



**ASIC**

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Australian Securities & Investments Commission

## **Submission on CLERP 9**

# **Corporate disclosure: strengthening the financial reporting framework**

**November 2002**

# Preface

This submission sets out ASIC's response to the Government's CLERP 9 paper, *Corporate disclosure: strengthening the financial reporting framework*.

The submission is divided into six sections:

- (a) Section 1: Accounting and audit;
- (b) Section 2: Analysts;
- (c) Section 3: Continuous disclosure;
- (d) Section 4: Disclosure requirements for shares and debentures;
- (e) Section 5: Enforcement issues; and
- (f) Section 6: Shareholder participation and information.

Each section may include two parts:

- (a) Part A, which covers proposals in the CLERP 9 paper in summary form and ASIC's response to those proposals;
- (b) Part B, which covers:
  - (i) issues or questions raised by the CLERP 9 paper that are not specific legislative proposals; and/or
  - (ii) matters not specifically the subject of a proposal or question in the CLERP 9 paper that ASIC wishes to comment on.

Note: In this submission, ASIC refers to the *Corporations Act 2001* as "the Act".

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# Executive Summary

1 ASIC welcomes the Government's initiatives set out in the CLERP 9 paper aimed at promoting improved transparency and confidence in Australian markets. It supports the focus of the paper on a stronger financial reporting framework, and on enhanced disclosure by corporations and other participants in Australian capital markets.

2 ASIC agrees that Australian corporate governance and disclosure standards are already strong, but that recent domestic and international examples show the need to refine and develop the Australian regime. The initiatives needed are likely to be a combination of changes to the substantive legislation, concerted industry action, and measures to ensure the statutory regulator has the right tools to effectively intervene where necessary.

3 ASIC particularly welcomes a systematic approach to ensuring that the financial reporting process results in high quality reports that investors, creditors and other stakeholders can rely on. The audit process is vital to achieving this objective.

4 ASIC sees the CLERP 9 proposals as essential to ensuring that the boards of listed and other entities take control of, and responsibility for, the audit process, and that public faith in the independence and professionalism of auditors is re-established and maintained.

5 Some of the structural changes proposed in the CLERP 9 paper are significant. The roles, powers and interaction between ASIC, the Financial Reporting Council (FRC) and the Companies Auditors and Liquidators Disciplinary Board (CALDB) will be key in the effectiveness and efficiency of regulation under the paper's proposals. In ASIC's view, it is especially important that the roles of these agencies be as clearly delineated as possible.

6 The proposals dealing with structural issues in the CLERP 9 paper are at a very high level. Many details that are yet to be discussed may be significant in the successful implementation of the CLERP 9 proposals. To assist in that implementation, ASIC has set out its views on these structural details.

7 Of course, a viable structure for regulation does not guarantee its success. For effective regulation, it is also vital that regulators have adequate enforcement remedies and are adequately resourced to use those remedies. ASIC comments on these issues throughout the submission, and deals with them in more detail in a separate confidential submission.

# Section 1: Accounting and audit

1.1 This section sets out ASIC's response to the CLERP 9 proposals dealing with accounting and audit. These are proposals 1 to 16 inclusive.

## PART A: RESPONSE TO CLERP 9 PROPOSALS

### PROPOSAL 1: EXPANDED FINANCIAL REPORTING COUNCIL

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The Government will expand the responsibilities of the Financial Reporting Council (FRC), which currently oversees the accounting standard setting process, to oversee auditor independence requirements in Australia.

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#### ASIC response

1.2 ASIC supports the proposal to expand the role of the FRC and to bring the Auditing and Assurance Standards Board (AuASB) under the auspices of the FRC. It is consistent with the FRC's broad oversight role that it has responsibility for both standard setting bodies.

1.3 In ASIC's view, it is important that any structural reorganisation maintain clear dividing lines between the responsibilities of the FRC, ASIC and the CALDB. Failure to maintain these clear dividing lines may result in regulatory duplication and gaps. ASIC considers that each of these bodies should play clearly defined roles:

- (a) *the FRC* should be responsible for overseeing and monitoring the auditing and accounting profession as a whole. It should not be involved in surveillance, enforcement or disciplinary actions;
- (b) *ASIC* should be responsible for surveillance, investigation and enforcement of the responsibilities of auditors and others in relation to financial reporting; and
- (c) *the CALDB* should be responsible for determining disciplinary action against individual auditors that relates to their future practice as auditors.

1.4 ASIC suggests the following refinements to the proposed restructure of the FRC's role:

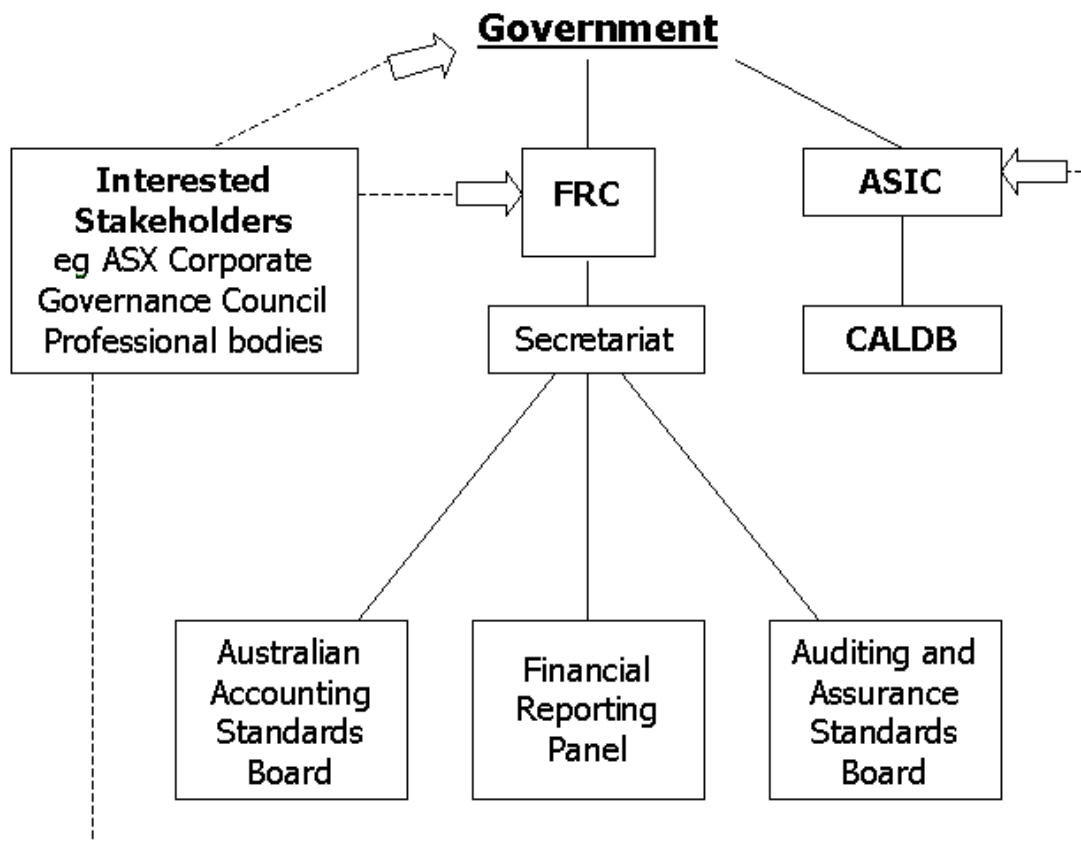
- (a) an expert Financial Reporting Panel (FRP) should sit under the umbrella of the FRC. The FRP should have power to make determinations on the application of accounting standards, the true and fair view requirement, and ASIC's proposed substance requirement (see paragraphs 1.76 to 1.81). While these determinations would not be legally binding, they would lead to speedy, expert resolution of disputes about financial reports, and a more informed market place. In many cases, the expert determinations may also lead to consensual agreements to restate

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financial reports. The FRP would also reduce the need for ASIC to commence legal proceedings on the application of accounting standards. (See paragraphs 1.9 and 1.10 for the proposed powers, functions and composition of the FRP);

- (b) the role of the FRC should be further expanded so that it can effectively oversee and monitor the profession as a whole; and
- (c) the FRC should not have a power to refer matters to the CALDB.

1.5 ASIC's proposed arrangements are outlined in the diagram below.



## Discussion

### Financial Reporting Panel (FRP): Why is it needed?

1.6 Currently, if ASIC is unable to resolve with a company its concerns about the accounting treatment in the company's financial report, it must pursue the matter in court. It may seek a declaration that the financial report does not comply with the Act. Alternatively, it may commence an action under s344 against the directors.

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1.7 This situation is disadvantageous for the market, the company and ASIC because:

- (a) judicial proceedings can be slow. This means that the market may be misinformed about the company's financial situation for some time;
- (b) judicial proceedings are costly for the company and ASIC; and
- (c) courts may lack the expertise to determine disputes dealing with the application of accounting standards, because they hear such matters infrequently.

The cost and complexity of ASIC's intervening in this way sometimes means that financial reporting issues effectively remain unaddressed. The FRP would provide a mechanism for an independent third party to determine contested issues that avoids these disadvantages.

1.8 The proposed FRP, at least in broad terms, is analogous to the United Kingdom's Financial Reporting Review Panel (FRRP). The FRRP considers whether the annual accounts of public companies and large private companies comply with the requirements of the *Companies Act 1985*, including applicable accounting standards. It does not have the power to make binding determinations on the correct application of accounting standards to particular situations. However, if it considers that the accounts do not comply with the accounting standards, it aims to persuade the directors to adopt a more appropriate accounting treatment, or to take some other remedial action. If the directors do not agree to undertake appropriate remedial action, the FRRP can commence judicial proceedings to secure the revision of the accounts. To date, since its establishment in 1991, the FRRP has resolved all 350 cases brought to its attention without having to apply for a court order.

### FRP: Function and powers

1.9 ASIC envisages that the FRP would operate as follows:

- (a) ASIC could refer a matter to the FRP if ASIC believes that the accounting treatment in a company's financial report lodged under Chapter 2M of the Act does not comply with:
  - (i) the accounting standards; or
  - (ii) the true and fair view requirement; or
  - (iii) ASIC's proposed substance requirement (see paragraphs 1.76 to 1.81);
- (b) both ASIC and the company (the parties) could make written submissions to the FRP. The FRP may elect to determine the matter on the basis of the written submissions, or it may hold a hearing into the matter. If it holds a hearing, the parties should be able to call accounting experts and question one another's experts. To ensure that hearings before the FRP are informal, quick and inexpensive, the parties should generally be represented before the FRP by their own officers. However,

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the FRP should have the power to give the parties leave to be represented by external lawyers;

- (c) the FRP's proceedings would be heard in private to enable the parties to make full and frank submissions. In particular, the company may feel able to more openly discuss its reports, and the transactions that lie behind those reports, if the FRP's proceedings are in private;
- (d) the parties should have the right to agree to withdraw a matter before the FRP at any time prior to the FRP's determination of the matter;
- (e) if the parties do not agree to withdraw the matter, the FRP must make a determination on how the accounting standards, the true and fair view requirement, or ASIC's proposed substance requirement apply in the particular situation, and how the financial reports should be amended to comply with the FRP's interpretation of those standards or requirements. The FRP must give written reasons for its determination;
- (f) the FRP's determination and reasons must be lodged with ASIC and, at the company's expense, sent to members of the company. If the company is listed, the determination and reasons must also be lodged with the market operator. Failure to lodge or distribute the determination and reasons would be a strict liability offence;
- (g) the FRP's determination and reasons should be publicly released by the FRP;
- (h) the FRP's determination is not binding or conclusive between the parties to the determination;
- (i) ASIC can, at any time, commence judicial proceedings to obtain a binding judgment on the legality of the company's financial report; and
- (j) if the FRP has made a determination prior to the court hearing, the court must have regard to the FRP's determination and reasons when deciding whether the financial report complies with the Act. The decision of the court would be subject to the standard appeal processes.

### FRP: Composition

**1.10** The members of the FRP must be both experts and independent. This will ensure the quality of their determinations and increase the likelihood that those determinations will be accepted by the parties, without the need for formal litigation. ASIC suggests that the FRP consist of at least 20 accountants and 7 lawyers. Each dispute referred to the FRP would be heard by a division consisting of 1 lawyer as chair (like the CALDB) and 2 or 4 accountants. These persons must not have any conflicts of interest in relation to the parties, the dispute, or the transaction type. To reduce the possibility of conflicts, the FRP members could include academics and corporate accountants. The FRP should be able to sit in multiple divisions simultaneously.

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### **FRP: Constitutional issues**

**1.11** ASIC believes that the proposed FRP is constitutional. As it does not determine existing rights and its determinations are not enforceable, the FRP would not be exercising the judicial power of the Commonwealth in contravention of constitutional limitations.

### **Further expansion of the FRC's role**

**1.12** ASIC considers that, to ensure that the FRC can effectively oversee the audit profession and the financial reporting framework, its role should be further expanded so that:

- (a) the FRC has a fully functional research capacity;
- (b) the FRC is required to monitor, assess and report on the ethical codes developed by the professional bodies;
- (c) the FRC sets, monitors and reviews the minimum competency requirements for registration and re-registration as an auditor (see paragraphs 1.66 and 1.67); and
- (d) the results of the FRC's monitoring and assessment are reported to the Government. These reports should also be made public.

**1.13** ASIC acknowledges that the FRC will need to have adequate resources to fulfil these roles effectively.

### **Relationship between the FRC, ASIC and the CALDB**

**1.14** ASIC considers that the FRC should not have the power to refer matters to the CALDB. The allocation of this power to the FRC is inconsistent with the need to ensure clear dividing lines between the responsibilities of the FRC, ASIC and the CALDB.

**1.15** The CALDB has no powers of investigation. Matters can only be referred to the CALDB once an investigation has been completed and an application supported by a statement of facts and contentions prepared.

**1.16** Therefore, the proposal that the FRC should have the power to refer matters to the CALDB implies that the FRC would have the capacity to investigate the performance of individual auditors, including through the use of compulsory powers, and prepare what is essentially a brief for the CALDB. Such a capacity is inconsistent with the FRC's core role of general oversight of the audit profession and the financial reporting framework. Investigating the work of individual auditors to determine whether they are complying with their obligations will detract from the FRC's performance of this core role.

**1.17** Currently, ASIC monitors and investigates the work of individual auditors to determine whether they are complying with their obligations, and refers appropriate matters to the CALDB. It is appropriate for ASIC to continue to perform this investigation and enforcement role. ASIC routinely exercises enforcement powers,

and ASIC's investigation of auditors is often conducted as part of a larger investigation of a company or a financial services provider. Confusion may result if ASIC shared this investigation role with another body, such as the FRC. Of course, if during its performance of its general oversight role, the FRC discovers evidence of a specific instance of misconduct by auditors, it should refer the matter to ASIC, for further investigation and possible referral to the CALDB.

### **PROPOSAL 2: GENERAL STATEMENT OF PRINCIPLE REQUIRING INDEPENDENCE**

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The Government will amend the Corporations Act (the law) to include a General Statement of Principle requiring the independence of auditors.

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#### **ASIC response**

**1.18** ASIC supports the proposal. In ASIC's view, the general statement of principle should:

- (a) be expressed as an obligation imposed on auditors to ensure that, in carrying out the duties of an auditor under the Act, they are independent with respect to each company whose financial reports they audit;
- (b) define independence so that it is clear that an auditor is not independent with respect to a company if:
  - (i) the auditor is not likely to exercise objective and impartial judgment on all issues encompassed within the auditor's engagement; or
  - (ii) a reasonable person with full knowledge of all relevant facts and circumstances would conclude that the auditor is not likely to exercise objective and impartial judgment on all issues encompassed within the auditor's engagement; and
- (c) make it clear that the general obligation is in addition to, and does not derogate from, any other provisions in the Act (such as s324) that deal with the independence of auditors.

**1.19** ASIC notes that there should be appropriate criminal and civil sanctions for breach of the obligation to be independent. In particular, these sanctions should extend beyond cancellation or suspension of the registration of a registered company auditor by the CALDB.

#### **Discussion**

##### **The need for a general obligation**

**1.20** The independence of auditors is a matter of significant public interest that should be substantially dealt with in the Act, rather than in the ethical rules of the

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professional bodies. The professional bodies should be able to provide guidance on independence, but this guidance should not be the major source of the obligation to be independent.

**1.21** The only way to deal comprehensively with independence in the Act is through the imposition of a general obligation to be independent. This is because it is impossible for the legislation specifically to list and prohibit all circumstances that threaten, or that may be perceived to threaten, independence.

### **Test of independence**

**1.22** ASIC agrees that, in the Australian context, it is appropriate to adopt a “reasonable person” test. This test acknowledges that investors and other persons use accounts. By proposing both a subjective and an objective test of independence, the CLERP 9 paper also acknowledges that, in order to ensure market confidence, auditors should both be independent and appear independent.

**1.23** However, in ASIC’s view, the test proposed in the CLERP 9 paper sets too low a standard of independence. Neither a court nor a reasonable person is likely to form the view that an auditor is “not capable” of exercising objective and impartial judgment. Arguably, a person is always capable of exercising objective and impartial judgment. The test should be amended so that it provides that an auditor is not independent with respect to an audit client if the auditor is not, or a reasonable person with full knowledge of all relevant facts and circumstances would conclude that the auditor is not, likely to exercise objective and impartial judgment on all issues that may be encompassed within the auditor’s engagement.

### **Relationship to other provisions**

**1.24** Proposals 2 to 8 deal with the independence of auditors and set out a number of different techniques to deal with the issue. For example, proposals 2 to 8 propose:

- (a) a general obligation to be independent;
- (b) the issue of guidelines on the meaning of independence by ASIC;
- (c) a declaration of independence;
- (d) restrictions or prohibitions on certain specific relationships;
- (e) reliance on ethical rules and guidance issued by professional bodies;
- (g) approval by the audit committee of the provision of non-audit services by the auditor; and
- (h) disclosure to shareholders of certain matters relevant to auditor independence.

**1.25** In order to prevent confusion, the relationship between these different proposals and techniques must be clear. In particular, the relationship between the general obligation and the specific restrictions or prohibitions should be clearly stated.

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**1.26** ASIC considers that the general obligation to be independent should apply in addition to any other statutory provision dealing with auditor independence, including the specific restrictions or prohibitions referred to in proposals 4 and 5. The general obligation should catch employment and financial relationships that are not specifically prohibited, but which, in the circumstances of the particular case, threaten independence. On the other hand, the general obligation should not be used to read down any of the specific restrictions or prohibitions. To achieve this, the Act should clearly state that the general obligation applies in addition to, and does not derogate from, the specific restrictions or prohibitions.

### ASIC guidelines

**1.27** ASIC will consider the final format of the legislation and the guidance issued by the professional bodies before determining what, if any, guidelines it should issue on the general obligation to be independent. ASIC will continue to monitor developments in the legislation and professional guidance against the background of changes in audit practice, and issue or amend its guidelines when necessary. See paragraphs 1.43 and 1.44 for a further discussion of this issue.

### Enforcement

**1.28** The obligation to be independent must be capable of being effectively enforced. It is appropriate for the CALDB to have the ability to cancel or suspend the registration of an auditor who has breached the obligation. However, additional sanctions are needed to address situations where the failure to ensure independence is wilful, or serious consequences have arisen from the failure. In the case of intentional conduct, it is appropriate to impose a criminal sanction. Appropriate civil remedies may include disgorgement of fees for the period during which the auditor was found to be not independent.

## PROPOSAL 3: ANNUAL DECLARATION BY AUDITOR

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The Government will amend the law to require the auditor to make an annual declaration that they have maintained their independence in accordance with the Corporations Act and the rules of the professional accounting bodies.

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### ASIC response

**1.29** ASIC supports the proposal.

**1.30** ASIC notes that:

- (a) it may be more appropriate if the declaration were made to the company or general meeting, rather than the board of directors. The general meeting has the primary right to appoint and remove the auditors: s325, 327 and 329. (ASIC considers that it should retain this right: see proposal 9.) Making the declaration to the company or general meeting

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would reinforce the notion that the auditors act in the interests of the general meeting or company as a whole, not the board; and

- (b) there should be appropriate criminal and civil sanctions for both failure to make the declaration and making a false or misleading declaration. ASIC recommends that failure to make the declaration should be a strict liability criminal offence. In addition, an appropriate civil sanction should be created by providing that an auditor is not entitled to audit fees if it has not made the annual declaration. An intentional false or misleading declaration should attract a criminal penalty. There should also be a civil sanction, such as the disgorgement of the audit fee for the period to which a false or misleading declaration relates. Finally, the auditor's conduct in failing to make the declaration or in making a false or misleading declaration should be referable to the CALDB.

### PROPOSAL 4: EMPLOYMENT RELATIONSHIPS

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The Government will amend the law to strengthen restrictions on employment relationships between an auditor and the audit client.

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#### ASIC response

**1.31** ASIC supports the proposal.

**1.32** ASIC assumes that the protections for inadvertent breaches will only apply if the auditor has effective internal procedures designed to allow meaningful checks as to independence both before and during an audit engagement.

**1.33** ASIC notes that appropriate criminal and civil sanctions should be imposed on those who consent to be appointed as an auditor, act as an auditor or prepare a report required by the Act to be prepared by an auditor, in breach of the amended restrictions on employment relationships. If the proposed amendments were made to s324, the sanctions that currently attach to a breach of that section would need to be reviewed. Currently, the section creates a strict liability offence that attracts a penalty of \$550. The penalty needs to be substantially increased for the provision to be effective. If there is protection for inadvertent breaches, it is appropriate that the offence remain one of strict liability, albeit with a higher penalty. An appropriate civil sanction may be to provide that an auditor is not entitled to audit fees for the period in which the breach occurred, again with a defence if the breach is inadvertent. Finally, the auditor's conduct should also be referable to the CALDB.

## PROPOSAL 5: FINANCIAL RELATIONSHIPS

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The Government will amend the law to impose new restrictions on financial relationships.

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### ASIC response

**1.34** ASIC supports the proposal to amend the law to impose new restrictions on financial relationships. ASIC repeats its comments in relation to enforcement issues raised by proposal 4: see paragraph 1.33.

## PROPOSAL 6: APPLICATION OF PROFESSIONAL STATEMENT F1

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The Government supports the immediate application of Professional Statement F1 on Professional Independence, which forms part of the Joint Code of Professional Conduct of the ICAA and CPAA.

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### ASIC response

**1.35** ASIC supports the immediate application of Professional Statement F1 on Professional Independence (Professional Statement F1).

**1.36** ASIC considers that both the general obligation to be independent in proposal 2 and Professional Statement F1 should be supplemented by specific legislative restrictions on the provision of certain non-audit services to audit clients. These restrictions should be based on the principle of prohibiting self-review and should be on the following activities:

- (a) making or participating in decisions that affect the whole or a substantial part of the business of the audit client, other than in the performance of the audit function;
- (b) exercising the capacity to significantly affect the audit client's financial standing, other than in the performance of the audit function;
- (c) communicating instructions or wishes to the directors or other officers of the audit client:
  - (i) knowing that the directors or other officers are accustomed to act in accordance with the auditor's instructions or wishes; or
  - (ii) intending that the directors or other officers will act in accordance with those instructions or wishes,other than in the performance of the audit function;
- (d) negotiating, initiating, approving, authorising or executing a transaction on behalf of the audit client;

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- (e) preparing source documents or originating data, or making changes to such documents or data, other than in the performance of the audit function;
- (f) if the audit client is a listed entity, providing accounting and bookkeeping services, other than in the performance of the audit function and;
- (g) promoting, dealing in or underwriting securities in an audit client;
- (h) valuing or providing advice supporting the value attributed to any assets, liabilities, contingent assets or contingent liabilities, including assessments of the likely or possible outcome of legal proceedings, or affecting the pricing of any products or services;
- (i) acting for or assisting an audit client in the resolution of a legal dispute or litigation, including providing expert opinion;
- (j) advocating a position with a taxation authority, including assisting the audit client in seeking a ruling from a taxation authority, acting as tax agent for the client, or preparing any information to be lodged with taxation authorities;
- (k) providing advice, due diligence or other services in connection with a material acquisition or financial transaction, other than forming an opinion on the appropriate accounting treatment for the audit client's actual or proposed transactions;
- (l) providing actuarial services; and
- (m) providing internal audit services.

Note: "Audit client" should include any controlled entities.

**1.37** Appropriate criminal and civil sanctions should be imposed on those who consent to be appointed as an auditor, act as an auditor or prepare a report required by the Act to be prepared by an auditor, in breach of the above restrictions on the provision of certain non-audit services.

## Discussion

### The need for specific restrictions or prohibitions

**1.38** ASIC agrees that a blanket prohibition on the provision of non-audit services to audit clients is inappropriate. As noted in the CLERP 9 paper and in the Ramsay report, no other jurisdiction has imposed such a blanket prohibition. ASIC also agrees that rapid changes in the area of non-audit services make it impossible to draft a list of all circumstances that could threaten the independence of an auditor.

**1.39** However, this does not mean that the best approach is to deal with non-audit services solely through the general obligation to be independent and the ethical rules of the professional bodies. It is clear that there are some non-audit services, the provision of which will always affect the auditor's independence or appearance of

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independence. That is, the provision of some non-audit services will always, or almost always, threaten the independence, or the appearance of independence, of auditors, regardless of the safeguards adopted. This is acknowledged in Professional Statement F1. Professional Statement F1 describes a number of non-audit services which should either not be provided to an audit client, or should be provided only in extremely exceptional circumstances. ASIC considers that the best approach is to prohibit the provision of such non-audit services through the Act, rather than through the ethical rules of the professional bodies.

**1.40** ASIC suggests a more limited and clearly defined list of prohibited non-audit services than that in the *Sarbanes-Oxley Act 2002* in the United States of America (USA). It is based on the principle that auditors should not review their own work, and only identifies non-audit services that create threats to independence, or the appearance of independence, which cannot be mitigated by appropriate safeguards. This still leaves considerable scope for the provision of non-audit services to audit clients.

**1.41** For the following reasons, statutory prohibitions on this class of non-audit services are preferable to reliance on ethical rules of professional bodies:

- (a) the statutory prohibitions provide greater clarity for both auditors and companies, than either the general obligation in proposal 2 or Professional Statement F1. They distinguish those non-audit services that cannot be provided in any situation, from those that can be provided if appropriate safeguards are in place;
- (b) breach of a statutory prohibition can attract appropriate criminal and civil sanctions. A breach of the ethical standards only leads to the threat of disciplinary action by the professional bodies and, ultimately, de-registration. Not all auditors are members of the professional bodies; and
- (c) statutory prohibitions will align the Australian approach with that of the USA.

### **Mechanism**

**1.42** To ensure flexibility to respond to developments in the audit industry, it may be appropriate to include the specific list of prohibitions in the regulations, and merely amend s324 so that it prohibits an auditor from providing to an audit client the non-audit services prescribed in the regulations.

### **ASIC guidelines**

**1.43** As stated in paragraph 1.27, ASIC will consider the exact form of the legislation and professional guidance before deciding what, if any, guidelines it should issue on the general obligation to be independent. ASIC believes the regime dealing with audit independence (including the provision of non-audit services) should not place regulatory reliance on ASIC guidance as if it had statutory force.

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**1.44** When considering whether to issue any guidelines, one matter that ASIC will take into account is whether the legislation contains specific prohibitions on the provision of certain non-audit services. If there are no such prohibitions, ASIC is likely to issue guidelines reflecting its view in paragraph 1.36.

### **Enforcement**

**1.45** ASIC repeats its comments in relation to enforcement issues raised by proposal 4: see paragraph 1.33.

## **PROPOSAL 7: NON-AUDIT SERVICES**

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The Government will implement a series of measures to deal with non-audit services.

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### **ASIC response**

**1.46** ASIC's general views on measures to deal with non-audit services are discussed in paragraphs 1.35 to 1.45.

### **Mandatory disclosure of non-audit fees**

**1.47** ASIC supports the proposal to require mandatory disclosure in the annual report of fees paid for non-audit services provided by the auditor.

**1.48** ASIC notes, however, that disclosure is not an adequate substitute for specific restrictions or prohibitions on activities or relationships that threaten independence or the appearance of independence.

### **Statement on whether non-audit services are compatible with independence**

**1.49** ASIC supports the proposal to require a statement in the annual report on whether the audit committee is satisfied that the provision of non-audit services is compatible with auditor independence. In particular, the audit committee should state that the provision of non-audit services by the auditor is not contrary to the auditor's general statutory obligation to be independent (see proposal 2) or the specific prohibitions, if any, that relate to non-audit services: see ASIC's response to proposal 6 at paragraph 1.36.

**1.50** If a listed company does not have an audit committee (see proposal 8), ASIC considers that the statement should be made by the independent directors, if any.

## PROPOSAL 8: AUDIT COMMITTEES

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It will be mandatory for the top 500 listed companies (that is those that compose the All Ordinaries Index) to have audit committees. The Government supports the role of the ASX Corporate Governance Council in developing best practice standards for audit committees.

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### ASIC response

**1.51** ASIC agrees that the listing rules should be amended to provide that audit committees are mandatory for the top 500 listed companies, and supports the role of the ASX Corporate Governance Council in developing best practice standards for audit committees.

### Discussion

#### International consensus on desirability of audit committees

**1.52** As noted in the CLERP 9 paper, there is strong consensus that international best practice requires listed entities to have an audit committee. Audit committees are responsible for the company's relationship with its auditor and ensure that this crucial relationship is managed by a body that is independent of management and able to represent the interests of shareholders.

**1.53** In addition to the international developments noted in the CLERP 9 paper, ASIC notes that the *Principles of Auditor Independence and the Role of Corporate Governance in Monitoring an Auditor's Independence*, released by the IOSCO Technical Committee in October 2002, recommends that a company should have an audit committee to oversee the relationship between the company and its external auditor. The IOSCO paper states that an audit committee should:

- (a) oversee the process of selection and appointment of the external auditor;
- (b) be the key representative body with which the auditor interacts;
- (c) have an established mandate that permits it to carry out its responsibilities free of any unreasonable restraints, and those responsibilities should include evaluating whether the fees charged by the auditor appear adequate to support the work required to provide an audit opinion independent of fees for any non-audit services;
- (d) meet on a regular and frequent basis with the auditor without management present and discuss with the auditor any contentious issues that have arisen with management during the course of the audit and whether they have been resolved to the auditor's satisfaction;
- (e) when recommending an auditor for appointment or reappointment, satisfy itself that the auditor is independent in accordance with applicable standards;

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- (f) oversee the company's policies on the provision of non-audit services; and
- (g) establish policies relating to the hiring from the audit firm of senior officers for the company.

**1.54** ASIC also notes other relevant international work:

- (a) *A Modern Regulatory Framework for Company Law in Europe* (November 2002), a report of the High Level Group of Company Law Experts established by the European Commission, recommends that responsibility for supervision for the audit of the company's financial statements should lie with a committee of non-executive or supervisory directors who are at least in the majority independent;
- (b) a number of corporate governance codes also recommend that corporations have an audit committee: see, for example, American Bar Association's *Special Study on Market Structure, Listing Standards and Corporate Governance* (May 2002, pp 57–58) and Weil, Gotshal & Manges, *Comparative Study of Corporate Governance Codes Relevant to the European Union and its Member States* (January 2002, p 78); and
- (c) the listing rules of a number of key foreign securities markets for smaller corporations require listed companies to have audit committees. In particular, the listing rules of the Nasdaq National Market, the Nasdaq Small Cap Market and the Hong Kong Growth Equity Market (GEM) mandate audit committees.

### The situation in Australia

**1.55** In spite of the emerging international consensus on the desirability of audit committees, some Australian stakeholders argue that a requirement to have an audit committee may impose unreasonable burdens on smaller companies listed on Australian Stock Exchange Ltd (ASX).

**1.56** In principle, however, the fact that a company is small does not make it any less risky for its shareholders, creditors and other stakeholders. Indeed, in many cases the audit process will be the most important means of external scrutiny, and the integrity of the audit process will be as important as it is for large listed entities.

**1.57** ASIC recognises that a significant proportion of entities listed on ASX's market are smaller than those on other markets. In these circumstances, ASIC is not suggesting that audit committees should be mandatory for all companies listed on ASX. However, ASIC believes that consideration should be given to a means of ensuring that those Australian listed entities that do not have an audit committee employ alternative mechanisms to achieve the outcomes that are achieved by audit committees.

**1.58** ASIC suggests that the ASX Corporate Governance Council could address this issue and ensure that appropriate mechanisms are employed to ensure the reliability

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of company audits and, therefore, the ongoing integrity and stability of ASX's market. The types of mechanisms that could be considered include a requirement that a majority, or a set number of directors, be independent. In this respect, Part 5C.5 of the Act (which provides that the responsible entity of a managed investment scheme must either have a majority of independent directors or a compliance committee) may be a useful analogy.

### Best practice standards for audit committees

1.59 ASIC anticipates that the work of the ASX Corporate Governance Council is likely to result in guidance on:

- (a) the role of the audit committee (eg sign off on audit mandate, ensure the mandate is carried out, review auditor independence, review audit issues with the auditors on a regular basis, regularly meet with auditors without management present, establish "whistle-blowing" procedures);
- (b) the composition of the audit committee (including the independence and minimum qualifications of audit committee members); and
- (c) the authority of the audit committee to engage independent lawyers and other advisors.

Such guidance would, in ASIC's view, be welcome.

## PROPOSAL 9: APPOINTMENT AND REMOVAL OF AUDITORS

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The Government will make audit partner rotation compulsory after 5 years.

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### ASIC response

#### Audit partner rotation

1.60 ASIC supports the proposal.

#### Appointment of auditors

1.61 In response to the related proposal that that the auditor of a company should be appointed and their remuneration determined on the recommendation of the company's audit committee, ASIC makes the following comments:

- (a) the audit committee should only perform the role currently given to the board by Part 2M.4. The AGM should continue to have a role in the appointment of auditors because the auditors should serve the interests of the members; and
- (b) if the company does not have an audit committee, the independent directors, if any, should perform its role.

## **PROPOSAL 10: ATTENDANCE OF AUDITOR AT AGM**

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The Government will amend the law to require an auditor to attend the AGM of a listed company at which the audit report is tabled and to answer reasonable questions about the audit.

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### **ASIC response**

**1.62** ASIC supports the proposal.

#### **Attendance at AGMs**

**1.63** ASIC notes that the Act should provide that the auditor is not required to attend the AGM, if reasonable circumstances preclude the auditor's attendance.

**1.64** ASIC considers that the Act should be amended to provide that a director must also attend the AGM, unless reasonable circumstances preclude the director's attendance.

#### **Questions at AGMs**

**1.65** ASIC considers that s250S (which deals with questions by members on management at an AGM) should be amended so that it mirrors the amended s250T (which deals with questions of auditors at an AGM). That is, s250S should also provide that the board or management is required to answer reasonable questions.

## **PROPOSAL 11: QUALIFICATIONS FOR REGISTRATION AS A COMPANY AUDITOR**

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Accountants seeking registration as company auditors will be required to meet agreed competency standards, to undertake to abide by an accepted code of professional ethics, and to complete a specialist auditing course prior to registration.

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### **ASIC response**

**1.66** ASIC agrees that the qualifications for registration need to be amended. ASIC proposes that s1280(2)(a) and (b) of the Act be repealed and replaced by a requirement that applicants meet competency standards issued by the FRC. The FRC should continually review these competency standards and amend them when appropriate.

**1.67** ASIC also considers that auditors should be required periodically (for example, every 5 years) to renew their registration and meet the relevant competency standards.

## **PROPOSAL 12: INCORPORATION OF AUDITORS**

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The Government will amend the law to allow auditors to incorporate.

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### **ASIC response**

**1.68** ASIC does not object to the proposal, provided that:

- (a) where appropriate, statutory obligations and liability are imposed on the individual audit partners responsible for the audit engagement, the corporate entity, or both, and necessary amendments are made to the Act and *ASIC Act 2001* (ASIC Act); and
- (b) the incorporated audit firms have either or both sufficient financial resources or insurance to meet reasonable claims that might typically be expected to be made against the firms. Consideration should be given to imposing similar requirements on partnerships and sole practitioners.

## **PROPOSAL 13: PROPORTIONATE LIABILITY**

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The Government will seek the agreement of the States to introduce proportionate liability.

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### **ASIC response**

**1.69** ASIC does not object to the proposal. ASIC does not believe that there is any reason to treat auditors differently from other professionals. Therefore, ASIC agrees that the broad question of auditor liability is more appropriately considered as part of the wider reform of tort law.

## **PROPOSAL 14: ADOPTION BY AUSTRALIA OF IASB ACCOUNTING STANDARDS BY 2005**

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Australia will adopt accounting standards issued by the International Accounting Standards Board (IASB) for reporting entities under the law for accounting periods beginning on or after 1 January 2005, in line with the European timetable.

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### **ASIC response**

**1.70** ASIC supports the proposal.

**PROPOSAL 15: EXPENSING SHARE OPTIONS**

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The IASB standard requiring expensing of share options will have the force of law on adoption by the AASB, expected to be in the second half of 2003.

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**ASIC response**

1.71 ASIC supports the proposal.

**PROPOSAL 16: REQUIREMENT FOR ACCOUNTS TO BE TRUE AND FAIR**

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The legal requirement that financial statements comply with accounting standards and that the financial statements and notes together present a true and fair view of an entity's financial position and performance will be maintained.

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**ASIC response**

1.72 ASIC supports the proposal but, as noted in paragraphs 1.76 to 1.81, ASIC considers that the regulatory objective of ensuring accurate, meaningful, and consistent financial reporting would be enhanced if the Act were amended to provide that accounting treatments applied by companies should reflect the substance of transactions.

## SECTION B: OTHER ISSUES

### CLERP 9 ISSUE: AUDIT STANDARDS SHOULD HAVE FORCE OF LAW

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The CLERP 9 paper states “Core audit standards should be given legislative backing to facilitate their enforcement by ASIC, consistent with international harmonisation objectives” (see Part 2.5, p27).

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#### ASIC response

1.73 ASIC supports the proposal to give core audit standards the force of law.

#### Discussion

1.74 ASIC supports the proposal to give core audit standards the force of law for the following reasons:

- (a) the proposal reinforces the importance of audit standards;
- (b) the proposal increases the likelihood that a change in a standard will have an immediate effect across the profession. This, in turn, enhances the system’s ability to respond to systemic problems; and
- (c) the proposal means that a breach of an audit standard can attract appropriate remedies. Currently, a breach of an audit standard can only be referred to the CALDB. Some breaches of audit standards do not warrant referral to the CALDB and possible de-registration of an auditor. On the other hand, some breaches are such that referral seems inadequate. Greater flexibility to address serious breaches would be available if a breach of a core audit standard was a breach of law.

1.75 ASIC recognises that the present audit standards are not drafted in a way that will facilitate legal enforceability. Careful thought needs to be given to how the standards should be re-written. Additionally, consideration should be given to appropriate transition periods for the re-written standards.

### ASIC ISSUE: SUBSTANCE OVER FORM

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The Act should be amended to provide that accounting treatments applied by companies should reflect the substance of transactions or balances.

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#### Why is this an issue?

1.76 Chapter 2M of the Act should be amended to require transactions and balances to be accounted for in a manner that reflects their substance. This requirement should

## ASIC SUBMISSION ON CLERP 9

have effect both in applying accounting standards and in accounting for items that are not covered by an accounting standard.

**1.77** This provision should be subject to the same remedies as other requirements in Chapter 2M in relation to the preparation of financial reports.

### Discussion

**1.78** Many accounting standards leave scope for some choice about how they apply to a particular transaction or balance. It is important that this element of choice is guided by a requirement to reflect the substance of transactions or balances, irrespective of their legal form. Such a requirement will provide accurate, meaningful, consistent and comparable financial information to users of financial reports. For example, two arrangements with identical substance should not be reflected differently in financial reports merely because of differences in the legal form of those arrangements. Disclosure of the substance of a transaction in the notes to the financial report is not always sufficient to properly inform users of financial reports, because often users focus primarily on the information provided on the face of the financial statements.

**1.79** In many cases, although accountants and auditors know the commercial objectives behind transactions and their substance, transactions are not properly accounted for in a manner consistent with their substance.

**1.80** A substance over form requirement would not be subject to the same abuse as the superseded true and fair “override”, because it affects *how* an accounting standard is applied, rather than *whether* the standard should be applied. Before 1991, the duty of the directors to ensure compliance with the accounting standards was subject to the overriding requirement that the accounts must give a true and fair view of the matters with which they deal. There was evidence of serious abuse of this true and fair override (eg companies refused to apply certain accounting standards on the basis that the application of the standard did not lead to a true and fair view). The figure arrived at following application of the standards by reference to the substance of transactions would still be included in the financial reports. A substance requirement would ensure that accounting standards are properly applied, rather than permitting a company to disregard an accounting standard. In this sense, substance over form is a narrower concept than a true and fair “override” and is subject to a much narrower interpretation.

### Accounting concepts

**1.81** Consideration should also be given to amending the ASIC Act to require the AASB to make an accounting standard containing the accounting concepts relating to the definition and recognition criteria for assets, liabilities, equity, revenue, expenses, contributions by owners and distributions to owners. These criteria assist in determining the proper treatment of items in the absence of specific accounting standards, and would be overridden by other specific accounting standards.

## Section 2: Analysts

2.1 This section sets out ASIC's response to the CLERP 9 proposals dealing with analysts. These are proposals 17 and 18.

### PART A: RESPONSE TO CLERP 9 PROPOSALS

#### PROPOSAL 17: GENERAL OBLIGATION AS IT APPLIES TO ANALYSTS

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There is a general duty on financial services licensees to ensure that financial services are provided "efficiently, honestly and fairly".

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#### ASIC response

2.2 ASIC believes that effective regulation of analysts requires an integrated legislative approach comprising:

- (a) restrictions or prohibitions on certain conduct which cannot otherwise be effectively regulated by an obligation to manage conflicts or disclose conflicts;
- (b) a general obligation on licensees to manage other conflicts when providing research reports; and
- (c) a specific obligation on licensees to disclose conflicts of interests when providing research reports.

2.3 ASIC also believes that relying on the general licensee obligation to act "efficiently, honestly and fairly" will not be a sufficiently effective way to address concerns about the conduct of analysts, even if guidance on that obligation were provided.

2.4 ASIC notes that its proposals are broadly consistent with approaches in some overseas jurisdictions (eg the USA, Canada, and the UK).

#### Discussion

##### Current difficulties in the regulation of analysts

2.5 Analysts are financial service providers that provide recommendations or opinions to clients (both wholesale and retail) about specific financial products (ie general advice about a specific product). (Typically, analysts will require an Australian financial services (AFS) licence under the Act.) These analyst opinions and recommendations, while not amounting to personal advice (in most circumstances), are intended to influence clients in making an investment decision about a particular financial product. This puts them in a special class of general advice providers.

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**2.6** The work of analysts is sufficiently influential to warrant special safeguards to ensure that direct and indirect users of reports can be reasonably confident that integrity is not flawed by conflicts. Conflict can occur either at the level of the individual doing the work, or in the organisational setting and context in which the work takes place.

**2.7** In ASIC's regulatory experience, it is uncertain and difficult to rely on the licensee's obligations to act efficiently, honestly and fairly as the sole basis to:

- (a) issue specific guidelines on minimum standards of conduct for a licensee or representatives of a licensee (eg individual researchers of an analyst);  
or
- (b) enforce specific minimum standards of conduct for a licensee or its representatives.

This uncertainty and difficulty would apply if ASIC were to rely on this general obligation, as canvassed in the CLERP 9 paper, to issue guidelines on the obligations of an analyst and its individual researchers to manage and disclose their conflicts of interest.

**2.8** ASIC sees the general obligation to act efficiently, honestly and fairly as being both a stand-alone and an encompassing obligation. This means that ASIC guidance and enforcement action normally relies on both the general obligation and on any relevant more particular obligation (eg the other more specific licensee obligations in s912A, or specific conduct and disclosure obligations applying either or both to a licensee or its representatives).

**2.9** ASIC has occasionally relied on the efficiently, honestly and fairly obligation as the sole basis for providing general guidance, or taking enforcement action. However, in its experience, regulatory outcomes are more effectively promoted by a combination of general obligations and tailored specific obligations. In ASIC's view, analysts' general obligations to act efficiently, honestly and fairly should be supplemented by a specific obligation to manage conflicts.

**2.10** The existing disclosure regime applying to general advisers does not provide a sufficient framework for conflict disclosure, as it applies to analysts' reports. The current conduct and disclosure provisions in Part 7.7 of the Act do not require specific conflicts and remuneration disclosure in a research report that contains a recommendation or opinion about a specific financial product to unidentified clients, or a class of clients. There is no obligation for a Statement of Advice (SOA) to be provided in such circumstances. An SOA requires specific disclosure of particular conflicts and remuneration arrangements when giving personal advice. A Financial Services Guide (FSG) may be provided to a client at some point before they receive a research report, but an FSG only gives general information about the service provider's conflicts and remuneration arrangements. An FSG is a one-off general-purpose disclosure document normally provided before any services (eg advice) are given. This means that the user of a research report may have received an FSG some considerable time before considering a current research report.

## ASIC SUBMISSION ON CLERP 9

**2.11** The current regulatory approach leaves clients who receive and may rely on research reports to make financial decisions without disclosure of specific conflicts and remuneration arrangements relating to that report.

### **The need for specific prohibitions relating to conflicts of interests**

**2.12** In ASIC's view, at a fundamental level, the Act needs to prohibit certain activities of analysts where conflicts cannot be effectively managed, and disclosure of such conflicts is not sufficient to mitigate consumer or market integrity risk. The activities that cause the most concern are those where the analyst or individual researcher has a direct pecuniary interest in the likely outcomes if clients acted on the recommendations or opinions expressed in the research report.

**2.13** ASIC recommends that prohibitions on the following activities be included in the Act:

- (a) trading by an analyst or its individual researchers in products that are the subject of a current research report, within a set period either side of the issue of the report (eg 30 days prior and 5 days afterwards); and
- (b) trading by an analyst or its individual researchers against a recommendation or opinion contained in a current research report.

It is important that these prohibitions apply directly to the employee or representative, as well as to the employing licensee.

**2.14** ASIC considers that the current market misconduct provisions in the Act (eg the insider trading prohibitions) do not address the instances of conduct in paragraph 2.13.

### **The need for a specific conflicts obligation**

**2.15** As noted in paragraph 2.12, analyst activity gives rise to both consumer protection and market integrity issues. For instance, there is the risk that analysts may be influenced in making recommendations or opinions in their research reports by conflicts of interest (eg between the research and investment banking activities of a financial services provider). Individual researchers of an analyst may be influenced by remuneration arrangements that reflect benefits obtained by conflicting sides of the analyst's business.

**2.16** Although ASIC considers some analyst conduct should be prohibited, ASIC does not believe that general conflicts faced by an analyst require separation of an analyst's research business from its other financial services activities. However, in ASIC's view, such analysts should be under a specific obligation to manage their conflicts of interest (in addition to being prohibited from clearly conflicted conduct).

**2.17** ASIC notes developments in jurisdictions such as the USA and Canada where quite specific conflicts obligations for analysts have been introduced. The obligations introduced in the USA and Canada include express rules about trading and ownership of financial products by analysts, individual researcher's remuneration

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and compensation arrangements, supervision of and management responsibility for individual researchers, and implementation of compliance and policy procedures.

**2.18** In ASIC's view, it is unsatisfactory to rely on the general obligation for licensees to act efficiently, honestly and fairly as the sole basis for delivering conflicts management regulatory outcomes.

**2.19** ASIC suggests that a specific obligation to manage conflicts of interest should at least apply to licensees that provide research reports (see also paragraph 2.23 where ASIC discusses whether the obligation should apply to other licensees). This obligation should be contained in the Act, rather than in the market operator's rules. Unlike the position in the USA, market operators in Australia do not regulate the greater population of analysts. Further, the obligation ASIC suggests is a principles-based obligation, and compliance with it should not be unduly onerous (eg compared to the position in the USA where quite specific obligations may apply).

**2.20** This specific obligation to manage conflicts of interest could be introduced under the Act by:

- (a) legislative amendment;
- (b) introducing a new licensee obligation by regulation under s912A(1)(j); or
- (c) a statutory supported licence condition (eg by regulation under s914A(8)).

**2.21** A possible working definition of a "research report" for discussion purposes is:

"Research report means a document or oral statement made in a public forum that includes a recommendation about or an analysis of a financial product, and provides information reasonably sufficient upon which to base a decision about that financial product."

**2.22** A possible specific conflicts management obligation could be drafted along the following lines:

"A financial services licensee providing research reports must have adequate arrangements for handling conflicts between the commercial interests of the licensee and its representatives, and its obligations to its clients."

**2.23** Consideration should also be given to whether this obligation should apply more broadly to all licensees that provide advice, or to all licensees. On a preliminary basis, ASIC sees no reason why, in principle, this obligation should not apply more universally to licensees.

### **Specific disclosures for research reports**

**2.24** The disclosure gap discussed in paragraphs 2.10 and 2.11 for specific disclosure of conflicts and remuneration arrangements by providers of research reports needs to be remedied. Disclosure requirements of this kind should supplement any general obligations on a licensee to manage conflicts (see paragraphs 2.15 to 2.23).

## ASIC SUBMISSION ON CLERP 9

**2.25** ASIC believes retail clients who receive research reports need to be informed of these details to determine what weight should be attached to the opinions or recommendations expressed in a research report. These details need to be given in the research report. It would not be possible to require these details to be disclosed in an FSG, as the details would not be known at the time of preparation of the FSG.

**2.26** ASIC considers that this new specific disclosure obligation could be implemented by legislative amendment or under a statutory supported licence condition (eg by regulation under s914A(8)). Legislative amendments would be needed to apply this obligation to research reports provided by unlicensed entities.

**2.27** An example of a specific conflicts disclosure obligation is an obligation to disclose, at the time and in the same form as the research report:

- “(a) information about any remuneration (including commission) or other benefits that any of a group of listed persons is to receive that might reasonably be expected to be or have been capable of influencing the providing entity (or its representatives) in providing the advice; and
- (b) information about:
  - (i) any other interests, whether pecuniary or not and whether direct or indirect, of a group of listed persons; and
  - (ii) any associations or relationships between the any of a group of listed persons and the issuers of any financial products;that might reasonably be expected to be or have been capable of influencing the providing entity (or its representatives) in providing the report or recommendation.”

### **PROPOSAL 18: FURTHER GUIDANCE ON DISCLOSURE BY ANALYSTS**

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The Australian Securities and Investments Commission (ASIC) will be asked to provide guidance by policy statement on the level and manner of disclosure required under this general duty, following consultations with relevant stakeholders.

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#### **ASIC response**

**2.28** Depending on the final legislative framework governing the obligations of analysts, ASIC will provide any relevant guidance about meeting the relevant obligations. In deciding the nature of that guidance, ASIC will take into account any guidance currently issued or under consideration by industry associations or market operators (such as ASX). ASIC notes that ASX is currently consulting on draft guidance for market participants.

## PART B: OTHER ISSUES

### CLERP 9 ISSUE: REASONABLE BASIS FOR GENERAL ADVICE

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Section 7.6.4 (p 126) of the CLERP 9 paper states, “The legislation could also oblige financial services licensees and their authorised representatives to have a reasonable factual basis for general advice, disclose information about that basis to retail clients, and warn retail clients if general advice could be based on any incomplete or inaccurate information.”

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#### ASIC response

**2.29** ASIC agrees with this approach. ASIC also considers that this approach is consistent with its comments on analysts in paragraphs 2.2 to 2.27. Further analysis would be required to ensure that its application did not lead to any unintended consequences (eg where general advice is given on less complex financial products).

### CLERP 9 ISSUE: DISCLOSURE OF ASSOCIATIONS

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Section 7.6.4 (p 127) of the CLERP 9 paper states, “These obligations could be extended to capture a wider range of persons in both FSGs and SOAs. For example, some reforms adopted overseas include disclosure of information about associations between product issuers and members of an analyst’s household or immediate family.”

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#### ASIC response

**2.30** ASIC agrees with this approach, and believes it is important that a wide definition of associated persons is adopted and in a manner consistent with international developments. ASIC agrees that these classes of persons should be included in the disclosure of associations for the purposes of the suggested research report disclosure (see paragraph 2.27), and for FSG and SOA purposes.

## CLERP 9 ISSUES:

### FORM OF DISCLOSURE

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Section 7.5.4 (p 127) of the CLERP 9 paper states, "Providing entities could be obliged to disclose information about 'conflicts of interest' in FSGs and SOAs. The same test could apply to FSGs and SOAs. For example, providing entities could be obliged to disclose conflicts of interest that 'might reasonably be expected to be or have been capable of influencing the providing entity'..."

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### CLARIFYING WHAT IS MEANT BY "CONFLICTS OF INTEREST"

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Section 7.5.4 (p 127) of the CLERP 9 paper states, "A related concern is that a general obligation to disclose 'conflicts of interest' could create uncertainty for providing entities. This could be largely resolved by defining 'conflicts of interest' to include the types of conflicts of interest that providing entities are already obliged to disclose ..."

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### ASIC response

- 2.31** ASIC's suggestions about analysts' disclosure of conflicts of interest are set out in paragraphs 2.24 to 2.27. ASIC supports greater clarity in disclosure of conflicts by licensees generally, and agrees that, for most licensees, the FSG or SOA is the appropriate place for disclosure.
- 2.32** When considering clarification of the meaning of conflicts of interest, ASIC suggest it includes conflicts between the commercial interests of the licensee and its representatives, and its obligations to its clients.

## Section 3: Continuous disclosure

3.1 This section sets out ASIC's response to the CLERP 9 proposals dealing with continuous disclosure. These are proposals 19 to 28 inclusive.

### PART A: RESPONSE TO CLERP 9 PROPOSALS

#### PROPOSAL 19: MAINTAIN AND ENHANCE CONTINUOUS DISCLOSURE

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The Government will maintain and enhance the framework of continuous disclosure.

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##### ASIC response

3.2 ASIC supports the proposal and endorses the fundamental settings in the Australian regime. In ASIC's view, the current continuous disclosure regime is crucial for promoting confidence in the integrity of Australian capital markets. If it works well:

- (a) market participants and users, shareholders, and potential shareholders can make their decisions to buy, sell or hold securities on the basis of fair and timely access to all relevant information;
- (b) securities research can take place effectively, so securities prices quickly and closely reflect underlying economic values; and
- (c) opportunities for insider trading and other market abuses are kept to a minimum.

3.3 In addition to being consistent with the trend of recent reform in the USA (as noted in the CLERP 9 paper), Australia's continuous disclosure regime is also consistent with current IOSCO guidance on international best practice. While regimes vary, the requirement for listed companies to provide timely information on matters likely to materially affect their share price is common to major world markets.

#### PROPOSAL 20: ENFORCEMENT RESPONSIBILITY

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Both ASIC and ASX will continue to have the capacity to enforce the continuous disclosure provisions that apply to listed entities.

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##### ASIC response

3.4 ASIC supports the proposal, and the current sharing of responsibilities for continuous disclosure.

## ASIC SUBMISSION ON CLERP 9

**3.5** ASIC also considers that this regime needs to be regularly monitored and reviewed including to take into account ASX's future commercial arrangements. This is because, in addition to ASX being the primary standard setter and regulator for the continuous disclosure regime (with the obligation under s792A to ensure that the market is a fair, orderly and transparent market), ASX also has commercial interests in relation to entities that wish to use its market facilities. This situation means there is potential for conflict between the regulatory role and commercial interest.

**3.6** In ASIC's opinion, the possibility of such a conflict of interest is not currently so pressing as to require a change in current arrangements. However, the issue needs to be subject to ongoing review, including through ASIC's annual review of the adequacy of each market licensee's arrangements, including ASX (see s794C(2)).

**3.7** Another reason ASIC considers this regime needs to be regularly monitored and reviewed is because there is more than one licensed market. This means there is a potential for significant variations in the content and administration of disclosure rules across different markets, in addition to the possibility of regulatory arbitrage.

**3.8** Consequently, ASIC considers two main issues require attention:

- (a) the potential for conflicts of interest arising in the case of demutualised, commercially focused and self-listed exchanges; and
- (b) the proliferation of licensed markets, with the potential for divergence in the content and administration of disclosure rules across different markets.

### **PROPOSAL 21: HIGHER MAXIMUM CIVIL PENALTIES**

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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 from \$200,000 to \$1 million.

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#### **ASIC response**

**3.9** ASIC supports the proposal.

### **PROPOSAL 22: ADMINISTRATIVE PENALTIES**

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ASIC will be given the power to impose financial penalties and issue infringement notices in relation to contraventions of the continuous disclosure regime.

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#### **ASIC response**

**3.10** ASIC supports the proposal. ASIC's view is that a power to impose administrative fines for contraventions of the continuous disclosure regime will

improve the flexibility, cost effectiveness and timeliness of remedies, and underpin the integrity of the law by providing a proportionate remedy for conduct that may not otherwise be addressed. A power to fine is an important tool particularly for late or inadequate disclosure, where existing remedies are ineffective or overly complex

**3.11** An ability to issue an infringement notice would allow ASIC to signal its views on appropriate disclosure practices to listed entities more effectively than through court action alone.

### **Discussion**

**3.12** Currently, contraventions of the continuous disclosure provisions are subject to both civil and criminal consequences. In the past, it has been extremely difficult to prosecute offences or take effective civil action for breaches of disclosure after the event. ASIC intervention can speed up and, in some cases, cause proper disclosure, but instituting formal proceedings, even of a civil nature, is not necessarily the best means of regulating and improving disclosure conduct.

**3.13** The ability for the regulator to respond quickly to contraventions of the continuous disclosure provisions is particularly important, since these types of contraventions have an immediate impact on the market. A quick remedy imposed without the delay inherent in court procedures is more relevant to the market. If there is a shorter period between the failure to disclose and the determination that a fine should be payable as a result of the failure, the enforcement action has more market impact and is more likely to change behaviour. Consequently, ASIC considers that a power to impose fines will provide an important enforcement tool that will give a relatively fast, flexible and proportionate outcome for a lower level failure to disclose by providing an immediate consequence that is a timely and appropriate reaction to the conduct. Such a remedy is also a means of encouraging a culture of disclosure, and reinforcing companies' obligations to ensure an informed market.

**3.14** The requirement to seek a court order to enforce an administrative penalty will be a significant safeguard against ASIC abusing its power or making erroneous decisions.

### **Aligning with international markets**

**3.15** Many foreign regulators use administrative penalty regimes to great effect. The widespread use of these schemes demonstrates that they are a valuable enforcement tool, flexible enough to be used in a variety of regulatory regimes to address a range of conduct. For example, in the UK, the Financial Services Authority (FSA) has been given considerable powers to levy financial penalties under the *Financial Services and Markets Act 2000*, which commenced in November 2001. The regime in the USA contemplates that administrative penalties will be imposed by the Securities Exchange Commission (SEC) in serious cases against entities it regulates (such as broker-dealers and registered representatives). Other jurisdictions where administrative penalties may be imposed by the regulator include Hong Kong, Ontario, Saskatchewan, Greece, Korea, China and Poland.

**3.16** It is important for Australian regulators to be on an equal footing to their international counterparts to encourage confident participation in Australian financial markets by international investors and financial service providers. However, this does not mean that Australian administrative remedies should exactly mirror those in overseas jurisdictions.

### **Level of penalty**

**3.17** Administrative penalties need to be proportionate to the conduct that amounted to a breach of the continuous disclosure obligations, and to be effective as an enforcement tool. The level of the fine needs to reflect the need to deter the conduct in question.

**3.18** The level of penalty should also reflect the consequences of non-disclosure. Penalties need to deter contraventions based on overly technical approaches. These contraventions are as harmful to the community of investors who “commonly invest in securities of a kind whose price or value might be affected by the information” (s676(2)(b)(i)), as intentional contravention. In other words, the market suffers the same harm regardless of whether or not the non-disclosure is intentional.

## **PROPOSAL 23: CIVIL PENALTIES IN RELATION TO OTHER PERSONS INVOLVED IN A CONTRAVENTION**

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In addition to its power to seek civil penalties in relation to contraventions of the continuous disclosure regime by disclosing entities, ASIC will be empowered to seek such a penalty against any other person involved in a contravention.

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### **ASIC response**

**3.19** ASIC supports the proposal. For it to be effectively implemented, the definition of “involved in” should be that in s79 of the Act.

## **PROPOSAL 24: COMPENSATION MECHANISMS**

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The Government will amend the civil recovery provisions relating to contraventions of the continuous disclosure provisions of the law to clarify that a person may seek compensation regardless of whether ASIC has sought a declaration of contravention.

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### **ASIC response**

**3.20** ASIC supports the proposal.

## PROPOSAL 25: DISSEMINATION OF INFORMATION

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All investors should have equal access to materially price sensitive information disclosed by listed entities.

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### ASIC response

**3.21** ASIC supports the proposal. In implementing this proposal, there seems no reason in principle why market operators' rules should not permit disclosure of price sensitive information to be provided by a variety of possible methods. These include:

- (a) through market operators making price sensitive information immediately available to all investors;
- (b) through listed entities establishing websites and posting materially price sensitive information at the same time that this information is first released by the relevant market operator;
- (c) by providing the material to a publisher (similar to requirements in the UK and USA); or
- (d) by other means.

## PROPOSAL 26: GUIDANCE TO LISTED ENTITIES

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Market operators will be encouraged to ensure that they provide listed entities with education and guidance to promote compliance with the continuous disclosure provisions of their respective listing rules.

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### ASIC response

**3.22** ASIC supports the proposal.

## PROPOSAL 27: EXTERNALLY GENERATED SPECULATION

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Market operators should require listed entities to respond to externally generated speculation in circumstances where the operator determines that this is having a significant impact on the market for their securities.

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### ASIC response

**3.23** ASIC supports the proposal. ASIC also considers a "false market" test would improve certainty in the case of market rumour by making it clear that companies must respond to market rumour in instances where those rumours are having an impact on their share price, regardless of whether the company has any other "information" to disclose. ASIC acknowledges recent ASX efforts in amending its

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listing rules in this area and, in particular, the Exposure Draft of the proposed ASX listing rule amendments on Enhanced Disclosure released in July 2002.

### **PROPOSAL 28: RELATIONSHIP WITH FUNDRAISING DISCLOSURE**

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Issuers of managed investment products that are continuously quoted securities will be permitted to issue transaction specific product disclosure statements.

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#### **ASIC response**

**3.24** ASIC supports the proposal.

## Section 4: Disclosure requirements for shares and debentures

4.1 This section sets out ASIC's response to the CLERP 9 proposals dealing with disclosure requirements for shares and debentures. These are proposals 29 to 31 inclusive.

### PART A: RESPONSE TO CLERP 9 PROPOSALS

#### PROPOSAL 29: IMPROVE THE PRESENTATION OF PROSPECTUSES

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The Government will improve the effectiveness of disclosure in prospectuses through extending the requirement for "clear, concise and effective wording and presentation" in Chapter 7 for product disclosure statements to Chapter 6D for prospectuses.

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##### ASIC response

4.2 ASIC supports the extension of the requirement for "clear, concise and effective wording and presentation" for a PDS in Chapter 7 to the Chapter 6D prospectus regime.

4.3 If this requirement is extended to Chapter 6D, the requirement should also apply in the context of other documents that require prospectus-like disclosure (eg takeover documents both for securities and managed investment schemes, and other change of control documents).

4.4 It should be clear that if the obligation is breached (either for prospectuses or PDS), ASIC may issue a stop order.

#### PROPOSAL 30: HARMONISATION OF WHEN DISCLOSURE IS NOT REQUIRED

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The Government will more closely align the exemptions from the disclosure regimes that apply to sophisticated investors and wholesale clients.

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##### ASIC response

4.5 ASIC supports the principle underlying the proposal. In implementing the proposal, further analysis of the particular exemptions will be required to take into account any key distinguishing features of a financial product among the broad range of financial products covered under the Act.

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**4.6** ASIC is concerned that any further harmonisation beyond what is set out in the proposal not be at the expense of investor protection. In particular, ASIC would be concerned about a proposal to introduce an “opt out” mechanism for point of sale disclosure (previously discussed during the drafting of FSR) so that investors could decide they did not want a prospectus or PDS.

**4.7** Because the exemption dealing with certification by licensees (under s708(10)) is quite limited in practice (due to liability concerns), it should be removed from the Act rather than extended to financial products.

### **PROPOSAL 31: IMPROVE THE OPERATION OF THE PLACEMENT PROVISIONS**

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The Government proposes that the disclosure requirements for secondary sales reflect the principle that where a person:

- already holds pertinent information, or
- has access to comparable information to what they would have otherwise received in a reasonable, timely and cost-effective manner,

no further disclosure obligations should apply.

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### **ASIC response**

**4.8** ASIC supports the principle underlying the proposal. An analogous exemption should be provided for other financial products under Chapter 7 of the Act if the requirements discussed in paragraphs 4.9 and 4.10 are met.

**4.9** Generally, ASIC believes that no further disclosure obligations should apply to the sale of a financial product if financial products of that class are already listed on ASX and either:

- (a) a current prospectus or PDS for the product existed at or after the time the financial product was issued, but before its sale; or
- (b) that class of product was listed for at least 12 months, and an “update” is lodged with ASX of any material information not already disclosed that would be otherwise be required in a PDS or s713 prospectus (if one were issued).

**4.10** ASIC also supports exemption from the secondary sales provisions for certain financial products that were originally issued under statutory or ASIC exemptions, where the strict application of the secondary sales provisions might result in unintended consequences. Examples are sales of products that were issued under dividend reinvestment or bonus share plans, or under ASIC relief for employee share schemes.

## **ASIC SUBMISSION ON CLERP 9**

**4.11** In November/December 2002, ASIC intends to issue a policy statement on “Disclosure for on-sale of securities and other financial products”. ASIC suggests that the relief to be provided under that policy addresses some of the possible unintended consequences of the secondary sales provisions. The policy might be a useful starting point in considering what further clarification might be given in the Act.

## Section 5: Enforcement issues

5.1 This section sets out ASIC's response to the CLERP 9 proposals dealing with enforcement issues. These are proposals 32 to 35 inclusive.

### PART A: RESPONSE TO CLERP 9 PROPOSALS

#### PROPOSAL 32: REVISION OF CIVIL AND CRIMINAL PENALTIES

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ASIC will monitor the adequacy of civil and criminal penalties and make such recommendations as are required to ensure consistency and adequacy of penalties under the law.

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##### ASIC response

5.2 ASIC agrees with the Government's view that civil and criminal penalties need to be reviewed in order to promote consistency and adequacy under the Act. This review should cover the adequacy of penalties in the Act generally, not just penalties for offences relating to financial reporting. It is important that the approach to penalties in the Act be consistent and coherent.

5.3 ASIC intends to make a separate confidential submission to Treasury about technical enforcement issues associated with the financial reporting provisions. ASIC's comments on enforcement matters in this CLERP 9 submission should be seen in the context of its more general comments in that separate enforcement submission.

#### PROPOSAL 33: AUDITOR'S DUTIES UNDER THE LAW WILL BE EXPANDED

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The Government will amend the law to expand matters, which auditors must report to ASIC to include any attempt to influence, coerce, manipulate or mislead the auditor.

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##### ASIC response

5.4 ASIC supports the proposal. ASIC makes the following comments about the current obligation under the Act on auditors to report to ASIC:

- (a) *The reporting obligation* — Section 311 of the Act should be amended so that matters are required to be reported to ASIC, irrespective of whether they can be adequately dealt with in the audit report or by bringing them to the attention of the directors. The report should be made within 7 days of the auditor becoming aware of a suspected contravention.

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- (b) *Copies of reports* — Consideration could be given to a specific obligation for auditors to provide ASIC with a copy of any qualified audit report and audit reports containing “emphasis of matter” paragraphs.
- (c) *Adequate remedies* — The current penalty for failure to comply with s311 should be increased, and a similar penalty should apply to a failure to report attempts to influence, coerce, manipulate or mislead an auditor.

## Discussion

### Section 311

**5.5** As it presently stands, s311 requires the auditor to notify ASIC only if the auditor has reasonable grounds to suspect that a contravention has occurred, and the contravention has not been or will not be adequately dealt with by commenting on it in the auditor’s report or bringing it to the attention of the directors. Under s1289, an auditor has qualified privilege for such notifications.

**5.6** In practice, many auditors seem reluctant to report suspected breaches of the Act to ASIC under s311, and place inappropriate reliance on bringing the matter to the directors’ attention. Additionally, where matters are reported, there can be substantial delays in such reporting. In ASIC’s view, this is almost certainly a result of both the current form of the obligation and the remedies available to ASIC if a contravention is proved.

**5.7** In light of these problems, in ASIC’s view, s311 should be amended so that suspected contraventions are required to be reported to ASIC, irrespective of whether they can be adequately dealt with in the audit report or by bringing them to the attention of the directors. The report should be made within 7 days of the auditor becoming aware of a suspected contravention.

**5.8** The regulatory benefit of strengthening s311 is significant. As an external and independent party reviewing a company’s financial statements, an auditor is in a good position to determine whether a contravention has occurred. It is therefore important that auditors be compelled to report *any* contravention of the law to ASIC, on a timely basis. Ultimately, the importance of financial reporting requires that there be such an obligation on the auditor.

**5.9** Moreover, it is anomalous for company auditors to be subject to a lesser obligation than, for example, auditors of AFS licence holders, who are subject to an unqualified obligation to report suspected breaches to ASIC within 7 days of becoming aware of a contravention (see s990K). However, under s311, company auditors are only required to notify ASIC of a contravention “as soon as possible”, which can result in substantial delays in reporting.

**5.10** In addition, most auditors do not currently bring qualified audit reports to the attention of ASIC because there is no specific obligation to do so. Consideration could be given to a specific obligation for auditors to provide ASIC with a copy of

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any qualified audit report. This obligation could also be extended to audit reports containing “emphasis of matter” paragraphs. These paragraphs allow the auditor to draw attention to a matter without committing to a qualified opinion.

**5.11** An obligation to draw attention to qualified audit reports would also remove practical problems that ASIC faces in identifying qualified audit reports, and thus enable ASIC to act quickly on non-compliance issues.

### **Adequate remedies/penalties**

**5.12** The current penalty available for a breach by an auditor of the obligation to report suspected contraventions to ASIC is manifestly inadequate.

**5.13** The current penalty is 10 penalty units (\$1,100) and/or 3 months imprisonment. This contrasts with the penalty that applies for similar provisions in other parts of the Act (eg 50 penalty units (\$5,500) and/or 1 year imprisonment for auditors of AFS licence holders who fail to report matters to ASIC under s990K).

**5.14** Similarly, under the *Insurance Act 1973* (as recently amended), the penalty for an auditor who contravenes the obligation to report to the Australian Prudential Regulation Authority (APRA) is 60 penalty units (for strict liability offences) and 100 penalty units (for other offences).

**5.15** Auditors’ reporting obligations will only be effective if failure to comply carries a significant penalty. The current penalty for failure to comply with s311 should be increased, and a similar penalty should apply to a failure to report attempts to influence, coerce, manipulate or mislead an auditor.

## **PROPOSAL 34: STREAMLINE AUDITOR DISCIPLINE ARRANGEMENTS**

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The institutional arrangements for taking disciplinary action against registered company auditors in the CALDB will be strengthened.

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### **ASIC response**

**5.16** ASIC supports strengthening the institutional arrangements for taking disciplinary action against auditors.

**5.17** ASIC suggests that it is inappropriate for the FRC to refer matters to the CALDB for enforcement (see ASIC’s response to proposal 1 at paragraphs 1.14 to 1.17).

**5.18** ASIC supports the proposal to allow the CALDB to provide information to the investigation and disciplinary committees of the accounting professional bodies. However, a similar power needs to be provided to ASIC to enable it to provide accounting professional bodies with the information it obtains during the course of an investigation. This proposal has already been raised by ASIC in a context other than the CLERP 9 proposals.

## PROPOSAL 35: REPORTING OF BREACHES TO ASIC BY AUDITORS

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The Government will amend the law to provide qualified privilege and protection against retaliation in employment for any company employee reporting to ASIC, in good faith on reasonable grounds, a suspected breach of the law.

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### ASIC response

**5.19** ASIC supports the proposal. The law should protect from legal and employment risks those who perform the important public service of drawing suspected contraventions to the attention of the regulator. ASIC has the following comments about the proposal's implementation:

- (a) instead of the protection operating for breaches reported in good faith and on reasonable grounds, ASIC suggests that the provision be worded so that the protection applies unless the reporting is frivolous or vexatious. This affords additional protection to the reporting employee, as it shifts the onus of proof for the application of the protection from the employee to the person challenging the protection;
- (b) the protection should extend to both voluntary and obligatory reporting, so that it applies to any obligations on corporate officers to report contraventions; and
- (c) the current proposal only extends to reporting to ASIC, and not to raising matters at a higher level within the corporation (ie with the directors) or with the auditor. In addition to protection when raising matters with ASIC, employees need to have the confidence to raise matters with the directors of the company or the auditor, without threat of retaliation. Therefore, ASIC suggests that the protection also be extended to employees/officers who report suspected contraventions of the Act to the *directors* or the *auditor*. These protections might include penalties for those who discriminate against such officers, compensation for damage, and immunity from civil actions for defamation and breach of confidentiality.

## PART B: OTHER ISSUES

### ASIC ISSUE: REPORTING OF BREACHES TO ASIC BY PERSONS OTHER THAN AUDITORS

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There should be an obligation on senior company officers parallel to that imposed on auditors to report suspected contraventions of the Act to ASIC.

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#### Why is this an issue?

**5.20** Currently, there is no obligation on senior company officers (who may be the first to know about accounting irregularities) to provide information to ASIC about accounting or reporting irregularities.

**5.21** ASIC proposes that, like auditors, senior company officers responsible for the financial reporting function should be subject to an express obligation to report suspected contraventions of the Act to ASIC. This obligation could be modelled on the obligation for auditors and actuaries under the life insurance legislation.

**5.22** The obligations should at least apply to the most senior finance officer who is not a board member (ie the CFO).

**5.23** Adequate protection should also be provided to such officers. ASIC notes that proposal 35 seeks to amend the law to provide qualified privilege and protection against retaliation in employment for any company employee reporting to ASIC a suspected breach of the law, and suggests that this proposal should apply to protect the CFO or other officers obliged to report to ASIC.

**5.24** Consideration should also be given to imposing penalties for those who discriminate against such officers, compensation for damage, and immunity from civil actions for defamation and breach of confidentiality.

#### Discussion

**5.25** Recent events (especially the evidence given in the HIH Royal Commission) strongly suggest the need for company officers, as well as auditors, to have a reporting obligation, together with appropriate protection from any adverse consequences of that action. Typically, breaches of the financial reporting obligations require systematic involvement or acquiescence on the part of company officers, as well as acquiescence by the auditor. It is likely that company officers may be aware of misconduct at an earlier stage than the auditor.

**5.26** Pressure from executive directors and other board members on senior officers responsible for the financial reporting function can be extremely strong and may threaten an officer's current and future employment, even more strongly than the economic pressure that is sometimes applied to auditors.

## **ASIC SUBMISSION ON CLERP 9**

**5.27** In these circumstances, it is ASIC's view that a clear obligation with strong protections is required to ensure that company officers fulfil their obligations to the company and its shareholders. In ASIC's view, this is best achieved by an express obligation on senior finance officers parallel to that applied to auditors. The obligation should at least apply to the most senior finance officer who is not a board member, and carry similar penalties for a failure to comply, with the protections referred to in proposal 35 for those who comply.

## Section 6: Shareholder participation and information

6.1 This section sets out ASIC's response to the CLERP 9 proposals dealing with shareholder participation and information. These are proposals 36 to 41 inclusive.

### PART A: RESPONSE TO CLERP 9 PROPOSALS

#### PROPOSAL 36: SHAREHOLDERS AND INVESTORS ADVISORY COUNCIL

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The Government will establish a Shareholders and Investors Advisory Council, to be chaired by the Parliamentary Secretary to the Treasurer, which it will consult on all disclosure-related reforms to ensure they meet the needs of retail investors.

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##### ASIC response

6.2 ASIC supports the proposal.

#### PROPOSAL 37: SHORTER, MORE COMPREHENSIBLE NOTICES OF MEETINGS

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The Government will encourage shorter, more comprehensible notices of meetings.

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##### ASIC response

6.3 ASIC agrees that shorter notices should be encouraged.

##### Short form notices

6.4 ASIC agrees that the Act should be amended to provide for short form notices. The relevant provision should be modelled on s712, dealing with short form prospectuses.

6.5 Members should be entitled to opt to receive short form notices, rather than full notices. They should also be entitled to ask for the full notice, after having received the short form notice.

6.6 There should be minimum statutory requirements as to the contents of the short form notice. The notice must set out sufficient information about the contents of the full notice to allow a member to decide whether to obtain a copy of the full notice. Some matters may be so significant that the legislation may provide that they must be fully disclosed in any short form notice (eg related party benefits or qualifications in an expert's report).

### Comfort provision for corporate officers

**6.7** ASIC notes that a comfort provision for corporate officers does not address the real reason for long notices, which is the validity of the meeting and resolutions passed at the meeting. Under the current law, if the notice is misleading, then the meeting or relevant resolution is invalid. Long notices are drafted primarily to avoid this invalidity, not to avoid officer liability. Most case law on meetings concerns the issue of validity, not the liability of corporate officers for defective notices.

**6.8** ASIC does not believe that a comfort provision should apply to protect the validity of the meeting or relevant resolution. The proposition that the meeting or relevant resolution is invalid if the notice is misleading, is correct as a matter of principle. Many members will decide whether and how to vote solely on the basis of the notice. ASIC considers that a misleading short form notice should affect the validity of the meeting, just as an ordinary misleading notice will affect the validity of the meeting.

**6.9** It is difficult to comment on the need for a comfort provision for corporate officers without seeing a draft of the provision. For example, if the short form notice of meeting is deemed, for some purposes, to include the long form notice of meeting, and members have the opportunity to obtain the latter without charge, then a comfort provision may be unnecessary.

### Guidelines

**6.10** The ASX Corporate Governance Council is well placed to develop best practice guidelines for listed entities on matters such as notices of meetings and electronic communication with shareholders. However, ASIC notes that best practice guidelines developed by the ASX Corporate Governance Council may not be appropriate for use by non-listed companies and may provide little assistance to this extremely large and diverse group of companies.

## PROPOSAL 38: BUNDLED RESOLUTIONS

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The proposed best practice guidelines on notices of meetings will include a section dealing with the explanatory material for “bundled resolutions”.

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### ASIC response

**6.11** ASIC supports the bundling of related resolutions. For ASIC’s comments on the development of best practice guidelines by the ASX Corporate Governance Council, see paragraph 6.10.

## **PROPOSAL 39: SHAREHOLDER PARTICIPATION USING NEW TECHNIQUES**

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The Government will facilitate improved shareholder participation by electronic means (including electronic proxy voting, internet broadcasting and related technologies).

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### **ASIC response**

**6.12** ASIC supports the removal of unnecessary legislative hurdles to the use of technologies.

**6.13** ASIC considers that any amendment to the Act to facilitate electronic communications should be consistent with the following key principles:

- (a) the provisions relating to electronic document delivery, and e-communications generally, should be consistent across the Act;
- (b) e-communications should be permitted as an “opt in” process only;
- (c) a person should have the right to request a paper version of a document previously sent electronically;
- (d) anything conducted electronically should be kept in such a way that allows it to be reproduced in written form at any time;
- (e) a document, notice, information or statement that is to be given in electronic form must, as far as practicable, be presented in a way that will allow the person to whom it is given to keep a copy of it so that the person can have ready access to it in the future; and
- (f) the mechanisms for authentication of electronic documents and identities should be clarified.

**6.14** For ASIC’s comments on the development of best practice guidelines by the ASX Corporate Governance Council, see paragraph 6.10.

## **PROPOSAL 40: DISCLOSURE OF OTHER DIRECTORSHIPS**

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The Government will amend the law to require the annual directors’ report for listed companies to disclose, with respect to each director holding office during the reporting period, details of all other directorship positions held currently and held over the past 2 reporting periods.

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### **ASIC response**

**6.15** ASIC supports the proposal.

**PROPOSAL 41: ELECTRONIC DISTRIBUTION**

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The Government will facilitate electronic distribution of annual reports.

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**ASIC response**

**6.16** ASIC supports the proposal to permit members to elect to receive annual reports and notices electronically. ASIC considers that any amendment to the Act to facilitate electronic communications with members should be consistent with the key principles in ASIC's response to proposal 39 at paragraph 6.13.

**6.17** For ASIC's comments on the development of best practice guidelines by the ASX Corporate Governance Council, see paragraph 6.10.