

Corporations Law Simplification program

Accounts and Audit  
Proposal for Simplification

Task Force  
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Simplification Task Force  
Attorney General's Department  
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# ACCOUNTS AND AUDIT PROPOSAL FOR SIMPLIFICATION

## Current problems

There are a number of problems with the current accounts and audit provisions of the Law (Part 3.6 and Divisions 2 and 3 of Part 3.7).

### *Uneven quality of financial information*

The Law uses 2 main mechanisms to try to ensure the reliability of accounts:

- compliance with accounting standards, but currently accounting standards apply only to 'reporting entities'
- auditing of accounts, but currently only some entities are required to have their accounts audited.

### *Unsatisfactory boundary between Law and standards*

The Law generally leaves the content of accounts to be determined in accordance with accounting standards made by the Australian Accounting Standards Board ('AASB'). In a number of areas, however, the Law contains specific accounting rules (eg section 191 concerning the issue of shares at a premium, section 294 concerning asset valuations and section 1058 relating to borrowing corporations). This can lead to different and even inconsistent approaches. It can also impede the development of new standards to meet emerging needs.

### *Special rules and exemptions*

Although the Law establishes a general set of requirements for accounts, it also introduces special rules for:

- banks
- life insurance companies borrowing corporations
- property trusts
- other prescribed interest schemes.

These special rules make it harder for users to draw comparisons between different entities.

### *Inadequate approach to prescribed interests/collective investments*

The rules for the accounts of many prescribed interest schemes are quite different from the rules that apply to companies. (Under reforms recently announced by the Attorney-General, the concept of a 'prescribed interest' will shortly be replaced by the concept of a 'collective investment'.)

Prescribed interest schemes with more than 100 members are generally regulated as disclosing entities. These schemes must prepare accounts which comply with Part 3.6. However, schemes with fewer than 100 members need only prepare a statement of accounts, which does not have to comply with Part 3.6.

### *Out of date information*

Most public companies can lodge accounts up to 6 months after the end of the financial year concerned. This means that the financial information may be out of date before some users are able to access it.

### *Too many defined terms*

The accounts and audit provisions use too many defined terms. Many of these terms are uninformative or even confusing. For example, section 295 defines a 'chief entity' to be a parent entity in an economic entity that is a reporting entity.

### *Repetition of similar rules*

The accounts and audit provisions are difficult for users because they keep repeating similar obligations, sometimes with only minor variations. For example, sections 293, 293A, 295B, 323A and 323D can all require a company to prepare a balance sheet.

### *Not meeting the needs of members*

Some of the detailed information required in annual reports can be unhelpful and even confusing for members. Annual reports also often lack the clear picture of the company's overall position and prospects which members are looking for.

## **The proposal**

The proposed changes will:

- require all public companies, large proprietary companies and regulated collective investment schemes to lodge annual accounts with the ASC
- require all accounts which have to be lodged:
  - to be audited
  - to comply with accounting standards
- wind back special rules and exemptions for particular types of entities
- reduce the number of defined terms in the Law
- take accounting rules out of the Law and put them in the accounting standards
- encourage directors' reports to focus on the entity's financial position and changes in that position
- encourage reporting to shareholders to focus on essential financial information, with more detailed disclosures available on request.

## **Benefits of the proposal**

The proposal will result in:

- more comparable and reliable accounts
- easier to understand obligations
- annual reports being more useful for shareholders.

## THE PROPOSAL

Proposal	Issues for consideration
<p><b>Accounting records</b></p> <p>1. Accounting records will have to be kept for 7 years for every:</p> <ul style="list-style-type: none"><li>• disclosing entity</li><li>• company</li><li>• collective investment scheme regulated by the Corporations Law. (The responsible entity which manages the scheme will have this obligation.)</li></ul> <p>2. The Court will have power to order inspection of books (including accounting records) on behalf of members by any suitable person, not just a legal practitioner or an auditor.</p> <p><b>Accounts</b></p> <p>3. Accounts will have to be prepared for every:</p> <ul style="list-style-type: none"><li>• disclosing entity</li><li>• public company</li><li>• large proprietary company</li><li>• collective investment scheme regulated by the Corporations Law (the responsible entity will have this obligation).</li></ul> <p>4. Under the First Corporate Law Simplification Bill, small proprietary companies will have to prepare annual accounts if they are:</p> <ul style="list-style-type: none"><li>• controlled by a foreign company</li><li>• required by shareholders holding 5% of the company's voting shares</li><li>• requested by the ASC.</li></ul>	

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<p><b>Consolidated accounts</b></p> <p>5. A company which controls other entities will have to prepare annual accounts for the entity itself and for the whole group. This rule will not prevent the use of equity accounting in appropriate situations.</p> <p><b>Half-year accounts</b></p> <p>6. As at present, disclosing entities will also have to prepare half-year accounts. If the entity controls another entity, it will only need to prepare consolidated half-year accounts.</p> <p><b>Contents of accounts</b></p> <p>7. Accounts will comprise:</p> <ul style="list-style-type: none"> <li>• a profit and loss statement</li> <li>• a balance sheet</li> <li>• a cash flow statement</li> <li>• notes to these 3 statements</li> <li>• additional disclosures required by the Law or the accounting standards.</li> </ul> <p><b>Accounting standards/ requirements</b></p> <p>8. All accounts required by the Corporations Law will have to comply with accounting standards (there will not be any exemptions for 'non-reporting' entities). If the accounts do not give a true and fair view, extra information will have to be included.</p>	<p>Should 'control' be defined? Should the definition in the accounting standard on consolidation (AASB 1024) be used? If not, what definition should be used?</p> <p>Are there any circumstances when an entity could be relieved of the obligation to prepare consolidated accounts? For example, would the interests of members, creditors, and others be adequately protected if the rule did not apply to:</p> <ul style="list-style-type: none"> <li>• companies which are not the parent of a group which is a reporting entity (the current rule), or</li> <li>• companies which are wholly-owned subsidiaries (the pre-1991 rule), or</li> <li>• companies which are proprietary companies, or</li> <li>• companies whose liabilities are guaranteed by some other company?</li> </ul> <p>If a company is required to prepare consolidated accounts, should it be relieved of the present obligation to prepare accounts for itself?</p> <p>Should the consolidation rules apply to a collective investment scheme which controls other entities? If so how?</p> <p>Should the AASB be able to require additional documents? Alternatively, should the definition of 'accounts' allow for additional documents to be required by regulation?</p> <p>Should the terminology used in this area be harmonised with international practice? If so, what changes should be made?</p> <p>Is the 'true and fair' test the best test for inclusion of additional information? If not, what test should be used?</p>

Proposal	Issues for consideration
<p>9. The rules under which banks and life insurance companies are exempted from some of the accounting requirements in the Law will be repealed. These exemptions will, however, be preserved until the accounting standards currently being developed for these bodies are completed.</p> <p>10. There will be no special accounting requirements or exemptions in the Law for:</p> <ul style="list-style-type: none"> <li>• borrowing corporations</li> <li>• investment companies (the other special rules for investment companies (sections 399 to 405) will also be removed).</li> <li>• property trusts</li> <li>• other prescribed interest schemes.</li> </ul> <p><b>Directors' responsibilities</b></p> <p>11. The directors will be required to prepare a report on the accounts. In the report, the directors must:</p> <ul style="list-style-type: none"> <li>• state that the accounts give a true and fair view</li> <li>• declare whether the company is solvent</li> <li>• discuss and analyse the entity's financial condition and the results of its operations.</li> </ul> <p>12. The directors will be required to lay the annual accounts before any annual general meeting.</p> <p>13. As at the present, the report on the halfyear accounts must also contain a review of operations and information about changes in the state of affairs.</p> <p><b>Audit</b></p> <p>14. Accounts (including consolidated accounts) which are required to be lodged with the ASC will have to be audited. The director's declaration about solvency will also have to be audited.</p> <p>15. As at present, an audit report for annual accounts will state whether the accounts:</p> <ul style="list-style-type: none"> <li>• comply with the Law</li> <li>• give a true and fair view of the entity's financial position.</li> </ul>	<p>Should this temporary exemption be given by regulation or by ASC class order?</p> <p>Do sections 399-405 still serve any need that has not been met by more general provisions in the Law?</p> <p>Should additional disclosures be required for property trusts or other collective investment schemes. If so, what should be required? Should these disclosures be included in the Law or left for the accounting standards?</p> <p>Should the directors also have to state anything else?</p> <p>Should the auditor be required to express an opinion on the discussion and analysis? What would be the form of this opinion? For instance, should the auditor be required to state whether the discussion and analysis is consistent with the financial statements?</p> <p>Should the Law require auditors to comply with standards made by the Auditing Standards Board? If so, what should be the sanction for failure to comply with standards?</p> <p>Should the form of an audit report be specified in the Law? If not, should it have to state anything in addition to the 2 matters mentioned here?</p>

Proposal	Issues for consideration
<p>16. As at present, the audit report for the halfyear accounts of a disclosing entity will be either:</p> <ul style="list-style-type: none"> <li>• a full audit report, as for annual accounts, or</li> <li>• a review of the accounts.</li> </ul> <p>17. The auditor must immediately notify the ASC in writing where the auditor has reasonable grounds to suspect that a contravention has occurred which cannot be adequately dealt with by commenting on the matter in the audit report or by bringing the matter to the attention of the directors.</p> <p><b>Giving annual accounts to members and the ASC</b></p> <p>18. Entities which are required to prepare annual accounts will have to send the following documents to members (unless members elect not to receive them):</p> <ul style="list-style-type: none"> <li>• the profit and loss statement</li> <li>• the balance sheet</li> <li>• the cash flow statement</li> <li>• the auditor's report</li> <li>• the directors' report.</li> </ul> <p>19. In addition, notes and disclosures will have to be sent to members where they are necessary for them to understand the financial statements and the overall position of the company.</p> <p>20. Other notes and disclosures, which provide information about the entity which is of less direct importance for members, but which nevertheless should be available on the public record, will have to be sent to members if they request it.</p> <p>21. If a member requests these additional disclosures, the entity will have to provide them within 14 days and free of charge.</p> <p>22. All these documents, including the notes and disclosures, will have to be lodged with the ASC before the following deadlines:</p> <ul style="list-style-type: none"> <li>• for disclosing entities, 90 days after the end of the entity's financial year</li> <li>• for other entities, 120 days after the end of the entity's financial year.</li> </ul>	<p>Should the auditors' obligation to notify the ASC be restricted to contravention of the accounting obligations in the Law or should it be more general as at present?</p> <p>If an entity is required to prepare both individual entity and consolidated accounts, in what circumstances should it be required to send both sets of accounts to members or only the consolidated accounts?</p> <p>Which notes and disclosures should have to be sent to members and which should only have to be lodged with the ASC?</p> <p>Are the current rules on the determination of an entity's 'financial year' (section 290) appropriate?</p>

Proposal	Issues for consideration
<p><b>Giving half year accounts to the ASC</b></p> <p>23. As at present, half year accounts will not have to be sent to members but will have to be lodged with the ASC within 75 days after the end of the entity's financial year.</p> <p><b>Penalties</b></p> <p>24. Directors will be subject to a civil penalty if they fail to take reasonable steps to comply with the obligations in the Law on accounting records and accounts.</p> <p><b>Powers of the ASC</b></p> <p>25. As at present, the ASC will be able to exempt companies from compliance with particular accounting obligations.</p> <p><b>Drafting</b></p> <p>26. In redrafting the provisions, the number of defined terms will be reduced.</p>	<p>Should any of the general class orders (for example, the class order on rounding) made by the ASC under its existing exemption powers (as opposed to industry-specific class orders) be written into the Law? If so, which orders?</p>

## **CURRENT RULES AND RECENT REFORM PROPOSALS**

### *Basic obligations for companies*

All companies must keep accounting records (section 289) and prepare annual accounts (section 292 and 293). A company which is a chief entity for a group is also obliged to prepare consolidated accounts for its group (sections 295A and 295B).

Under the First Corporate Law Simplification Bill, small proprietary companies will not have to prepare annual accounts unless requested by the ASC or members holding 5% of the company's shares.

Disclosing entities must also prepare half-year accounts (see section 111A0). Accounts have to comply with prescribed requirements (mainly contained in Schedule 5 to the Corporations Regulations) and applicable accounting standards (sections 297 and 298). Directors must also provide any additional material to ensure that the accounts give a true and fair view (section 299).

### *Review of Schedule 5*

The AASB is currently reviewing Schedule 5 of the Corporations Regulations (which contains a number of accounting obligations).

### *Directors' statements*

The directors of a company must state whether the profit and loss account and balance sheet give a true and fair view (sections 301 and 302).

### *Directors' reports*

The directors must also report on specified matters including the names of the directors, principal activities, proposed and actual dividends and directors' benefits from contracts with the company (sections 304 and 309).

### *Notes and disclosures*

There are many provisions which require notes or disclosures to be included in the accounts (including sections 307, 308 and 309 in the Law and regulation 7.12.15 (7) (b) and Schedule 5). All of these provisions will be reviewed in the course of this project.

### *Financial reporting to shareholders*

In May 1994 the Task Force released a proposal on simplification of the rules on financial reporting to shareholders. The proposal recommended that a company be able to send a concise report to shareholders and that a report with more detailed disclosures and notes be lodged with the ASC. The public submissions sent to the Task Force have provided strong support for the proposal.

### *Management discussion and analysis*

Several submissions have suggested that directors' reports do not provide shareholders with a useful picture of the overall position of the company. They have recommended the introduction of new rules, based on those in force in the United States and Canada, requiring a 'management discussion and analysis of financial condition and results of operation'.

The opportunity should be taken to merge the current directors' statement with a revised form of the directors' report.

### *Time for preparation of accounts*

For disclosing entities annual accounts must be lodged with the ASC not later than 90 days after the end of the financial year. Half-year accounts must be lodged with the ASC not later than 75 days after the end of the half-year.

Other companies must prepare accounts in time to send them to members at least 14 days before the company's annual general meeting (section 315). The meeting must be held within 6 months of the end of the financial year for exempt proprietary companies and 5 months for other companies (section 245). A company must have the same financial year as each of the entities it controls, unless the ASC makes an order to the contrary (section 290).

Under the First Corporate Law Simplification Bill, large proprietary companies which prepare accounts must send them to members and lodge them with the ASC within 120 days of the end of the company's financial year.

### *ASC exemption power*

A company may apply to the ASC for relief from various accounting requirements in the Law (section 313).

### *Audit*

Exempt proprietary companies need not appoint an auditor if members agree. Other companies must have their accounts audited (section 296).

An auditor has a statutory duty to inform the ASC of defaults or contraventions of the Law by the company (section 332(9) and (10)).

Currently, the Law requires an auditor to report to the ASC if the auditor is 'satisfied' that a breach has occurred or will occur. The House of Representatives Standing Committee on Legal and Constitutional Affairs has recommended that section 332(10) of the Law be amended so that auditors should have to report to the ASC if they have 'reasonable grounds to suspect' malpractice.

### *Audit standards*

The Auditing Standards Board produces standards and statements of auditing practice. The Law does not expressly require compliance with auditing standards.

The House of Representatives Standing Committee on Legal and Constitutional Affairs has recommended that the Auditing Standards Board be given the same recognition in the Law as the AASB.

### *Prescribed interests/collective investments*

Most prescribed interest schemes with more than 100 members are disclosing entities. This means they must prepare half-year and full year accounts which comply with the Law. Trust deeds for other prescribed interest schemes must include a covenant that the trustee will send to members a statement of accounts within 2 months of the end of the financial year (section 1069(1)(f)).

The Government has recently announced its intention to change the rules concerning those prescribed interests which will be collective investments regulated by the Corporations Law. In the case of the accounts and audit provisions, the intention is to as far as possible align the rules for collective investments with the rules applying to companies.

### *Access to company records*

A member of a company may apply to the court for an order for the inspection of the books of the company by an auditor or legal practitioner on the member's behalf (section 319). In November 1991, the House of Representatives Standing Committee on Legal and Constitutional Affairs recommended that section 319 allow a Court to provide access to 'any suitable person'.

It has been recommended that members of collective investment schemes should have similar rights of access to scheme records.

### *Special accounting rules*

Apart from the general accounts and audit rules, the Corporations Law also contains a number of specific accounting rules dealing with matters such as:

- the issue of shares at a premium (section 191)

- writing off bad debts, and company asset valuations (section 294)
- investment companies (sections 406 and 407)
- accounts prepared by borrowing corporations (sections 334 and 1058(5) and (6)).

### *Special exemptions*

A special exemption from the accounts and audit requirements of the Law is provided for banks and life insurance corporations (Part 4.5). A Working Party established by the then AttorneyGeneral and Treasurer in 1992 recommended that this exemption be removed from the Law and replaced by accounting standards.

### *Investment companies*

A body primarily engaged in investing in marketable securities for profit may be declared by the ASC to be an investment company (section 399(3)). The ASC can impose borrowing conditions, underwriting restrictions, investment restrictions, dealing restrictions and special accounting requirements on investment companies (sections 400 to 407). No body has been declared by the ASC (or its predecessor, the NCSC) to be an investment company since 1986.