



The BDW Guide to CLERP 9

Practical guide to the Corporate Law
Economic Reform Program (Audit Reform
and Corporate Disclosure) Act 2004





Introduction

The *Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Act 2004 (Cth)* (**CLERP 9 Act**) was passed by Parliament on 25 June 2004, and received Royal Assent on 30 June 2004. The CLERP 9 Act amends a number of Acts, including the *Corporations Act 2001*, to give effect to reforms aimed at restoring public confidence in corporate Australia after a number of significant instances of misconduct and corporate failure.

This Guide provides an overview of the CLERP 9 Act amendments, as well as practical guidance for corporate counsel and company secretaries. The Guide is also useful for directors, chief financial officers and people involved in corporate affairs and investor relations.

Currency

This Guide is current as at 1 July 2004, taking into account ASIC policy and proposed policy as published at that date.

Further advice

This Guide provides a general description and summary of the CLERP 9 Act.

We invite you to contact us for any further information or assistance using the details provided on page 45.



This publication is intended only to provide a summary of the subject matter covered. It does not purport to be comprehensive or to render legal advice. No reader should act on the basis of any matter contained in this publication without first obtaining specific professional advice. Where applicable, liability limited by the Solicitors' Scheme, approved under the *Professional Standards Act 1994 (NSW)*.

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Overview of the CLERP 9 Act

The reforms contained in the CLERP 9 Act can be grouped into the following general categories:

Remuneration disclosure, directors' report and financial reporting and shareholder participation and information

The changes covered include:

Remuneration of directors and executives , dealing with...	expanded remuneration disclosure	see page 7
	shareholder approval of the "remuneration report" at AGMs	see page 8
	termination benefits and shareholder approval	see page 9
Financial reporting , dealing with...	the CEO and CFO declaration in relation to a listed entity's financial reports	see page 10
	management discussion and analysis in directors' reports	see page 10
	"true and fair" view in financial reports	see page 11
	Financial Reporting Panel, a body to consider accounting disagreements between ASIC and reporting entities	see page 11
Shareholder participation and information , dealing with...	electronic distribution of information to shareholders	see page 12
	notification of directorships and company secretaries' qualifications	see page 13
Register of information about relevant interests , dealing with...	listed companies and managed investment schemes maintaining a public register of information on relevant interests that the company or scheme obtains	see page 14

Continuous disclosure reforms

The changes covered include:

Continuous disclosure , dealing with...	liability for people involved in continuous disclosure contraventions	see page 15
	ASIC infringement notices	see page 15

Audit reform

The changes covered include:

Audit reform , dealing with...	auditor appointment, independence and rotation	see page 19
	auditors and AGMs	see page 24
	expansion of auditor's duties	see page 26
	qualified privilege for auditors	see page 27
	audit oversight	see page 27
	qualifications of auditors	see page 29
	registration of authorised audit companies	see page 29

Conflict of interest management, prospectus and Product Disclosure Statement requirements and exemptions, enforcement and other technical amendments

The changes covered include:

Management of conflicts of interests by financial services licensees , dealing with...	conflicts of interest rules for Australian financial services licensees when dealing with clients	see page 30
Disclosure rules , dealing with...	presentation of prospectuses and other disclosure documents	see page 31
	Product Disclosure Statements (PDS) for continuously quoted securities	see page 31
	secondary sales of securities and exemptions from disclosure requirements	see page 32
Enforcement , dealing with...	revision of criminal penalties for a range of offences	see page 36
	whistleblowing provisions protecting employees who report contraventions	see page 36
	disqualification of directors	see page 37
Officers, senior managers and employees , dealing with...	definitional changes, and distinguishing between "senior managers" and "employees" in the <i>Corporations Act</i>	see page 38
Proportionate liability , dealing with misleading conduct claims...	shared responsibility between plaintiff and defendant in misleading conduct claims and proportionate liability as between two or more defendants in misleading conduct claims	see page 40

The commencement dates of the changes are noted at each relevant section below.

Overview of some significant changes for entities

Directors' reports

For financial years commencing on or after 1 July 2004 (with a few exceptions), the following additional disclosures will be required in the annual report:

New section	Additional information required	Timing	
Directors' report			
295(4)(e)	For listed entities, a statement that the directors have received a declaration from the CEO/CFO under section 295A on the financial reports	Applies to financial years that commence on or after 1 July 2004	see page 10
298(1A) full years	If additional "true and fair" information is included in the financial report, the directors' report must set out the reasons for including the information, and its location in the financial report	Applies to financial years that commence on or after 1 July 2004	see page 11
306(2) half years			
299A	Companies and listed public companies must include information on the operations, financial position and business strategies and prospects	Applies to financial years that commence on or after 1 July 2004	see page 10
300(1)(ca)	The names of each officer of the company who was a former partner or director of the entity's current audit firm or audit company	No transitional provision. Applies to all reports prepared after the commencement of the CLERP 9 Act	see page 19
300(10)(d)	For listed entities, qualifications and experience of each person who is a company secretary of the company	Applies to financial years that commence on or after 1 July 2004	see page 13
300(11A)	Where an auditor is relying on a declaration from ASIC modifying auditor rotation requirements, a copy of that notice	Applies to audits of financial years that commence on or after 1 July 2006	see page 24
300(11B) and (11C)	Under a separate heading "Non-audit services" in the directors' report include: <ul style="list-style-type: none"> - amounts paid or payable for non-audit services to the auditor - a statement on whether the directors are satisfied that the non-audit services are compatible with the general standard of independence for the auditor - a statement of the directors' reasons for being satisfied (The audit committee must provide advice to the board on the matters described above) 	Applies to financial years that commence on or after 1 July 2004	see page 19
300(11)(e)	For listed entities, details of directorships of other listed companies held by each director in 3 years prior to end of the financial year to which the report relates	Applies to financial years that commence on or after 1 July 2004	see page 13
306(2)	A copy of the auditor's independence declaration under section 307C	Applies to financial years that commence on or after 1 July 2004	see page 20

New section	Additional information required	Timing	
The "Remuneration Report" within the directors' report			
300A(1)(a)	Discussion on board policy in relation to the remuneration of directors, secretaries and senior managers	Applies to financial years that commence on or after 1 July 2004	see page 7
300A(1)(b)	Discussion of the relationship between the remuneration policy and the company's performance, including details of the performance for the last 4 financial years	Applies to financial years that commence on or after 1 July 2004	see page 7
300A(1)(ba)	Details of performance conditions that apply to any element of remuneration	Applies to financial years that commence on or after 1 July 2004	see page 7
300A(1)(c)	Details of remuneration of each director and each of the 5 named company executives (and in certain instances, group executives) who receive the highest remuneration for that year	Applies to financial years that commence on or after 1 July 2004	see page 7
300A(1)(d)	Explanation of reasons for directors or executives receiving securities not subject to performance conditions as part of remuneration	Applies to financial years that commence on or after 1 July 2004	see page 8
300A(1)(e)	For each of the directors and named executives: <ul style="list-style-type: none"> - explanation of the relative proportion of remuneration that is related to performance - value of any options that form part of remuneration - aggregate and percentage values of remuneration for the financial year that consists of options - if the person is employed under a contract: duration, notice, termination and termination payment details 	Applies to financial years that commence on or after 1 July 2004	see page 8

Annual General Meetings

The following changes have been made to the notices for, and the conduct at, annual general meetings:

New section	Additional information required or changes made	Timing	
249J	Notices of meetings can be distributed electronically	Applies to notices given after 30 September 2004	see page 12
249L(2)	Notice of meeting must include information about the remuneration report resolution	Applies to remuneration reports for financial years commencing on or after 1 July 2004	see page 8
249L(3)	A notice of meeting must be worded and presented in a clear, concise and effective manner	Applies to notices given after 30 September 2004	see page 12
249LA	Permits regulations to be made that specify that certain information need not be included in a notice of meeting	Applies to notices given after 30 September 2004	see page 12
249X(1A)	A member can appoint a body corporate as well as an individual as their proxy	Applies on and from 1 July 2004	see page 12
250A(1A)	Permits regulations to be made prescribing methods for electronic verification for proxies	Applies on and from 1 July 2004	see page 12
250R(2)	Resolution put to shareholders that the remuneration report be adopted	Applies to remuneration reports for financial years commencing on or after 1 July 2004	see page 8
250SA	The chair of a meeting must allow members as a whole a reasonable opportunity to ask questions about or comment on the remuneration report	Applies to remuneration reports for financial years commencing on or after 1 July 2004	see page 8
250PA(1)	Members can submit questions to the auditor concerning the auditor's report or the conduct of the audit	Applies to annual meetings for financial years commencing on or after 1 July 2004	see page 24
250PA(9)	Company must make auditor's list of questions available at AGM	Applies to annual meetings for financial years commencing on or after 1 July 2004	see page 24
250RA	Lead auditor or a suitable representative must attend an audited body's AGM	Applies to annual meetings for financial years commencing on or after 1 July 2004	see page 25
250T	Chair of an AGM must allow the members as a whole a reasonable opportunity to ask questions of the auditor	Applies to annual meetings for financial years commencing on or after 1 July 2004	see page 25
314(4) and (5)	Permits the distribution of annual reports electronically	Applies to annual reports for financial years commencing on or after 1 July 2004	see page 12

Remuneration of directors and executives

The CLERP 9 Act expands the disclosures required for executive and director remuneration, and seeks to increase shareholders' consideration of director and executive remuneration. These amendments include:

- broadening section 300A and the disclosures required for director and executive remuneration, both in terms of board policy and the required level of mandatory disclosure of actual remuneration;
- a requirement for listed companies to propose a non-binding advisory resolution on the remuneration report prepared by the directors and allow questions and comments on this remuneration report by members; and
- a requirement for shareholder approval for termination payments that exceed up to 7 times (in certain cases) a director's or executive's annual average salary for the last 3 years.

Annual directors' report – specific informational

Timing: the changes apply to financial years commencing on or after 1 July 2004.

For listed companies, the disclosure requirements applying to director and executive remuneration have been enhanced. A directors' report must now include a section called the "Remuneration report" comprising the information required by section 300A of the *Corporations Act*, being:

- section 300A(1)(a) – a discussion of board policy in relation to the remuneration of directors, secretaries and senior managers of the company or the officers of the consolidated entity if consolidated financial statements are required;
- section 300A(1)(b) – a discussion of the relationship between the policy and the company's performance – this is a pre-CLERP 9 Act requirement. However, the

discussion of the company's performance must now specifically deal with the company's earnings and the consequences for shareholder wealth in the financial year to which the report relates and the previous 4 financial years. In considering the consequences for shareholder wealth, regard should be had to:

- dividends paid;
- changes in share price from the beginning of the financial year and the end; and
- any return of capital to shareholders during the financial year that involved a cancellation of shares and a payment that exceeded the price at which the shares were trading when the shares were cancelled (sections 300A(1AA) and (1AB);
- section 300A(1)(ba) – if an element of remuneration is dependent upon meeting a performance condition:
 - a detailed summary of the condition and an explanation of why it was chosen;
 - a summary of the methods used in assessing whether the condition is satisfied and an explanation of why those methods were chosen; and
 - if the condition involves a comparison with external factors, a summary of those factors and if a factor relates to the performance of another company, companies or index, the identity of the company, companies or index;
- section 300A(1)(c) – details prescribed by regulations of the remuneration of each director of the company and each of the 5 named company executives who receive the highest remuneration for that year. Where consolidated financial statements are required, the details of the 5 named group executives and the 5 named company executives who receive the highest remuneration for that year must also be provided.

"Company executive" means a company secretary or senior manager of the company (section 300A(1B)).

"Senior manager" means a person (other than a director or company secretary of the corporation) who:

- makes, or participates in making, decisions that affect the whole, or a substantial part, of the business of the corporation; or
- has the capacity to affect significantly the corporation's financial standing.

"Group executive" for a consolidated entity means:

- the directors of the companies or bodies within the consolidated entity;

- the secretaries of the companies or bodies within the consolidated entity;
- the senior managers of any corporation within the consolidated entity;
- the partners, and senior managers, of any partnership within the consolidated entity;
- the trustees, and senior managers, of any trusts within the consolidated entity; and
- the senior managers of any joint venture within the consolidated entity (section 9).

Where the highest paid company executives are the highest paid group executives, only the remuneration of the top 5 company executives needs to be disclosed. Alternatively, for a consolidated entity that has its 5 highest paid senior managers employed by consolidated entities other than the parent entity, section 300A(1)(c) will require the remuneration to be disclosed of the top 5 (or possibly 10) group and company executives;

- section 300A(1)(d) – where any of the directors or named company or group executives receive securities as part of their remuneration that are not subject to performance conditions, an explanation of why the securities are not subject to performance conditions; and

- section 300A(1)(e) – for each of the directors and named company or group executives:
 - an explanation of the relative proportion of remuneration that is and is not related to performance;
 - the value, at the time they are granted, exercised or lapse, of any options that form part of remuneration;
 - aggregate and percentage values of remuneration for the financial year that consists of options; and
 - if the person is employed under a contract: duration, notice, termination and termination payment details under the contract.

Action points

- Commence planning now for the enhanced disclosure requirements for securities and option payments and the reasons why performance conditions may or may not have been applied.
- Consider how options which have been “granted”, “exercised” and “lapsed” during a year are to be valued. (There are some conceptual difficulties with the requirement now included in new section 300A(1)(e). For example, further guidance is required as to how to value an option that has lapsed.)
- Identify all persons who may be a “relevant group executive” for the purposes of the *Corporations Act*. These persons would include each of the following persons who are not otherwise a director of the company:
 - the directors and company secretaries of the companies or bodies within the consolidated entity;
 - senior managers of any corporation within the consolidated entity (see page 7 for definition of “senior manager”);
 - the partners, and senior managers, of any partnership within the consolidated entity;
 - the trustees, and senior managers, of trusts within the consolidated entity; and
 - the senior managers of any joint venture within the consolidated entity.
- Consider AASB 1046 *Director and Executive Disclosures by Disclosing Entities*. AASB 1046 applies a different test in relation to financial reports’ disclosure. That is, AASB 1046 is not limited to the 5 highest paid company executives or group executives. Rather, entities must disclose the remuneration of at least 5 executives in the entity with the “greatest authority”.

Non-binding resolutions on the remuneration report

Timing: applies to remuneration reports for financial years that start on or after 1 July 2004.

Additional requirements are also imposed on listed companies to put the remuneration report for each financial year up for adoption at the company’s AGM (section 250R(2)). However, the vote on the resolution is advisory only and does not bind the directors or the company (section 250R(3)).

The notice of AGM must inform members that the resolution will be put at the AGM (section 249L) and the chair must also allow a reasonable opportunity for the members as a whole to ask questions about or comment on the remuneration report (section 250SA).

Action points

- Revise the standard form of the notice of AGM in time for the 2005 AGM to include the non-binding vote on the remuneration report.
- Consider methods to communicate to shareholders (including at the AGM) the substance of the remuneration report to ensure a clear understanding at the AGM of the content and rationale behind the remuneration report.

Shareholder approval for certain termination payments

Timing: applies to agreements entered into on or after 1 July 2004.

The existing section 200B(1) of the *Corporations Act* prohibits a company from giving a person a benefit in connection with that person's retirement from a "board or managerial office" in a company. Previously, a "genuine payment by way of damages for breach of contract" or a payment made under an agreement that was entered into before the person became the holder of the office as the consideration, or part of the consideration, for taking up the office, were not prohibited and did not need shareholder approval.

However, the CLERP 9 Act has revised section 200F so that shareholder approval is not required for a termination payment, provided it does not exceed a specified amount.

Shareholder approval will be required where the value of the benefit given in connection with the retirement from office, when added to the value of all other payments (if any) already made or payable in connection with the person's retirement of office, exceeds the greater of:

- the person's average remuneration for the last 3 years multiplied by the time (in years) the person has held an office in relation to the company (capped at 7 years); and
- the person's remuneration (or estimated remuneration) for the last 12 months.

Existing agreements are not covered by the new section 200F. However, any new arrangements with executives going forward will need to consider the effect of section 200F. Significantly, the term "board or managerial office" defined in section 9 of the *Corporations Act* captures a person who is a director of the company or an executive of the company involved with the management of the body who is also a director of any related body of the company.

Action point

- Consider when negotiating executive salaries the quantum of any potential future termination payments and whether they may require shareholder approval. Note that there is also a requirement to disclose certain details of employment contracts in directors' reports (see page 8).

Financial reporting

The CLERP 9 Act makes changes to the directors' report and establishes the Financial Reporting Panel (**FRP**).

The directors' report for a listed entity will need to include the following:

- a declaration by the directors that they have received a declaration by the CEO/CFO about the entity's financial records and financial statements; and
- information about the entity's operations, financial position and business strategies and prospects for future financial years.

Additionally, the FRP has been established to consider disputes between ASIC and entities concerning accounting treatments in financial reports.

CEO/CFO declarations

Timing: applies to directors' declarations in relation to financial reports for financial years that start on or after 1 July 2004.

The directors of listed entities can only make their directors' declaration in each year as required by section 295(4), after they have received the CEO/CFO declaration.

The content of the directors' declaration has been expanded to include a declaration "that the directors have been given the declaration required by section 295A" (section 295(4)(e)).

Content of CEO/CFO declaration

Section 295A(2) provides that each person who performs a "chief executive function" or a "chief financial officer function" must give a declaration whether, in the person's opinion:

- the financial records of the listed entity for the financial year have been properly maintained in accordance with section 286;
- the financial statements, and the accompanying notes, for the financial year comply with the accounting standards;
- the financial statements and notes for the financial year give a true and fair view; and
- any other matter prescribed by regulations.

The CEO/CFO declaration must be in writing, specify the date it was given and the capacity of the person making the declaration and be signed (section 295A(3)).

Sections 295A(4) and (6) define "chief executive function" and "chief financial officer function". For

most entities, the section 295A declaration will be given by the entity's CEO or managing director and the CFO. If one person is both the CEO and CFO, then that person can give a single declaration in both capacities.

Action points

- Identify who performs the "chief executive function" and "chief financial officer function" in the listed entity.
- Review the processes for preparing the directors' declaration on the financial statements – the declaration can only be given once the new section 295A declaration has been given by the CEO/CFO.
- Ensure a financial reporting system is in place to enable the CEO/CFO to provide the section 295A declarations. Recommendations 4.1 and 7.2 of the ASX Corporate Governance Council *Principles of Good Corporate Governance and Best Practice Recommendations* currently recommend that CEO/CFO provide similar, but not identical, declarations to the board. See also the G100 guidance on CEO/CFO representations.
- Review the wording of any current CEO/CFO representation letters (if any) provided to the board to ensure consistency with section 295A(2) and any applicable regulations.

Directors' report – management discussion and analysis

Timing: applies to directors' reports for financial years that start on or after 1 July 2004.

Additional information for directors' reports

Companies and listed public companies must include in their directors' reports information that members of the company would reasonably require to make an informed assessment of:

- the operations of the entity reported on;
- the financial position of the entity; and
- the entity's business strategies and its prospects for future financial years (section 299A).

If consolidated financial statements are required by the accounting standards, then the information must relate to the consolidated entity.

Information may be omitted if it is likely to result in unreasonable prejudice to the entity. If information is omitted, the directors' report must state this.

Action point

- Consider existing “operations and activities” disclosure to ensure coverage of matters required by section 299A.

The information required by section 299A is similar to that required by ASX Listing Rule 4.10.17, although the scope of that Listing Rule is narrower, only requiring a review of the entity’s “operations and activities”. The Explanatory Memorandum at 5.307 states that “in considering the issues to be addressed in their review, directors will have regard to best practice guidance such as that prepared and published by the Group of 100... The G100 guidance may be used for the purpose of satisfying the [section 299A] requirements.”

“True and fair” in financial reports

Timing: applies to directors’ reports for financial years that start on or after 1 July 2004. This would include directors’ reports for the half year ending 31 December 2004.

An entity’s financial report must include information in order to ensure that the financial report gives a “true and fair” view of the financial performance and position of an entity.

If information is included in a full year or half-year report to ensure that the financial report gives a “true and fair” view, new sections 298(1A) and 306(2) require that the directors’ report:

- sets out the directors’ reasons for forming the opinion that the inclusion of the additional information was necessary; and
- specifies where the “true and fair” additional information can be found in the financial report.

The auditor’s report must also include a statement of the auditor’s opinion on whether the inclusion of the additional “true and fair” information was necessary to give the “true and fair” view of the entity’s financial performance and position.

Action points

- Consider the nature and presentation of any supporting reasons if additional “true and fair” information is required for an entity’s financial report.
- Ensure the auditor is aware of when additional “true and fair” information is required and the auditor’s report includes the auditor’s opinion on the additional information.

Financial Reporting Panel

Timing: applies to financial reports lodged with ASIC on or after 1 January 2004.

The CLERP 9 Act inserts a new “Part 13 – Financial Reporting Panel” into the *Australian Securities and Investments Commission Act 2001*, under which the Financial Reporting Panel (FRP) is established. A new “Division 9 – Reference of financial report to the Financial Reporting Panel” has been inserted into Part 2M.3 of the *Corporations Act*.

Purpose and role of the FRP

The purpose of the FRP is to provide a forum where disputes between ASIC and an entity (listed and unlisted) that has lodged a financial report with ASIC can be reviewed.

The role of the FRP is to consider a financial report that has been referred to it, and prepare a report that states whether, in the FRP’s opinion, the financial report complies with the relevant financial reporting requirements (section 323EK(1)).

Referral to the FRP

Disputes between ASIC and an entity concerning a financial report can be referred to the FRP by:

- ASIC, after giving the entity whose financial report is considered deficient 14 days to respond to a notice stating ASIC’s intention to refer the matter to the FRP and the reasons for doing so and any changes necessary to correct the financial report (section 323EC); or
- an entity, where ASIC has informed the entity that its financial report does not comply with the *Corporations Act* and ASIC has consented to the referral to the FRP (section 323EG).

The FRP also has the power to dismiss at any stage a referral (section 3232EL).

Status of an FRP report

A report of the FRP on whether a financial report complies with the financial reporting requirements of the *Corporations Act* is not binding. However, a Court may have regard to the FRP’s report in determining whether the entity’s financial report complied with the *Corporations Act* (section 323EM).

The FRP is required to give a copy of its report to ASIC and the entity. If the entity is listed, a copy must also be given to the relevant market operator (eg ASX). ASIC also “must take such steps as it considers reasonable and appropriate” to publicise the FRP’s report and whether the entity has made the changes to its financial report (if any) recommended by the FRP (section 323EK).

Shareholder participation and information

The CLERP 9 Act makes amendments that are intended to facilitate the exercise by shareholders of their right to be informed, to participate and to vote at general meetings. The amendments are designed to:

- encourage shorter, more comprehensible notices of meetings;
- facilitate distribution of notices of meeting and annual reports by electronic means;
- improve access to general meetings by facilitating voting by proxy; and
- require disclosure by directors of listed companies of other directorships held.

Each amendment outlined below sits within a new framework that embraces technology and electronic communication.

Notices of meetings

Timing: amendments in relation to notices of meetings apply to notices given after 30 September 2004.

Section 249L, which contains rules about the content of notices of general meetings, has been amended to include a new section 249L(3) requiring that notices are worded and presented in a “clear, concise and effective” manner.

In addition, new section 249LA permits regulations to be made that identify certain kinds of information that need not be included in a notice of meeting. According to the Explanatory Memorandum to the CLERP 9 Act, the regulations could, for example, expressly allow notices of meetings to exclude complex descriptions of a possible transaction for which member approval is sought, on condition that the full details are clearly referred to and made readily available to members who wish to examine them.

Electronic distribution of annual reports and notices of meetings

Notices of meetings

Timing: applies to distribution of notices of meetings given after 30 September 2004.

The CLERP 9 Act introduces electronic notification of meetings by amending section 249J of the *Corporations Act* to provide that a member may nominate to be notified of meetings using electronic means. A member may also nominate electronic means by which they can access the notice of meeting.

Sending annual reports

Timing: applies to reports for financial years that start on or after 1 July 2004.

Section 314 of the *Corporations Act* requires companies and certain other entities to send annual reports to members. Members may now also receive annual reports electronically, in the same manner as in relation to notices of meetings. If the facility is offered, members would be able to nominate an electronic “notification means”, such as e-mail, by which they would be advised that a report is available, and an electronic “access means” by which they would access the report (sections 314(4) and (5)).

Proxy voting

Timing: applies on and after 1 July 2004.

The provisions relating to the appointment of proxies have been amended to provide that a member may appoint an individual **or** a body corporate as a proxy (section 249X(1A)), and also that a body corporate appointed as a proxy may then nominate an individual to exercise its powers at meetings (section 250D(1)(d)).

In line with the general acceptance of electronic communications in the CLERP 9 Act, new section 250A(1A) will permit regulations to prescribe authentication mechanisms to authenticate proxy appointments. This has the potential to eventually include various digital signature and encryption methods.

Again, the use of electronic communications is encouraged with the amendment of section 250B(3), which deals with the receipt of proxy documents. Companies would be permitted to offer a facility for electronic submission of proxy appointment forms and related appointment authorities, such as powers of attorney.

Listed companies – notification of directorships and company secretaries' qualifications

Timing: applies for directors' reports for financial years that commence on or after 1 July 2004.

Listed companies will now be compelled to disclose in their annual report, details of directorships of other listed companies held by each director in the 3 years prior to the end of the financial year to which the report relates (section 300(11)(e)).

Section 300(10)(d) now also requires that the qualifications and experience of each person who is a company secretary of the company at the end of a year, be included in the directors' report.

Action points

- Develop processes and encourage shareholders to nominate electronic receipt and notification of notices of meetings and annual reports.
- Ensure that notices of meetings are worded in a clear, concise and effective manner. Is the notice relevant and complete, does it promote members' understanding and highlight important information, having regard to the needs of the users?
- Update the directors' report to include details of the directorships of listed companies held by directors within the last 3 years, and the qualifications and experience of all company secretaries of the company.
- Liaise with the share registrar in relation to appointment of a body corporate as proxy and validating attendees (including a corporate proxy's representatives) at shareholder meetings.

Register of information about relevant interests

Timing: applies to information about relevant interests received by a listed company or listed managed investment scheme on or after 1 January 2005.

Section 672DA will require listed companies and listed managed investment schemes to keep a register of information about relevant interests received by the company or scheme after issuing a notice under section 672A or received after ASIC issues a section 672C notice.

Content of register

Section 672DA(1) requires that the register must include:

- details of the nature and extent of a person's relevant interest in shares in the company or interests in the scheme;
- details that give rise to the relevant interest;
- the name and address of a person who has a relevant interest;
- details of instructions that a person has given about the acquisition or disposal of shares or scheme interests, the exercise of any voting or other rights, any other matter relating to shares in the company or scheme interests; and
- the name and address of a person who has given the instructions on acquisition, disposal and voting.

In addition, section 672DA(6) requires that the register includes:

- the name of each holder of shares in the company or interests in the scheme, to whom the beneficial interest information relates;
- against the name of each such holder:
 - the name and address of each person who, according to information received by the company or responsible entity, has a relevant interest in shares or interests (along with details of the relevant interests and circumstances because of which the other person has the relevant interest); and
 - the name and address of each person who, according to information received by the company or responsible entity, has given relevant instructions in relation to the shares or interests; and
 - the date the information was entered into the register.

ASIC can give approval for registers to contain information different from that required by section 672DA(6) above.

The information must be entered into the register within 2 days of a company or responsible entity receiving the information (section 672DA(9)).

Location of register

The section 672DA register must be maintained at the company's or responsible entity's registered office, principal place of business or a place in Australia where the work involved in maintaining the register is done. A notice must be lodged with ASIC within 7 days of establishing a register at a place or moving it (sections 672DA(2), (3) and (4)).

Access to the register

Any member of the company or scheme can access the register free of charge. For others, the company or scheme must make the register open for inspection where a person pays the inspection fee (if any is required by the company or scheme) (section 672DA(7)).

A person can request a copy of the register. A company or scheme must give a copy of the register to a person after a request is received within 21 days of the payment of any access fees established by the company or scheme.

Action points

- Liaise with the share registrar in relation to establishing and maintaining the new register.
- Ensure register is operational for information received on or after 1 January 2005.
- Consider the implications for a company or scheme if relevant interest information is publicly available.
- Ensure that the notice of the location of the register is lodged with ASIC within 7 days of establishing the register.

Continuous disclosure

The continuous disclosure regime in the *Corporations Act* has undergone the following changes:

- individuals “involved” in an entity’s contravention of the continuous disclosure provisions of the *Corporations Act* can now be personally held responsible for the contravention, subject to a due diligence defence; and
- ASIC now has the power to issue “infringement notices” where it considers an entity not to have met its continuous disclosure obligations.

Liability for people involved in continuous disclosure contraventions

Timing: applies to a contravention of the continuous disclosure provisions occurring on or after 1 July 2004.

A person involved in a listed entity’s contravention of the continuous disclosure provisions – in failing to immediately disclose information that a reasonable person would expect to have a material effect on the price or value of the entity’s securities – can be personally responsible for a contravention of section 674(2A). A contravention of this section is a civil liability provision.

The Explanatory Memorandum to the CLERP 9 Act states that there must be “some form of intentional participation and actual knowledge” before a person will personally liable.

However, a person will not be liable if the person proves that they:

- took all steps (if any) that were reasonable in the circumstances to ensure that the listed entity complied with its continuous disclosure obligations; and
- after doing so, believed on reasonable grounds that the listed disclosing entity was complying with its obligations.

Action points

- Review policy outlining communication of information throughout the entity, including establishing clear responsibilities for continuous disclosure and a pro-active system to identify price-sensitive information, regardless of whether that information is good or bad news.
- Educate business unit managers and senior managers so they understand what can constitute price-sensitive information, the entity’s disclosure obligations and the personal liability they might face if they are involved in a breach.
- Ensure the reporting channels are efficient in identifying all price-sensitive information. This may include a process where managers have the ability to report any material concern in real time to a compliance officer who will investigate and, in discussion with senior management, make a decision about disclosure.
- Ensure the board regularly checks the health of the entity’s continuous disclosure framework in terms of policy, education and reporting channels.
- Maintain records in order to establish a due diligence defence if an entity’s continuous disclosure framework fails resulting in a breach of the entity’s continuous disclosure obligations.

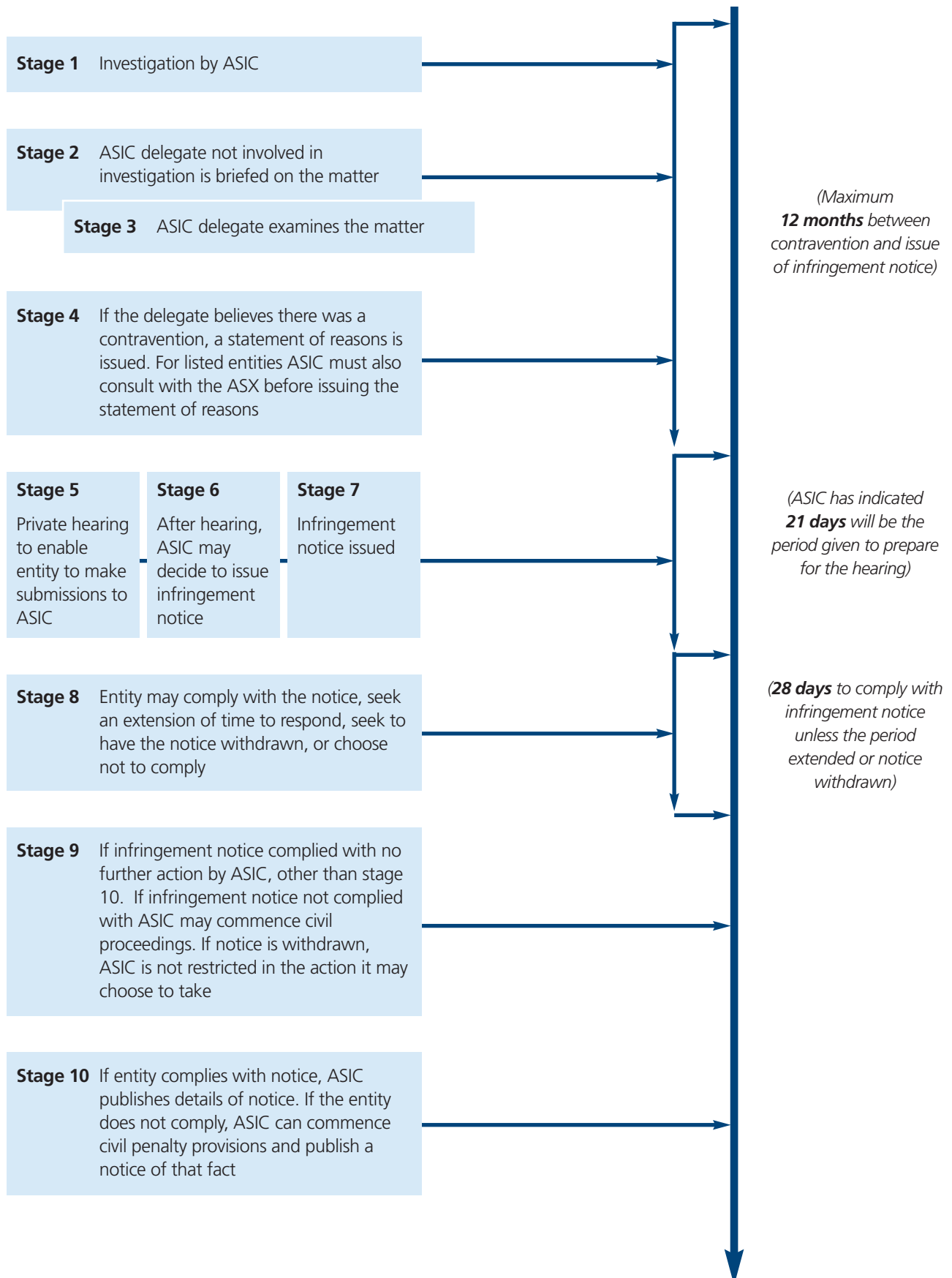
Infringement notices

Timing: applies to contraventions of the continuous disclosure provisions occurring on or after 1 July 2004.

New Part 9.4AA provides a regime where ASIC can issue “infringement notices” where it has reasonable grounds to believe that a disclosing entity (including both listed and unlisted entities) has contravened the continuous disclosure provisions (section 674(2) or 675(2)).

The process for issuing infringement notices is shown below, taking into account the provisions of Part 9.4AA and indicative ASIC policy.

The 10 stages of an infringement notice



ASIC has released a draft policy indicating how it will enforce the infringement notice regime. ASIC has indicated that infringement notices will only be used for less serious contraventions of the continuous disclosure requirements. When assessing the seriousness of the contravention, ASIC has indicated it may take into account the following:

- the price sensitivity of the entity's securities to the alleged contraventions and the number of securities traded during the period of the alleged contraventions;
- the materiality of the information the subject of the alleged contraventions, that is whether the information went to the heart of the entity's continuing operations;
- the factual situation of the alleged contraventions, that is whether the entity's behaviour was negligent, reckless or deliberate;
- the adequacy of the entity's internal controls and whether they were complied with; and
- the conduct of the entity, for example, was professional advice sought in regard to the disclosure, and were steps taken to correct the disclosure.

Key points

Other significant points on "infringement notices" are:

- infringement notices can only be issued within 12 months of an alleged contravention of the continuous disclosure provisions;
- the decision to issue an infringement notice is not subject to merits review in the Administrative Appeals Tribunal;

Market capitalisation as at the end of the financial year for which the last financial report was lodged with ASIC before the infringement notice was issued	Penalty for an infringement notice	Penalty for an infringement notice, where entity previously convicted of contravening the continuous disclosure provisions
Market capitalisation above \$1,000 million	\$100,000	\$100,000
Market capitalisation above \$100 million but below \$1,000 million	\$66,000	\$100,000
Market capitalisation below \$100 million	\$33,000	\$66,000

- evidence or information provided by an entity in a hearing before ASIC issues an infringement notice is not admissible in evidence in any proceedings against the disclosing entity in any proceedings or its representative (other than proceedings for giving false or misleading information); and
- the penalties that ASIC can impose for listed entities are based on market capitalisation (see the table).

Complying with an infringement notice

If an infringement notice is complied with (including paying the penalty and making any required disclosures) within the time provided:

- **no contravention or offence** – an entity is not regarded as having contravened the continuous disclosure provisions or having been convicted of an offence (section 1317DAF(4));
- **immunity from ASIC proceedings** – ASIC cannot commence civil or criminal proceedings in relation to the alleged contravention or the alleged offence (section 1317DAF(5)); and
- **no general immunity** – the immunity from ASIC proceedings does not restrict others from bringing actions, for example an action by a person against the entity for compensation for loss or an action by the market operator (eg ASX) for a contravention of the listing rules (section 1317DAF(6)).

ASIC may publish a statement of an entity's compliance with an infringement notice. The statement may be publicly released or published in the Government Gazette or both. In addition to details of the infringement notice, any published statement must also include a statement that the entity has complied with the infringement notices, compliance is not an admission of guilt or liability, and the entity is not regarded as having contravened the continuous disclosure provisions (section 1317DAJ).

Apart from a statement of compliance with an infringement notice, there are no other provisions of the new Part 9.4AA that permit ASIC to make publicly available details of an infringement notice or that one has been issued. However, ASIC has indicated that if it commences civil proceedings against an entity for failing to comply with an infringement notice, it will publish that fact.

Not complying with an infringement notice

An entity can make written submissions to ASIC under section 1317DAI seeking withdrawal of an infringement notice that has been issued.

If an infringement notice is not withdrawn, and an entity does not comply with it, ASIC can commence proceedings for a declaration of contravention under the civil penalty provisions of the *Corporations Act*, including a pecuniary penalty order. ASIC can also seek an order from the Court requiring the entity to release certain information to ASX (section 1317DAG).

Considerations

If an entity has been issued an infringement notice, the entity is faced with 2 alternatives:

- complying with the notice which, while not an admission of guilt, could be seen as a relatively convenient means to settle (with a penalty of up to \$100,000) what could otherwise be protracted and expensive litigation with ASIC; or
- rejecting the notice, and chance ASIC commencing civil penalty proceedings for the alleged contravention.

Action points

- Ensure that the continuous disclosure policies and systems are in place and regularly brought to the attention of employees (see page 15).
- Consider strategies for dealing with ASIC investigations and statements of reasons, in anticipation of ASIC issuing an infringement notice.

Audit reform

Auditor appointment, independence and rotation

Some of the most significant changes made by the CLERP 9 Act are to the auditor appointment, independence and rotation requirements. These are now found in the expanded Part 2M.4 of the *Corporations Act*.

The changes fall into the following categories:

- additional disclosures in the directors' report on the auditor and the audit;
- general auditor independence requirements;
- specific auditor independence requirements;
- restrictions on auditors being employed by an audit client; and
- auditor rotation for listed companies.

With the exception of the directors' report disclosures, the changes made to ensure auditor independence are imposed on auditors, audit firms, audit companies and others involved in audit activity, rather than audit clients.

Directors' report disclosures

Timing:

Disclosure of officers who are former auditors – as there is no applicable transitional provision, applies to directors' report for the current financial year.

Non-audit services – applies to an audit of a financial report for a financial year if the financial year begins on or after 1 July 2004.

Auditor's independence declaration – applies to a financial report for financial years that start on or after 1 July 2004. This would include financial reports for the half year ending 31 December 2004.

The directors' report for disclosing entities must include the following:

- **former auditors** – the name of each officer of the disclosing entity during the financial year who:
 - was formerly a partner or director of an audit firm or audit company that is currently the disclosing entity's auditor; and
 - was a partner or director at a time when the audit firm or audit company conducted an audit of the disclosing entity (section 300(1)(ca)). This information is required for current financial years, as there is no transitional provision.

- **non-audit services** – for listed companies, disclosure of non-audit services in a section of the directors' report headed "Non-audit services". Both the board and the audit committee have a role to play in preparing the "non-audit services" disclosure (described below).
- **auditor's independence declaration** – for all disclosing entities, a copy of the auditor's independence declaration under new section 307C.

"Non-audit services" disclosure

The "Non-audit services" section of the directors' report must include:

- details of the amount paid or payable to the auditor for non-audit services provided by, or on behalf of, the auditor during the year (including the names of the auditor and the dollar amount that the listed company paid, or must pay, for each of the non-audit services) (sections 300(11B)(a) and (11C));
- a statement whether the directors are satisfied that the provision of non-audit services by the auditor during the year is compatible with the general standard of independence for auditors imposed by the *Corporations Act* (section 300(11B)(b)); and
- a statement of the directors' reasons for being satisfied that the auditor's independence was not compromised (section 300(11B)(c)).

The board can only make the statements on non-audit services and the auditor's independence required by sections 300(11B)(b) and (c) in accordance with:

- advice provided by the listed company's audit committee, if the company is in the All Ordinaries Index or otherwise has an audit committee; or
- a resolution of the directors if the listed company does not have an audit committee (section 300(11D)).

The board's section 300(11B) statement on non-audit services must be consistent with the advice of the audit committee and must not contain any material omission of material included in that advice. In addition, the audit committee's advice must:

- be endorsed by a resolution passed by the members of the audit committee; and
- be written advice and signed by a member of the audit committee on behalf of the audit committee and given to the directors (section 300(11E)).

Auditor's independence declaration

If an auditor conducts an audit for a financial year, or half-year, the auditor must give the directors of the company, registered scheme or disclosing entity a written declaration in the form of one of the following:

- that, to the best of the auditor's knowledge and belief, there have been no contraventions of:
 - the auditor independence requirements of the *Corporations Act* in relation to the audit; and
 - any applicable code of professional conduct in relation to the audit review; or
- that, to the best of the individual auditor's knowledge and belief, the only contraventions of the two points above are those contraventions which have been set out in the declaration (section 307C).

A failure to give such a declaration is an offence of strict liability. Self-incrimination is no excuse from the requirement to give the section 307C declaration. However, the declaration is inadmissible as evidence against the individual auditor in any criminal proceedings or any proceedings that would expose the

individual to a penalty, with an exception for proceedings for giving a false declaration.

The directors' report must include a copy of the auditor's independence declaration (sections 298(1)(c) and 306(2)).

General requirements for auditor independence

Timing: applies to an audit of the financial report for a financial year, or an audit or review of the financial report for a half-year in a financial year, if the financial year begins on or after 1 July 2004.

Applies to all relationships that exist between an auditor and an audited body on or after 1 July 2004 (including a relationship that exists because of circumstances that came into existence before 1 July 2004).

Division 3 of Part 2M.43 "Auditor independence" sets out a general standard of auditor independence, as well as specific relationships which, when present, will compromise auditor independence. The sections are complex and need to be considered carefully when determining whether the standards of auditor independence are maintained – especially for the directors' declaration on auditor independence and non-audit services (see page 19).

Some of the provisions promoting general auditor independence are described below:

Individual auditor or audit company aware of a conflict of interest situation

It is a contravention of section 324CA if an individual auditor or audit company engages in audit activity of an audited body and at that time:

- a "conflict of interest situation" exists in relation to the audited body;
- the auditor or audit company is aware of the conflict of interest situation; and
- the auditor or audit company does not take reasonable steps to ensure that the conflict of interest situation ceases to exist as soon as possible after they become aware of the situation (section 324CA(1)).

Requirement to notify ASIC if conflict of interest situation continues

If an individual auditor or audit company becomes aware of a conflict of interest situation and 7 days after becoming aware, the conflict of interest situation still exists, ASIC must be notified (section 324CA(1A)). Section 324CA(1C) provides limited protection for individuals by prohibiting the use of any disclosure

Action points

- Identify any current directors, company secretaries or senior managers who were once partners or directors of the company's auditor.
- Regularly identify, quantify and review all non-audit services provided by the auditor.
- Ensure the company's audit engagement letter with the auditor includes a requirement for the auditor to comply with the *Corporations Act*, which now includes a requirement for an independence declaration.
- Start planning for the audit committee and board review of auditor independence (where non-audit services have been provided) in time for the directors' report for the 2004/5 financial year. Consider the information the audit committee may require.
- Review the powers of the audit committee under its charter to undertake the required activities to provide the advice to the board on non-audit services and independence.
- Consider how the "general standard of independence" for auditors applies to your auditor (see pages 20 and 21).
- Plan for any transition to non-audit service providers that may be required to ensure auditor independence under the new requirements.

made to ASIC in criminal proceedings against the individual.

*Individual auditor or audit company **not** aware of a conflict of interest situation*

An individual auditor or audit company will contravene section 324CA(2) if a conflict of interest situation exists and the individual auditor or the audit company is not aware of that situation, but would have been aware if they had in place a "quality control system reasonably capable of making the auditor aware" of the conflict of interest situation.

Section 324CA(4) provides a defence if the individual auditor or audit company has reasonable grounds to believe that a quality control system used by the auditor provided reasonable assurance that the individual auditor, or audit company (or their employees) complied with the auditor independence requirements.

Like section 324CA described above, sections 324CB and 324CC impose similar obligations on members of an audit firm and directors of audit companies to avoid conflict of interest situations and to notify ASIC where a conflict of interest situation continues to exist.

What is a "conflict of interest situation"?

The general auditor independence requirements are founded on the concept of a "conflict of interest situation". Section 324CD provides that a conflict of

interest situation exists in relation to an audited body if, at that time:

- the auditor, or a professional member of the audit team, is not capable of exercising objective and impartial judgment in relation to the conduct of the audit of the audited body; or
- a reasonable person, with full knowledge of all relevant facts and circumstances, would conclude that the auditor, or a professional member of the audit team, is not capable of exercising objective and impartial judgment in relation to the conduct of the audit of the audited body.

When considering whether an auditor is not capable of exercising objective and impartial judgment, regard must be given to the circumstances arising from past, current or possible relationships between:

- the individual auditor, audit firm, current or former audit firm member, audit company or any current or former audit company director; and
- the audited body, its current or former directors or managers.

The following terms are relevant for the new Part 2M.4:

"Professional members of the audit team" (section 324AE) are:

- any registered company auditor who participates in the conduct of the audit;
- any other person who participates in the conduct of the audit and, in the course of doing so, exercises professional judgment in relation to the application of, or compliance with, accounting standards or auditing standards or the provisions of the *Corporations Act* dealing with financial reporting and the conduct of audits; and
- any other person who is in a position to directly influence the outcome of the audit because of the role they play in the design, planning, management, supervision or oversight of the audit.

A **"lead auditor"** (section 324AF) is the registered company auditor who is primarily responsible to the audit firm or the audit company for the conduct of the audit.

A **"review auditor"** (section 324AF) is the registered company auditor (if any) who is primarily responsible to the individual auditor, the audit firm or the audit company for reviewing the conduct of the audit.

An individual auditor, audit firm or audit company engages in **"audit activity"** if they:

- consent to be appointed as auditor of an audited body for a financial year;
- act as the auditor of the audited body for a financial year; or
- prepare a report in relation to the audited body that is required by the *Corporations Act* to be prepared by a registered company auditor or an auditor of the audited body in relation to a financial year or half-year.

An **"audited body"** means the company or registered scheme in relation to which the audit is, or is to be, conducted.

Specific requirements for auditor independence

Timing: applies to all relationships that exist between an auditor and an audited body on or after 1 July 2004 (including a relationship that exists because of circumstances that came into existence before 1 July 2004).

Individual auditor or audit company aware of a section 324CH(1) relationship

Individual auditors (under section 324CE), audit firms (under section 324CF) and audit companies (under section 324CG) contravene the specific independence requirements if:

- the auditor is engaged in audit activity, (while reference is made only to “an auditor”, in this context “auditor” refers to individual auditors, audit firms and audit companies);
- at that time, a section 324CH(1) relationship exists (described below);
- the auditor becomes aware of the section 324CH(1) relationship; and
- the auditor does not take all reasonable steps to ensure that the individual auditor to act in the audit.

Requirement to notify ASIC if a section 324CH(1) relationship continues

Under section 324CE, 324CF or 324CG, auditors must also notify ASIC if they become aware of a section 324CH(1) relationship and after 7 days that relationship continues to exist. A notice is also required under section 327B(2A) or section 331AAA(2A) within 21 days from the date the section 324CE, 324CF or 324CG notice is given – a failure to do so will result in a termination of the auditor appointment (described below at page 24).

Individual auditor or audit company not aware of a section 324CH(1) relationship

It is also a contravention if the auditor is engaged in an audit and a section 324CH(1) relationship exists, regardless of the auditor’s knowledge. It is a defence to this strict liability provision if the auditor had reasonable grounds to believe that the auditor had in place a quality control system that provided reasonable assurance that the auditor and its employees complied with the specific auditor independence requirements.

Relevant relationships under section 324CH(1)

The relevant relationships covered by section 324CH(1) vary slightly between “individual auditors”, “audit firms” and “audit companies”. However, some of the more common relationships are:

- **officer or audit-critical employee** – the individual auditor, or a professional member of the audit team, being related to the audited body by being an officer or audit-critical employee of the audited body;
- **former officer of audit-critical employee** – the individual auditor, or professional member of the audit team, being related to the audited body by being an officer or audit-critical employee of the audited body within the last 12 months before the financial year being audited;
- **former professional employee of the auditor who fails the “independence test”** – a former professional employee of the auditor related to the audited body by being an officer or audit-critical employee who can influence the policies of the auditor, participates in business or professional activities of the auditor’s practice, or receives a commission from the auditor for generating business; and
- **non-audit service provider who exceeds the “maximum hours test”** – if a non-audit service provider has provided more than 10 hours of non-

Action points

- Ensure your auditor has a system in place to identify any circumstances that might put in question the auditor’s ability to exercise objective and impartial judgment in relation to the audit.
- Ensure your auditor has a system in place to identify any relevant relationships (identified in section 324CH(1)) that may impact on their specific auditor independence obligations.
- Consider including the requirements in the audit engagement letter.
- Implement systems to monitor whether any non-audit services provider exceeds the maximum hours test.
- Ensure the audit committee and the board consider whether auditors who also provide non-audit services meet the standard of independence imposed by the *Corporations Act* (see page 19).
- Consider the requirement for legal advice to ensure that the general and specific auditor independence standards are met.

audit services during the period being audited, or the 12 months immediately before the audited period, and that non-audit service provider has certain investments in the audited body.

If these or other relationships in section 324CH(1) are present, the specific audit independence requirements will be contravened unless the auditor takes all reasonable steps to ensure that the auditor ceases to act on the audit.

“Audit-critical employee” means for a company or responsible entity an employee who is able, because of his or her position, to exercise significant influence over a material aspect of the contents of the financial report being audited, or the conduct or efficacy of the audit (section 9).

The specific auditor independence requirements, including the specific relationships that are prohibited between an auditor and an audited body, are complex. The above is a brief summary only.

Restrictions on auditors being employed by audit clients

Timing: sections 324CI and 324CJ apply only if the relevant departure time for the purposes of the sections occur on or after 1 July 2004.

Section 324CK applies to a person only if the person is on 1 July 2004, or becomes after 1 July 2004 a member of the audit firm concerned, or a director of the audit company concerned, and becomes an officer of the audited body concerned on or after 1 July 2004.

In addition to the general and specific auditor independence requirements described above, there are specific restrictions on former auditors taking up positions with former audit clients.

2 year cooling off period

A member of an audit firm, or director of an audit company who was a professional member of an audit team, cannot become an officer (director, company secretary or senior manager) of an audit client until 2 years from the date of ceasing to be with the audit firm or audit company (section 324CI).

Section 324CJ applies similar rules for lead or review auditors.

Multiple former audit firm partners or audit company directors

There is now a limit on the number of former audit firm partners or audit company directors who can become an officer of an audit client. A person will contravene section 324CK if:

- an audit firm or audit company is an auditor of an audited body for a financial year;
- the person has at any time been a member of the audit firm or a director of the audit company;
- the person becomes an officer of the audited body; and
- at the time when the person becomes an officer of the audited body, another person who is or who has at any time been a member of the audit firm or a director of the audit company, at a time when the audit firm or audit company undertook an audit of the audited body is also an officer of the audited body.

In the case of listed companies, for the purposes of sections 324CI and 324CK described above, the definition of officer also includes being an officer of a related body corporate of the audit client.

The restrictions described above do not apply to small proprietary companies.

Auditor rotation for listed companies

Timing: applies to an audit of the financial report for a financial year or an audit or review of the financial report for a half-year in a financial year, if the financial year begins on or after 1 July 2006.

Rotation after significant role in an audit in 5 out of 7 years

Section 324DA requires rotation of a person who “plays a significant role in an audit” in 2 situations:

- if an individual has played a significant role in the audit for 5 successive financial years, the individual must not play a significant role in the audit for at least 2 successive financial years (section 324DA(1)); and
- if an individual has played a significant role in the audit for 5 out of 7 successive financial years the individual must not play a significant role in the audit (section 324DA(2)).

A person “plays a significant role in the audit” generally, if the person is a lead or review auditor for the audit (section 9).

A member of an audit firm could be found guilty of a contravention of section 324DC if another member of the firm acts as lead or review auditor for an audit, and that person is not eligible to play a significant role in the audit. Where a member of an audit firm becomes aware that an ineligible person is acting on an audit they must as soon as possible after becoming aware ensure that either:

- the firm resigns the audit; or
- the lead or review audit partner ceases to act on the audit.

A member of an audit firm who is unaware that an ineligible audit partner is acting on an audit of a listed company, will also be guilty of a contravention of section 324DC. However, a defence is available if the member of the audit firm has reasonable grounds to believe that the audit firm had in place a quality control system that provided reasonable assurance that the audit firm and its employees complied with the independence requirements.

Section 324DD imposes similar obligations on audit companies and audit company directors.

Under section 342A, ASIC has power to modify the operation of section 324DA and the auditor rotation requirements so that the rotation requirements apply to a person who has played a significant role in an audit in 6 or 7 successive financial years (rather than 5 successive financial years). Auditors who have the benefit of a section 342A declaration must give a notice of the declaration to their audit client. This notice must be referred to in that entity’s directors’ report (see section 300(11A)).

Action point

- Assess the audit team that currently conducts the audit of the financial report, to consider whether the rotation requirements could adversely impact on the team knowledge of your company if key members of the audit team were required to rotate off the audit.

Appointment and removal of auditors

Division 6 of Part 2M.1 deals with the appointment, removal and fees of auditors. While some of the concepts in this division have been carried over from the pre-CLERP 9 Act law, some concepts are new.

The circumstances where an auditor ceases to hold office have been expanded to now include, where the auditor:

- ceases to be capable of acting as auditor due to a failure to be registered as an auditor; or
- initially gives ASIC a notice of a conflict of interest situation (under the general requirement of auditor independence) or of a specified relationship (under the specific requirements of auditor independence) and does not give ASIC a further notice within 21 days from the first notice stating that the conflict or relationship has ceased (sections 327B(2A), (2B) and (2C)). (Similar provisions apply to auditors of registered scheme (see section 331AAA).)

Auditors and AGMs

Timing: applies to annual general meetings at which financial reports for financial years that commence on or after 1 July 2004 are considered.

The CLERP 9 Act has made the following changes:

- shareholders can submit written questions to the auditor before an AGM provided that it relates to the auditor’s report or the conduct of the audit;
- the auditor must attend an entity’s AGM; and
- the chair must allow a reasonable opportunity for members as a whole to ask questions of the auditor, and for the auditor to respond.

Shareholders’ questions to the auditor

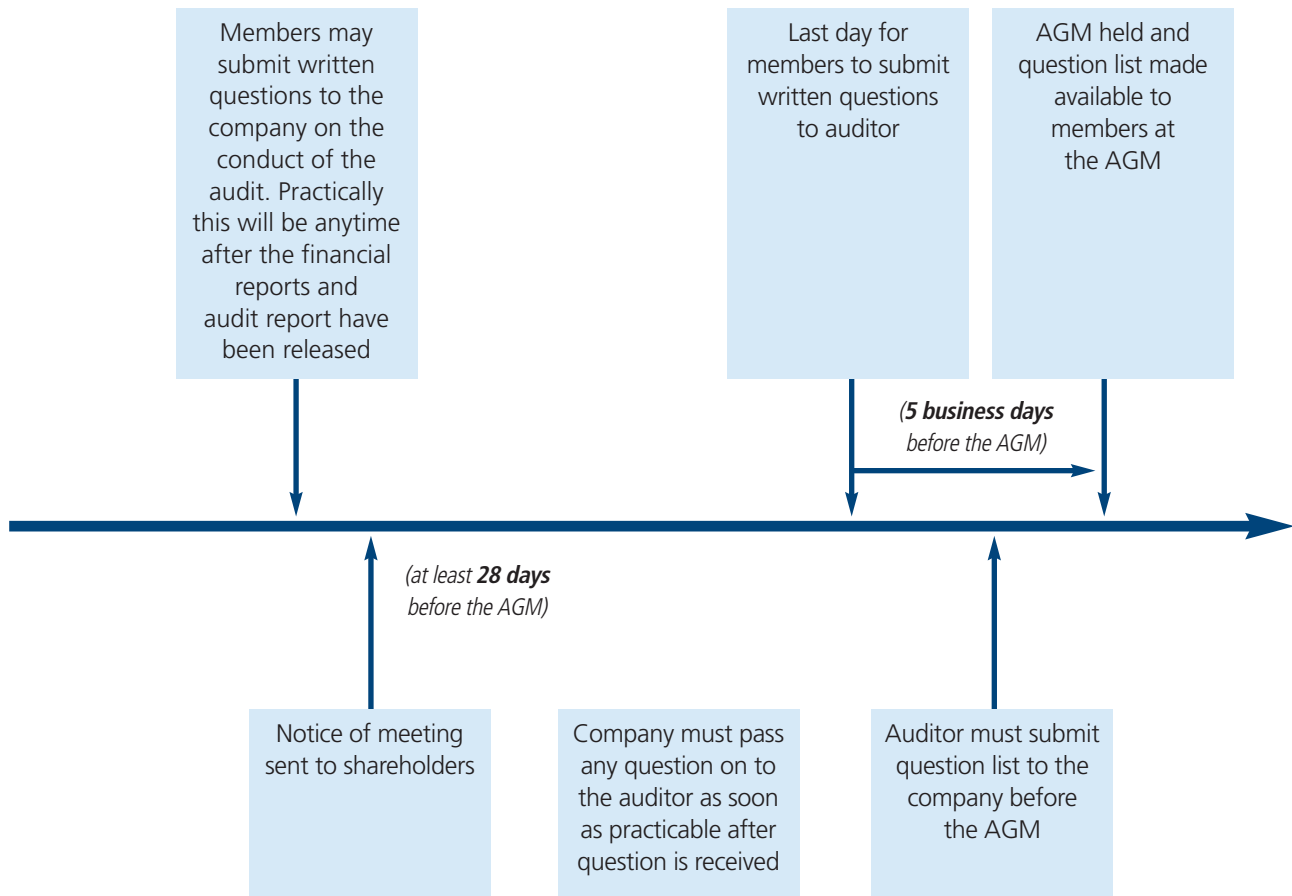
Section 250PA gives members the right to submit written questions to the auditor (via the company) no later than 5 business days before the AGM. These questions must relate to the content of the auditor’s report or the way the audit was conducted.

The written questions submitted to the company must be passed onto the auditor “as soon as practicable” after the question is received, regardless of whether the company believes it to be irrelevant.

The auditor is required to submit to the company a list of those questions submitted by shareholders that are considered by the auditor to be relevant to the content of the auditor’s report or the way the audit was conducted.

A question will not need to be included on the auditor’s list of questions where the list already includes a question of the same substance or where it is impractical to decide whether to include the question due to the time the question was passed onto the auditor.

Submitting questions to the auditor



The listed company must at or before the start of the AGM make the copies of the question list available to the members at the AGM.

Where the auditor has prepared written answers to the written questions submitted by members prior to the AGM, the chair of the AGM may permit the auditor or the auditor's representative to table the written answers to questions. The written answers must be made reasonably available to members as soon as practicable after the AGM.

Auditor's attendance at AGMs

Section 250RA makes it an offence for the lead auditor not to attend a listed company's AGM, or arrange to be represented by a suitably qualified member of the audit team who is in a position to answer questions about the audit.

Questions at the AGM

Section 250T now requires that, where a company's auditor or representative attends the AGM, the chair of the AGM must:

- allow a reasonable opportunity for the members as a whole to ask the auditor or their representative questions relevant to:
 - the conduct of the audit;
 - the preparation and content of the auditor's report;
 - accounting policies adopted by the company in relation to the preparation of the financial statements; and
 - the independence of the auditor in relation to the conduct of the audit; and

- allow a reasonable opportunity for the auditor or their representative to answer written questions submitted to the auditor under section 250PA (described above).

It should be noted that there is no requirement for the auditors to provide answers to written questions either at the AGM or following the meeting.

Action points

- Develop procedures for enabling shareholders to submit written questions to the auditor (including via the company's website, or question sheets sent with the annual report and notice of meeting).
- Develop procedures for receiving written questions from members and forwarding to the auditor as soon as practicable.
- Develop procedures for distributing the auditor's question list to members attending the AGM at or before the start of the AGM.
- Consider ways in which the auditors can best effectively and clearly communicate their responses to members at the AGM.

Expansion of auditor's duties

Timing: commences on or after 1 July 2004.

Before the CLERP 9 Act, section 311 of the *Corporations Act* imposed an obligation on auditors to notify ASIC "as soon as possible" where the auditor has reasonable grounds to suspect that there has been a contravention of the *Corporations Act*, and believed that the contravention has not been or will not be adequately dealt with by making a comment in the auditor's report or bringing it to the attention of the directors.

The CLERP 9 Act significantly expands the scope of the auditor's duty to inform ASIC of suspected contraventions.

The expanded provision

An auditor conducting an audit must notify ASIC as soon as practicable, and in any case within 28 days, if the auditor is aware of circumstances:

- of a person attempting, in relation to an audit, to unduly influence, coerce, manipulate or mislead a "person involved in the conduct of an audit";

- of a person attempting to otherwise interfere with the proper conduct of an audit; or
- that the auditor has reasonable grounds to suspect, amount to a contravention of the *Corporations Act*, and either:
 - the contravention is significant: or
 - the contravention is not significant, but the auditor believes that the contravention has not, or will not be adequately dealt with by making a comment in the auditor's report or bringing it to the attention of the directors.

Similar amendments have been made to the audit of compliance plans for managed investment schemes (section 601HG(4)).

An individual auditor is responsible for notifying ASIC, if the individual auditor is conducting the audit. If an audit company is conducting the audit, the audit company **and** the lead auditor, contravene section 311 if the lead auditor does not notify ASIC as required.

What is a "significant" contravention?

In determining whether a contravention is "significant" the auditor must have regard to:

- the level of penalty provided for the contravention;
- the effect that the contravention has, or may have, on:
 - the overall financial position of the company, registered scheme, or disclosing entity; and
 - the adequacy of the information available about the overall financial position of the company, registered scheme or disclosing entity; and
- any other relevant matter.

Action points

- Review internal procedures to ensure that:
 - employees understand the role of the entity's auditor and do not influence, coerce, manipulate or mislead the auditor.
 - employees do not otherwise "interfere" with the proper conduct of the audit.

"Person involved in the conduct of an audit" means the auditor, the lead auditor for the audit, the review auditor for the audit, a professional member of the audit team for the audit, or any other person involved in the conduct of the audit.

Retention of audit working papers

Timing: applies to an audit of the financial report for a full year, or an audit or review of the financial report for a half-year in a financial year, where the financial year begins on or after 1 July 2004.

Section 307B now requires an auditor to retain working papers for an audit of a financial report for a financial year, or a review or audit of the financial report for a half year, until the end of 7 years after the date of the audit report.

Qualified privilege for auditors

Timing: commences on or after 1 July 2004.

Part 7.8 of the *Corporations Act* has been amended to extend the existing qualified privilege of individual auditors to registered company auditors acting on behalf of audit companies and to all auditors in relation to certain new disclosures required as a result of other amendments made by the CLERP 9 Act.

What is qualified privilege?

Where a provision of the *Corporations Act* expresses that a person has qualified privilege in respect of an act, matter or thing, that person:

- has qualified privilege in proceedings for defamation; or
- is not, in the absence of malice on the person's part, liable to an action for defamation at the suit of another person,

as the case requires, in respect of that act, matter or thing (section 89).

Previously, qualified privilege applied to individual auditors in respect of:

- statements that the auditor made (orally or in writing) in the course of the auditor's duties as auditor;
- reports lodged with ASIC in relation to any contraventions of the *Corporations Act* uncovered during audit activities; and
- statements made by the auditor (orally or in writing) on a directors' report.

Qualified privilege now also applies in relation to the following disclosure situations required as a result of amendments to the *Corporations Act*:

- all auditors in respect of answering questions put to the auditor by the members of a company either prior to an AGM or during the AGM (section 1289(3)); and
- all auditors in respect of disclosures made in response to requests for information given to the auditor by the FRC (sections 990L(1)(d), 990L(2)(d), 1289(1)(d) and 1289(2)(d)).

Audit oversight

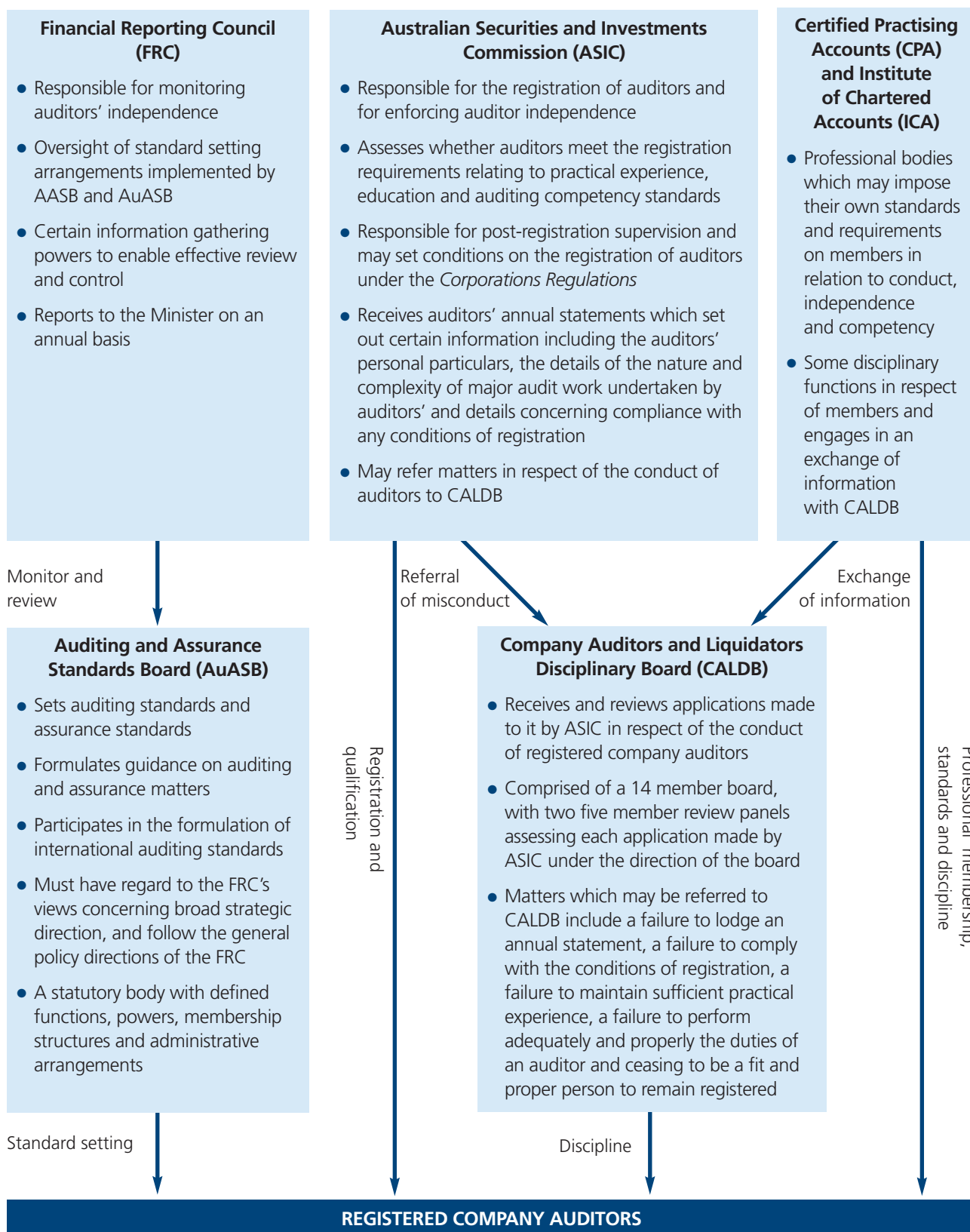
The audit regulation and oversight regime has been strengthened by the CLERP 9 Act. The roles and functions of regulatory bodies have been modified, in an attempt to have a more coordinated approach to audit regulation.

The Financial Reporting Council (**FRC**) has been significantly enhanced to include broad oversight of the processes for setting not only accounting standards, but also auditing standards. The FRC must now monitor, and must report annually to the Minister on, the effectiveness of auditor independence in Australia.

The Auditing and Assurances Standards Board (**AuASB**) has been reconstituted and established as a body corporate under the *Australian Securities and Investments Commission Act*. The primary functions of the AuASB are to make auditing standards under the new section 336 of the *Corporations Act*. Under section 336 auditing will have the force of law, with transitional provisions for existing auditing standards.

The following diagram shows the shape of the post-CLERP 9 Act regulatory landscape once the bodies have been established (for example the FRC amendments take effect on 1 January 2005).

Audit regulation and oversight regime



Qualifications of auditors

Strengthening audit registration requirements

Auditor qualification requirements have been expanded, with the general changes described below:

- practical experience – auditors will be able to fulfil the practical experience requirements for registration as a company auditor by satisfying all the components of an auditing competency standard;
- educational requirements – auditors will be required to have completed a specialist course in auditing, which will be prescribed under the *Corporations Regulations* and administered by the professional accounting bodies; and
- auditing competency standards – ASIC will approve auditing competency standards on application of any professional body or accounting firm if the standard:
 - requires a person’s performance against the standard to be verified by a registered company auditor familiar with that person’s work;
 - is not inconsistent with the *Corporations Act* or any other Commonwealth law under which ASIC has regulatory responsibilities;
 - adequately addresses the level of practical experience needed for registration as a company auditor; and
 - is harmonised as much as possible with other approved competency standards.

ASIC will now have power to impose conditions on the registration of an auditor, in order to enhance post-registration supervision of the auditor’s activities. Conditions may include, for example, a requirement that an auditor who is not a member of a professional body undertake continuing professional development. Any conditions must be consistent with the regulations made for this purpose.

Annual statements by auditors

The previous triennial statement required of auditors has been replaced with an annual statement which must be lodged by 31 January each year. The annual statement must include:

- details of the nature and complexity of major audit work undertaken by the auditor; and
- details concerning compliance with any conditions that may be imposed on the auditor’s registration.

Revised powers of CALDB in relation to auditors

The matters that may be referred to the Companies Auditors and Liquidators Disciplinary Board (**CALDB**) have been revised to include:

- failing to lodge an annual statement;
- failing to comply with an ASIC condition of the person’s registration; and
- ceasing to have the practical experience necessary for carrying out audits, as demonstrated by a failure to perform audit work during a continuous period of 5 years.

The CALDB will continue to have power to cancel or suspend a person’s registration as an auditor.

Registration of authorised audit companies

Who can be registered as an “authorised audit company”?

Part 9.2A of the *Corporations Act* deals with “authorised audit companies”. A company can now apply to be an authorised audit company if all of the following conditions are met:

- each director of the company is a registered company auditor (and is not disqualified from managing a corporation);
- each share in the company is held and beneficially owned by an individual or the legal personal representative of an individual;
- a majority of the voting power attaches to shares held and beneficially owned by individuals who are registered company auditors;
- ASIC is satisfied that the company has adequate and appropriate professional indemnity insurance for claims that may be made against the company in relation to the audit of companies and registered schemes (ASIC has issued a policy paper proposal on this issue); and
- the company is not externally administered (section 1299B).

Management of conflicts of interest by financial services licensees

Under section 912A(1)(aa), AFS licensees will now have an obligation to have in place adequate arrangements to manage conflicts of interests that may arise either wholly or partially in relation to activities undertaken by the AFS licensee or their representatives in the provision of financial services as part of the financial services business of the AFS licensee or their representative.

This obligation supplements an AFS licensee's current obligation to provide financial services efficiently, honestly and fairly.

The amendment attempts to ensure there is market confidence in the integrity of AFS licensees by ensuring that AFS licensees are required to manage conflicts of interest effectively.

ASIC guidance

ASIC has released a policy proposal paper, *Licensing: Managing conflicts of interest*. ASIC has adopted the view that arrangements to manage conflicts which are not consistent with ASIC's proposals under the policy proposal paper are unlikely to be adequate. An AFS licensee must therefore examine the policy proposal paper in detail and apply it to their financial services business. The following 3 key mechanisms for managing conflicts of interest are listed in the policy proposal paper.

Controlling conflicts

Controlling conflicts requires an AFS licensee to ensure that the quality of their financial services should not be significantly compromised by conflicts. This requires an AFS licensee to identify, assess and evaluate conflicts and decide upon, implement and maintain appropriate policies and procedures in accordance with the policy proposal paper to deal with conflicts.

Disclosing conflicts

Disclosing conflicts requires AFS licensees to ensure that their clients are sufficiently informed about any conflicts which may affect the provision of financial services. Disclosure should be timely, prominent and specific, occur before or when a financial service is provided and contain sufficient details to enable the client to understand the potential impact of the conflict on the financial service provided to the client.

Avoiding conflicts

Avoiding conflicts requires an AFS licensee to avoid those conflicts of interest which have a serious impact on an AFS licensee or client and cannot be managed through controlling or disclosing the conflict.

ASIC also expects AFS licensees to document their arrangements for managing conflicts of interests. This is recommended for all arrangements an AFS licensee has in place as it enables an AFS licensee to demonstrate their compliance with legislative and regulatory requirements.

Disclosure rules

Presentation of prospectuses and other disclosure documents

Timing: applies to disclosure documents lodged with ASIC on or after 1 July 2004.

Information in prospectuses and other disclosure documents in respect of securities must now be “worded and presented in a clear, concise and effective manner” under new section 715A.

ASIC has been given power to issue a stop order in relation to an offer of securities if it is satisfied that this standard is not met. Offerors must also lodge a supplementary or replacement disclosure document if they become aware that a disclosure document does not meet the standard.

An equivalent requirement was included in the *Financial Services Reform Act 2001* provisions prescribing the content of Product Disclosure Statements (**PDS**) (which are required for certain offers of financial products such as other than securities) under Part 7.9 of the *Corporations Act*.

ASIC has released a policy proposal paper in relation to this aspect of the CLERP 9 Act. ASIC suggested that it would apply Policy Statement 168 (which was issued primarily in relation to PDS) when assessing compliance with the new standard. ASIC noted, in particular, that Policy Statement 168 requires disclosure to be:

- timely;
- relevant and complete;
- promote investment understanding;
- promote investment comparison;
- highlight important information; and
- have regard to consumer needs.

ASIC’s policy proposal paper also suggests that the “clear, concise and effective” standard extends to the structure, length, language and readability of a disclosure document.

The operation of section 715A should be considered in light of any final ASIC policy concerning the “clear, concise and effective” requirement.

Product disclosure statements for continuously quoted securities

Timing: applies to a PDS that is required to be given on or after 1 July 2004.

The inclusion of a new section 1013FA attempts to provide a framework similar to that in section 713 of the *Corporations Act* which allows “transaction specific” prospectuses. Product issuers for continuously quoted securities will now be able to issue shorter, or “transaction specific” PDSs.

Under new section 1013FA, PDSs for continuously quoted securities will no longer be required to include information contained in:

- the most recently lodged annual financial report lodged with ASIC by the product issuer;
- any half-year financial report lodged with ASIC by the product issuer after lodgment of that annual financial report but before the date of the PDS; and
- any continuous disclosure notices given by the product issuer after lodgment of that annual financial report and before the date of the PDS, where the PDS:
 - states that as a disclosing entity the issuer of the product is subject to regular reporting and disclosure obligations; and
 - informs people of their right to obtain a copy of any of the documents referred to above.

If the PDS informs people of their right to obtain a copy of any of the documents referred to above, the issuer of the product must give a copy of the document free of charge to anyone who asks for it.

ASIC will have the power to determine that section 1013FA does not apply for continuously quoted securities if ASIC is satisfied that in the previous 12 months the issuer of the continuously quoted securities has contravened:

- the provisions of Chapter 2M (relating to financial reports and audit);
- section 674(2) or 675(2) (which require continuous disclosure by listed and unlisted disclosing entities);
- section 1012DA(9) (which is a new section requiring a product issuer to correct defective notices); and

- section 1308 (false and misleading statements) as it applies to a notice under section 1012DA(5) (concerning the transfer or sale of quoted securities).

ASIC policy

The Explanatory Memorandum for the CLERP 9 Act makes it clear that the continuously quoted securities which the amendments apply to are managed investment products which are defined in the *Corporations Act* to mean, amongst other things, interests in managed investment schemes.

ASIC has issued a policy proposal on the product disclosure amendments under the CLERP 9 Act. In relation to transaction specific PDSs, ASIC will apply Practice Note 66 *Transaction specific prospectuses* with any necessary adaptations. Prior to excluding a product issuer from relying on section 1013FA, ASIC has indicated that it will generally offer the disclosing entity an opportunity to make submissions to ASIC. It will not be sufficient merely to argue that the contravention has been rectified in some way.

Some secondary sales of securities exempted from disclosure document requirements

Amendments have been made to Chapter 6D relating to the secondary sale of securities issued without a disclosure document. The amendments made by the CLERP 9 Act are complex and the description below is a general summary only.

New section 708A largely enacts the relief formerly provided by categories 1 and 2 in Schedule C of ASIC Class Order 02/1180.

A person offering to sell a body's securities within 12 months after their issue where the body issued the securities without disclosure to investors under Part 6D.2 is exempted in certain circumstances from the requirement for disclosure under that Part (that is, the requirement to use a prospectus, profile statement or offer information statement for the offer).

The exemption is not available if the body issued the securities with the purpose of the person to whom they were issued selling or transferring the securities, or granting, issuing or transferring an interest in, or option over, them.

ASIC may make a determination disallowing the exemption in relation to a body if ASIC is satisfied that in the previous 12 months the body contravened certain provisions of the *Corporations Act* relating to disclosure obligations, including continuous disclosure and financial reporting obligations.

The exemption will apply in each of the 3 cases described below.

Case 1 – Notice given to ASX

Where all of the following apply:

- the relevant securities are in a class of securities that were “quoted securities” at all times in the 12 months before they were issued;
- trading in that class of securities was not suspended for more than 5 days in that 12 months;
- none of the body or its directors or auditors was exempted from the disclosing entity provisions relating to financial reporting and continuous disclosure at any time in that 12 months; and
- before the day on which the offer for the sale of the relevant securities is made, the body gives the ASX a notice that complies with the following requirements:
 - it is given within 5 business days after the securities were issued by the body (the requirement in ASIC Class Order 02/1180 was for the notice to be given within 2 business days);
 - it states that the body issued the securities without disclosure to investors and that as at the date of the notice the body has complied with the financial reporting and continuous disclosure provisions in Chapter 2M and section 674 of the *Corporations Act* (this is a new requirement that was not part of ASIC Class Order 02/1180);
 - it sets out information that, in accordance with the ASX listing rules, has not previously been disclosed in a continuous disclosure notice but which is information that investors and their professional advisers would reasonably require for the purpose of making an informed assessment of:
 - the assets and liabilities, financial position and performance, profit and losses and prospects of the body; and
 - the rights and liabilities attaching to the relevant securities.

This information need only be included to the extent that it is reasonable for investors and their professional advisers to expect to find the information in a disclosure document.

A notice which purports to be a notice under Case 1 but which fails to comply with the requirements for that case will not result in a contravention of the requirement for offers of securities to be made using a disclosure document which has been lodged with ASIC. However, the general provisions in sections 1308 and

1309 prohibiting the making of false or misleading statements are specifically applied to the notice. The CLERP 9 Act also introduces an explicit obligation to correct a defective notice where the body becomes aware of the defect within 12 months after the relevant securities are issued.

Case 2 – Contemporaneous prospectus

Where all of the following apply:

- the relevant securities are in a class of “quoted securities”; and
- a prospectus for an offer of securities issued by the body that are in the same class of securities as the relevant securities is lodged with ASIC either:
 - on or after the day in which the relevant securities were issued but before the day on which they are offered for sale; or
 - before the day on which the relevant securities were issued provided that offers under that prospectus are still open for acceptance on the day in which the relevant securities were issued (this is a new circumstance that was not included under ASIC Class Order 02/1180).

Case 3 – Issue to an underwriter

Where all of the following apply:

- the body offered to issue securities under a prospectus;
- the body issued the relevant securities to a person named in the prospectus as an underwriter of the issue or to a person nominated by the underwriter (the ability to issue the securities to a person nominated by the underwriter was not part of ASIC Class Order 02/1180. Further, the requirement under ASIC Class Order 02/1180 that the securities be issued “under an underwriting agreement” has not been included in section 708A);
- the relevant securities were issued to that underwriter or nominated person at or about the time that persons who apply for securities under that prospectus were issued with those securities; and
- the relevant securities were in a class of “quoted securities”.

For each of the above cases ASIC Class Order 02/1180 operated in respect of “quoted ED securities”, whereas the new provisions operate in respect of “quoted securities”. The definition of “quoted securities” has been amended by the CLERP 9 Act such that the security is required to be “quoted”, rather than “listed for quotation”.

Some financial product recommendations and secondary sales of financial products exempted from PDS requirements

Consistent with the changes made by the new section 708A, some other changes have been made in the context of financial product disclosure.

New section 1012DA largely enacts the relief formerly provided by categories 3 and 4 in Schedule C of ASIC Class Order 02/1180. The relief has been extended so that it is available in respect of all quoted financial products, not just quoted managed investment products.

Section 1012DA applies so that a regulated person:

- offering, or receiving an offer, to sell a financial product to a retail client within 12 months after the issue of the financial product where the product was issued without a PDS; or
- recommending that a retail client acquire such a financial product,

is exempted in certain circumstances from the requirement to give the client a PDS.

The exemption is not available if the product was issued by the issuer with the purpose of the person to whom they were issued selling or transferring the product, or granting, issuing or transferring an interest in, or option over, the financial product.

ASIC may make a determination disallowing the exemption in relation to an issuer of a financial product if ASIC is satisfied that in the previous 12 months the issuer contravened certain provisions of the *Corporations Act* relating to disclosure obligations, including continuous disclosure and financial reporting obligations.

The exemption will apply in each of the 3 cases described below.

Action point

- Monitor any notice given under section 708A for a period of 12 months after securities are issued to ensure that the notice was not defective.

Case 1 – Notice given to ASX

Where all of the following apply:

- the relevant financial product is in a class of financial products that were “quoted securities” at all times in the 12 months before the relevant financial product was issued;
- trading in that class of financial products was not suspended for more than 5 days in that 12 months;
- none of the issuer or its directors or auditors was exempted from the disclosing entity provisions relating to financial reporting and continuous disclosure at any time in that 12 months; and
- before the day on which the recommendation or offer for the sale of the relevant financial product is made, the issuer gives the ASX a notice that complies with the following requirements:
 - it is given within 5 business days after the relevant financial product was issued (the requirement in ASIC Class Order 02/1180 was for the notice to be given within 2 business days);
 - it states that the relevant financial product was issued without a PDS, that the issuer is subject to regular reporting and disclosure obligations and that as at the date of the notice the issuer has complied with the financial reporting and continuous disclosure provisions in Chapter 2M and section 674 of the *Corporations Act* (this is a new requirement that was not part of ASIC Class Order 02/1180); and
 - it sets out information that, in accordance with the ASX listing rules, has not previously been disclosed in a continuous disclosure notice but which is information that a person would reasonably require for the purpose of making a decision, as a retail client, whether to acquire the relevant financial product.

This information need only be included to the extent that it is reasonable for such a person to expect to find the information in a PDS.

A notice which purports to be a notice under Case 1 but which fails to comply with the requirements for that case will not result in a contravention of the requirement to give a PDS. However, the general provisions in sections 1308 and 1309 prohibiting the making of false or misleading statements are specifically applied to the notice. The CLERP 9 Act also introduces an explicit obligation to correct a defective notice where the issuer becomes aware of the defect within 12 months after the relevant financial product is issued.

Case 2 – Contemporaneous PDS

Where all of the following apply:

- the relevant financial product is in a class of “quoted securities”; and
- a PDS for an issue of a financial product that is in the same class of financial products as the relevant financial product is lodged with ASIC either:
 - on or after the day in which the relevant financial product is issued but before the day on which the recommendation or offer is made; or
 - before the day on which the relevant financial product is issued, provided that on the day on which the relevant financial product is issued the PDS is still being used by the issuer for offers of financial products in the same class as the relevant financial product (this is a new circumstance that was not included under ASIC Class Order 02/1180).

Case 3 – Issue to an underwriter

Where all of the following apply:

- a PDS for an issue of a financial product that is in the same class of financial products as the relevant financial product is given;

- the relevant financial product was issued to a person named in the PDS as an underwriter of the issue or to a person nominated by the underwriter (the ability to issue the financial product to a person nominated by the underwriter was not part of ASIC Class Order 02/1180. Further, the requirement under ASIC Class Order 02/1180 that the financial product be issued “under an underwriting agreement” has not been included in section 1012DA);
- the relevant financial product was issued to that underwriter or nominated person at or about the time that persons who apply for the financial product under that PDS were issued with that product; and
- the relevant financial product is in a class of “quoted securities”.

For each of the above cases ASIC Class Order 02/1180 operated in respect of “quoted ED securities”, whereas the new provisions operate in respect of “quoted securities”. The definition of “quoted securities” has been amended by CLERP 9 Act such that the security is required to be “quoted”, rather than “listed for quotation”.

Issuers of financial products that are not managed investment products are able to take advantage of the exemptions.

Action point

- Monitor any notice given under section 1012DA for a period of 12 months after a financial product is issued to ensure that the notice was not defective.

Enforcement

The CLERP 9 Act seeks to strengthen the provisions dealing with corporate mismanagement by:

- doubling the fines and more than doubling the jail term associated with certain existing offences relating to materially false or misleading statements or information;
- introducing provisions to protect “whistleblowers” who report contraventions of the *Corporations Act*; and
- giving Courts the power to increase the period of automatic disqualification of a director under the *Corporations Act* by a further 15 years (on an application from ASIC).

Revision of criminal penalties

Timing: commences on 1 July 2004.

Penalties have been increased for the following existing offences:

- section 1308 – knowingly making or authorising the making of false and misleading statements or material omissions in documents lodged with ASIC now carries a fine of \$22,000 or a jail term of up to 5 years or both.
- section 1309 – an officer of a corporation making available, authorising or permitting information to be made available or giving to a director, auditor, member, debenture holder or trustee for debenture holders of the corporation, an operator of a financial market or an officer of such a market, information that relates to the corporation and is false or misleading in a material particular or contains a material omission:
 - with the knowledge of the officer, now carries a fine of \$22,000 or a jail term of up to 5 years or both; or
 - without taking reasonable steps to ensure that the information was not false or misleading and did not contain material omissions, will be subject to a fine of up to \$11,000 or 2 years imprisonment or both.

Protection for whistleblowers reporting contraventions

Timing: the whistleblower provisions apply to all disclosures made on or after 1 July 2004, and includes any disclosure of information about circumstances that arose before that day.

Whistleblower protection – no victimisation

Part 9.4AAA provides protection for officers, employees and contractors (and employees of a contractor) of a company who report contraventions or suspected contraventions of the Corporations legislation to ASIC, the company’s auditor, a director or other authorised person where:

- the person has reasonable grounds to suspect the disclosure indicates a contravention of the Corporations legislation;
- the disclosure is made in good faith; and
- before making the disclosure, the person provides their name to the person to whom they are disclosing the information (section 1317AA).

“Corporations legislation” is defined in section 9 to include the *Corporations Act* and the *Australian Securities and Investments Commission Act*.

Persons making a disclosure within Part 9.4AAA will not be subject to civil or criminal liability or the enforcement of contractual rights or remedies on the basis of the disclosure (section 1317AB). The provisions specifically prohibit victimisation – which carries with it a fine of \$2,750 and/or imprisonment for 6 months – and provide whistleblowers with a right to compensation where victimisation has occurred and damage has been suffered (sections 1317AC and 1317AD). A Court can also order a company who has wrongly terminated the employment of a whistleblower because of disclosing a suspected contravention to reinstate the employee.

Note that Part 9.4AAA protection does not apply where a person does not provide their name before making the disclosure (section 1317AA(1)(c)).

Requirement to keep disclosed information confidential

If a whistleblower discloses information that qualifies for protection under Part 9.4AAA, the person to whom it is disclosed (being company’s officers, the auditor of a member of the audit team, or a person authorised by the company to receive the information) can only disclose the information or the identity of the whistleblower to:

- ASIC, APRA or the Australian Federal Police; or
- another person with the consent of the whistleblower (section 1317AE).

Action points

- Review existing whistleblower policies to ensure procedures deal with disclosures that qualify for protection under Part 9.4AAA.
- Ensure that any whistleblower policy is understood by employees, through effective communication and continued training.
- Review procedures to ensure that disclosures are handled appropriately – that is, not disclosed to anyone other than ASIC, APRA or the Australian Federal Police without the whistleblower's consent.
- Ensure that there are processes to protect whistleblowers from victimisation after they have made a disclosure that qualifies for Part 9.4AAA protection.

Disqualification of directors

Timing: applies to convictions on or after 1 July 2004.

Increased disqualification periods

ASIC will have the power to apply to the Court to extend, by up to an additional 15 years, the period of automatic disqualification of a director from managing a corporation under the *Corporations Act* (section 206BA).

Section 206B(1) of the *Corporations Act* provides for the automatic disqualification from managing a company where a person is convicted on indictment of an offence concerning such things as the decisions that affect the whole or substantial part of the business of the corporation or acts that have the capacity to significantly affect the corporation's financial standing. The section also relates to offences in contravention of the *Corporations Act* or equivalent foreign law, and punishable by imprisonment for greater than 12 months, or involving dishonesty and punishable by imprisonment for at least 3 months.

Officers, senior managers and employees

Technical changes to the *Corporations Act* have been introduced to clarify the classes of corporate personnel who have duties and obligations under the *Corporations Act*.

Previously, the *Corporations Act* contained 2 definitions of an officer. The definition in section 82A (now repealed by the CLERP 9 Act) included employees within the definition of officer. This inclusion sometimes gave rise to doubt as to whether provisions that imposed duties and obligations on an officer applied to an ordinary employee with no potential to influence the general conduct of a company.

By repealing section 82A and leaving the section 9 definition of officer, the CLERP 9 Act clarifies where provisions of the *Corporations Act* are intended to apply to officers only, and where provisions are intended to apply to both officers and employees.

The CLERP 9 Act also introduces a new definition of "senior manager". This definition is used in relation to audit services and the new sections on the remuneration of directors and executives.

Who is an officer?

An officer of a corporation means a director or secretary of the corporation, a receiver, or receiver and manager, of the property of the corporation, an administrator of the corporation, an administrator of a deed of company arrangement executed by the corporation, a liquidator of the corporation, a trustee or other person administering a compromise or arrangement made between the corporation and someone else or a person:

- who makes, or participates in making, decisions that affect the whole, or a substantial part, of the business of the corporation;
- who has the capacity to affect significantly the corporation's financial standing; or
- in accordance with whose instructions or wishes the directors of the corporation are accustomed to act (excluding advice given by the person in the proper performance of functions attaching to the person's professional capacity or their business relationship with the directors of the corporation).

Who is a senior manager?

A senior manager of a corporation means a person (other than a director or company secretary of the corporation) who:

- makes, or participates in making, decisions that affect the whole, or a substantial part, of the business of the corporation; or
- has the capacity to affect significantly the corporation's financial standing.

Who is an employee?

An employee of a corporation is not specifically defined under the *Corporations Act*, and has a wide meaning in general law. Depending on the circumstances, the employees of a corporation may include salaried employees, casual employees or contract employees.

Continued application of the statutory duties

The application of the statutory duties contained in sections 180 to 184 of the *Corporations Act* remains unchanged by the CLERP 9 Act.

Directors and other officers are under a duty to exercise their powers and discharge their duties with a reasonable degree of care and diligence (section 180), in good faith in the best interests of the corporation and for a proper purpose (section 181).

Directors, other officers and employees must not improperly use their position or improperly use information obtained as a director, officer or employee to gain an advantage for themselves or someone else or to cause detriment to the corporation (sections 182 and 183).

Provisions and offences which continue to apply to employees

The CLERP 9 Act makes a number of amendments throughout the *Corporations Act* which clarify when certain provisions and offences are intended to continue to apply to employees.

- Employees who fail to disclose certain information or make misrepresentations about certain matters in relation to a company under external administration are now expressly in contravention of the *Corporations Act* (section 590).
- Employees who commit fraud against the company or against other persons in relation to the property of the company or the extension of any credit to the company while under external administration are now expressly in contravention of the *Corporations Act* (section 596).
- Off-market takeover bids are expressly prohibited from containing conditions requiring that payments be made to employees as compensation for the loss of, or in consideration in connection with retirement from, any position of employment.

- Exceptions to the insider trading prohibitions now contain express exceptions in relation to the knowledge and actions of employees, as well as officers, of corporations.
- Employees who:
 - fail to ensure that a corporation maintains appropriate corporate registers at designated locations (section 1302);
 - engage in conduct that results in the concealment, destruction, mutilation or falsification of any books or securities relating to the corporation (section 1307); and
 - provide information to directors, auditors, members, debenture holders or an operator of a financial market that the employee knows is false or misleading in a material particular or has omitted from it a matter which renders the information false or misleading in a material respect (section 1309),

will continue to be deemed to commit an offence under the *Corporations Act*.

The CLERP 9 Act also makes a variety of technical amendments to provisions relating to the conduct of officers and employees during the external administration of companies.

Proportionate liability

Timing: the amendments take effect on a date to be fixed by Proclamation. However, if the provisions do not commence by 1 January 2005 they commence automatically. Causes of action arising after the commencement will be subject to the new provisions.

The CLERP 9 Act includes 2 measures concerning apportioning responsibility in relation to misleading conduct claims for economic loss or property damage under section 1041H of the *Corporations Act*, section 12DA of the *Australian Securities and Investments Commission Act 2001* and section 52 of the *Trade Practices Act 1974*:

- apportionment as between the plaintiff and defendant in a similar manner to negligence cases (eg the plaintiff may be held 20 per cent to blame and so only recovers 80 per cent of damages); and
- apportionment on the basis of proportionate liability as between defendants if there are 2 or more defendants.

Proportionate liability between defendants means that a Court must apportion on a percentage basis (eg 20, 30, 50 per cent) and then each defendant is liable for its proportion and no more. Before this amendment, if one defendant could not pay, the other defendants had to meet the shortfall. After the amendment, the plaintiff bears the risk of a particular defendant not being able to pay.

The provisions dealing with joint defendant proportionate liability are complex and raise some questions that will have to be answered in the Courts.

Checklist of action points

A summary of suggested action points follows. Refer to the relevant section of the Guide for details of applicable commencement dates.

Action points – directors’ report

- Commence planning now for the enhanced disclosure requirements for securities and option payments and the reasons why performance conditions may or may not have been applied.
- Consider how options which have been “granted”, “exercised” and “lapsed” during a year are to be valued. (There are some conceptual difficulties with the requirement now included in section 300A(1)(e). For example, further guidance is required as to how to value an option that has lapsed.)
- Identify all persons who may be a “relevant group executive” for the purposes of the *Corporations Act*. These persons would include each of the following persons who are not otherwise a director of the company:
 - the directors and secretaries of the companies or bodies within the consolidated entity;
 - senior managers of any corporation within the consolidated entity;
 - the partners, and senior managers, of any partnership within the consolidated entity;
 - the trustees, and senior managers, of trusts within the consolidated entity; and
 - the senior managers of any joint venture within the consolidated entity.
- Consider AASB 1046 *Director and Executive Disclosures by Disclosing Entities*. AASB 1046 applies a different test in relation to financial reports disclosure. That is, AASB 1046 is not limited to the 5 highest paid company executives or group executives. Rather, entities must disclose the remuneration of at least 5 executives in the entity with the “greatest authority”.

Action points – remuneration report at AGM

- Revise the standard form of the notice of AGM in time for the 2005 AGM to include the non-binding vote on the remuneration report.
- Consider methods to communicate to shareholders (including at the AGM) the substance of the remuneration report to ensure a clear understanding at the AGM of the content and rationale behind the remuneration report.

Action point – termination payments

- Consider when negotiating executive salaries the quantum of any potential future termination payments and whether they may require shareholder approval. Note that there is also a requirement to disclose certain details of employment contracts in directors’ reports (see page 8).

Action points – CEO/CFO declaration

- Identify who performs the “chief executive function” and “chief financial officer function” in the listed entity.
- Review the processes for preparing the directors’ declaration on the financial statements – the declaration can only be given once the new section 295A declaration has been given by the CEO/CFO.
- Ensure a financial reporting system is in place to enable the CEO/CFO to provide the section 295A declarations. Recommendations 4.1 and 7.2 of the ASX Corporate Governance Council *Principles of Good Corporate Governance and Best Practice Recommendations* currently recommend that CEO/CFO provide similar, but not identical, declarations to the board. See also the G100 guidance on CEO/CFO representations.
- Review the wording of any current CEO/CFO representation letters (if any) provided to the board to ensure consistency with section 295A(2) and any applicable regulations.

Action point – management discussion and analysis

- Consider existing “operations and activities” disclosure to ensure coverage of matters required by section 299A.

Action points – true and fair financial reports

- Consider the nature and presentation of any supporting reasons if additional “true and fair” information is required for an entity’s financial report.
- Ensure the auditor is aware of when additional “true and fair” information is required and the auditor’s report includes the auditor’s opinion on the additional information.

Action points – annual reports and notices of meeting

- Develop processes and encourage shareholders to nominate electronic receipt and notification of notices of meetings and annual reports.
- Ensure that notices of meetings are worded in a clear, concise and effective manner. Is the notice relevant and complete, does it promote members’ understanding and highlight important information, having regard to the needs of the users?
- Update the directors’ report to include details of the directorships of listed companies held by directors within the last 3 years, and the qualifications and experience of all company secretaries of the company.
- Liaise with share registrar in relation to appointment of a body corporate as proxy and validating attendees (including a corporate proxy’s representative) at shareholder meetings.

Action points – register of information about relevant interests

- Liaise with share registrar in relation to establishing and maintaining the new register.
- Ensure register is operational for information received on or after 1 January 2005.
- Consider the implications for a company or scheme if relevant interest information is publicly available.
- Ensure that the notice of the location of the register is lodged with ASIC within 7 days of establishing the register.

Action points – continuous disclosure

- Review policy outlining communication of information throughout the entity, including establishing clear responsibilities for continuous disclosure and a pro-active system to identify price-sensitive information, regardless of whether that information is good or bad news.
- Educate business unit managers and senior managers so they understand what can constitute price-sensitive information, the entity’s disclosure obligations and the personal liability they might face if they are involved in a breach.
- Ensure the reporting channels are efficient in identifying all price-sensitive information. This may include a process where managers have the ability to report any material concern in real time to a compliance officer who will investigate and, in discussion with senior management, make a decision about disclosure.
- Ensure the board regularly checks the health of the entity’s continuous disclosure framework in terms of policy, education and reporting channels.
- Maintain records in order to establish a due diligence defence if an entity’s continuous disclosure framework fails resulting in a breach of the entity’s continuous disclosure obligations.

Action points – continuous disclosure and infringement notices

- Ensure that the continuous disclosure policies and systems are in place and regularly brought to the attention of employees (see page 8).
- Consider strategies for dealing with ASIC investigations and statements of reasons, in anticipation of ASIC issuing an infringement notice.

Action points – auditor’s independence and non-audit services

- Identify any current directors, company secretaries or senior managers who were once partners or directors of the company’s auditor.
- Regularly identify, quantify and review all non-audit services provided by the auditor.
- Ensure the company’s audit engagement letter with the auditor includes a requirement for the auditor to comply with the *Corporations Act*, which now includes a requirement for an independence declaration.
- Start planning for the audit committee and board review of auditor independence (where non-audit services have been provided) in time for the directors’ report for the 2004/5 financial year. Consider the information the audit committee may require.
- Review the powers of the audit committee under its charter to undertake the required activities to provide the advice to the board on non-audit services and independence.
- Consider how the “general standard of independence” for auditors applies to your auditor (see pages 20 and 21).
- Plan for any transition to non-audit service providers that may be required to ensure auditor independence under the new requirements.

Action points – general and specific standards of auditor independence

- Ensure your auditor has a system in place to identify any circumstances that might put in question the auditor’s ability to exercise objective and impartial judgment in relation to the audit.
- Ensure your auditor has a system in place to identify any relevant relationships (identified in section 324CH(1)) that may impact on their specific auditor independence obligations.
- Consider including the requirements in the audit engagement letter.
- Implement systems to monitor whether any non-audit services provider exceeds the maximum hours test.
- Ensure the audit committee and the board consider whether auditors who also provide non-audit services meet the standard of independence imposed by the *Corporations Act*.
- Consider the requirement for legal advice to ensure that the general and specific auditor independence standards are met.

Action point – auditor rotation

- Assess the audit team that currently conducts the audit of the financial report, to consider whether the rotation requirements could adversely impact on the team knowledge of your company if key members of the audit team were required to rotate off the audit.

Action points – shareholders’ questions to the auditor

- Develop procedures for enabling shareholders to submit written questions to the auditor (including via the company’s website, or question sheets sent with the annual report and notice of meeting).
- Develop procedures for receiving written questions from members and forwarding to the auditor as soon as practicable.
- Develop procedures for distributing the auditor’s question list to members attending the AGM at or before the start of the AGM.
- Consider ways in which the auditors can best effectively and clearly communicate their responses to members at the AGM.

Action points – no interference with the conduct of the audit

- Review internal procedures to ensure that:
 - employees understand the role of the entity’s auditor and do not influence, coerce, manipulate or mislead the auditor.
 - employees do not otherwise “interfere” with the proper conduct of the audit.

Action point – secondary sales of securities

- Monitor any notice given under section 708A for a period of 12 months after securities are issued to ensure that the notice was not defective.

Action point – secondary sale of financial products

- Monitor any notice given under section 1012DA for a period of 12 months after a financial product is issued to ensure that the notice was not defective.

Action points – whistleblowers

- Review existing whistleblower policies to ensure procedures deal with disclosures that qualify for protection under Part 9.4AAA.
- Ensure that any whistleblower policy is understood by employees, through effective communication and continued training.
- Review procedures to ensure that disclosures are handled appropriately – that is, not disclosed to anyone other than ASIC, APRA or the Australian Federal Police without the whistleblower’s consent.
- Ensure that there are processes to protect whistleblowers from victimisation after they have made a disclosure that qualifies for Part 9.4AAA protection.

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