

LABOR SENATORS' AND MEMBERS' MINORITY REPORT

The terms of reference required the Committee to examine:

- the small/large criteria in section 45A of the Corporations Law;
- the appropriateness of having requirements for audit and the lodgement of financial statements for some classes of proprietary companies;
- the appropriateness of the criteria for the exercise of ASIC's discretion to provide relief from the accounting provisions in subsections 342(2) and (3) of the Corporations Law;
- the manner in which ASIC has exercised that discretion; and
- the effectiveness and costs of the process of ASIC providing exemptions from the audit requirements in Chapter 2M of the Corporations Law through the exercise of an administrative power.

The Labor members of the Committee wish to comment on the first two terms of reference.

1. APPROPRIATENESS OF HAVING REPORTING REQUIREMENTS

The objective of requiring companies to lodge and audit financial accounts must be to ensure that all relevant end-users have access to that information and that information is accurate.

While the Labor members acknowledge that for some proprietary companies the only relevant end-users are the shareholders¹, the Labor members do not believe that is true for all proprietary companies. Financial accounts provide information to shareholders, creditors, employees and others in order to enable those people to make decisions concerning their dealings with a company.

These considerations make it appropriate for there to be requirements for the audit and lodgement of financial accounts for some classes of proprietary companies.

2. SMALL/LARGE CRITERIA

2.1 Small/Large Criteria

As discussed at paragraph 2.2 of the Committee's report, the previous classification of proprietary companies as exempt and non-exempt reflected the status of the company but was not a consistent rationale for identifying companies in which there was a public interest. Financial accounts provide important information to a range of people and is necessary to assist them in their dealings with a company.

Further, as ASIC suggested, in determining reporting requirements for proprietary companies regard must be had to recent legislative changes to the Corporations Law which facilitate their fundraising from the public and to the current focus of

¹ The Labor members of the Committee note that section 293 of the Corporations Law permits shareholders with at least 5% of the votes in a small proprietary company to direct the company to prepare a financial report.

Parliament on employee entitlements, including the Corporations Law Amendment (Employee Entitlements) Act.²

Regard must also be had to the cost to companies of complying with reporting requirements.

All of these considerations confirm the need for the reporting requirements of proprietary requirements to be linked to the public interest and the economic significance of the company.

Submissions from Bentleys MRI, Institute of Chartered Accountants and CPA Australia, Mr Ian Langfield Smith and Incat Pty Ltd suggested the above objective would best be achieved by adopting a “reporting entity” concept. However, as the Committee has previously concluded the reporting entity concept “does not provide a test of sufficient certainty to enable an objective assessment to be made of whether a company falls within the entity test.”³

Reverting to the previous exempt-proprietary rule, as suggested by the Australian Institute of Company Directors (AICD) and Atkinson Gibson would also not achieve the desired objective. Further, as suggested by the AICD in evidence it gave to the Committee, the definition of “exempt proprietary company” is “somewhat convoluted” and should be refined and simplified, with an emphasis on family-owned companies⁴.

The Labor members of the Committee also note that claims of a loss of commercial privacy must be balanced against the benefits of limited liability which companies enjoy. Since shareholders are only liable for the amount of capital they have contributed to a company, creditors need to be able to reassure themselves that the company has sufficient capital to pay their debts. One way of obtaining this reassurance is to review the accounts of the company.

The AICD has suggested that all companies be required to lodge a solvency declaration. The limitations of this suggestion are that if it is a representation as to solvency, it is only at a particular point in time and, without additional financial information, stakeholders cannot determine the level of solvency or changes in the level of solvency from time to time. Without change to the Corporations Law, such a declaration would also not assist in determining liability, or rebutting defences, under the insolvent trading provisions.

Retaining the current small/large test is favoured by ASIC, PricewaterhouseCoopers and the National Institute of Accountants. The Labor members of the Committee agree it provides the best approximate of the economic significance of, and public interest in, a company.

² ASIC, Submission to the Parliamentary Joint Statutory Committee on Corporations and Securities – Review of Aspect of the Regulation of Proprietary Companies, 21 March 2000, p. 2

³ Parliamentary Joint Committee on Corporations and Securities, *Report on the First Corporate Law Simplification Bill 1994*, 2 March 1995, p.16

⁴ Hansard, 28 June 2000, pg. CS 3-4

This is supported by statistics from ASIC as to the number of time lodged accounts of large proprietary companies are accessed. ASIC concluded in the 1988 report that there is a significant level of use of the accounts of proprietary companies which lodge accounts.

Accordingly, the Labor members believe that the small/large test best meets the objectives of reporting requirements for proprietary companies.

2.2. Simplicity

An additional objective of the small/large test, is to simplify and clarify the law and to reduce reporting requirements for most proprietary companies.

As previously discussed, the “reporting entity” concept would not achieve this objective. Mr Agland from the National Institute of Accountants told the Committee:

“Definition 45A has the advantage of having three criteria and these criteria are easy to understand and easy to apply....The reporting entity concept, on the other hand, relies too heavily on subjective decision making of the directors who may, for one reason or another, not wish to report, even though they should. It is a difficult test to police and one that is dependent on expert knowledge to make an accurate decision.”

On its face, the definition of exempt proprietary company seems simple. However, the Labor members note the comments from the AICD discussed above. Further, the transition to the small/large test has meant that 99.4% of all proprietary companies which would have been required to prepare financial statements prior to the *First Corporate Law Simplification Act* now have no financial reporting requirements.⁵

2.3. Areas of Concern

The Labor members of the Committee however, are not blind to the concerns raised in the submissions in regard to the small/large test.

One issue raised was the inconsistency between the small/large test and the reporting entity concept, with the result that lodged accounts are not prepared in accordance with the full requirements of accounting standards.

However, as ASIC advised the Committee, the reports of companies must still give a true and fair view of its financial position and the Labor members support the view of ASIC that this would require all large proprietary companies to observe the recognition and measurement provisions of accounting standards. Accordingly, this is a regulatory matter, rather than a factor supporting a change in the small/large test.

A second issue raised was that non-grandfathered proprietary companies are at a competitive disadvantage to grandfathered proprietary companies and that a market has been created in grandfathered proprietary companies.

⁵ ASIC, Submission to the Parliamentary Joint Statutory Committee on Corporations and Securities – Review of Aspect of the Regulation of Proprietary Companies, 21 March 2000, p. 3

In its submission, ASIC suggested that the unlevel playing field created by grandfathering could be addressed by:

- removing grandfathering or making it subject to a sunset provision;
- extending grandfathering to all companies which would have met the previous exempt proprietary company definition; or
- not requiring any proprietary company to lodge accounts but have their accounts audited.

The Labor members would recommend that the consequences of removing grandfathering or making it subject to a sunset provision be examined by the Government.

A third issue raised was that a proprietary company could reorganise their affairs such that they cease to be large and are no longer subject to the reporting requirements of the Corporations Law.

It should be noted that section 45A already refers to entities that the company “controls” in calculating the gross operating revenue and gross assets of the company. Any attempt to modify and extend this concept would need to be balanced against the loss of simplicity in the definition of a small proprietary company.

A fourth issue raised was that ASIC could not identify those companies which are large proprietary companies but not complying with reporting companies. The Labor members of the Committee acknowledge that it would be easier to identify which companies are non-exempt proprietary companies from information on shareholders already lodged with ASIC. However, for the reasons outlined above, the Labor members prefer to retain the small/large test.

The Labor members also note that no estimate was provided of the extent of this problem, and would hope that most proprietary companies would want to comply with the Law.

ASIC has recommended that the problem could be partially addressed by requiring each proprietary company to report annually to ASIC that the directors have considered whether the company is large or small for its last financial year, and requiring the company to state whether it was small or large.⁶

The final issue raised was that companies can be re-classified as a small or large company each year depending on seasonal factors and exceptional events, such as asset sales.

The Labor members of the Committee note however, that statistics collected by ASIC indicate that the majority of companies lodging accounts exceeded all the criteria, not just the two criteria necessary to be classified as a large proprietary company, and that the majority of the companies were well above the criteria comprising the large/small test. This is discussed more fully at paragraph 2.12 of the Committee’s Report.

⁶ Ibid., p. 9

The Labor members also note that ASIC has a discretion to make exemption orders and class orders under section 342 of the Corporations Law.

3. RECOMMENDATIONS

The Labor members are not convinced that there is sufficient impetus for another legislative change to the reporting requirements of proprietary companies, nor that it would be desirable to revert back to the previous exempt and non-exempt proprietary company classification. Of all the options examined, we believe that the small/large test best meets the objectives of reporting requirements for proprietary companies. While the small/large test has some problems, all the other suggested alternatives also have shortcomings.

The Labor members of the Committee recommend that the existing small/large test continue for the time being.

The Labor members of the Committee recommend that the Government examine the consequences of removing the grandfathering provisions or making it subject to a sunset provision.

The Labor members of the Committee recommend that the Corporations Law be amended to require each proprietary company to report annually to ASIC that the directors have considered whether the company is large or small for its last financial year, and to state whether the company was small or large.

The Labor members recommend that ASIC continue to collect and review, to the best of its resources, the statistics of the kind presented by it to the Committee and also, if the previous recommendation is adopted, the number of companies which state they are large or small each year. The Labor members recommend that ASIC report to the Committee in 2 years on its review.

Mr Bob Sercombe, MP

Senator Stephen Conroy

Senator Barney Cooney

Mr Kevin Rudd, MP

