

CLERP 9: An overview of key policy changes

The draft Bill incorporates most of the aspects of the CLERP 9 discussion paper that was released on 18 September 2002. What follows is a brief summary of key issues covered by the draft Bill and the explanatory memorandum. The two documents combined total almost 380 pages, with some of the implications of the draft legislation only becoming clear when the legislation itself is carefully read.

Financial Reporting Council

The FRC has been given what appears to be a swag of wide-reaching powers that includes very strong information gathering provisions resembling those possessed by the corporate regulator, the Australian Securities and Investments Commission. Other oversight functions given to the Council as part of this process are the oversight of the auditing standard setter, compliance by auditors and companies with audit-related disclosure requirements, and the teaching of ethics in universities and by the accounting profession generally. The draft Bill tends to replicate the FRC's powers over the Australian Accounting Standards Board for the purposes of overseeing the auditing standard setter, the Auditing and Assurance Standards Board. Excluded from that scope paragraph of the AuASB's responsibilities is a requirement to develop a conceptual framework. See comment piece for further analysis of the provisions for the FRC and the AuASB.

Legal backing for auditing standards

The Federal Government continues its takeover of processes of setting professional standards for accountants and auditors by drafting provisions that give the auditing standards legal backing. CLERP 9 proposed legal backing following angst expressed by the corporate regulator about an alleged lack of power to get regulatory outcomes against auditors and audit firms. A modification to the views expressed on what auditing standards should be given legal backing in the CLERP 9 paper on auditing standards is apparent in the draft legislation. All auditing standards will be given legal backing after stakeholders and the ASIC asserted to the government during the consultative phase that it was difficult to define what standards constituted a 'core' group of standards.

Auditor rotation

Auditors will be rotated every five years under the draft provisions but the ASIC will be able to give relief for people out in the bush.

CEO/CFO signoff

Company boards will receive a certification from chief executive officers and chief financial officers to state the accounts are prepared in accordance with all mandatory requirements.

Financial Reporting Panel

Courts of law are seen as being notoriously unreliable when it comes to understanding accounting standards and their interpretation. Both the ASIC and the general populace of the profession support the concept of establishing an expert body responsible for the

interpretation of accounting pronouncements where the ASIC and an entity are in dispute. The current proposal limits the person capable of putting the issue to the FRP, which will probably operate in a similar fashion to the existing takeovers panel, to the ASIC. Rumblings from within the profession are likely to result in a series of submissions suggesting that companies can opt to put issues before the commission themselves.

Conflicts of interest.

The draft bill will require people operating in financial services entities to provide disclosures regarding conflicts of interest. This is of particular relevance to the analyst community, which has been under scrutiny in the US following the various collapses of major corporations such as Enron and WorldCom.

Infringement notices

Companies that fail to follow continuous disclosure rules may be hit by the corporate regulator with a 'speeding ticket' style infringement notice. 'An infringement notice will specify payment of a financial penalty based on a company's market capitalisation and disclosure of information if considered necessary by ASIC, and will indicate that compliance with the notice will be published,' the summary in the explanatory memorandum states. 'In proceedings to impose a civil penalty (following a failure to comply with an infringement notice), the court's discretion as to the amount of the penalty will not be further restricted.'

Disqualification of directors

Those directors that find themselves at the sharp end of an investigation by the ASIC could in extreme circumstances cop a 15-year suspension, which is 10 years more than the current five-year automatic suspension or disqualification period. A court application will need to be made by the ASIC to get the triple-scoop disqualification in place.

Sophisticated and retail investors

There was not progress on this issue. While it was raised in CLERP 9 the Federal Government says there was no apparent consensus on how retail/wholesale and sophisticated investors should be defined.

Executive remuneration

There are several issues the draft legislation covers in relation to executive remuneration. Key points covered in the draft bill include:

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

HIH Recommendations

One of the reasons for the delay in progressing the corporate law reforms has been the Federal Government's struggle to find a way of properly fitting the recommendations of the HIH Royal Commissioner, Justice Neville Owen. The report was released in April and a select number of those recommendations have been incorporated into the legislation. A new standard of independence test will be included in the legislation that will force boards of directors and auditors to seriously evaluate whether they can afford to be seen to be associating with each other at all in the commercial sense. 'The general standard of independence proposed in CLERP 9 will be refined to provide that an auditor is not independent with respect to an audited body if the auditor *might* be impaired — or a reasonable person with full knowledge of all relevant facts and circumstances *might* apprehend that the auditor might be impaired — in the auditor's exercise of objective and impartial judgment on all matters arising out of the auditor's engagement,' the explanatory memorandum states.

Directors will be required to provide a statement of all non-audit services they have sourced from the audit firm and the relevant fees paid to the external audit firm for each of those items of work. Directors will also be required to explain why they believe independence is not under threat when the external auditor provides non-audit services.

Partners and staff of accounting firms will be subject to fairly stringent cooling off periods of up to four years, which is the period during which they cannot take a position with a board of directors that is overseeing the operations of a former audit client. Professional employees engaged in the audit and making decisions on how accounting and auditing standards should be applied by the client are also caught. They will face a cooling-off period of four years. Those partners that have had no contact with the audit will be banned from joining the board of a former client of their firm for two years.

No more than one former partner can be a director or senior officer with an audited body. This is directly drawn from the HIH Royal Commissioner's recommendations.

Mandatory management discussion and analysis will be required in company annual reports so shareholders receive a narrative account of the past, present and expected future direction of companies.

The Bill is also an attempt to clarify who an officer in a company is for the purposes of determining responsible individuals under the Corporations Act.

This article was supplied by Tom Ravlic. Tom Ravlic is a financial journalist who has spent the past seven years covering the accounting profession, accounting and audit standard setting and corporate governance. His work has appeared in various publications including *Business Review Weekly*, *Personal Investment* (now *Personal Investor*), *The Age*, *CFO Magazine*, the *Australian CPA*, the *Company Director Journal* and the

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