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Douglas Niven
Senior Executive Leader, Financial Reporting and Audit
Australian Securities and Investments Commission
Level 5, 100 Market Street
Sydney NSW 2000
By email: policy.submissions@asic.gov.au

Dear Doug,

ASIC CP 267 Remaking ASIC class orders and guidance on audit and financial reporting (August 2016)

I am pleased to make this submission on ASIC's proposals to refresh various Class Orders on financial reporting. I make this submission in my private capacity.

I have had many years of experience advising on financial reporting and Corporations Act related issues, primarily at my former employer Ernst & Young. My role included answering complex questions from staff and clients around the country on Class Orders, and drafting and reviewing internal guidance on Class Orders.

In general, I believe both Class Order 98/1417 and Class Order 98/1418 are operating effectively and efficiently. I offer some comments on their current operation, and the proposed Class Orders continuing their relief.

I believe that the relief in both Class Orders should continue.

I agree with the proposal to disallow companies that are APRA regulated from obtaining relief.

I make no comments on the proposals relating to:

- Class Order [CO 01/1256] *Qualified accountant*
- Class Order [CO 98/106] *Financial reports of superannuation funds, approved deposit funds and pooled superannuation trusts*
- Class Order [CO 99/1225] *Financial reporting requirements for benefit fund friendly societies*

Class Order 98/1418 Wholly-Owned Entities

Existing Class Order

I believe that the following requirements, and the implications for non-compliance are not well known:

 Ceasing to be a wholly-owned entity during financial year

 The requirement (existing clause (u) and proposed clause 7(3)) (subject to exclusions) that if the company ceases to be a wholly-owned entity, within 2 months it prepares, (has audited), and lodges with ASIC a financial report and directors' report for the previous financial year.

 The exclusions are that:

- It is less than one month to the end of the next financial year, or
- The company is subject to relief under the Corporations Act or another ASIC instrument, or
- Within one month of ceasing to be wholly-owned, the entity joins another Class Order Deed of Cross-Guarantee.

 Ceasing to be a wholly-owned entity soon after year end

 The requirement for the company not only to be wholly-owned at the end of the financial year, but also be wholly-owned until the consolidated financial statements are lodged (up to 4 months after financial year end) (existing clause (n) and proposed clause 6(j)). If this requirement is not met (subject to exclusions), then financial statements for the company need to be prepared. The exclusions are:

- if within one month of ceasing to be wholly-owned, the entity joins another Class Order Deed of Cross-Guarantee, or
- that directors expect that they will join such an arrangement for the next financial year (in terms of timing will be the current financial year, being the next financial year after the relevant financial year).

There is no problem if a group sells a subsidiary (or subsidiaries) to a purchaser with an existing wholly-owned entity class order deed of cross-guarantee.

While the use of the class order is widespread, I believe that it is common for previously owned wholly-owned entities to be sold to purchasers without a deed in place, or plans to put one in place. The consequence of such sales is that the company (or companies) sold will have to prepare (and have audited) financial reports for the previous financial year.

I believe that these requirements are not well known. Consequently the company is inadvertently breaching the Corporations Act. In such situations, the company will prepare a financial report (which should be with comparatives for the relevant financial year) for the next financial year.

I suggest that ASIC investigate the practical implementation of these requirements, and if not operating as intended, remove the requirement that results in inadvertent breaches of the Corporations Act, or undertakes appropriate enforcement and communication activities.

Comparatives

The Class Order requires comparatives, unless it is the first year of operation.

I have encountered questions in relation to comparatives relating to changes in the Closed Group. Specifically, if one or more wholly-owned entities leaves the Closed Group, should the comparatives remain as published (representing the Closed Group as it was), or should the comparatives be adjusted to show the comparatives of the Closed Group as it exists at balance date?

Opt-in Notices

The opt-in notices provide an efficient basis for companies notifying ASIC and the public that they have taken advantage of the relief. It is far more efficient than the previous method of annual notifications.

However, it is now some years since the opt-in system was introduced, and some years since companies who adopted the system when it commenced lodging a notice.

It is now becoming difficult and time consuming for the public to work out if a company is part of a class order deed of guarantee (by having to locate a document lodged on the ASIC database all those years ago), and being able to obtain (for a fee) the related consolidated financial statements, or is exempt from lodgement.

I do not recommended reinstating annual notifications of relief.

I do not recommended introducing regular (say 5 yearly) refreshes of notifications, as that is going to cause complications for companies having to remember to lodge the notifications, and potentially causing inadvertent breaches of relief.

I recommend that the ASIC database system be updated to show in the Company Summary information area whether an opt-in notice has been lodged (without a corresponding opt-out notice).

I also recommend that the ASIC database system provide a way, free of charge, to identify who the Holding entity is to enable financial reports to be obtained. At present, it costs \$19 to get a copy of the Deed, and then more money to get the financial statements.

Proposed Class Order

I believe the proposed Class Order be amended for the issues I identified relating to the existing Class Order/

My additional comments are:

Commencement Date

CP267 states that the existing Class Order will sunset on 1 October 2016. However, the proposed new class order only commences for financial years ending on or after 1 January 2017.

It appears that there is a gap for financial years ending 1 October 2016 to 31 December 2016, despite the extension of the previous class order under Section 12.

Title

I believe the former title of the class order referring to Wholly-Owned entities was more useful than the proposed Wholly-owned companies and recommend the title revert to use the previous terminology.

Referring to entities rather than companies emphasised that non-company entities could be part of the Deed of Cross Guarantee, i.e. part of the Closed Group and Extended Closed Group, even if such entities did not gain statutory financial reporting relief. I note that the definition of closed group refers to wholly-owned entities.

Capitalisation of key terms

The Instrument is complex. The drafting in the previous Class Order of capitalising key terms and definitions helped highlight the importance of those terms. I disagree with the proposed drafting of not capitalising key terms and definitions.

Proposed clause (t)(iv)(B) and clause (w)(iii)

I do not understand the requirements of proposed clause (t)(iv)(B) and clause (w)(iii) which cross-reference to each other, but do not clearly articulate what is required.

Proposed clause (t)(iv)(B) seems to stop suddenly after “or”

Class Order 98/1417 Audit relief for proprietary companies

Commencement Date

Similar to my comment for Class Order 98/1418 above, CP267 states that the existing Class Order will sunset on 1 October 2016. However, the proposed new class order only commences for financial years ending on or after 1 January 2017.

It appears that there is a gap for financial years ending 1 October 2016 to 31 December 2016, despite the extension of the previous class order under Section 8.

Auditor requirements

It is not clear why the references in the old Class Order to providing the auditor (if any) from section 307 and section 308 have not been transferred, but reference to section 314(3) has been included.

Assessment of consolidated profit – closed group and extend group

The references in clause (p)(ii)(B) to all entities part of the deed does not seem to have been updated for changes to the wholly-owned entities class order that excludes from the Extended Closed Group the trustee if it is not a Group Entity.

Section 7(2) Lodgement deadline

Section 7(2) lodgement deadline of 4 months after financial year end does not include the previous provision for an ASIC extension.

Proposed Regulatory Guide 115

Paragraph 32 should be updated for the change in the Corporations Act Section 45A that now refers to consolidated revenue, rather than gross operating revenue. The example for once-off revenue should also be updated for change to IFRS where sales of PPE are now generally recognised on a net gain basis, rather than old AGAAP on proceeds from sale being included in revenue.

Paragraph 49 should be updated to clarify that for the class order, all requirements must be met. Further, that for individual relief, ASIC may accept compensatory actions if particular requirements of the “automatic” class order cannot be met. Cross-reference to Section D may also be appropriate.

Paragraph 61 – Does ASIC regard the right-to-use lease asset to be recognised under IFRS 16 an intangible or tangible asset?

Paragraph 71 – I suggest highlighting that if an audit is required in the second year (after failing the profit test), that the company loses the ability to use this “automatic” class order as it has had an audit, and therefore future relief will need to be applied for on an individual basis (i.e. Section D).

Yours faithfully,

David Hardidge FCPA