

ABBREVIATIONS

AASB	Australian Accounting Standards Board
AAT	Administrative Appeals Tribunal
AGM	Annual General Meeting
ARWP	Audit Review Working Party
ASIC	Australian Securities and Investments Commission
ASIC Act	<i>Australian Securities and Investments Commission Act 2001</i>
ASX	Australian Stock Exchange Ltd
AUASB	Auditing and Assurance Standards Board
CAB	Corporations Amendment Bill 2002
CAC Act	<i>Commonwealth Authorities and Companies Act 1997</i>
CALDB	Companies Auditors and Liquidators Disciplinary Board
CEO	Chief Executive Officer
CFO	Chief Financial Officer
CLERP 9	Corporate Law Economic Reform Program Paper No. 9 <i>Corporate Disclosure — strengthening the financial reporting framework</i>
Corporations Act	<i>Corporations Act 2001</i>
CPAA	CPA Australia
FRC	Financial Reporting Council
FRP	Financial Reporting Panel
G100	Group of 100 Inc

HIHRC	HIH Royal Commission
IAASB	International Auditing and Assurance Standards Board
IASB	International Accounting Standards Board
IASC	International Accounting Standards Committee
ICAA	The Institute of Chartered Accountants in Australia
IFAC	International Federation of Accountants
JCPAA	Joint Statutory Committee of Public Accounts and Audit
NIA	National Institute of Accountants
PDS	Product Disclosure Statement
Ramsay report	<i>Independence of Australian Company Auditors</i>
SEC	Securities and Exchange Commission
Trade Practices Act	<i>Trade Practices Act 1974</i>

INTRODUCTION

REFORM PROCESS TO DATE

1. The Corporate Law Economic Reform Program (CLERP) was initiated in 1997 as a vehicle for the ongoing review and reform of Australia's corporate and business regulation to ensure that it is modern, responsive and promotes business activity. Overall, CLERP has delivered substantial changes to the Corporations Act and the corporate regulatory framework more generally, particularly in the areas of accounting standards, fundraising, directors' duties, takeovers and financial services.

2. The most recent stage in the Government's reform agenda — CLERP 9, *Corporate Disclosure: Strengthening the financial reporting framework* — was released in September 2002 and proposes a range of measures designed to enhance audit regulation and the general corporate disclosure framework. Since the release of CLERP 9, the Government has consulted widely with stakeholders. Over 60 submissions were received and the Business Regulation Advisory Group was consulted on both the policy proposals and the provisions of the CLERP (Audit Reform & Corporate Disclosure) Bill (the Bill).

3. The Bill generally implements the reforms proposed in the policy proposal paper subject to changes to reflect the outcome of consultations. In addition, the Bill incorporates recommendations contained in the Ramsay report *Independence of Australian Company Auditors* (Ramsay report), which was released in October 2001 and takes account of the relevant recommendations of the report of the Joint Committee of Public Accounts and Audit's Report 391 (*Review of Independent Auditing by Registered Company Auditors*) released on 18 September 2002. The Bill also implements relevant recommendations of the HIH Royal Commission.

OVERVIEW OF THE REFORMS

4. The underlying objective of the reforms is to improve the operation of the market by promoting transparency, accountability and shareholder activism. To this end, the Bill sets up a framework with the following features:

- Measures designed to improve the reliability and credibility of financial statements through enhanced auditor independence:
 - The role of the Financial Reporting Council (FRC) will be expanded to cover oversight of the audit standard setting process and monitoring and advising on auditor independence.
 - Auditors will be required to meet a general standard of independence and make an annual declaration that they have maintained their independence.
 - Disclosure will be required of certain matters in relation to all non audit services.
 - Restrictions on certain employment and financial relationships will be introduced and/or enhanced.
 - Auditors will be required to rotate after five years (and up to seven years where ASIC relief has been granted).
 - Auditors will be required to attend company Annual General Meetings (AGMs).
 - Australian Securities and Investments Commission (ASIC) will be given a power to impose conditions on Auditors' registration.
- Improved enforcement arrangements:
 - The operational capacity of the Companies Auditors and Liquidators Disciplinary Board will be enhanced by appointing a deputy chair and facilitating concurrent hearings. In addition, the majority of members will be non accountants.
 - A financial reporting panel will be established to resolve disputes between ASIC and companies regarding the application of accounting standards.
 - Auditing standards will be made legislative instruments in the same way as Australian Accounting Standards Board (AASB) accounting standards.
 - Protection will be available for employees and others who report suspected breaches of the law to ASIC.
 - The obligations for auditors to report suspected breaches of the law to ASIC will be strengthened.

- Measures to better allocate and manage risk:
 - Auditors will be able to incorporate and a regime of proportionate liability will be introduced. Incorporation will protect auditors who are not responsible for loss caused by another auditor in the audit firm. Proportionate liability will ensure that liability rests with all defendants in proportion to their contribution to the plaintiff's loss. The proportionate liability reforms are of general application and are not confined to auditors.
- Better disclosure to shareholders and improved shareholder activism:
 - The presentation of disclosure documents and the operation of the secondary sale provisions are being improved.
 - Disclosure requirements applying to director and executive remuneration will be enhanced and shareholders will be better equipped to hold directors accountable for their decisions regarding remuneration.
 - Shareholders will have greater ability to ask auditors questions regarding the conduct of the audit and the content of the audit report.
 - Mechanisms for shareholders to participate and vote in general meetings will be improved.
- Better enforcement mechanisms for continuous disclosure:
 - The maximum civil penalty for a contravention of the continuous disclosure (and other financial services civil penalty) provisions by a body corporate will be increased.
 - Persons involved in a contravention of the continuous disclosure regime by a body corporate will be subject to civil penalties.
 - ASIC will be given the power to issue infringement notices specifying payment of a financial penalty in relation to contraventions of the continuous disclosure regime.
- A specific duty on analysts to manage conflicts of interest.

POLICY CHANGES REFLECTED IN THE BILL

5. Since the release of the policy proposal paper, a number of changes have been made to the proposed reforms. The more significant changes are described below.

Legal backing for auditing standards

6. CLERP 9 proposed that core auditing standards have the force of law on the same basis as AASB accounting standards.

7. Given the views of stakeholders and ASIC that it is not possible to identify a selection of auditing standards that are applicable to all Corporations Act audits, all standards will have legal backing.

Auditor rotation

8. CLERP 9 proposed that auditors of listed companies be rotated after five years.

9. The Bill retains a five year rotation requirement, however, in light of concerns surrounding the impact of this requirement on smaller audit firms and those operating in rural and regional areas, ASIC will be given a power to provide relief by allowing up to a seven year rotation in appropriate circumstances.

CEO/CFO signoff

10. The Bill will require CEO/CFOs to certify to the board of directors that the financial statements are in accordance with the Act and accounting standards and that they present a true and fair view. While CLERP 9 did not make any policy recommendations on this issue, there has been substantial public debate on desirability of such a requirement. The Joint Statutory Committee of Public Accounts and Audit and a number of submissions received on CLERP 9 supported the introduction of such a measure.

Financial Reporting Panel

11. The Bill establishes a Financial Reporting Panel to resolve disputes between ASIC and companies concerning the company's accounting treatments in its financial report.

Managing conflicts of interest

12. CLERP 9 proposed that ASIC provide guidance via policy statement on the level and manner of disclosure of conflicts of interest required under the general duty to provide financial services 'efficiently, honestly and fairly'.

13. The Bill will instead introduce an additional licensing obligation to supplement the general duty to provide financial services 'efficiently, honestly and fairly'. This will provide a stronger legislative basis for ASIC to develop guidance and take enforcement action.

Infringement notices

14. CLERP 9 proposed that ASIC have the power to issue infringement notices specifying payment of a fixed financial penalty in relation to contraventions of the continuous disclosure regime.

15. An infringement notice will specify payment of a financial penalty based on a company's market capitalisation and disclosure of information if considered necessary by ASIC, and will indicate that compliance with the notice will be published. In proceedings to impose a civil penalty (following a failure to comply with an infringement notice), the court's discretion as to the amount of the penalty will not be further restricted.

Disqualification of directors

16. The Bill will allow ASIC to apply to a Court for an extension of up to 15 years on the current five year automatic disqualification period contained in section 206B of the *Corporations Act 2001* (Corporations Act). Further, in response to recommendations of the Cole Royal Commission, the maximum period of disqualification by a Court of directors for insolvency and non-payment of debts is increased from 10 to 20 years.

17. Minor amendments clarify the content required in ASIC's register of persons disqualified from managing corporations.

Retail/wholesale and sophisticated investor test

18. CLERP 9 proposed to more closely align the exemptions from the disclosure regimes that apply to sophisticated investors and wholesale clients under Chapters 6D and 7 of the Corporations Act.

19. While there was in-principle support, there was no consensus over how this proposal could be practically achieved.

20. This proposal is not being advanced at this stage for the following reasons:

- to avoid creating unnecessary uncertainty that would interfere with the transition to the Financial Services Reform (FSR) regime, given any harmonisation proposal would require significant amendments to the FSR's retail-wholesale test; and
- to gain better informed comment and analysis on how to progress this proposal through greater experience with both the sophisticated investor and wholesale client test in practice.

Executive remuneration

21. The Bill will introduce a number of measures designed to promote transparency and accountability in relation to the remuneration of directors and company management. In particular the Bill will:

- require disclosure to be in a clearly identified section of the annual directors' report;
- expand the range of disclosures required;
- apply the disclosure requirements to senior managers employed within a corporate group;
- allow shareholders the opportunity to discuss the remuneration section of the annual directors' report and vote on a non-binding resolution; and
- provide shareholders with greater say in relation to the termination benefits of directors.

HIH recommendations

22. The HIH Royal Commission released its report on 15 April and made a number of recommendations relevant to financial reporting and corporate governance. The Bill will implement the following recommendations:

- The general standard of independence proposed in CLERP 9 will be refined to provide that an auditor is not independent with respect to an audited body if the auditor *might* be impaired — or a reasonable person with full

knowledge of all relevant facts and circumstances *might* apprehend that the auditor might be impaired — in the auditor's exercise of objective and impartial judgment on all matters arising out of the auditor's engagement.

- Directors must provide a statement in the annual report that identifies *all* non-audit services provided by the audit firm and the fees applicable to each item of work and explain why those non-audit services do not compromise audit independence.
- A mandatory cooling off period of four years will apply to a former partner who was directly involved in the audit of a client before the partner can become a director of the client or take a senior management position with the client. This restriction will be extended to include key senior audit personnel. In addition, a two year cooling off period will apply to former partners of the audit firm who were not directly involved in the audit of a client.
- A prohibition will be introduced on any more than one former partner of an audit firm, at any time, being a director of or taking a senior management position with an audited body.
- Companies will be required to prepare an operating and financial review to provide an overview of the past, present and expected future direction of the company.
- Uncertainty and anomalies arising from two definitions of 'officer' in the Corporations Act will be addressed.

PENALTIES

23. Penalties for the offences contained in the Bill have not been specified. These matters are still under consideration. It is proposed however that the penalties contained in the Bill will be broadly comparable to those already contained in the Corporations Act although consideration is being given to whether an increase in penalties in some areas is warranted.

TRANSITIONAL ARRANGEMENTS

24. The transitional provisions are still being developed and the Bill therefore does not yet specify all transitional arrangements. Some arrangements are contained in Schedule 12 of the Bill.

