

PKF Accounting Bulletin

A QUARTERLY PUBLICATION



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Accountants &
business advisers



Welcome to the winter edition of the PKF Accounting Bulletin.

Winter Edition 2014

In this edition we explain 18 financial reporting, corporate governance and regulatory topics to inform and assist CFOs and directors in the discharge of their responsibilities and to help manage their risks. Specifically, we focus on accounting standards and related developments for the 30 June reporting season – learning lessons from ASIC's financial reporting surveillance program, and the new standards.

There are significant developments regarding the Australian Charities and Not-for-profits Commission (ACNC) as well as developments around governance and compliance risks. For a glimpse of the future, attention is drawn to two critical standards relating to hedging and revenue.

We look forward to working with you on the challenges ahead.

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Corporate Reporting Corner

Attention directors and management – ASIC surveillance results

On the eve of the 30 June reporting period, ASIC announced the results of its review of the 31 December 2013 financial reports of 135 listed and other public interest entities (PIEs), identifying 11 areas where there were deficiencies in the financial reporting. These must be areas of attention for directors and management during the 30 June reporting season.

Be warned, as part of the surveillance of financial reporting from 1 July 2014, ASIC will publicly announce when, following contact from ASIC, a company makes material changes to information previously provided to the market.

As a result of the surveillance, ASIC contacted 23 companies about their financial reports. Matters ASIC looked at included inadequate impairment of assets and inappropriate accounting treatments. This resulted in changes to previously reported financial information in all but six instances.

While the results from the review of 31 December are incomplete, ASIC's surveillance program led to material changes to 4% of the financial reports previously reviewed for reporting periods ended 30 June 2010 to 30 June 2013.

Inquiries made by ASIC to date related to 48 matters. The top seven were: impairment and other asset values (9); tax accounting (7); consolidation of other entities (5); amortisation of intangibles (4); operating and financial review (3); joint arrangements (3); and segment reporting (2).

Now let us look at the ASIC financial reporting surveillance findings in detail.

Asset values and impairment testing:

ASIC continues to identify concerns regarding assessment of the recoverability of the carrying values of assets, including goodwill, other intangibles, and property, plant and equipment. As a result of ASIC inquiries, a number of entities have made significant impairment write-downs and will improve their disclosures on matters such as key assumptions.

In relation to the carrying amount of cash generating units (CGUs), ASIC identified cases where:

- CGUs appeared to have been identified at too high a level, or CGU concepts were applied as an inappropriate justification for assets whose cash flows are largely independent;
- Entities did not include all assets that generate the cash inflows in the carrying amount of a CGU, such as inventories and trade receivables;

- The benefit of tax losses were included in determining the recoverable amount of a CGU; and
- Liabilities were incorrectly deducted from the carrying amount of a CGU.

Reasonableness of cash flows and assumptions:

There continued to be cases where the cash flows and assumptions used by entities in determining recoverable amounts were not reasonable or supportable having regard to matters such as historical cash flows, the manner in which an entity was funded, and market conditions. In particular, ASIC found cases where:

- Cash flows for value in use calculations included estimated future cash inflows or outflows expected to arise from future restructuring or development plans;
- Assumptions derived from external sources were not assessed for consistency and relevance; and
- Forecasts extended beyond five years for value in use calculations even though the entity had a poor history of making forecasts.

Fair value assessments of recoverable amounts under AASB 13:

In fair value assessment, ASIC continued to see entities using discounted cash flow techniques that were dependent on significant management inputs, without considering recoverable amounts for comparable transactions, where available. Where it is not possible to determine fair value because there is no basis for making a reliable estimate of the price receivable on disposal of an asset in an orderly transaction between market participants, the entity may need to attribute the asset's value in use as its recoverable amount.

Impairment indicators:

Some entities were not attaching appropriate weight to impairment indicators, such as obsolescence and market capitalisation, relative to reported net assets.

Disclosures:

A number of entities were not making necessary disclosure of:

- Sensitivity analysis where there was limited excess of an asset's recoverable amount over the carrying amount and where a reasonably possible change in assumption(s) could lead to impairment;
- Key assumptions including discount rates and growth rates; and

- Periods covered by forecasts.

Remember, these disclosures are important to investors and other users of financial reports given the subjectivity of these calculations/assessments. Such disclosures enable users to make their own assessment about the carrying values of the entity's assets and risk of impairment given the estimation uncertainty associated with many asset valuations.

Off-balance sheet arrangements and new standards:

Accounting standards AASB 10 Consolidated Financial Statements, AASB 11 Joint Arrangements, AASB 12 Disclosure of Interests in Other Entities and AASB 13 Fair Value Measurement apply to 30 June 2014 financial reports for the first time. AASB 10 and AASB 11 can significantly change the identification of controlled entities and accounting for joint arrangements. AASB 13 can affect aspects of the determination of fair values of financial instruments or other assets.

Tax accounting:

ASIC is making inquiries of certain entities concerning their accounting for income tax and in particular, the substantiation of their income tax expense positions. This includes where:

- There is no apparent reason why the tax expense is low, having regard to reported profit and the lack of associated disclosure;
- Where temporary differences and deferred tax balances appear to have arisen from non-ongoing transactions; and
- There are unusual reconciling items between accounting profit and tax expense/benefit that result in significant tax benefits.

ASIC is also making inquiries of other entities as to whether it is probable that future taxable income will be sufficient to enable the recovery of deferred tax assets relating to tax losses.

Amortisation of intangible assets:

ASIC is making inquiries of certain entities concerning the appropriateness of their assessment of indefinite useful life and/or the amortisation periods attributed to intangibles. Amortisation should take place as the benefits of an intangible asset are consumed by the entity, which may differ from the periods over which revenue is expected to be generated by the asset. Where the useful life of an intangible asset arises from contractual or legal rights the amortisation period must not exceed the period of the contractual or legal rights. Useful life extends to the contract term, including renewal periods where renewal is expected to occur and renewal costs are not significant. Expense deferral: Expenses should only be deferred where there is an asset as defined in the accounting standards and it is probable that future economic benefits will arise. ASIC's particular inquiries concern the recognition of intangible assets arising from the development phase where the strict criteria for deferral do not appear to be met.

Revenue recognition:

ASIC continues to note instances where the disclosure of revenue recognition policies is not sufficiently specific to the entity, its business and sources of revenue. 'Boilerplate' accounting policies do not assist users of a financial report to understand the basis of revenue recognition, particularly where

business models are more complex and there are multiple sources of revenues.

Estimates and accounting policy judgements:

ASIC observed instances where entities need to improve the quality and completeness of disclosures in relation to key assumptions, estimation uncertainties, and significant judgments in applying accounting policies. Disclosures in this area are important to allow users a fully informed assessment of the reported financial performance and position of an entity.

Disclosure in the operating and financial review (OFR):

ASIC Regulatory Guide 247 Effective disclosure in an operating and financial review (March 2013) assists directors of listed entities in providing useful and meaningful analysis and information in the OFR as required by law. ASIC has continued to see a substantial reduction in instances where entities sought to rely on an exemption for information that could cause unreasonable prejudice and did not disclose any information on business strategies and prospects for future financial years. ASIC reminded entities to continue to refer to RG 247 and review how best to articulate their business model, strategies, and underlying drivers of financial performance.

Segment reporting:

Some entities do not appear to have met the core principle in AASB 8 Operating Segments, failing to disclose segment information in the financial report that may be important to investors. This includes some entities that provide select segment information in market announcements and other documents but do not disclose segment information in their financial reports.

Non-IFRS financial information:

ASIC reviews continue to show that entities are following the guidance in ASIC Regulatory Guide 230 Disclosing non-IFRS financial information.

Other areas:

ASIC is also making inquiries of certain entities in relation to: classification of instruments as equity rather than liabilities; the appropriateness of applying the going concern assumption; and possible understatement of provisions.

Large proprietary companies reporting flaws – ASIC findings

ASIC reviewed the financial reports of 100 proprietary companies required to lodge financial reports in respect of the year ended 30 June 2013. The reviews resulted in changes to financial reporting in relation to the following matters:

- Companies with substantial manufacturing and trading operations for which it is reasonable to expect significant numbers of users dependent on general purpose financial reports that had prepared special purpose financial reports that omitted significant disclosures;
- Two companies had failed to make a provision against materially impaired assets;
- Two companies had misclassified financial instruments as equity rather than debt;
- One company inappropriately deferred costs as an asset;
- One company misclassified gains on available for sale financial instruments in the income statement; and
- Companies had purported to rely on ASIC relief from

auditing requirements, even though they did not meet the financial or other conditions for use of that relief.

Many new and revised AASBs operative for 30 June

The June 2014 financial reporting season sees the biggest change to financial statements preparation since Australia moved to IFRS equivalents back in 2005 and 2006. The new and revised Standards and Interpretations are:

- AASB 10 Consolidated Financial Statements
- AASB 11 Joint Arrangements
- AASB 12 Disclosure of Interests in Other Entities
- AASB 13 Fair Value Measurements
- AASB 119 (2011) Employee Benefits
- AASB 127 (2011) Separate Financial Statements
- AASB 128 (2011) Investments in Associates and Joint Ventures
- INT 20 Stripping Costs in the Production Phase of a Surface Mine
- AASB 2011-4 Amendments to Australian Accounting Standards to remove individual key management personnel disclosure requirements
- AASB 7 Financial Instruments: Disclosures amendments regarding rights of offset and related arrangements (such as collateral) for financial instruments under an enforceable master netting agreement or similar arrangement
- Annual Improvements 2009–2011 Cycle Amendments to Australian Accounting Standards including: clarification of the requirements for comparative information, classification of servicing equipment, and tax effect of the distribution to holders of equity instruments
- Amendments to the Australian Conceptual Framework, AASB 1 First-time Adoption of Australian Accounting Standards, and AASB 1048 Interpretation of Standards that removed Interpretation 1039 Substantive Enactment of Major Tax Bills in Australia from the list of 'other Australian interpretations' contained in AASB 1048

Some of these require:

- transitional adjustments and the preparation of a third Statement of Financial Position
- comparatives revision
- changes in accounting policies
- identification of new sources of information regarding the extensive disclosures
- judgements at the level of aggregation and disaggregation of disclosure
- significant revisions to the financial reporting template

Tackle excessive note disclosure

As preparers turn their minds to 30 June reporting season, the AASB published a staff paper To Disclose or Not to Disclose: Materiality is the Question which is designed to prompt preparers of financial statements to rethink their criteria for determining which disclosures to include in their financial statements.

The paper was written because of an increasing concern about 'disclosure overload', and provides some practical actions that preparers can take (or not take) to help reduce the overload. Future work of the AASB will consider what standard-setters can do to further help reduce concerns about overload, and thereby better meet the needs of users of financial statements. The paper identifies a number of immediate 'substantive things not to do when making an assessment about what information should be included in the financial statements'. These include do not:

- include every disclosure illustrated in model financial statements, as these are a 'cater for all possible scenarios' tool
- blindly copy what other entities have disclosed, instead of exercising judgement in deciding on appropriate disclosure
- repeat information from prior financial years, but adapt to changed circumstances
- disclose accounting policy choices made under accounting standards unless they are relevant and necessary to understanding information provided – this includes not disclosing accounting policies for transaction types not in the financial statements
- assume auditors will require every disclosure required by accounting standards
- fear regulators, which are increasingly confirming they will not pursue immaterial disclosures

Bear in mind the concept of materiality. Items are considered to be material if their omission or misstatement, individually or collectively, could influence the economic decisions that users make on the basis of the financial statements. Materiality depends on the size and nature of the omission or misstatement judged in the surrounding circumstances. The size or nature of the item, or a combination of both, is therefore the determining factor.

ASIC has stated that it does not pursue immaterial disclosures that may add unnecessary clutter to financial reports, and that 'preparers of financial reports should ensure that they provide high quality, useful and meaningful information'. A good way to tackle the clutter is by performing a pre-issuance review of the template that forms the foundation of the financial statements.

Hedge accounting amendments – early adopt?

The AASB released amending Standard AASB 2013-9 Amendments to Australian Accounting Standards – Conceptual Framework, Materiality and Financial Instruments which incorporates the IASB's Standard IFRS 9 Financial Instruments (Hedge Accounting and amendments to IFRS 9, IFRS 7 and IAS 39). The main amendments regarding financial instruments are to:

- add Chapter 6 Hedge Accounting and make consequential

amendments to AASB 9 Financial Instruments and numerous other Standards

- permit requirements relating to the 'own credit risk' of financial liabilities measured at fair value to be applied without applying any other requirements of AASB 9 at the same time
- amend the mandatory application date of AASB 9 so that it is required to be applied for annual reporting periods beginning on or after 1 January 2017 instead of 1 January 2015; and
- add or amend the Australian Accounting Standards – Reduced Disclosure Requirements for AASB 7 Financial Instruments: Disclosures and AASB 101 Presentation of Financial Statements. AASB 1053 Application of Tiers of Australian Accounting Standards provides further information regarding the differential reporting framework and the two tiers of reporting requirements for general purpose financial statements

The IASB introduced a new hedge accounting model, together with corresponding disclosures about risk management activity for those applying hedge accounting. The new model represents a substantial overhaul of hedge accounting that will enable entities to better reflect risk management activities in their financial statements. The most significant improvements apply to those that hedge non-financial risk, and so these improvements are expected to be of particular interest to non-financial institutions.

Chapter 6 Hedge Accounting of AASB 9 supersedes the general hedge accounting requirements in AASB 139, which many considered to be too rules-based and arbitrary. Chapter 6 requirements include a new approach to hedge accounting that is intended to more closely align hedge accounting with risk management activities undertaken by entities when hedging

financial and non-financial risks.

Key changes from AASB 139 include:

- allowing hedge accounting of risk components of non-financial items that are identifiable and measurable (many of which were prohibited from being designated as hedged items under AASB 139)
- changes in the accounting for the time value of options, the forward element of a forward contract and foreign-currency basis spreads designated as hedging instruments
- modification of the requirements for effectiveness testing (including removal of the 'bright-line' effectiveness test that offset for hedging must be in the range 80-125%).

Revised disclosures about an entity's hedge accounting have also been added to AASB 7. The key message is that the new requirements for general hedge accounting are now available for early application.

AASB 15 'Revenue' imminent and substantive!

The International Accounting Standards Board (IASB) and the Financial Accounting Standards Board (FASB) jointly issued a converged Standard on the recognition of revenue from contracts with customers. IFRS 15 Revenue from contracts with customers will improve the financial reporting of revenue and improve comparability of the top line in financial statements globally. The AASB is to consider IFRS 15 in the Australian context soon.

Revenue is a vital metric for users of financial statements and is used to assess a company's financial performance and



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prospects. However, the previous requirements of both IFRS and US GAAP were different and often resulted in diverse accounting for transactions that were economically similar. Furthermore, while revenue recognition requirements of IFRS lacked sufficient detail, the accounting requirements of US GAAP were considered to be overly prescriptive and conflicting in certain areas.

Responding to these challenges, the IASB and FASB developed new, fully converged requirements for the recognition of revenue in both IFRS and US GAAP – providing substantial enhancements to the quality and consistency of how revenue is reported while also improving comparability in the financial statements of companies reporting using IFRS and US GAAP.

The core principle of the new Standard is for companies to recognise revenue to depict the transfer of goods or services to customers in amounts that reflect the consideration (that is, receipt) to which the company expects to be entitled in exchange for those goods or services. To recognise revenue, a company would apply the following five steps:

1. identify the contract(s) with the customer
2. identify the performance obligations in the contract
3. determine the transaction price
4. allocate the transaction price
5. recognise revenue when a performance obligation is satisfied

Although IFRS 15 specifies the accounting required for an individual contract, in some cases a company may be able to apply the requirements to a portfolio of contracts instead

of applying the requirements separately to each contract with a customer. IFRS 15 also includes requirements for accounting for some costs that are related to a contract with a customer. A company would recognise an asset for the incremental costs of obtaining a contract if those costs are expected to be recovered.

To help investors better understand the nature, amount, timing and uncertainty of revenue and cash flows from contracts with customers, IFRS 15 requires a company to disclose quantitative and/or qualitative information. IFRS 15 will also result in enhanced disclosures about revenue, provide guidance for transactions that were not previously addressed comprehensively (for example, service revenue and contract modifications) and improve guidance for multiple-element arrangements.

IFRS 15 supersedes IAS 18 Revenue (AASB 118), IAS 11 Construction Contracts (AASB 111) and a number of revenue-related interpretations. It applies to nearly all contracts with customers: the main exceptions are leases, financial instruments and insurance contracts.

Companies using IFRS (and AASBs) will be required to apply the standard for reporting periods beginning on or after 1 January 2017. That means preparers who are performing full retrospective transition rather than the alternate method may want to have systems in place to capture data for dual reporting by 1 January 2015.

After the completion of your 30 June reporting period, start to get your mind around IFRS 15 and other recently released AASB standards. There is much effort required here. We would be pleased to assist.

Governance, fraud and private benefit charity concerns

Concerns about charity governance, fraud and private benefit are the leading causes for complaints about charities according to the ACNC in its report: ACNC compliance – an overview of the compliance activity. The report includes identified case studies and lessons for other charities facing compliance issues, based on observations of the ACNC in its first year as the national charity regulator.

The ACNC compliance team received and assessed 202 charity-related concerns. The majority of concerns fell into three main risk types: governance (50), fraudulent or criminal activity (48), and private benefit (21).

Of the concerns, 131 were raised by the public, 40 were referred by other government agencies and the remainder (31) came from other sources and active intelligence. Of the current 55 open cases, eight involve investigations of serious matters.

The top charity concerns were:

- **Governance (25%):** a conflict of interest between a charity's board members and the operational decisions made; the charity not following its constitution; financial mismanagement; lack of or inadequate policies and procedures
- **Fraudulent or criminal activity (24%):** sham charity soliciting funds; bank accounts changed, funds missing, sale of charity assets; fundraising scams
- **Private benefit (10%):** charity resources used for personal use; inappropriate personal expenses; corporate sponsorship used for personal rather than charitable purpose, and
- **Other (41%):** soliciting funds when not carrying out any charitable activities; insolvency; harm to those who benefit from the charity

The ACNC responds to concerns raised about charities and undertakes intelligence gathering and investigations, when appropriate. When wrongdoing occurs, it is often not just a financial loss that damages the charity; there is the impact on reputation and the effects on staff, volunteers, beneficiaries and board members.

Charities deregistration risk

Charities that the ACNC believes are no longer operating will have their registration revoked if they unable to be contacted. If the ACNC does not hear from these charities by 30 September 2014, it will commence a revocation process. After revocation, the charities will no longer have access to tax concessions. Prior to 3 December 2012 the ATO endorsed charities for charity tax concessions. These charities were automatically registered with the ACNC based on information provided by the ATO. A number of registered charities have not responded to communication from the ACNC (as a result of no known address/contact

details or correspondence being returned).

The ACNC needs to determine whether these charities are still operating. Each quarter it will publish a 'notice of intention to revoke registration' of charities that have not been in contact with the ACNC, together with a searchable list of those charities. What should you do if your charity is on this list?

1. **If your charity is still operating:** Download from the ACNC website and complete and lodge form 3B Change of charity. Request a password and log into the charity portal and complete your 2013 Annual Information Statement and update other details. Also read the 'Manage my charity section' on the website to understand the ongoing obligations.
2. **If your charity ceased operating before 3 December 2012:** Write to the ACNC confirming the date of cessation and provide evidence of this if possible, for example a notice of deregistration from another regulator.
3. **If your charity ceased operating after 3 December 2012:** Download from the ACNC website and complete and lodge form 5A Application to deregister charity.

What is required for 2014 financial reports?

Unless falling into the exemption, medium sized charities (annual revenue in the range \$250,000 to \$999,999) and large charities (annual revenue of \$1,000,000 or more) must also submit an annual financial report which includes:

1. the charity's financial statements and notes thereto, and
2. a declaration made by the charity's responsible persons (such as committee or board members, or trustees)

The ACNC will accept financial statements that are either general purpose or special purpose.

Medium charities must have their reports independently reviewed or audited and submit the review statement or auditor's report. Large charities must have their reports audited and submit an auditor's report. Small charities can choose to submit financial reports, but this is not required.

The exemption:

1. If the charity meets the medium or large size thresholds, is an incorporated association, cooperative or charitable fundraising organisation, and currently submits financial reports to a state or territory regulator, it can submit the same financial report to the ACNC in satisfaction of its 2014

2. The charity remains obligated to complete and submit to the ACNC its 2014 annual information statement (AIS).

If a registered entity is not exempted from preparing financial statements, and is not a reporting entity (thus deeming special purpose financial reporting appropriate) it is required to apply the following accounting standards:

- AASB 101 Presentation of Financial Statements
- AASB 107 Statement of Cash Flows
- AASB 108 Accounting Policies, Changes in Accounting Estimates and Errors
- AASB 1031 Materiality
- AASB 1048 Interpretation of Standards
- AASB 1054 Australian Additional Disclosures

Charity passport launched – red tape easing

The ACNC launched the Charity Passport, a secure online system designed to save charities from reporting the same information to multiple government agencies. The Charity Passport has potential to create substantial time and cost savings for charities. Through the passport, the ACNC can securely share information it collects from registered charities with authorised government agencies. Authorised government agencies that use the Charity Passport will have access to substantive information about charities, including their contact details, registration information, charitable purpose and who benefits from their work, their size, activities, responsible persons, governance documents, and enforcement outcomes.

Agencies that need information from charities in relation to Commonwealth grants should use the Charity Passport rather than asking the charity to provide the same information again, as outlined in the Commonwealth Grant Guidelines. When government agencies request information, charities may direct them to the ACNC to source information already provided such as governing documents or financial reports.

The Charity Passport is being rolled out in two phases. The first phase uses a File Transfer Protocol (FTP) repository, enabling authorised government agencies to securely access and download the files they need, using an FTP

client or a web browser. The second phase is scheduled for implementation at the end of 2014. It will improve integration with agencies' IT systems, increase data currency and have additional functionality to improve the experience for agencies that use it.

ACNC future – options paper released

On 27 March 2014 the Senate referred the Australian Charities and Not-for-profits Commission (Repeal) (No. 1) Bill 2014 to the Senate Economics Legislation Committee for inquiry and report. In the Federal Budget the ACNC's full allocation of funding in the Forward Estimates was retained for 2014-15.

A majority Senate Committee report tabled on 16 June recommended the Bill to abolish the ACNC be passed by the Senate. The two dissenting minority reports called for the continuation of Australia's national charity regulator. The ACNC (Repeal) (No1) Bill 2014 was referred to the Senate Economics Legislation Committee after it was introduced in the House of Representatives in March. Over 150 submissions were received by the committee, with more than 80 per cent opposing the proposed legislation to abolish the ACNC.

The Department of Social Services released an 'Options Paper, Australia's Charities and Not-for-profits' (the Paper) to seek feedback from charities and interested parties on the proposed replacement options for the ACNC. The Paper sets out the policy directions proposed by the Government to introduce replacement arrangements that reduce the burden of regulation on the civil society sector. Comments and feedback on the paper will inform development of the replacement arrangements. Written submissions, using a submissions template will be accepted until 20 August.

The Repeal Bill and the Senate inquiry have caused confusion and uncertainty for parts of Australia's charity sector over recent months. The ACNC remains the regulatory body until Parliament votes otherwise. The ACNC Commissioner, Susan Pascoe, stated the national charity regulator will continue to regulate the sector and perform its legislative functions until future arrangements are known.

'When wrongdoing occurs, it is often not just a financial loss that damages the charity; there is the impact on reputation and the effects on staff, volunteers, beneficiaries and board members'



Governance Rules

Revised ASX corporate governance rules

The ASX Corporate Governance Council (Council) released the third edition of its 'Corporate Governance Principles and Recommendations' reflecting developments in corporate governance both in Australia and internationally, since the 2007 edition. The third edition is effective for an entity's first full financial year commencing on or after 1 July 2014. The Council encourages listed entities to adopt the third edition earlier.

There are nine new recommendations for listed entities to consider, and adopt as appropriate:

- Undertake appropriate checks before nominating or appointing a director, and provide security holders with all material information relevant to a decision on whether or not to elect or re-elect a director (Recommendation 1.2)
- Have a written agreement with each director and senior executive setting out the terms of their appointment (Recommendation 1.3)
- The company secretary should be accountable directly to the board, through the chair, on all matters to do with the proper functioning of the board (Recommendation 1.4)
- Have a program for inducting new directors and provide appropriate professional development opportunities for directors to develop and maintain the skills and knowledge needed to effectively perform their role (Recommendation 2.6)
- Ensure that the external auditor attends the AGM and is available to answer questions from security holders relevant to the audit (Recommendation 4.3)
- Provide website information about the entity and its governance (Recommendation 6.1); with supporting changes to the ASX Listing Rules, listed entities now have greater flexibility to make governance disclosures on their website rather than in their annual report
- Give security holders the option to receive communications from, and send communications to, the entity and its security registry electronically (Recommendation 6.4)
- Disclose if it has an internal audit function, how the function is structured and what role it performs; alternatively, if it does not have an internal audit function, disclose the processes it employs for evaluating and continually improving the effectiveness of its risk management and internal control processes (Recommendation 7.3)
- Disclose whether it has any material exposure to economic,

environmental and social sustainability risks and, if it does, how it manages those risks (Recommendation 7.4)

Several new Recommendations (1.2(b), 1.3, 1.4, 2.6, 4.3, 6.1, 6.4 and 7.3) appeared as guidance in the commentary in the second edition; however with their elevation they should be considered contemporary governance standards rather than matters of guidance.

‘The third edition is effective for an entity’s first full financial year commencing on or after 1 July 2014. The Council encourages listed entities to adopt the third edition earlier’

Other key changes in the third edition include:

- Recommendations on risk (7.1 – 7.4) have been substantially enhanced to reflect the lessons of the Global Financial Crisis
- Recommendations dealing with nomination, audit, risk and remuneration committees and internal audit (2.1, 4.1, 7.1, 8.1 and 7.3 respectively) allow for listed entities to adopt and report alternative practices
- Recommendations on diversity (1.5) have been modified
- CEO/CFO certification of financial statements has been revised (4.2) to reflect that the board should, before it approves the entity's financial statements for any financial period (for example, now including financial reporting at the half-year) receive from its CEO and CFO a declaration as to: the proper maintenance of the financial records, the compliance of the financial statements with appropriate accounting standards, the presentation of the financial statements so as to give a true and fair view, and the effectiveness of the system of risk management and internal control
- A number of recommendations have been modified or expanded to recognise that not all ASX-listed entities are incorporated in Australia.

- Boards should consider whether or not follow the Council's early adoption recommendation for the 30 June reporting period. Alternatively, they should prepare an implementation plan for 2015.

Directors' and audit committee roles on audit quality – ASIC's view

To help directors and audit committees develop robust standards as part of ASIC's commitment to improve audit quality, ASIC released Information Sheet 196 'Audit quality: The role of directors and audit committees'. It explains: why audit quality is important; the responsibilities of the auditor; the roles of directors and audit committees; the responsibilities of directors for auditor independence; who should manage the appointment of auditors; what matters should be considered in setting audit fees, and what directors and audit committees can do to promote audit quality.

INFO 196 suggests directors and audit committees consider:

- non-executive directors recommending auditor

appointments and setting audit fees

- assessing the commitment of the auditors to audit quality
- reviewing the resources devoted to the audit, including the amount of partner time and the use of experts
- accountability within the audit firm for quality
- support by company management for the audit process
- two-way communication with the auditor on concerns and risk areas
- ensuring independence of the auditor
- reviewing audit firm responses to findings from ASIC audit inspections

The quality of the independent audit process supports confidence in the quality of financial reports. Audit is important to companies, so they can raise capital and conduct business, and so that investors are confident and informed. The quality of audits is also important to a wider group of stakeholders, such as creditors. Directors and audit committees play a crucial supporting role, along with

Compliance Concerns

Directors banned following company failures

ASIC banned Sydney chef Mr Justin Russell North and his wife Georgina North from managing corporations following their involvement in the failure of three companies. Mr and Mrs North were banned for two years and 18 months respectively. Liquidators were appointed to Becasse Pty Limited on 20 June 2012, and to Etch Restaurant Pty Limited and North Food Catering Pty Limited on 20 July 2012. ASIC found Mr and Mrs North failed to exercise their powers and discharge their director's duties with the requisite degree of care and diligence, resulting in large deficiencies and aggregate debts to creditors in excess of \$7 million. Section 206F of the Corporations Act 2001 allows ASIC to disqualify a person from managing corporations for up to five years if, within a seven year period, the person was an officer of two or more companies, and those companies were wound up and a liquidator provides a report to ASIC that the company is unable to pay its debts. A reminder, ASIC issued Regulatory Guide 217 'Duty to prevent insolvent trading: Guide for directors'.

Former CEO of IT companies charged

Mr Peter Mavridis appeared before the Melbourne Magistrates Court after an ASIC investigation led to him facing 24 charges of obtaining financial advantage by deception, 10 charges of false accounting and 1 charge of dishonest use of position as a director. ASIC's investigation followed the collapse of the S Central Group of companies, which provided information technology services to customers in Victoria, New South Wales and Queensland.

ASIC alleged that Mr Mavridis, as the chief executive officer of the S Central Group, either directly or through his financial controller, submitted duplicated and falsely inflated invoices to National Australia Bank (NAB) to secure credit in excess of \$3 million for companies within the group. ASIC also alleged that Mr Mavridis falsified other documents that were required by NAB in support of the false invoices that were submitted. The S Central Group ceased trading in October 2009, with liquidators appointed to various companies within the group. For charges of obtaining financial advantage by deception (sec 82(1)) and of false accounting (sec 83(1)(b)) of the Crimes Act 1958 (Vic), the maximum penalty for each is 10 years imprisonment. Charges of dishonestly using a position as director under sec 184 of the Corporations Act 2001, attach a maximum penalty of \$220,000 or 5 years imprisonment, or both.

Continuous disclosure breach \$1.2m

ASIC has commenced action in the Federal Court against Newcrest Mining Limited for briefing analysts on

market-sensitive information ahead of its disclosure to the market. ASIC alleged that in a series of briefings from 28 May 2013 Newcrest disclosed information regarding expected gold production for the 2014 financial year, and on 5 June 2013 it disclosed information regarding expected capital expenditure for the 2014 financial year.

ASIC alleged that this market-sensitive information was selectively disclosed to analysts, and the company was obliged to disclose it to the ASX. ASIC alleges the contraventions continued until 7 June 2013 when Newcrest released the information publicly.

Newcrest admitted the contraventions and the parties filed a joint application for civil penalties to be imposed. The Federal Court heard a joint submission from ASIC and Newcrest as to the appropriate penalties. The parties jointly proposed, and the Court ordered, a penalty of \$1.2m against Newcrest for the contraventions.

In handing down his judgment, the Hon Justice Middleton said, 'Within the confines of the maximum penalty of \$1,000,000 for each contravention, the penalties are such to send a strong message to market participants to be mindful of the care and caution needed when interacting with analysts. These penalties also reinforce the message that equal access to market sensitive information is paramount in ensuring that markets operate on an informed, and equally informed, basis'.

To court over late accounts

Hancock Prospecting and two related entities faced court for failing to lodge their annual financial reports on time. Hancock Prospecting Pty Ltd, Hancock Minerals Pty Ltd and Hope Downs Iron Ore Pty Ltd appeared in Perth Magistrates Court where the companies faced a total of 13 counts of breaching section 319 of the Corporations Act 2001. Under the law, the reports are due within four months of the end of the relevant financial year.

ASIC alleges that the companies failed to lodge annual reports within the time period required for the following years: Hancock Prospecting Pty Ltd in 2010, 2011 and 2012; Hancock Minerals Pty Ltd in 2008, 2009, 2010, 2011 and 2012; and Hope Downs Iron Ore Pty Ltd in 2008, 2009, 2010, 2011 and 2012. The matter was adjourned. The maximum penalty for each offence relating to failing to lodge financial reports is \$13,750. Ensure that you lodge your accounts on time and avoid the regulatory consequences as well as the reputational ones.

Fraud \$4.6m guilty pleas

A former Phosphagenics Ltd employee pleaded guilty in relation to his role in the alleged theft of more than \$4.6 million from the company, following an ASIC investigation. Dr Robert Gianello appeared in Melbourne Magistrates Court and pleaded guilty to three charges of obtaining money by

deception from Phosphagenics Ltd and its subsidiary, Vital Health Sciences Pty Ltd (VHS). The three charges cover the period from November 2004 to August 2012, and involve \$4,635,917.

During the period from November 2004 to June 2008, Dr Gianello was employed by Monash University and worked on research and development on behalf of VHS. He was also a partner in a business which submitted allegedly false invoices to VHS. In July 2008, Dr Gianello joined Phosphagenics Ltd as an employee and, until August 2012, agreed to the submission of the allegedly false invoices by a company associated with Dr Woei-Jia Jiang.

Dr Jiang was the director of two companies which submitted allegedly false invoices to Phosphagenics and VHS. Dr Jiang, also appeared in Melbourne Magistrates Court and pleaded guilty to three charges of obtaining money by deception. The three charges against Dr Jiang cover the period from June 2008 to June 2013, and involve \$4,392,035. Dr Gianello and Dr Jiang were bailed to appear before the County Court on 20 August 2014.

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