

26 April 2007

Mr Peter Hallahan
Secretary
Senate Standing Committee on Economics
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Parliament House
Canberra ACT 2600

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Dear Mr Hallahan

Re: Inquiry into Private Equity Investment

The National Institute of Accountants (NIA), an Australian professional accounting body representing more than 14,000 accountants, is pleased to provide the Senate Standing Committee on Economics with issues that we believe require further consideration given the increased profile of private equity investment in our economy.

Our submission is focused on the issue of appropriate regulatory responses to the growth in activity of private equity, specifically to do with the issue of financial reporting and disclosure.

We submit our principle concern as being the lower degree of transparency in terms public accountability that may result when an economically significant entity shifts from a status of being either proprietary or public company into another corporate structure such as a trust. We believe a lower degree of transparency is untenable because it runs against the core principles of financial reporting that have existed within our accounting framework for many years. It is our view that the underlying principles embedded within the Statement of Accounting Concepts (SAC) on the definition of the reporting entity ought to be the basis for making decisions on which entities ought to report rather than their ownership structure, whether it be a proprietary company, public company, partnership or trust. The reporting entity concept is centred around the public interest in an entity's activities because of what it does not necessarily whether it is owned by three people or listed on a stock exchange.

This submission does not argue that legislators should hamper the economic activity but rather consider the existing reporting requirements that operate under the *Corporations Act 2001* and whether entities in specific industries deemed to be of a great public interest should be required to report in some way. It is our preference that the parliament determine what types of entities should be regarded as being economically significant given the range of their activities and determine an appropriate mechanism for them to prepare and lodge financial statements and ensure they are freely available to the public. Options for this are discussed below.

For the purpose of this discussion we will use the illustration of a listed entity converting into a private equity structure.

Existing reporting requirements

A listed public company is required to prepare a range of documents for lodgement with the corporate regulator, the Australian Securities and Investments Commission (ASIC), and the securities market, the Australian Securities Exchange (ASX). These reports are available to the general community via public forums such as the web site of the ASX, company web sites and a user pays service that is provided by the ASIC. Information is available to all of the possible stakeholders of an entity relating to its financial performance and financial position as well as other details of governance that have the ultimate goal of ensuring confidence in a business with a significant role in the Australian economy. The respective entity can then have its operations and its governance judged by the broader marketplace. This reporting is based solely on the nature of the ownership of an entity rather than the substance of an entity's activities.

The ownership focus of our legislated reporting requirements creates several challenges when an entity moves from being a publicly listed entity to one with private equity investors. It is the NIA's view that the level of public accountability of certain entities is not diminished by the change in ownership structure. The level of information about the ongoing activities of an entity could reduce and impact adversely on the trust the community has in the entity concerned. It is in the community interest to ensure that economically significant entities such as utilities and entities engaged in significant activity such as transport, for example, be required to report publicly so as to ensure a high degree of transparency exists and most, if not all, stakeholders are given the opportunity to have confidence in the entities concerned.

It is not lost on us that there are individuals or entities within the community that have been seeking for some time to avoid a public reporting obligation for their operations. A private equity structure is one means by which individuals can do so. There is a need for us as a community to ensure that entities of importance to our economy report to an appropriate authority irrespective of whether it is an industry based registrar or the ASIC or publicly available via a web site.

We would consider it sufficient for such entities to be required to prepare financial statements in accordance with accounting standards as well as an overview of their operations. While we are conscious of the intense lobbying by some commentators for mandatory reporting on sustainability or environmental issues we consider this to be an area where the boards and managements of entities should use their own judgment. The market will decide whether the entities have provided sufficient disclosure on the ways various elements of its operations impact on the community.

There is an important difference between private equity-held entities and listed companies. We would see no need for the community to be given a detailed breakdown of executive remuneration such as the breakdown presently given by listed entities. In our view the accountability of private equity reporter would not extend to a level beyond specifying an aggregate total of employee benefits.

Options

This committee must as part of its consideration on this matter reflect on the appropriate accountabilities of entities that have private equity investors. We consider there are two options the committee may wish to consider on reporting issues. The options to be considered are:

- Amendment of the *Corporations Act 2001* to provide Treasury with the authority to issue a regulation that lists specific industries deemed to be economically significant that imposes an obligation to prepare, have audited and lodge financial statements in accordance with accounting standards and other disclosure requirements deemed appropriate by legislators irrespective of ownership structure or size; or,
- Specific additions to industry-based legislation to ensure that all players in an industry are obliged to lodge audited financial statements in accordance with accounting standards and other disclosure requirements deemed appropriate by legislators irrespective of ownership structure or size.

It is our view implementation of either of these suggestions would ensure the maintenance of a level of transparency in circumstances where the community might fear a lower level of information being available.

We would be pleased to present before the committee at any hearings it has on this topic.

Kindest Regards

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National Institute of Accountants