

Commercial & corporate

Amending Legislation

The *Corporations Amendment (Corporate Reporting Reform) Act 2010* No 66 (**Reporting Reform Act**) that amends the *Corporations Act 2001* (Cth) (**Principal Act**) came into effect on 28 June 2010.

When do the changes take effect?

All the changes apply for financial years ended on and after 30 June 2010 except the changes to section 299A of the **Principal Act**, relating to annual directors' reports.

Primary purpose

The primary purpose of the **Reporting Reform Act** is to: improve Australia's corporate reporting framework by reducing unnecessary red tape and regulatory burden on companies; improve disclosure requirements; and implement a number of other important refinements to the corporate regulatory framework.

Summary of key changes

Below is a snapshot of key changes under the **Reporting Reform Act**.

Companies limited by guarantee

- A new definition of 'small company limited by guarantee' has been introduced;
- a new three-tier financial reporting framework for all companies limited by guarantee has been inserted (see below);
- the distribution of annual financial reports for companies limited by guarantee has been streamlined; and
- the payment of dividends by companies limited by guarantee registered on or after 28 June 2010 is prohibited.

Consolidated entity and parent financial statements

- If the accounting standards require financial statements to be prepared for a consolidated entity, the need for separate financial statements for the consolidated entity and the parent has been removed; and
- limited information about the parent entity is now required to be disclosed by way of a note in the consolidated financial statements.

Update: In response, ASIC issued a new class order [CO 10/654] on 26 July 2010 to allow companies, registered schemes and disclosing entities that provide consolidated financial statements to also provide separate parent entity financial statements.

Payment of dividends

- The profit test in section 254T has been removed;
- a solvency test for the payment of dividends, explained in more detail below, has been introduced; and
- the *Income Tax Assessment Act 1936* (Cth) has been amended as a result of the **Reporting Reform Act** to provide that dividends paid out of amounts other than profits are treated as dividends paid out of profits.

Changing reporting periods

- Allows the length of an entity's financial year to be changed (after the first financial year) on specified conditions.

Extending annual directors' report disclosure to all listed entities

- Listed registered schemes are required to comply with section 299A by disclosing information to members about the schemes operations, financial position and business strategies for financial years ending on and after 30 June 2011.

Directors' declaration and IFRS

- The directors' declaration of a company, disclosing entity or registered scheme that are already required by accounting standards to comply with international financial reporting standards (IFRS), must include a statement of compliance with IFRS in notes to the financial statements.

Lost capital reductions

- Section 258F has been amended to clarify that a company may only cancel share capital because of lost capital if the cancellation is not inconsistent with the requirements under Australian accounting standards.

What is a small company limited by guarantee?

Under the **Reporting Reform Act**, a 'small company limited by guarantee' is defined as a public company:

- that is a company limited by guarantee for the whole of the financial year; and
- whose revenue (or consolidated revenue) is less than \$250,000 (defined as the threshold amount);

but is not:

- a deductible gift recipient (commonly referred to as a DGR) at any time during the financial year;
- a Commonwealth company or a subsidiary of a Commonwealth company or Commonwealth authority; or
- a transferring financial institution under clause 1 of schedule 4 of the **Principal Act** or permitted to use the expression 'building society', 'credit society' or 'credit union' under the *Banking Act 1959*.

Financial reporting requirements

A new three-tiered framework of financing reporting has been introduced for companies limited by guarantee. The following table provides an overview of each tier's reporting requirements.

Tier 1	Small company limited by guarantee.	Exempt from: <ul style="list-style-type: none">– preparing a financial report;– preparing a directors' report;– having a financial report audited; and– notifying members of reports; unless directed by ASIC or by members with 5 per cent of the voting power.
Tier 2	Company limited by guarantee with annual revenue (or consolidated annual revenue) less than \$1 million.	Must: <ul style="list-style-type: none">– prepare a financial report;– prepare directors' report (although more streamlined⁽¹⁾);– either have financial report audited or reviewed⁽²⁾; and– give reports to members who elect to receive them⁽¹⁾.
Tier 3	Company limited by guarantee with annual revenue (or consolidated annual revenue) of \$1 million or more.	Must comply with full reporting and audit requirements but the directors' report is more streamlined and members must elect to receive reports ⁽¹⁾ .

Note 1: Tier 2 and Tier 3 companies are required to prepare a simplified directors' report and members must elect to receive financial reports and notify how they want to receive them.

Note 2: If a Tier 2 company elects to have its financial report reviewed rather than audited, the review must be carried out by either an auditor or a person holding an accounting practising certificate (ICAA, CPA or NIA). The review is intended to be low level enquiry and therefore less expensive than a full audit.

Annual general meetings

Unless the company has only one member, a company limited by guarantee must still hold an AGM.

In the case of a small company limited by guarantee, unless financial reports are required by direction from ASIC or by members or further clarifying amendments are made to the **Principal Act**, the main purpose for holding an AGM will be the election of directors.

Lodging reports with ASIC

Unless the company qualifies as a small company limited by guarantee, a company limited by guarantee will still have to lodge reports with ASIC.

Auditing

A company limited by guarantee still has to appoint an auditor.

In the absence of further amendment to the **Principal Act**, or ASIC issuing a standing exemption and modification of Part 2M.4 of the **Principal Act**, as companies limited by guarantee are classified as public companies for the purposes of the **Principal Act**, section 327 continues to apply. That section requires all public companies, irrespective of size, to appoint an auditor and to keep that position filled at all times.

It is not yet clear whether ASIC will issue a standing exemption and modification from that obligation for small companies limited by guarantee that are exempt from the auditing and reporting requirements under the **Principal Act**.

Changes to dividend rules

The profits test has been replaced with a solvency-based test to allow a company to pay dividends from sources other than profits subject to the company satisfying the following three tests:

- assets exceed liabilities immediately before the dividend is declared and the excess covers the dividend (balance sheet test); and
- the payment is fair and reasonable to shareholders as a whole; and
- the payment does not materially prejudice the company's ability to pay its creditors.

The balance sheet test must be determined in accordance with accounting standards in force at the relevant time (even if the standard does not apply). If a company is not required to prepare an audited financial report (for example, a small proprietary company), the balance sheet test can be determined by reference to the accounting records required to be kept by all companies under section 286 of the **Principal Act**.

Section 254T now operates to prohibit the payment of a dividend unless the three tests are met and applies to all companies except companies limited by guarantee registered on or after 28 June 2010.

While the new rules are intended to provide more flexibility for the payment of dividends, they raise some uncertainties and practical issues that need to be considered. For example:

- it is uncertain whether a company can now distribute share capital as a dividend without shareholder approval subject to meeting the three tests;
- many company constitutions provide that dividends can only be paid out of profits (a restatement of former section 254T); and
- many company constitutions provide for the directors to 'determine' rather than 'declare' that dividends are payable, because if it is 'declared', it becomes a debt owing to the shareholders at that time rather than when paid.

If a company's constitution provides for dividends to be paid out of profits, directors must first, apply the three new tests under new section 254T and second, apply the constitution's profit test, when considering whether a dividend can be paid to shareholders for the financial year ended 30 June 2010 and after. If the company satisfies both the constitutional test and the statutory test, a dividend may be paid out of profits.

Existing constitutions should be reviewed and, if necessary, amended to remove or amend the existing provisions that now restrict payments of dividends only from profits in order to take advantage of the flexibility to pay a dividend out of an amount other than profits under the new regime.

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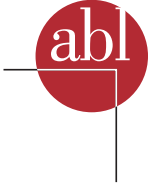
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