevents Australia from realising the full benefits of IFRS in relation to the facilitation of foreign investment.

10.87 Auditing Standards also require an auditor to make a declaration of IFRS compliance in the audit report, but there is no corresponding requirement in the directors' declaration and this may create some confusion.

### Conclusion

10.88 A statement of IFRS compliance should be required in the directors' declaration. This will provide benefits to companies by creating consistency between the auditor's report and directors' declaration and will help ensure international recognition of Australia's adoption of IFRS. This amendment would not generate any additional costs as an analogues statement is already required in the notes to a company's financial statement. It would merely ensure that IFRS compliance is stated more prominently.

## Lost capital reductions

***Problem***

10.89 Under section 258F of the Corporations Act, companies are allowed to cancel paid-up capital that is lost or not represented by available assets of the company. The provision is intended to allow companies to write down the value of the company's capital in situations where a company incurs certain types of losses. This is done by writing-off past accumulated losses against the share capital of the company.

10.90 Concerns have been expressed that companies may be able to use section 258F to overstate the profitability of the company by taking expenses directly to share capital rather than recognising them in the statement of financial performance. Such action would be in breach of Australian accounting standards.

***Conclusion***

10.91 Section 258F should be amended to make it clear that a company can only cancel share capital in circumstances where it is not inconsistent with the requirements in Australian accounting standards. The proposed amendment will still allow companies to write off accumulated losses to share capital but will not allow companies to take expenses directly to share capital.

10.92 The proposed amendment is of a technical nature and is designed to clarify the manner in which section 258F is intended to operate. There is no evidence that there is, or has been, widespread misuse of the section and, as a consequence, the proposed amendment will have minimal, if any, impact on companies that are required to prepare financial statements.

## improvements to the Financial Reporting Council's functions and funding arrangements

***Problem***

10.93 Prior to the enactment of the *Governance Review Implementation (AASB and AUASB) Act 2008* (the GRI Act), the Australian Accounting Standards Board (AASB) and the Australian Accounting Standards Board (AUASB) were statutory bodies governed by the *Commonwealth Authorities and Companies Act 1997* (CAC Act). The GRI Act has transferred the AASB and the AUASB from the CAC Act to the *Financial Management and Accountability Act 1997* (FMA Act) framework.

10.94 As a consequence of the enactment of the GRI Act, the specific accounting and auditing standards functions given to the FRC under s.225(2)(i) and (j) and s 225A(2)(i) and (j) of the *Australian Securities and Investments Commission Act 2001* (ASIC Act) are now obsolete and unnecessary. These provisions require the FRC to:

- seek contributions towards the costs of the Australian accounting standard and auditing standard setting processes; and

- monitor the level of funding, and the funding arrangements, for those processes.

***Conclusion and recommended option***

10.95 Paragraphs 225(2)(i) and (j) and 225(2A)(2)(i) and(j) of the ASIC Act should be repealed as they are no longer necessary or appropriate having regard to the fact that the AASB and the AUASB are now FMA agencies for purpose of the FMA Act.

## Improvements to the Companies Auditors and Liquidators Disciplinary Board's (CALDB) processes including immunities and appointments

***Problem***

10.96 The *Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Act 2004* (CLERP 9) amended CALDB's structure. As a result of the CLERP 9 changes, CALDB's membership was increased from three to 14 members, all of whom are appointed by the Minister on a part-time basis. Membership consists of:

- a Chairperson and a Deputy Chairperson, each of whom must be enrolled as a barrister and/or a solicitor or a legal practitioner in Australia;
- three members selected from a panel of seven nominated by the Board of the ICAA;
- three members selected from a panel of seven nominated by the Board of CPAA; and
- six business members. Business members need not be nominated by any particular body. The Minister must be satisfied that a business representative has knowledge or qualifications in a business or law-related discipline.

10.97 There are problems with this approach. There are three professional accounting bodies in Australia, the ICAA, CPAA and the National Institute of Accountants (NIA). Additionally, there is also a recognised professional body representing insolvency practitioners, the Insolvency Practitioners Association of Australia (IPAA). Under the current framework, the NIA and other professional and interested parties are unable to nominate members for CALDB.

10.98 Under s 221 of the ASIC Act, immunity consistent with that of a Justice of the High Court is conferred on Panel Members of the CALDB when exercising powers in relation to a hearing. Witness and legal and other representatives receive immunity equivalent to that which they would receive if appearing before the High Court.

10.99 However, s 1294A of the Corporations Act also allows the Chairperson to conduct pre-conference hearings. This was introduced to streamline the hearing process. Immunity under s 211 is not available for pre-conference hearings conducted by the Chairperson.

### *Conclusion and recommended option*

10.100 The requirement for the two professional accounting bodies to directly nominate members to the CALDB should be replaced with a new approach whereby accounting members would be drawn from nominations received from all relevant professional bodies and other interested parties, with the Minister retaining responsibility for selecting the most appropriate accounting member once the list is compiled. This is similar to the current arrangements for the appointment of business members to CALDB.

10.101 The immunity under s 221 of the ASIC Act should be extended to include pre-conference hearings conducted under s 1294A of the Corporations Act.

## Implementation

10.102 The preferred options identified above will be progressed through the Corporations Act Amendment (Corporate Reporting Reform) Bill 2010.

10.103 Several of the issues identified above are long standing issues, which are the result of extensive previous review processes. These issues include reporting by companies limited by guarantee, parent-entity financial reports, and the requirement to pay dividends from profit.

10.104 In August 2008, several of the preferred options identified above were included as part of a targeted consultation process with key stakeholders. Feedback from the targeted consultation process suggests that there is broad support for the proposed reforms among stakeholders, and that the measures would be well received by the wider corporate community.

10.105 In addition, an exposure draft of the amendments was subject to a two month public consultation period ending in February 2010.

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