GOVERNMENT RESPONSE

TO

PARLIAMENTARY JOINT COMMITTEE ON CORPORATIONS AND FINANCIAL SERVICES

THE REPORT ON THE CORPORATE LAW ECONOMIC REFORM PROGRAM (AUDIT REFORM AND CORPORATE DISCLOSURE) BILL 2003

March 2005

GOVERNMENT RESPONSE TO RECOMMENDATIONS OF THE PARLIAMENTARY JOINT COMMITTEE ON CORPORATIONS AND FINANCIAL SERVICES

BACKGROUND

On 8 October 2003 the Parliamentary Joint Committee on Corporations and Financial Services (PJC) resolved to inquire into and report on the *Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Bill 2003* (the CLERP 9 Bill). The PJC tabled its report on the CLERP 9 Bill in two parts – part 1 was tabled on 4 June 2004. Some recommendations contained in part 1 were agreed to by the Government and moved as amendments during the Bill's passage through the Parliament.

Part 2 of the PJC report was tabled on 15 June 2004. In light of the timetable for debate of the Bill in the Parliament, there was insufficient time for detailed consideration of the recommendations in part 2 of the report. As a result, during the Senate debate on the CLERP 9 Bill, the Government undertook to consider the recommendations of the PJC in detail and to provide a written response following commencement of the CLERP 9 Act.

It is noted that some recommendations from parts 1 and 2 of the report were moved as amendments by the Democrats and agreed to by the Government during debate in the Senate.

The Government's response to the Committee's recommendations is outlined below.

PART 1 – ENFORCEMENT, EXECUTIVE REMUNERATION, CONTINUOUS DISCLOSURE, SHAREHOLDER PARTICIPATION AND OTHER

RECOMMENDATION 1

The Committeee recommends that the *Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Act 2004* (the CLERP 9 Act) require corporations to establish a whistleblower protection scheme that would both facilitate the reporting of serious wrongdoing and protect those making or contemplating making a disclosure from unlawful retaliation on account of their disclosure. The Committee refers to Australian Standard AS8004—2003 as a starting point for corporations.

Response

The Government does not accept this recommendation.

In recognition that the whistleblowing provisions apply to companies of varying size and characteristics, the CLERP 9 Act has adopted a flexible framework which does not mandate the establishment of particular systems to deal with formal complaints. Prescribing particular systems which all companies must implement in order to facilitate whistleblowing could prove to be overly rigid and unsuitable for particular companies in the Australian market.

The CLERP 9 provisions acknowledge that individual companies are best placed to determine what internal systems are most appropriate for them according to their circumstances.

RECOMMENDATION 2

The Committeee recommends that CLERP 9 require the Australian Securities and Investments Commission (ASIC) to publish a guidance note designed for all companies, using AS8004—2003 as a model, to help further promote whistleblowing protection schemes as an important feature of good corporate governance.

Response

This is a matter for consideration by ASIC.

RECOMMENDATION 3

The Committeee recommends that paragraph 1317AA(1)(a)(iv) read "an employee of a person who has contracted for services with, or the supply of goods to, a company".

Response

The Government accepts this recommendation.

Prior to the passage of the CLERP 9 Act through the Parliament, the Government amended paragraph 1317AA(1)(a) in order to implement this recommendation.

RECOMMENDATIONS 4 - 6

Recommendation 4 – The Committeee recommends that the threshold test of "in good faith" be removed and replaced by "an honest and reasonable belief".

Recommendation 5 - The Committeee recommends that the whistleblowing provisions should stipulate that the report must relate to "a serious offence".

Recommendation 6 – The Committeee recommends that the Government give serious consideration to providing for anonymous reports. It believes that by having the requirements that a person must have an honest and reasonable belief that an offence has or will be committed and that the offence is a serious offence will represent a sufficient safeguard against frivolous or vexatious reporting.

Response

The Government does not accept these recommendations as their implementation would alter the overall whistleblowing framework within the CLERP 9 Act.

The CLERP 9 Act provides protection for officers, employees and subcontractors of a company who report suspected breaches of the *Corporations Act 2001* (the Corporations Act) and the *Australian Securities and Investments Commission Act 2001* (the ASIC Act) to ASIC or to specified persons within the company. As a way of minimising vexatious disclosures, the provisions require that the disclosure be made in good faith and on reasonable grounds. In addition, to promote the integrity of the whistleblowing provisions, anonymous disclosures are not permitted.

This is a package of measures which seeks to balance two competing objectives: encouraging company employees and officers to report suspected breaches of the law, while at the same time ensuring that the whistleblowing protections are not abused or used for a malicious purpose.

The CLERP 9 Act encourages the reporting of wrongdoing by prohibiting companies from victimising employees, officers or subcontractors when they report a suspected breach of the Corporations Act and related legislation in good faith and on reasonable grounds. Whistleblowers who make disclosures in accordance with the Act receive protection from criminal or civil liability and attract qualified privilege in respect of the disclosure. Requiring all disclosures to be made in good faith is designed to enhance the integrity of the system by ensuring that persons making disclosures do not have ulterior motives. Further, to attract the whistleblowing protections contained in the CLERP 9 Act, there must be a reasonable basis to suspect that a breach has been committed.

Recommendations 4 to 6 propose changes to the threshold requirements that determine whether a particular disclosure will attract the protection of the whistleblowing provisions.

Implementing Recommendation 4 would mean that the purpose or motive of the person making the disclosure would no longer be relevant. This could give rise to the possibility that a disgruntled employee might attempt to use the provisions as a

mechanism to initiate an unnecessary investigation and thereby cost the company time and money.

Implementing Recommendation 5 would result in the application of the protections to disclosures that relate only to serious offences. It could prove difficult for many company employees to determine what constitutes 'a serious offence' and to assess whether their disclosures would attract the protections afforded by the whistleblowing protections.

Further, providing for anonymous reports as suggested in Recommendation 6 may encourage the making of frivolous reports, and would generally constrain the effective investigation of complaints. Allowing anonymity would also make it more difficult to extend the statutory protections to the relevant whistleblower.

Overall, the Government considers that the framework in the CLERP 9 Act achieves an appropriate balance between the policy objectives and should therefore be maintained.

RECOMMENDATION 7

The Committeee recommends that a provision be inserted in the proposed whistleblowing scheme that expressly provides confidentiality protection to persons who make protected disclosures to ASIC or to the designated authorities within a company. Similar provisions should also be inserted to protect the rights of persons who are the subjects of disclosures.

Response

The Government accepts the general intent of the PJC's recommendation to provide confidentiality protection.

Under section 127 of the ASIC Act, protected information provided to ASIC must be treated confidentially. The Government considers that disclosures made to ASIC under the whistleblowing provisions will be protected from unauthorised use or disclosure by section 127 of the ASIC Act. Therefore, the Government does not consider an amendment is required to implement this aspect of Recommendation 7.

In relation to information given to designated authorities within a company, the CLERP 9 Act inserted section 1317AE in order to ensure that protected information provided to a company is treated confidentially.

RECOMMENDATION 8

The Committeee recommends that the Government review the proposed penalty to be set down in Schedule 3 as item 338 to ensure that it is comparable with other jurisdictions and offences of a similar nature.

Response

The Government does not accept this recommendation.

Item 338 of Schedule 3 in the CLERP 9 Act provides that a breach of subsection 1317AC(1), (2) or (3) of the provisions attracts a penalty of up to 25 penalty units and/or 6 months imprisonment. This penalty is consistent with similar provisions contained in the *Inspector General of Taxation Act 2003*.

RECOMMENDATION 9

The Committeee recommends that a provision be inserted in the whistleblowing provisions that would allow ASIC to represent the interests of a person alleging to have suffered from an unlawful reprisal.

Response

The Government does not accept this recommendation.

Where a company violates the whistleblowing provisions, whistleblowers are entitled to pursue compensation under the statute. Existing section 50 of the ASIC Act already provides ASIC with the ability in certain circumstances to commence civil proceedings in a person's name to recover damages. Where it is in the public interest, this would generally permit ASIC to represent a whistleblower in a claim for damages. However, this provision would not permit ASIC to conduct a criminal prosecution or to represent a whistleblower in an action for reinstatement. The Government considers that an ability for ASIC to represent a person in this sort of action is not necessary.

RECOMMENDATION 10

The Committee recommends that ASIC release as soon as possible a guide that leaves no doubt that the remuneration report is to contain a discussion on the board policy for determining the remuneration of its most senior executives which is to be presented in such a way that links the remuneration with corporate performance.

Response

This is a matter for ASIC.

The Government notes that paragraph 300A(1)(b) of the Corporations Act, as amended by paragraph 300A(1)(ba) of the CLERP 9 Act, requires disclosure of the link between the board's remuneration policy and company performance.

RECOMMENDATION 11

The Committee also recommends that regulations to be promulgated under this section adopt the direct and specific language used in the Explanatory Memorandum and not the vagueness of the wording in the Bill. The Committee recommends that regulations make clear that what must be included in the remuneration report is information "such as performance hurdles to which the payment of options or long term incentives of directors and executives are subject; why such performance hurdles are appropriate and the methods used to determine whether performance hurdles are met".

Response

The Government does not accept this recommendation.

Paragraph 300A(1)(ba) of the CLERP 9 Act requires that where an element of remuneration is contingent on satisfying a performance condition, details of the performance condition and the methods used to determine whether performance has been met must be included in the directors' report.

Regulations made pursuant to paragraph 300A(1)(c) require additional information in respect of performance related remuneration to be disclosed. Regulation 2M.3.03 cross references relevant disclosure paragraphs of the Accounting Standard AASB 1046 *Director and Executive Disclosures by Disclosing Entities*, including estimates of the maximum and minimum amounts of bonuses in forthcoming financial years that could be paid under a current remuneration agreement.

The Government considers the changes recommended by the PJC are unnecessary given that section 300A, including associated regulations, requires specific disclosures in relation to performance based remuneration.

RECOMMENDATION 12

The Committee recommends that the Government review the penalty provisions for contraventions of section 300A with a view to allowing a greater degree of flexibility in applying penalties especially for offences unlikely to satisfy the test that the contravention "materially prejudices the interests of the corporation or materially prejudices the corporation's ability to pay its creditors or is serious or is dishonest".

Response

The Government does not accept this recommendation.

The current penalties for breaches of remuneration disclosure provisions are those that apply in respect of other breaches of general purpose reporting requirements in Chapter 2M of the Corporations Act.

A breach of section 300A attracts a civil penalty where the breach is not dishonest, but the contravention either:

- materially prejudices the interests of acquirers or disposers of the relevant financial products; or
- materially prejudices the issuer of the relevant financial products or if the issuer is a corporation or scheme, the members of that corporation or scheme; or
- is serious.

In these circumstances a Court may impose a pecuniary penalty of up to $200 000.

If the breach is dishonest, a fine of up to 2000 Penalty Units ($220 000) and/or five years imprisonment may be imposed pursuant to subsection 344(2).

The CLERP 9 Act also implements non-financial sanctions such as increasing directors' accountability to shareholders via the non-binding vote on the remuneration report. This is an important mechanism to lift standards within companies rather than relying merely on the imposition of financial penalties. The impact of the shareholder vote should be gauged before changes to penalties are considered.

RECOMMENDATION 13

The Committee recommends that a new sub section 300(10)(d) be inserted in CLERP 9 which would require the directors' report to include details of the qualifications and experience of each person who has held the position of company secretary during the reporting period.

Response

The Government accepts this recommendation.

Amendments were made to the CLERP 9 Act to implement this recommendation.

RECOMMENDATION 14

The Committee recommends that the Government include in the Corporations Act a general principle that executive directors not be involved in determining their own remuneration unless there are reasonable grounds for that not to occur.

Response

The Government does not accept this recommendation.

The approach adopted in the CLERP 9 Act to director and executive remuneration is to enhance disclosures made to the market to assist shareholders to hold directors accountable. The Act does not interfere with the internal management of companies.

The CLERP 9 Act requires that information on remuneration be disclosed in a remuneration report and presented to shareholders at the company AGM. This mechanism provides an avenue whereby shareholders are able to provide directors with a clear view on the appropriateness of their decisions regarding remuneration and thereby influence those decisions. The Government's policy has not been to prohibit directors' involvement in setting their remuneration but rather to ensure there is appropriate disclosure and accountability.

RECOMMENDATION 15

The Committee recommends that CLERP 9 be amended to include a provision that requires equity based schemes as a form of executive remuneration to be subject to shareholder approval.

Response

The Government does not accept this recommendation.

The CLERP 9 Act looks to maintain clear lines of accountability whereby shareholders set directors' remuneration and directors are responsible for determining the remuneration of executives. The Act implemented measures to enhance the accountability of the board of directors to shareholders in respect of those decisions. The Government does not consider it appropriate to introduce more intrusive measures which would blur these lines of accountability.

In respect of executives who are also directors of a company, the Government notes that the ASX Listing Rules already require shareholder approval where directors are granted equity remuneration.

RECOMMENDATION 16

The Committee recommends that all payments made to directors be subject to shareholder resolution including payments such as the maximum annual cash payment and any retirement benefit or termination payout.

Response

The Government does not accept this recommendation.

Prior to the measures introduced in the CLERP 9 Act, shareholders already had a significant direct influence over non-executive directors' remuneration under the Corporations Act and ASX Listing Rules.

The Corporations Act provides that directors are to be paid remuneration as determined by the company at a general meeting. This requirement is a replaceable rule. In relation to listed companies, the related party provisions of the Corporations Act require shareholder approval in order to give a financial benefit to a director. Shareholder approval is not required for 'reasonable' remuneration. 'Reasonable' is determined with reference to the circumstances of the company and the director in question, including the responsibilities of the director.

The ASX Listing Rules require shareholder approval of any increase in the total pool of directors' fees payable to all directors. This does not apply to the salary of an executive director.

In light of the above, the Government considers that there are already appropriate mechanisms available that require shareholder approval of non-executive directors' remuneration.

The non-binding shareholder vote introduced by the CLERP 9 Act is a powerful tool to hold directors to account for their decisions regarding remuneration.

RECOMMENDATION 17

The Committee notes the many concerns expressed about the proposed infringement notice regime. In particular, the Committee refers to the blurring of ASIC's functions of investigator and adjudicator. In light of these concerns, the Committee recommends that ASIC's guide on issuing infringement notices more fully explain and document the procedures it will adopt to ensure that there is a clear and definite separation of its responsibilities to investigate and to adjudicate.

Response

This is a matter for ASIC.

On 20 May 2004, ASIC released *Continuous disclosure obligations: infringement notices – An ASIC guide*. The guide provides information to interested parties about ASIC's general approach to the infringement notice remedy and the stages in the infringement notice process.

RECOMMENDATION 18

The Committee recommends that CAMAC review the operation of the infringement notice provisions two years after they come into force. It recommends further that in light of comments suggesting that ASIC is not fully or effectively using its current powers to enforce the continuous disclosure provisions that the review take a broader approach and examine the effectiveness of the enforcement regime for continuous disclosure as a whole including the criminal and civil provisions.

Response

The Government partially accepts this recommendation.

The Government has undertaken to review the provisions in two years. The terms of the review and the persons to undertake it will be determined at that time.

RECOMMENDATION 19

The Committee recommends that a three-year sunset clause relating to the infringement notice provisions be inserted in CLERP 9.

Response

The Government does not accept this recommendation.

The Government does not favour a sunset clause and, in the light of the response to Recommendation 18, it would be inappropriate to agree to Recommendation 19 because there is no certainty that the review, and Government consideration and implementation action, will have been completed within this timeframe.

The Government has, however, committed to reviewing the operation of these provisions after two years.

RECOMMENDATION 20

The Committee recommends that Treasury make the submissions it receives on the draft due diligence defence publicly available.

Response

The Government accepts this recommendation.

The submissions are available on the Treasury website.

RECOMMENDATION 21

The Committee recommends that the law be amended to ensure that the voting intentions of shareholders through their proxyholder are carried out according to their instructions.

Response

The Government did not consider that the CLERP 9 Act was an appropriate vehicle to progress this recommendation, as it did not allow sufficient time for consultation and consideration. Issues surrounding proxy voting are being considered as part of the exposure draft Corporations Amendment Bill (No. 2) 2005, which the Government exposed for public consultation on 7 February 2005.

RECOMMENDATION 22

The Committee recommends that the provisions governing voting at meetings be reviewed by CAMAC with a focus on the matters that have been raised during the inquiry but which the PJC has not examined in depth, including the disclosure of voting —numbers for, against and abstentions on each resolution before the meeting.

Response

The Government does not accept this recommendation.

Issues surrounding proxy voting, including the disclosure of voting, are being considered in the context of the exposure draft Corporations Amendment Bill (No. 2) 2005 (see Recommendation 21 above).

RECOMMENDATION 23

The Committee recommends that, as best practice, institutional investors:

- include a discussion of their voting policies in their annual report which includes how they manage conflicts of interest in regard to their investments.
- disclose their voting record in the annual report.

Response

The Government agrees that these issues are best dealt with through industry self-regulation. Industry guidelines, such as those issued by the Investment and Financial Services Association (IFSA) and the Association of Superannuation Funds of Australia (ASFA), are flexible enough to ensure improved disclosure without imposing unnecessary compliance costs.

The success of this approach is demonstrated by a recent IFSA survey *(Shareholder Activism Among Fund Managers: Policy and Practice, 2003),* which was verified by KPMG and found that 94 per cent of IFSA members have a formal voting policy.

Industry guidelines are currently moving to improve disclosure of voting record. IFSA recently released guidelines, which require disclosure of an aggregate summary of

voting records. This is preferable to requiring disclosure of every resolution that an institutional investor may vote on. This approach would be costly to compile and unlikely to be of any use or comprehensible to retail members.

RECOMMENDATION 24

The Committee recommends that the 100 member rule for the requisitioning of a general meeting be removed from section 249D of the Corporations Act.

Response

The Government did not consider that the CLERP 9 Act was an appropriate vehicle to progress this recommendation, as it did not allow sufficient time for consultation and consideration. The exposure draft Corporations Amendment Bill (No.2) 2005 proposes to remove the 100 member rule from section 249D of the Corporations Act. The draft Bill was exposed for public consultation on 7 February 2005 and submissions will be accepted on proposals up until 1 April 2005.

RECOMMENDATION 25

The Committee recommends that the Government examine carefully ASIC's submission to Treasury and its surveillance report on research analyst independence with a view to amending the provisions on managing conflicts of interest to provide clearer direction on circumstances that must be avoided and activities that must not be undertaken because of conflicts of interest.

Response

The Government does not accept this recommendation.

The CLERP 9 Act inserted an additional licensing requirement on financial services licensees to have adequate arrangements for managing conflicts of interest. The licensing requirement should ensure that there is adequate disclosure of conflicts to investors, who can then consider their impact before making investment decisions. This requirement takes effect from 1 January 2005 and will be monitored by ASIC.

On 30 August 2004, ASIC released Policy Statement 181 *Licensing: Managing conflicts of interest*, which provides guidance on the steps that ASIC expects licensees to take in order to comply with the licensing obligation. ASIC is currently finalising guidance on research report providers and will release this as a separate document in the near future.

The additional licensing obligation will require internal policies and procedures for preventing and addressing potential conflicts of interest that are robust and effective.

This will include ensuring that there is adequate disclosure of conflicts to investors, who can then consider their impact before making investment decisions.

It is considered that the licensing obligation to manage conflicts, along with ASIC guidance, should be sufficient to deal with any analyst conflicts of interest without the need to expressly prohibit trading by an analyst, or mandating disclosure in analyst research reports of their remuneration, interest or associations.

RECOMMENDATION 26

The Committee recommends that provisions be inserted in the Corporations Act that would require the annual report of listed companies to include a discussion of the board's policy on making political donations.

Response

The Government does not accept this recommendation.

Issues regarding political donations would be more appropriately regulated by the current electoral legislative framework (the *Commonwealth Electoral Act 1918*) rather than the Corporations Act.

Information regarding political donations by companies is already publicly available from the Australian Electoral Commission.

The decision by a company to donate money to political parties, or to any recipient, is one of a commercial nature. Unless the amount to be donated is of such a scale that it may be classified as an extraordinary transaction, it will generally not be a matter for the shareholders of the company, but rather a matter for the company's management.

RECOMMENDATION 27

The Committee recommends that the Government reinstate in the Act the requirement for listed companies to keep a public register of notices of beneficial ownership.

Response

The Government accepts this recommendation.

The PJC proposal involves reinstating a provision (as closely as possible) that was in the Corporations Law until 1996 (and before that in the *Companies ([name of State]) Code*), which required listed companies to include responses they receive to tracing notices in a public register. That provision was repealed by the *First Corporate Law Simplification Act 1995* on the basis that the information was available from other sources, which have subsequently discontinued providing the information.

Reinserting this provision will not require the listed company or responsible entity to seek any further information (since it relates only to material already collected) and a transition period of six months is intended to give adequate time to establish the register.

This recommendation was implemented by Government amendments moved to the Bill. The relevant provisions commenced on 1 January 2005.

PART 2 – FINANCIAL REPORTING AND AUDIT REFORM

RECOMMENDATION 1

The Committee recommends that the Chief Executive Officer (CEO) and Chief Finance Officer (CFO) sign-off requirement should be amended to accommodate practical contingencies and allow for the CEO's and CFO's reasonable reliance on information provided by others when making the certification.

Response

The Government does not accept this recommendation.

It is considered that the present formulation of the requirement is appropriate and that there is no need for an amendment along the lines suggested by the Committee.

To comply with the CEO/CFO sign-off requirement, it is expected that the officers occupying these positions will undertake the level of "due diligence" needed to enable them to sign the declaration to the directors. This approach is in keeping with that adopted in the ASX Corporate Governance Council guidelines.

RECOMMENDATION 2

The Committee draws the Government's attention to the apparent inconsistency between the proposed Operating and Financial Review requirements, concise reports and AASB 1039 and recommends that the necessary amendments be made to avoid a duplication of requirements.

Response

The Government notes that the AASB announced in December 2004 that it intends to exempt listed companies from providing discussion and analysis information pursuant to AASB 1039.

RECOMMENDATION 3

The Committee recommends that where alternative accounting treatments are possible in an accounting standard, and where the alternative/s not selected could have resulted in the company recording a loss for the financial year, or substantial losses rather than gains, or have materially affected its solvency, then the reason for the choice of the more favourable alternative over the less favourable alternative must be disclosed by the external auditor.

Response

The Government does not accept this recommendation.

Disclosure of alternative accounting treatments has the potential to inject a significant degree of complexity into financial reports and has the danger of losing the key message to shareholders.

The Government notes that AASB 101 *Presentation of Financial Statements* will require the preparers of financial reports to disclose key decisions that are fundamental to the accounts. While these disclosures might not be as detailed as those envisaged by the Committee, they will be included in the financial statements, thus making the directors responsible for them, and they will be subject to audit, thus providing an independent assessment of the directors' explanations.

RECOMMENDATION 4

The Committee recommends that the Bill should insert a definition of "true and fair view" into the *Corporations Act 2001* to clarify that its purpose is to ensure that the financial reports of a disclosing entity or consolidated entity represent a view that users of the reports (including investors, shareholders and creditors) would reasonably require to make an informed assessment of matters such as investment in the entity or the transaction of business with the entity.

Response

The Government does not accept this recommendation.

In the area of financial reporting, the expression "true and fair view" is now regarded as a term of art.

The need for a definition of the expression has been considered on a number of occasions over an extended period of time. However, there has generally been a lack of agreement on the scope of the definition.

In addition, the inclusion of a unique Australian definition of the expression (other jurisdictions also use equivalent expressions) could result in international accounting standards applying differently in Australia to the way they apply in other jurisdictions.

RECOMMENDATION 5

The Committee recommends that sections 297 and 305 of the Corporations Act should be amended:

- to provide that, in undertaking the assessment of a true and fair view, directors must consider the objectives contained in subsection 224(a) of the ASIC Act and must include a statement in the financial report that they have done so;

- to delete the footnote that states: If the financial statements and notes prepared in compliance with the accounting standards would not give a true and fair view, additional information must be included in the notes to the financial statements under paragraph 295(3)(c);

- to add new subsections for the following:

  - In the case of conflict between sections 296 (compliance with accounting standards) and 297 (true and fair view), the notes to the financial statements must indicate why, in the opinion of the directors, compliance with the accounting standards would not give a true and fair view of the financial performance and position of the company;

– The notes to the financial statements must include a reconciliation to provide additional information necessary to give a true and fair view.

Response

The Government accepts the substance of this recommendation, and amended the CLERP 9 Bill prior to its passage through the Parliament.

RECOMMENDATION 6

The Committee recommends that the Government explore ways in which the administrative functions and statutory obligations of the Australian Accounting Standards Board and the Auditing & Assurance Standards Board can be managed so as to avoid duplication of costs and effort.

Response

The Government accepts the general intent of this recommendation.

The need to integrate the administrative functions and statutory obligations of the Australian Accounting Standards Board (AASB) and the Auditing and Assurance Standards Board (AUASB) to the maximum extent possible and to provide for the interchange of the technical staff has been noted.

Initially, it is envisaged that the administrative staff of the AASB will also provide administrative support for the AUASB. It is also envisaged that the statutory reporting obligations of the AUASB will be covered by the preparation of a single report covering the FRC, AASB and AUASB.

More comprehensive changes to the existing administrative structures should be considered once the AASB has fully completed the transition to international accounting standards and the AUASB has reviewed the profession's auditing standards and remade them as disallowable instruments.

Any changes to the existing administrative structures should be undertaken in consultation with the Chairmen of the FRC, AASB and AUASB and representatives of other interested stakeholder groups.

RECOMMENDATION 7

The Committee recommends that the Government explore ways of combining the administrative and technical teams of the Australian Accounting Standards Board and the Auditing & Assurance Standards Board to provide a working environment that meets the expectations of suitably qualified professionals.

Response

See the response to Recommendation 6.

RECOMMENDATION 8

The Committee recommends that Note 2 be deleted from proposed subsection 227B(1) of CLERP 9 so that the Auditing & Assurance Standards Board will not be required to divert resources on unnecessary work.

Response

The Government does not accept this recommendation.

The Government considers that the legislative framework for formulating and making auditing standards, which is based on the framework for making accounting standards, is appropriate.

It is not clear how removal of Note 2 will overcome the need for the AUASB "to divert resources on unnecessary work", as the note is a "sign-post" pointing to the provisions establishing the framework within which the AUASB is to formulate and make auditing standards.

RECOMMENDATION 9

The Committee recommends that the *Australian Securities and Investments Commission Act 2001* should be amended to ensure that the Financial Reporting Council:

- is required to conduct its meetings in public. This should not prevent meetings occasionally being held as closed proceedings where the matters are of such sensitivity that that is appropriate.

- conducts public consultation on proposals within its functions and responsibilities that have a public interest element.

Response

The Government does not accept this recommendation.

The Government does not consider that legislation should mandate that the FRC hold its meetings in public. The issue of whether the FRC should conduct its meetings in public is a matter for the FRC to determine.

The Council has already taken steps – such as providing detailed bulletins on the FRC website – to increase transparency. Where possible, FRC bulletins are posted on the FRC website within three business days following the FRC meeting.

The FRC is currently conducting a review of its operations, including the need to increase the transparency of its operations, and the outcome of this review is scheduled for discussion at the Council's February 2005 meeting.

RECOMMENDATION 10

The Committee recommends that urgent provision should be made for an adequately staffed and funded secretariat, independent of the Department of the Treasury and other Government departments, for the Financial Reporting Council.

Response

The Government does not accept this recommendation.

The FRC's work program over the next few years is very full and it would be desirable to consider this issue once the work program has been bedded down.

The establishment by the FRC of its own dedicated Secretariat would require the FRC to be reconstituted as a body corporate. This change of status would be needed to enable the FRC to employ its own staff, engage is own consultants and operate its own bank account. These are significant changes and entail corresponding reporting obligations which would need to be considered.

RECOMMENDATION 11

The Committee recommends that the *Australian Securities and Investments Commission Act 2001* should be amended so that members appointed to the Financial Reporting Council must have knowledge of, or experience in, business, accounting, auditing or law; or can demonstrate a sufficient involvement in the investment community or interest in corporate reporting to bring a user's perspective to the Council.

Response

The Government does not accept this recommendation.

The ASIC Act does not prescribe qualifications for members of the FRC. This is in keeping with the Government's view that the FRC is primarily a representative body.

The members of the FRC are drawn from nominations from:

- The professional accounting bodies;
- Users, preparers and analysts of financial statements;
- Governments and public sector entities; and
- Bodies, such as the ASIC and the Australian Stock Exchange.

Notwithstanding the absence of legislative requirements concerning qualifications for members of the FRC, when the Government is making appointments to the FRC, the Government has regard to the skills of individuals nominated by the stakeholder groups and the contribution each individual could make to the work of the Council.

RECOMMENDATION 12

The Committee recommends that the membership mix of the Financial Reporting Council should be evenly weighted between preparers of financial statements; accountants and auditors; and business and public interest representatives and users.

Response

The Government does not accept this recommendation.

The need for changes to the membership structure of the FRC will be considered by the Government after the new functions introduced by the CLERP 9 Act are fully implemented.

RECOMMENDATION 13

The Committee recommends that the Government should confirm that it will provide the funding for the Financial Reporting Council, the Australian Accounting Standards Board and the Auditing & Assurance Standards Board on a permanent basis beyond 2004-05.

Response

The 2004-05 Budget indicated that funding will be reviewed in the 2005-06 Budget context.

Additional funding of $4.8 million per annum for 2005-06 to 2007-08 has been set aside in the contingency reserve pending further consideration being given to the ongoing funding of the FRC and the need for any cost recovery beyond the current Budget year.

RECOMMENDATION 14

The Committee recommends that the Bill should be amended so that the Financial Reporting Council will not have a function of 'determining the Auditing & Assurance Standards Board's (AUASB's) broad strategic direction'. Instead, the Financial Reporting Council should produce and make public its critique of the AUASB's strategic direction as part of the Financial Reporting Council's oversight function.

Response

The Government does not accept this recommendation.

The purpose of the FRC is to provide practical business direction to the technical accounting and auditing standard setters.

Users and preparers of financial reports may efficiently critique the strategic direction of the AUASB on their own. The FRC provides a focal point for stakeholders in accounting/auditing standard setting to be directly involved in the priorities of the accounting/auditing standard setter.

Oversight of the AUASB by the FRC has been modelled on the FRC's oversight of the AASB. The strategic oversight function in respect of the AASB was introduced in the *Corporate Law Economic Reform Program Act 1999* (CLERP Act 1999).

Continuing to allow strategic directions issued to the AUASB by the FRC will ensure its long term operational planning is taken from a broad public interest perspective.

RECOMMENDATION 15

The Committee recommends that the Bill should be amended so that the Financial Reporting Council will not have a function of 'approving' the AUASB's priorities, business plans and budgets. Instead, the Financial Reporting Council should produce and make public its critique of the AUASB's priorities, business plans and budgets.

Response

The Government does not accept this recommendation.

This is out of step with overseas practice (for example, Canadian oversight bodies have similar functions to those proposed for the FRC).

The Australian National Audit Office provides statutory and performance audits of Government instrumentalities. It is unnecessary for the FRC to duplicate this role.

Under the *Commonwealth Authorities and Companies Act 1997*, the FRC's members are the board of directors of the AUASB. The FRC cannot function as a board if it does not have authority over the priorities, business plan and budget of that body.

RECOMMENDATION 16

The Committee recommends that the *Australian Securities and Investments Commission Act 2001* should be amended so that the Financial Reporting Council will no longer have a function of 'determining the Australian Accounting Standards Board's (AASB's) broad strategic direction'. Instead, the Financial Reporting Council should produce and make public its critique of the AASB's strategic direction as part of the Financial Reporting Council's oversight function.

Response

The Government does not accept this recommendation.

The purpose of the FRC is to provide practical business direction to the technical accounting and auditing accounting standard setters.

Users and preparers of financial reports may efficiently critique strategic direction of the AASB on their own. The FRC provides a focal point for stakeholders in accounting standard setting to be directly involved in the priorities of the accounting standard setter.

The strategic oversight function in respect of the AASB was introduced in the CLERP Act 1999.

Continuing to allow strategic directions issued to the AASB by the FRC will ensure its long term operational planning is taken from a broad public interest perspective.

RECOMMENDATION 17

The Committee recommends that the *Australian Securities and Investments Commission Act 2001* should be amended so that the Financial Reporting Council will no longer have a function of 'approving' the Australian Accounting Standards Board's (AASB's) priorities, business plans and budgets. Instead the Financial Reporting Council should produce and make public its critique of the AASB's priorities, business plans and budgets.

Response

The Government does not accept this recommendation.

This is out of step with overseas practice (for example, Canadian oversight bodies have similar functions to those proposed for the FRC).

The Australian National Audit Office provides statutory and performance audits of Government instrumentalities. It is unnecessary for the FRC to duplicate this role.

Under the *Commonwealth Authorities and Companies Act 1997*, the FRC's members are the board of directors of the AASB. The FRC cannot function as a board if it does not have authority over the priorities, business plan and budget of that body.

RECOMMENDATION 18

The Committee recommends that the professional accounting bodies should liaise with the Australian Securities and Investments Commission (ASIC) to ensure that their complaints-handling procedures meet benchmarks which ASIC considers are necessary for effective complaints handling.

Response

This is a matter for ASIC and the professional accounting bodies.

The FRC will have a new responsibility to monitor disciplinary procedures of the professional accounting bodies to the extent they apply to auditors and advise Government.

If there are concerns about the practices of the professional bodies regarding their disciplinary arrangements there is always the scope for the FRC to advise the Government or the bodies themselves on how those arrangements could be changed or improved.

ASIC has its own powers to prosecute auditors for breaches of the Corporations Act. These powers include referring matters to the Companies Auditors and Liquidators Disciplinary Board.

RECOMMENDATION 19

The Committee recommends that the Bill should be amended to ensure that the new responsibilities for the Financial Reporting Council should not come into force until:

- the Financial Reporting Council has an adequately staffed and funded secretariat that is independent of the Department of the Treasury and other Government departments; and

- the Government confirms that the Financial Reporting Council will be government-funded beyond 2004-05.

Response

The Government does not accept this recommendation.

The Commonwealth Government contributes $2.5 million per annum to the costs of Australian accounting standard setting. In addition, the 2003-04 Budget allocated an additional $4 million over 4 years. The 2004-05 Budget committed $3.4 million in the current Budget year. Ongoing funding for the FRC will be considered in the 2005-06 Budget, however contingency funding until 2007-08 of $4.8 million per annum for the FRC has been set aside if required.

The current Budget funding arrangements are sufficient for the FRC, AASB and AUASB to carry out their functions pursuant to the Corporations Act and the ASIC Act (as amended by the CLERP 9 Act).

The location and composition of the FRC Secretariat are matters that are appropriately dealt with after the FRC has had an opportunity to fully implement its expanded role under the CLERP 9 Act.

Legislative changes would be required to establish the FRC as a body able to engage its own staff. Any delay in implementation of the FRC's role in relation to auditor independence or Auditing Standard setting is undesirable.

The FRC's current work program is extensive; any delays due to restructuring may have a negative impact on the FRC's access to international networks and relationships with stakeholders.

RECOMMENDATION 20

The Committee recommends that an auditor attending the annual general meeting of an entity should be required to answer shareholders' reasonable questions about:

- critical accounting policies adopted by management and the basis upon which the financial statements were prepared; and

- the auditor's independence.

Response

The Government partially accepts this recommendation.

During debate in the Senate, the Government agreed to amendments to subsection 250T(1) moved by the Australian Democrats which requires the chairman of the AGM to allow shareholders to ask the auditor questions "relevant to the conduct of the audit, the preparation and content of the auditor's report, the accounting policies adopted by the company in relation to the preparation of the financial statements, and the independence of the auditor in relation to the conduct of the audit". The new paragraph 250T(1)(b) also requires the chairman of the AGM to allow the auditor a reasonable opportunity to answer written questions submitted to the same effect under proposed section 250PA.

The provisions do not place a direct obligation on the auditor of a company but instead maintain the current framework whereby the obligation is placed on the chairman of the AGM to allow the auditor to answer reasonable questions about the subject matter.

RECOMMENDATION 21

The Committee recommends that the chairman of an entity should allow shareholders a reasonable opportunity to ask the auditor reasonable questions about:

- critical accounting policies adopted by management and the basis upon which the financial statements were prepared; and
- the auditor's independence.

Response

The Government accepts this recommendation.

This recommendation was incorporated into the legislation by an amendment to subsection 250T(1) moved by the Australian Democrats during debate in the Senate. The amendment requires the chairman of the AGM to allow shareholders to ask the auditor questions "relevant to the conduct of the audit, the preparation and content of the auditor's report, the accounting policies adopted by the company in relation to the preparation of the financial statements, and the independence of the auditor in relation to the conduct of the audit".

RECOMMENDATION 22

The Committee recommends that an auditor attending an annual general meeting should be permitted to table written answers to shareholders' questions which have been lodged in accordance with proposed section 250PA of the Bill if the auditor has prepared answers in this form.

Response

The Government does not accept this recommendation.

The Government does not consider that a legislative amendment is required to implement this proposal. The Corporations Act does not prevent the auditor from tabling written answers to shareholders' questions which have been lodged in accordance with section 250PA.

RECOMMENDATION 23

The Committee recommends the deletion of the provision in the Bill (proposed section 324CK) prohibiting more than one former audit firm partner or audit company director from becoming an officer of the audited body.

Response

The Government does not accept this recommendation.

Section 324CK implements the recommendation of the HIH Royal Commission that a prohibition be introduced preventing more than one former partner of an audit firm, or director of an audit company, at any time becoming an officer of an audit client while the audit firm or audit company is the auditor of the client.

The Government considers that the multiple former audit partners issue was a major failing in the HIH context which the Royal Commission concluded had led to the perception that the independence of the auditors of HIH was compromised.

RECOMMENDATION 24

The Committee recommends that purposive definitions for "lead auditor" and "review auditor" should be adopted to reflect the rationale underlying the rotation requirements. In particular, the Committee recommends that the definition of "review auditor" should be amended to ensure that a rotation obligation will not apply to a review auditor in circumstances where:

- the review auditor performs a merely technical role in the audit; and
- the review auditor's contact with the audit client could not be regarded as material to the day-to-day conduct of the audit as a whole.

Response

The Government does not accept this recommendation.

The extent to which a "review auditor" is involved in an audit will vary greatly from case to case and determining where it constitutes "a merely technical role" or where contact with the client is not "material" may be difficult to determine in practice.

Review auditors are a critical part of the audit process and there is the potential for conflicts of interest to arise between the review auditor and the client which may give rise to concerns about independence. The HIH Royal Commission recommended that the rotation provisions be applied not only to the lead and review partners but also to key senior audit personnel. The Act does not extend the rotation requirements to key senior audit personnel due to concerns that it could effectively require audit firm rotation in some circumstances. However the rotation of the review as well as the lead auditor is appropriate as it is these parties who are responsible for forming the final opinion on the financial statements of the client.

ASIC will have the ability to defer the rotation requirement from five to up to seven years in cases where the rotation requirements are onerous on a company or auditor.

RECOMMENDATION 25

The Committee recommends that the Bill should be amended so that the rotation requirements only apply to the top 300 listed entities by market capitalisation. In arriving at this cut-off point, the Committee took into account the various suggestions made by witnesses and the statistics provided by The Institute of Chartered Accountants in Australia on the auditing market in Australia.

Response

The Government does not accept this recommendation.

Most of the auditor independence requirements are to apply to all listed companies on the basis that such companies are seeking capital from the general public.

Limiting the proposal to the top 300 companies is somewhat arbitrary and there would be "boundary issues" in dealing with companies that move in and out of the top 300 while a particular auditor had responsibility for the audit. The complexity of such a rule would make it difficult to apply in practice.

RECOMMENDATION 26

The Committee recommends that amendments should be made to the Bill to accommodate short-term postponement of rotation by the Australian Securities and Investments Commission if this is not already provided for elsewhere in the *Corporations Act 2001*.

Response

The Government does not accept this recommendation.

Subsection 342A of the CLERP 9 Act allows ASIC to postpone the rotation requirements so that rotation will be required after six or seven rather than five successive years, where the auditor or the company makes a written application to ASIC.

RECOMMENDATION 27

The Committee recommends that the relevant provisions with respect to the registration of an authorised company auditor be amended to remove the Australian Securities and Investments Commission's power to impose restrictions and conditions retrospectively and to limit the exercise of its discretion in this regard by the prescription of appropriate criteria.

Response

The Government does not accept this recommendation.

Section 1299D of the Corporations Act provides that ASIC may impose conditions on the registration of an authorised audit company at the time the company is registered or subsequent to registration. Any conditions imposed by ASIC on an authorised audit company would only operate prospectively.

It is important that ASIC should have the power to impose conditions on an audit company's registration to ensure that ASIC can fulfil its regulatory responsibilities. ASIC's flexibility to impose conditions should not be fettered, having regard to the wide range of circumstances that may apply.

RECOMMENDATION 28

The Committee recommends that:

- Some of the members from the accounting profession should be appointed to the Companies Auditors and Liquidators Disciplinary Board (CALDB) on an individual basis rather than as representatives of a professional association;
- Auditors and/or liquidators should be included in the selections from the accounting profession; and
- Consideration should be given to including users of financial reports appointed from the public, private and not-for-profit sectors.

Response

The Government generally does not accept this recommendation.

The CLERP 9 Act amendments looked to address concerns about the CALDB's operational capacity and perceived independence from the accounting profession by expanding the composition of the Board.

In relation to the proposed structure of appointments involving members of the accounting profession, the current framework already existing within the ASIC Act is generally being retained.

It is understood that many auditors and liquidators would be members of the two primary professional accounting bodies and so would be eligible to be chosen as nominees of those bodies.

Additionally, the CLERP 9 Act's amendments to the CALDB provisions, which provide for the appointment of business members, would be broad enough to allow for the appointment of users of financial reports where appropriate.

RECOMMENDATION 29

The Committee recommends that the role of the Financial Reporting Panel (FRP) should be restricted to making determinations on financial reports after their publication. The Committee does not support proposals for the FRP to have a "pre-publication" jurisdiction.

Response

The Government accepts this recommendation. This position is currently reflected in the CLERP 9 Act.

RECOMMENDATION 30

The Committee recommends that lodging entities should be able to refer matters to the FRP without having to obtain the consent of the ASIC.

In particular, the lodging entity should be subject to the same notification procedures (amended as appropriate) that presently apply when ASIC refers a matter to the FRP.

Response

The Government does not accept this recommendation.

Given that a company's interests will be affected by a decision of the FRP and in light of stakeholders' submissions, the draft CLERP 9 Bill was amended to provide that once ASIC has informed a company that its financial report does not comply with the financial reporting requirements, the company may, with ASIC's consent, refer the matter to the FRP.

Requiring ASIC's consent for a referral will prevent vexatious referrals and ensure that the FRP is not used to frustrate or delay the regulator's ability to instigate legal proceedings where appropriate.

RECOMMENDATION 31

The Committee recommends that CLERP 9 should clarify that the determinations of the FRP should not have a wider application as precedents for the interpretation of financial reporting requirements.

Response

The Government does not accept this recommendation.

The FRP will consider specific matters referred to it on a case by case basis. While the determinations of the FRP will not act as binding precedents for the interpretation of financial reporting requirements, it is expected that the FRP's determinations will provide useful guidance for the application of accounting standards at a domestic level. Further, in making its determinations, it is expected that the FRP will have regard to any interpretations issued by the International Financial Reporting Interpretations Committee.

RECOMMENDATION 32

The Committee recommends that an auditor should be entitled to attend the proceedings of the FRP if the financial reports audited by that auditor are in dispute. The Committee recommends that the auditor should have rights to be notified of a referral, to have its response included with the ASIC's referral and to make submissions to the FRP.

Response

The Government does not accept this recommendation.

The primary purpose of the FRP is to resolve disputes between ASIC and companies concerning the application of accounting standards in companies' financial reports. Given that it is these entities that are the parties to the dispute, it is appropriate that companies be notified of a referral and be permitted to make submissions in FRP proceedings. It would, however, be open to companies to request the attendance of their auditors at proceedings.

RECOMMENDATION 33

The Committee recommends that the Government should amend CLERP 9 to require the FRP to provide a copy of its determinations including reasons for these determinations to the AASB.

Response

The Government does not accept this recommendation.

The CLERP 9 Act states that the FRP must provide its report to ASIC and the company, who are the relevant parties to FRP deliberations. ASIC must then take reasonable steps to publicise the FRP's report. Additionally, if the disputed financial report is that of a listed company or listed registered scheme, the FRP must also provide its report to the relevant market operator. It is considered that these requirements in the Act provide an adequate avenue for relevant stakeholders to be apprised of the FRP's decisions.

RECOMMENDATION 34

The Committee recommends that the provisions in CLERP 9 under which auditing standards will be disallowable instruments should not be proceeded with until a thorough review determines how legislative backing can be achieved without threatening international convergence and audit quality. Once these issues are resolved, the Committee would support the conferral of legislative backing on auditing standards.

Response

The Government does not accept this recommendation.

The Government considers that this initiative will significantly lift the rigour of auditing in Australia. The FRC is currently considering the strategic direction of audit standard setting and in this context will consider international convergence issues.