

CHAPTER 2: FINANCIAL REPORTING

291. Schedule 2 of the Bill contains the following amendments:

- Part 1 True and fair view
- Part 2 CEO and CFO declarations in relation to listed entity's financial report
- Part 3 Content of directors' report for listed public companies
- Part 4 Financial Reporting Panel

PART 1: TRUE AND FAIR VIEW

Overview

292. The Corporations Act provides that the annual financial statements and notes must give a true and fair view of the financial position and performance of an entity and, where consolidation is required, the consolidated entity (section 297). In addition, the financial report must comply with accounting standards (section 296). Where the financial statements prepared in accordance with accounting standards would not give a true and fair view, such additional information as is needed to ensure the financial statements do give a true and fair view must be included in the notes to the financial statements (paragraph 295(3)(c)).

293. As these legislative provisions are considered to have operated in a satisfactory manner, proposal 16 in CLERP 9 recommended:

- the retention of the existing legislative requirements; and
- seeking the reform of accounting standards where any deficiencies in the standards have a general, unintended result that compliance with the standard would not result in a true and fair view.

294. The true and fair requirements of the Corporations Act were also considered in the Joint Standing Committee on Public Accounts and Audit's (JCPAA's) Report 391 (*Review of Independent Auditing by Registered Company Auditors*), which was released at the same time as CLERP 9. The Committee's conclusions in respect of the true and fair requirements were set out in recommendations 6 and 7 of the report.

295. The JCPAA's recommendations in relation to the true and fair requirements have merit and it is proposed that they be implemented in the Bill. The Bill therefore provides that, where compliance with accounting standards would result in the financial statements and notes together not giving a true and fair view, the directors' report should set out:

- the directors' reasons why compliance with accounting standards would not result in the financial statements giving a true and fair view; and
- the additional information and explanations needed to give a true and fair view.

Additional information to be included in directors' report

296. Items 2 and 5 amend sections 298 (annual directors' report) and 306 (half-year directors' report) for the purpose of giving effect to the JCPAA's recommendation 6.

297. Where an entity's directors consider that compliance with the accounting standards would result in an entity's financial statements not giving a true and fair view, and they include additional information in the notes to the financial statements in accordance with paragraph 295(3)(c) (financial year) or 303(3)(c) (half-year) in order to give such a view, the directors will be required to include in their directors' report:

- their reasons for forming the view that the additional information was needed for the purpose of giving a true and fair view in accordance with sections 297 or 305; and
- the location of the additional information in the financial report.

Additional information to be included in auditor's report

298. Items 6 to 8 amend sections 307 (audit), 308 (auditor's report on annual financial report) and 309 (auditor's report on half-year financial report) for the purpose of giving effect to the JCPAA's recommendation 7.

299. Where directors provide additional information in the notes to an entity's financial statements in accordance with paragraph 295(3)(c) or 303(3)(c) in order to ensure the statements give a true and fair view, the auditor of the entity will be required to:

- form an opinion on whether the additional information is needed to give a true and fair view in accordance with section 297 or 305 (proposed paragraph 307(aa)); and
- include in the auditor's report their opinion on whether the additional information is needed to give such a view (proposed subsections 308(3B) and 309(5B)).

300. While it might be argued that the amendment to section 307 is unnecessary, as the auditor is already required to form an opinion about any additional information provided in accordance with paragraph 295(3)(c) or 303(3)(c), the amendments to sections 308 and 309 extend the present requirements by requiring the auditor to specifically comment in the auditor's report on the inclusion of the additional information in the financial statements. It is envisaged that users of the financial statements will be in a

position to make a more considered assessment of the financial statements through having the auditor's opinion on whether the additional information is needed to ensure the statements give a true and fair view.

Directors' declaration

301. Subsections 295(4) and 303(4), which, respectively, set out the contents of the directors' declaration on the annual and half-year financial statements, contain slightly different requirements for the two declarations. These requirements will be brought into line with each other.

302. Subsection 295(4) requires, among other things, directors to make a declaration:

- that the financial statements, and the notes required by the accounting standards, comply with the accounting standards (paragraph 295(4)(a));
- that the financial statements and notes give a true and fair view of a company's or, where consolidated financial statements are required, the consolidated entity's financial position and performance (paragraph 295(4)(b)); and
- whether, in the directors' opinion, the financial statements and notes are in accordance with the Corporations Act, including:
 - section 296 (which requires the financial report to comply with the accounting standards); and
 - section 297 (which requires the financial statements and notes to give a true and fair view of a company's or, where consolidated financial statements are required, the consolidated entity's financial position and performance) (paragraph 295(4)(d)).

303. Although paragraphs 295(4)(a) and (b), which require directors to make a specific declaration about compliance with sections 296 and 297, differ from paragraph 295(4)(d)¹, which requires directors to express their opinion about compliance with those sections, the similarity of the requirements has been an ongoing source of confusion for many companies and their professional advisers since the legislation was amended in 1998.

¹ Paragraph 295(4)(d) is the result of an amendment to the *Company Law Review Bill* moved by Senator Andrew Murray — see page 4013 of the Senate Hansard for 24 June 1998.

304. Item 1 repeals paragraphs 295(4)(a) and (b). In deciding to repeal these paragraphs, rather than paragraph 295(4)(d), it was noted that paragraphs 295(4)(a) and (b) impose a higher compliance burden on companies and their directors in that they must be satisfied that the financial statements and notes meet the requirements of sections 296 and 297. There may be circumstances in which directors cannot be totally certain that these requirements have been satisfied, but would be able to legitimately form an opinion that the financial statements and notes comply with the requirements of the Corporations Act, including sections 296 and 297.

305. Items 3 and 4 amend subsection 303(4) (directors' declaration on the half-year financial statements) to bring its requirements into line with those in subsection 295(4).

Transitional arrangements

306. Proposed section 1458 of the Corporations Act (see item 1 of Schedule 12) provides that the amendments in Part 1 of Schedule 2 apply in respect of a financial year that commences on or after the date on which the amending legislation commences.

PART 2: CEO AND CFO SIGNOFF

Overview

307. The Corporations Act requires directors to declare whether, in their opinion, the financial statements and notes are in accordance with the Act (including the accounting standards) and with the requirement that the financial statements and notes give a true and fair view of the company's financial position. However, the Act is silent on what inquiries, or other action, should be taken by the directors prior to making their declaration.

308. In practice, many Chief Executive Officers (CEOs) of listed companies are executive members of the board and must sign off on the accounts as directors. In addition, companies will often require the CEO and/or Chief Financial Officer (CFO) to sign off to the board as a matter of best practice.

309. In the United States, the Sarbanes-Oxley Act, which was enacted by the US Congress largely in response to a number of major corporate and accounting scandals, introduced a requirement under which the CEO and CFO of an issuer have to certify that periodic financial statements filed with the Securities and Exchange Commission (SEC) fairly present the operations and financial condition of the issuer.

310. The JCPAA's Report 391 (*Review of Independent Auditing by Registered Company Auditors*) recommended that the Corporations Act be amended to require the CEO and CFO of a company to sign a statutory declaration that the company's financial reports comply with the Corporations Act and are materially truthful and complete. The report further recommended that the declaration be attached to the company's financial reports when they are lodged with Australian Securities and Investments Commission (ASIC) and provided to the company's members and the market operator pursuant to the Corporations Act.

311. Following consideration of overseas developments, the JCPAA's recommendation and comments in a number of public submissions on CLERP 9 recommending the adoption of a CEO/CFO sign off requirement, the Corporations Act will be amended to require CEOs/CFOs to certify to the directors of a listed entity that:

- the annual financial statements are in accordance with the Corporations Act and accounting standards; and

- the statements present a true and fair view.

312. The sign-off requirement will not derogate in any way from the directors' responsibilities in relation to the financial report.

Directors' declaration

313. Item 9 amends subsection 295(4) by adding a requirement for directors of a listed entity to state, in the declaration they are required to make pursuant to subsection 295(4), that they have been given a declaration by the CEO and CFO in relation to the entity's financial statements.

Declaration by CEO and CFO

314. Item 10 inserts section 295A which sets out the requirements for the declaration that is to be made by the CEO and CFO.

315. The directors of a listed entity are not to make the directors' declaration under subsection 295(4) until they receive declarations from both the CEO and CFO saying whether, in the opinion of the person making each declaration:

- the financial records of the entity for the financial year have been properly maintained in accordance with section 286;
- the financial statements, and the notes referred to in paragraph 295(3)(b), for the financial year comply with the accounting standards; and
- the financial statements and notes for the financial year give a true and fair view (proposed subsections 295A(1) and (2)).

316. Proposed paragraph 295A(2)(d) provides that the regulations may prescribe additional matters that need to be covered in the declarations by the CEO and CFO. This requirement is intended to add long-term flexibility to the provision. There is no current intention to prescribe any matters.

317. Each declaration made by a CEO and CFO must be in writing, specify the date on which it was made the capacity in which the person is making the declaration and be signed by the person making it. Where a person performs the duties of both CEO and CFO, they are only required to make one declaration (proposed subsection 295A(3)).

318. To facilitate the drafting of proposed section 295A, the terms 'chief executive function' and 'chief financial officer function' have been developed (see proposed subsections 295A(4) and (6)).

319. Where no one person performs either the chief executive function or the chief financial officer function, but a number of people together perform one or both of those functions, each of those people is required to make a declaration (proposed subsections 295A(5) and (7)).

320. Proposed subsection 295A(8) is designed to ensure that the declarations made by the CEO and CFO do not derogate from the primary responsibility of directors to ensure that the financial statements comply with the Corporations Act.

Transitional arrangements

321. Proposed section 1458 of the Corporations Act (see item 1 of Schedule 12) provides that the amendments in Part 2 of Schedule 2 apply in respect of a financial year that commences on or after the date on which the amending legislation commences.

PART 3: CONTENT OF DIRECTORS' REPORT FOR LISTED PUBLIC COMPANIES

Overview

322. Recommendation 13 of the HIH Royal Commission (HIHRC) proposed, among other things, that the Corporations Act be amended to require the inclusion of an operating and financial review as part of an annual report and that the disclosures be the subject of audit.

323. In making this recommendation, the Commissioner noted that the UK Company Law Review (CLR) had recommended that public and large proprietary companies publish such a review as part of their annual report. The review would contain such information as the directors decide is necessary to obtain an understanding of the business. It would include details of the company's performance, plans, opportunities, corporate governance and management risks. The CLR recommended that the auditor should review the operating and financial review.

324. In Australia, discussion and analysis-type disclosures are contained in the Australian Stock Exchange (ASX) Listing Rules and accounting standard AASB 1039 *Concise Financial Reports*.

- The ASX Listing Rules require companies to include a review of operations and activities for the reporting period in their annual report (listing rule 4.10.17). Best practice guidance for complying with the ASX requirement is published by the Group of 100 Inc. and is supported by the ASX (ASX Guidance Note 10). The Listing Rules also require the inclusion of a commentary on the results for the period in the preliminary final report submitted to the Exchange (listing rule 4.3A).
- Accounting standard AASB 1039 requires a discussion and analysis of the principal factors affecting the financial performance, financial position and financing and investing activities of the entity to be included in every concise financial report prepared in accordance with the standard.

325. The only Corporations Act provision currently dealing with the preparation of information similar to that normally contained in a discussion and analysis-type commentary is subsection 299(1), which requires the inclusion of a range of general information (including a review of operations, details of any significant changes in the entity's state of affairs and the entity's

principal activities and any significant changes in the nature of those activities) in the annual directors' report.

326. The Bill will implement this recommendation of the HIIHRC and require the preparation of an operating and financial review. However, as such disclosures are usually of a descriptive nature and reflect directors' views about the past, present and future performance of a company or group of companies, they not do readily lend themselves to audit. Accordingly, the Bill will not require that the review be subject to audit.

Operating and financial review

327. Proposed section 299A, which is included in the Corporations Act by item 14, sets out the requirements for the operating and financial review.

328. Proposed subsection 299A(1) provides that the directors' report must contain information that members of a company would reasonably require to make an informed assessment of:

- the operations of the entity;
- the financial position of the entity; and
- the entity's business strategies and its prospects for future financial years.

329. The preparation of an operating and financial review is increasingly being accepted in the world's capital markets as an integral part of good corporate governance and high quality financial reporting. As such, it is a means of providing users of financial statements with an analysis of a company's business as seen through the eyes of the directors.

330. The content requirements for the review have been expressed in broad terms. The purpose of this is:

- to enable directors to make their own assessment of the information needs of members of the company and tailor their disclosures accordingly; and
- to provide flexibility in form and content of the disclosures as the information needs of shareholders, and the wider capital market, evolve over time.

331. It is expected that, in considering the issues to be addressed in their review, directors will have regard to best practice guidance such as that prepared and published by the Group of 100 Inc (G100). As noted earlier, use of the G100 guidance material is already supported by the ASX for the purpose

of complying with listing rule 4.10.17. The G100 guidance may be used for the purpose of satisfying the legislative requirements.

332. On the basis of the G100 guidance material, the issues that could be discussed and analysed in the report include:

- corporate overview and strategy;
- review of operations;
- investments for future performance; and
- review of financial condition.

333. While the requirements for the operating and financial review are in addition to the existing directors' report disclosure requirements, it is envisaged that, in practice, the existing requirements will be addressed as part of the review rather than being presented as a separate report.

334. Proposed subsection 299A(2) provides that the requirements are applicable to:

- an individual company or disclosing entity that is a listed public company when consolidated financial statements are not required; and
- the consolidated entity if consolidated financial statements are required.

Other amendments

335. Items 11 to 13, 15 and 16 make technical amendments to sections 285, 298, 300 and 314 of the Corporations Act by inserting cross-references to proposed section 299A (items 11 and 12) and existing section 300A (items 11, 13, 15 and 16).

Transitional arrangements

336. Proposed section 1458 of the Corporations Act (see item 1 of Schedule 12) provides that the amendments in Part 3 of Schedule 2 apply in respect of a financial year that commences on or after the date on which the amending legislation commences.

PART 4: FINANCIAL REPORTING PANEL

Overview

337. Currently where there is a dispute between ASIC and companies on the application of accounting standards and the true and fair view requirement contained in the Corporations Act, ASIC must initiate legal proceedings in order to resolve the matter. As an alternative to court proceedings, a Financial Reporting Panel (FRP) will be established to resolve disputes between ASIC and companies concerning accounting treatments in financial reports. The FRP will represent a less expensive method of resolving these disputes and will allow matters to be heard by persons with particular expertise. This will overcome concerns about the unfamiliarity of courts with subject matter concerning the application of accounting standards and the true and fair view.

338. The FRP's hearings are intended to be expeditious and informal and the parties will not require legal representation. Following a hearing, if the FRP considers it warranted, it will encourage companies to voluntarily restate their financial reports in a manner that is considered consistent with requirements in accounting standards and the true and fair view. Such consensual agreements with companies would overcome existing concerns with judicial proceedings, which can be costly and slow, resulting in the market being misinformed about a company's financial situation for prolonged periods.

339. The FRP's findings will not be binding on either ASIC or the company and the dispute may ultimately be pursued in the Court. ASIC in its enforcement role would be able to institute legal proceedings against the company at any time outside of the 'stay periods'. Where a company does not accept an FRP determination and ASIC subsequently initiates court proceedings, the Court may have regard to the findings of the FRP.

Establishment and membership of the FRP

340. Schedule 2, Part 4 of the Bill relates to the Financial Reporting Panel. Item 17 amends paragraph 1(1)(d) of the ASIC Act to include the FRP in the list of bodies established under the ASIC Act. Item 18 inserts a new Part, 'Part 13 — Financial Reporting Panel' into the ASIC Act after existing Part 12. Proposed Division 1 of Part 13 deals with general issues regarding the FRP. Proposed section 239AA establishes the Financial Reporting Panel.

341. The FRP will consist of at least five members who may be part-time or full-time, and who will be appointed by the Minister (see proposed subsections 239AB(1) to (3)). Although it is envisaged that the FRP would comprise around 30 part-time experts, there is no maximum limit placed on the amount of members who may be appointed. This is to ensure that there is a wide enough pool from which to draw a panel of three members without any conflicts of interest to hear a particular matter. To allow for flexibility in appointments, provision has been made for the appointment of full-time members. The members must have experience or knowledge in accounting, auditing, business, the administration of companies, or law (proposed subsection 239AB(4)). The Chairperson, appointed by the Minister, is to be a member of the FRP (proposed section 239AC).

342. Proposed sections 239AE to 239AL provide for terms of appointment of the Chairperson and members, resignation and termination, remuneration, leave of absence and acting arrangements for the Chairperson.

343. By 31 October each year, the FRP must prepare a report describing its operations for that financial year and give a copy to the Minister. The Minister must table the report (proposed section 239AM).

Issue 2.1

Some stakeholders have suggested that the Financial Reporting Council should oversee the operation of the FRP. Comments are invited on potential oversight arrangements for the FRP.

Constitution of a particular panel of the FRP

344. Proposed Division 2 of Part 13 sets out how the FRP's business will be conducted. A Panel which is constituted to hear a particular matter will consist of a Chairperson, Deputy Chairperson and a third member. The Chairperson may give directions as to which members are to sit on a Panel (see proposed subsections 239BA(1) to (3)). If a member chosen for a particular Panel is no longer available (such as where a conflict of interest has arisen or where the member is unable to attend the hearing), before the proceedings are determined, the Chairperson may revoke their original directions and reconstitute the Panel by giving new directions (proposed subsection 239BA(4)).

Disclosure of interests

345. The members of a Panel which is to be constituted for a particular matter must disclose any conflicts of interest to the Chairperson and the parties involved. A member with a conflict of interest must not take part in the Panel's hearings or deliberations except with the Chairperson's consent. Such consent may only be given if the interest is immaterial or indirect and it will not prevent the member from acting impartially (proposed subsections 239BB(1) and (2)).

Confidentiality

346. The confidentiality requirements contained in section 127 of the ASIC Act will apply to the FRP (proposed section 239BC).

Interpretation

347. Proposed Division 3 of Part 13 has effect as if a reference to the FRP refers to the Panel as constituted for a particular matter. Further, references to the Chairperson or Deputy Chairperson refer to the persons holding those positions on a Panel as constituted for the particular matter (proposed subsection 239CA(1)).

FRP Proceedings

348. Proposed section 239CB allows a Panel to conduct proceedings to exercise the FRP's functions and powers. The proceedings must be conducted in private unless a company that is a party to the proceedings elects for the hearing to take place in public (proposed subsections 239CC(1) and (2)). If the company has chosen public proceedings, the Panel may require part of those proceedings to be private in order to protect another person's interests or the confidentiality of certain evidence. The Panel may give directions as to the persons who will be entitled to be present at private proceedings (see proposed subsections 239CC(3) to (5)). ASIC is entitled to have a representative at the proceedings (proposed subsection 239CC(7)).

349. To preserve confidentiality or the public interest, or to avoid unfair prejudice to a person's reputation, the Panel may choose to prevent or restrict the publication of evidence or documents given to the Panel (see proposed section 239CD).

350. Pursuant to proposed subsections 239CE(1) and (2), a person may be summoned to appear at proceedings to give evidence and produce documents referred to in the summons. For the purposes of giving evidence a person may be required to take an oath or make an affirmation (proposed subsection 239CE(3)). A failure to comply with these requirements is an offence under proposed section 239CJ (proposed subsection 239CE(5)). Proposed section 239CL further provides that where a person fails to comply with the provisions of proposed section 239CE, the Panel may certify the failure to the Court and the Court may order the person to comply with matters specified in the Court order. The FRP may pay witness expenses (proposed subsection 239CE(6)).

351. As a means of promoting the informal and expeditious nature of Panel proceedings, it is intended that parties to proceedings not be legally represented. However, legal representation will be possible where leave is granted by the Panel (proposed section 239CG). The provisions of proposed section 239CG are not meant to preclude an employee of a party who holds legal qualifications from attending the proceedings as a general representative.

352. In Panel proceedings, two members will form a quorum (proposed section 239CF). Proposed sections 239CI and 239CK provide protections for Panel members, as well as prohibiting a person from acting in contempt of the Panel.

353. As a way of ensuring that the FRP is able to achieve consistency in the conduct of Panel proceedings, it will be able to determine the procedural rules to be followed in proceedings (proposed subsection 239CH(1)). The Panel is to observe the rules of procedural fairness to the extent that they are not inconsistent with the provisions of the Act or the regulations (see proposed subsection 239CH(4)).

Reference of a financial report to the FRP

354. Item 21 inserts proposed new Division 9, dealing with the reference of a financial report to the FRP, at the end of Part 2M.3. Under the Corporations Act, a company's financial report must comply with accounting standards (existing section 296) and the financial statements and notes must present a true and fair view of the company's financial position (existing section 297). Existing sections 304 and 305 replicate these requirements in relation to half-yearly reports. Where a company's financial report does not comply with these provisions, ASIC may refer the financial report to the FRP (proposed subsection 323EA(1)). Before the referral, however, ASIC must notify the company in writing of its intention to refer the matter and explain how the report fails to comply with the financial reporting requirement(s) and the changes that should be made to the report (proposed section 323EB). Within 14 days of receiving this notice, the company must respond and indicate what

action, if any, it proposes to take (proposed subsection 323EC(1)). During this period, ASIC is not able to initiate proceedings against the company in relation to the reporting requirements (see proposed subsections 323EE(1) and (2)). Generally, the information contained in the company's response cannot be used in evidence against the company if the matter later proceeds to court (proposed subsection 323EC(2)).

355. Following receipt of the company's response, ASIC has 14 days in which to refer the matter to the FRP for its consideration (proposed paragraph 323ED(1)(d)). If ASIC refers the matter to the FRP, ASIC is again not able to initiate proceedings against the company until after the FRP has given a copy of its report to ASIC (see proposed subsections 323EE(4) and (5)).

356. Within seven days after a financial report is referred to the FRP, the FRP must notify ASIC and the company of the cut-off date by which written submissions must be made. The cut-off date must be at least 14 days after the date of the notice (proposed section 323EF). It is intended that, wherever possible, the Panel will resolve the matter on the basis of the written submissions.

Issue 2.2

Comments are sought on whether a company should also be allowed to refer a matter to the FRP, where there is a dispute between ASIC and the company regarding the company's application of accounting standards in its financial report?

FRP to consider the financial report

357. The Panel must prepare a report that states whether the financial report complies with the relevant reporting requirement(s). If the financial report does not, the Panel must indicate what changes are necessary in order for the financial report to comply with the reporting requirements in the Corporations Act. The Panel's report must not include any confidential commercial information obtained in the Panel proceedings (proposed subsection 323EG(1)).

358. If the Panel gives notice to ASIC and the company, the Panel may provide its report within 90 days from when the matter was referred to the FRP (proposed subsection 323EG(3)). Otherwise, within 60 days of the referral, the Panel must give a copy of its report to ASIC and to the company. In the case of publicly listed companies, the Panel must also give a copy of its report to the relevant market operator (proposed subsection 323EG(2)).

359. Where the company is publicly listed, once the Panel's report is lodged with the market operator, the market operator must take reasonable steps to make the information available to the market (proposed subsection 323EG(5)). This will ensure that users of the market are informed of the Panel's findings regarding the company's application of accounting standards in its financial report. In addition, ASIC must take reasonable steps to publicise the report and the company's response to the Panel's findings (proposed subsection 323EG(4)). If the company amends its financial report, there is provision for it to re-lodge the documents under existing section 322 of the Corporations Act.

360. In the case of unlisted companies, the Panel's report will only be given to ASIC and the company (see proposed subsection 323EG(2)). Once ASIC has received the Panel's report, it must take reasonable steps to publicise the report, along with information concerning whether the company has made any recommended changes to its financial report (proposed subsection 323EG(4)).

361. ASIC's obligation in relation to publicising the report may involve the relevant information being made available on the internet (proposed subsection 323EG(4)). By publicising the report, the Panel's findings can serve as precedent or guidance for other companies as to the application of the accounting standards and the true and fair requirement in particular circumstances.

Court may have regard to an FRP report

362. In the event that ASIC refers the matter to the Court for its consideration, the Court or a tribunal of fact may have regard to the Panel's report in determining whether a company's financial report complied with the relevant Corporations Act requirements (proposed section 323EH).

