CHARTERED SECRETARIES
AUSTRALIA

Leaders in governance

17 November 2010

The Hon David Bradbury MP
Parliamentary Secretary to the Treasurer
Parliament House
CANBERRA ACT 2600

Dear David

Corporations Amendment (Corporate Reporting Reform) Act 2010

Chartered Secretaries Australia (CSA) is the independent leader in governance, risk and compliance. As the peak professional body delivering accredited education and the most practical and authoritative training and information in the field, we are focused on improving organisational performance and transparency. Our Members are all involved in governance, corporate administration and compliance with the Corporations Act (the Act). Our Members work in both public listed and public unlisted companies, as well as in private companies. We have drawn on their experience in the formulation of this submission.

Concerns with lack of clarity as to application of new test for payment of dividends from capital

CSA is on record as having supported the repeal of the 'profits test' in the Act and its replacement with a more flexible requirement allowing a company to pay dividends. That is, CSA's support was subject to an understanding that the profits test would be replaced by a basic solvency test, so that a company could pay a dividend provided it did not affect its ability to pay its debts as and when they become due.

The changes to the legislation allow a company to pay a dividend other than out of profits, subject to meeting the three new tests that:

1. the company's assets must exceed its liabilities immediately before the dividend is declared and the excess is sufficient for payment of the dividend
2. the payment of the dividend is fair and reasonable to the company's shareholders as a whole
3. the payment of the dividend does not materially prejudice the company's ability to pay its creditors.

CSA notes that the first test is a balance sheet test, rather than a solvency test. The second and third tests are additional requirements to those required for dividends paid out of profits.
CSA notes that it has already written to the government (our letter of 20 July 2010 is attached) setting out our concerns with a late amendment to the Corporations Amendment (Corporate Reporting Reform) Bill 2010, that saw the insertion of a provision that ties the calculation of 'assets' and 'liabilities' to the International Financial Reporting Standards (IFRS) in relation to

the reform of the test for the payment of dividends. Our concern with the onerous compliance burden this late amendment introduces for smaller companies remains.

We are now writing, not only to reiterate this concern, but to seek further clarification on the application of the new tests for the payment of dividends. As companies seek to meet the requirements of the new tests, some very real practical concerns have arisen as to how the legislation is to be interpreted.

CSA Members are keen to ensure that their companies comply with the legislation and strongly encourage the government to provide further clarification on the issues set out below. There is particular urgency attached to the need to receive guidance on how companies can comply with the legislation, given that the companies with a 30 June balance date will need to provide advice to their boards in January 2011 on how payments of dividends can be effected.

1 Application of the net assets test to group companies

The net assets test is based on net assets. Where dividends are being 'streamed up' to the ultimate holding company in a corporate group, each company within the stream must meet the test.

However, a wholly owned subsidiary in the group may not meet the net assets test, even though the group as a whole does. For example, a parent company may have a very profitable wholly owned subsidiary which is held through an intermediate wholly owned holding company. If there is a deficiency of assets in the intermediate holding company, the parent company may not be able to access the dividends from the profitable subsidiary to permit the parent company to pay dividends to its shareholders.

In many corporate groups a deed or deeds of cross-guarantee may be in place effectively providing comfort that the group as a whole will meet the debts of each company in the group.

Under the current provisions, although the group is solvent and can meet the net assets test on a consolidated basis, the position of an intermediate entity which is deficient in terms of meeting the test can prevent a dividend payment being 'streamed up' through the group. Such a prohibition will not affect the ability of the group to pay its debts, but might prevent the parent company in the group paying dividends to its shareholders.

CSA recommends that for wholly owned subsidiaries in corporate groups the solvency test is the only test that would be applied to payments of dividends, subject to the consolidated group being solvent and a deed of cross guarantee being in place.

2 'Fair and reasonable' test

It is not clear in the context of a dividend what is meant by the requirement that it be 'fair and reasonable to the company's shareholders as a whole'. Proprietary company directors can decide to pay differential dividends. Some companies have constitutions that provide for special dividend rights for the holders of different classes of securities that they may issue. The new test may therefore compromise the ability to pay differential dividends.

CSA recommends that the government provide clarification as to how the legislation is intended to operate in different circumstances, such as where there are multiple classes of shares on issue.

3 Reduction of share capital

It is unclear as to whether a dividend paid under the new provision can be an authorised reduction of share capital that does not have to satisfy the requirements of Chapter 2J of the Act. CSA notes that there are divergent legal views held on this issue, reflecting the lack of clarity as to how the new provision is meant to operate.

CSA recommends that the government provide clarity as to whether the new provision operates as an exception to the requirements in Chapter 2J of the Act (for example, that paying a dividend will be an 'otherwise authorised' method of reducing share capital for the purposes of section 256B(1) of the Act).

4 Declaration of dividend

The new tests require that assets exceed liabilities immediately before the dividend is declared. Most company constitutions currently provide for the board to 'determine' that dividends are payable rather than declare a dividend. The issue is that once the dividend is 'declared' by the directors of a company, it becomes a debt owing to shareholders by the company at the time it is declared rather than at the payment date (s 254V).

There are divergent legal views as to how the drafting is to operate. One view is that the reference to 'declaration' of the dividend is to be treated as a reference to a resolution to pay the dividend. A second view is that dividends now need to be declared, which means that at the time of payment of the dividend a contingent liability is in place even if the directors decide not to proceed with the payment due to changed circumstances, as the liability arises when the dividend is declared. This would herald a return to the capital maintenance doctrine, yet the new provision is expressly designed to move away from this doctrine.

CSA notes that companies are amending constitutions by removing any reference to the 'out of profits' test for the payment of dividends. CSA is concerned that additional amendments to the constitution that are being put to shareholders that involve the word 'declared' could prove, in time, to be problematic, due to the uncertainty as to how the provision operates in relation to this word.

Further, given that the test requires assets to exceed liabilities 'immediately' before the dividend is declared, there are practical difficulties as to how this test can be met. Most group accounts are prepared on a month-end basis and directors are presented with the latest set of accounts that may at a minimum be weeks out of date.

CSA recommends that the government provide clarity as to how the words 'declared' and 'immediately' are to operate in the new provision. CSA notes that it would be useful for the government to provide companies with specific examples to which they can refer when implementing the test.

5 Tax implications

The new provision gives rise to tax implications, as the Australian Taxation Office (ATO) could disallow the franking benefit to dividends paid other than out of realised profits (such as reserves). Given that a consequential amendment to the *Tax Assessment Act 1936* was made in order to provide that a dividend paid out of an amount other than profits would, in normal circumstances, be capable of being franked, any such disallowance would operate against the policy objectives of the new provision, which was not intended to interfere with the current imputation rules.

CSA recommends that the government clarify that any dividends paid other than out of realised profits (such as reserves) attract the franking benefit.

Conclusion

CSA notes that, if companies are required to seek legal, accounting, tax and auditing advice on the matters raised in this letter, the cost is one borne by shareholders. CSA is of the view that it is not reasonable to expect shareholders to fund the clarification of legal issues attaching to the payment of dividends. Moreover, CSA notes that in many instances there are divergent views

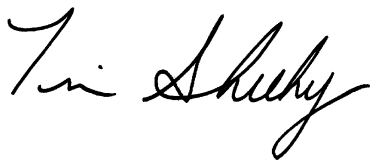
as to how the new provisions are to be interpreted, which means that any advice sought cannot bring certainty to either shareholders or the officers of their companies.

We strongly urge the government to provide clarification on the matters raised in this letter, so that companies may have certainty that they are applying the legislation correctly and in order to ensure that the payment of dividends to shareholders is effected without difficulty.

There is particular urgency attached to the need to receive guidance on how companies can comply with the legislation, given that the companies require certainty as to how payments of dividends can be effected. Clarification of the issues raised in this letter is needed as soon as possible given that most companies seek to pay dividends every six months.

CSA Members would be happy to meet with the government to discuss these matters further.

Kind regards



Tim Sheehy
CHIEF EXECUTIVE

cc Mark Sewell, Manager Corporate Reporting and Accountability Unit, Treasury
Belinda Gibson, Deputy Chairman, Australian Securities and Investments Commission

CHARTERED SECRETARIES
AUSTRALIA

Leaders in governance

20 July 2010

The Honourable Chris Bowen MP
Minister for Financial Services, Superannuation and Corporate Law
Room M124
Parliament House
Canberra ACT 2600

By email: ashley.midalia@treasury.gov.au

Dear Minister Bowen

Corporations Amendment (Corporate Reporting Reform) Act 2010

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We are writing to express our concerns with the late amendment to the Corporations Amendment (Corporate Reporting Reform) Bill 2010, that saw the insertion of a provision that ties the calculation of 'assets' and 'liabilities' to the International Financial Reporting Standards (IFRS) in relation to the reform of the test for the payment of dividends. This provision was not subject to public consultation as it was added once consultation on the Exposure Draft had closed.

CSA supported, and remains supportive of, the repeal of the 'profits test' and its replacement with a more flexible requirement allowing a company to pay dividends if the company's assets exceed its liabilities and the excess is sufficient for the payment of the dividend; it is fair and reasonable to the company's shareholders as a whole; and it does not materially prejudice the company's ability to pay its creditors. CSA commends the government for introducing this reform.

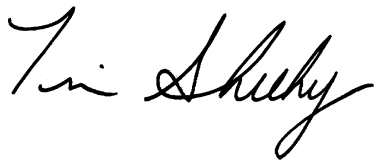
However, by tying the calculation of assets and liabilities to IFRS, the Act now requires companies that are not currently obliged to prepare their financial statements in accordance with IFRS to consider and apply IFRS before paying a dividend.

This creates a new and unreasonable compliance and cost burden for a great many companies (many of which are small businesses), which defeats the policy objective of the Act to reduce the regulatory burden on companies. In CSA's submission, such cost impost would be of

overwhelming economic detriment to a great many small proprietary companies and of no legitimate probative value to the spirit and intent of the bill.

We strongly urge the government to delete the new provision tying the calculation of assets and liabilities to IFRS in the spring sitting of parliament, to ensure that the increase in the regulatory burden placed on small companies is removed as soon as possible.

Yours sincerely



Tim Sheehy
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cc Mark Sewell, Manager Corporate Reporting and Accountability Unit, Treasury