

9 June 2010

The Hon Chris Bowen MP
Minister for Financial Services, Superannuation and Corporate Law
PO Box 6022
House of Representatives
Parliament House
Canberra ACT 2600

Email: Chris.Bowen.MP@aph.gov.au

Dear Minister Bowen,

We refer to the introduction of the Corporations Amendment (Corporate Reporting Reform) Bill 2010 (Bill) into the House of Representatives on 26 May 2010 and write to express our concerns regarding the test for the payment of dividends proposed by the Bill.

The Australian Institute of Company Directors is the second largest member-based director association worldwide, with over 26,000 individual members from a wide range of corporations: publicly-listed companies, private companies, not-for-profit organisations, charities, and government and semi-government bodies. As the principal professional body representing a diverse membership of directors, we offer world class education services and provide a broad-based director perspective to current director issues in the policy debate.

The Australian Institute of Company Directors strongly supports effective efforts to reduce red tape. In this regard we have advocated for some time that the current requirement for dividends to be paid out of profits, be removed from the Corporations Act.¹ The need for this change increased with the introduction of International Financial Reporting Standards (IFRS) into Australia which, amongst other things, require that reported profits be reduced as part of asset write-downs under certain circumstances – notwithstanding that there may not be any impact on the company's solvency.

On 3 February 2010, the Australian Institute of Company Directors provided a detailed submission to Treasury in respect of the exposure draft of the Bill and subsequently attended a roundtable with Treasury on this issue in Sydney. Our submission, which is available on our website, and our comments at the roundtable were largely supportive of the Bill, given that many of the reforms will have the effect of reducing red tape for business. We did however, query the "assets greater than liabilities" test for dividends and suggested that the appropriate way forward would be to simply delete section 254T from the Corporations Act. Our concerns with the "assets greater than liabilities" test have been magnified in recent weeks following the insertion into the Bill of a provision that ties the calculation of "assets" and "liabilities" to IFRS requirements.

¹ We refer to Australian Institute of Company Directors' Position Paper No. 7, February 2008: *A Solvency Based Test for Dividends*. The paper, amongst other things, noted that the "dividends out of profits" test was based on an outdated capital maintenance concept.

We are therefore of the view that it is important to draw to your attention, our continuing and heightened concerns regarding the proposed test for the payment of dividends included in the Bill.

In summary, section 254T(1) of the Bill proposes that a company must not pay a dividend unless its company's assets exceeds its liabilities. Section 254T(2) then provides that assets and liabilities are to be calculated in accordance with the accounting standards in force at the relevant time. As a consequence of the changes proposed to section 254T, companies that are not required to prepare their financial statements in compliance with IFRS, will need to consider and apply IFRS before paying a dividend.

We are concerned that:

- the “assets greater than liabilities” test is inappropriate as it can have little relationship to solvency (the test does not take into account the timing and magnitude of inflows and outflows of funds);
- the proposed linkage of the test to IFRS places an unreasonable burden on companies that are not otherwise required to comply with IFRS (many of which are small businesses);
- the proposed test has the opposite effect to what is intended by the Bill (it increases rather than decreases red tape costs, which is clearly contrary to the Government's stated intention of reducing the regulatory burden on businesses);
- using an “assets greater than liabilities” test based on IFRS calculations will give rise to some of the problems that exist with the existing profits test – namely the negative impact of asset write-downs required by IFRS on the ability of companies to pay dividends notwithstanding the fact that those write-downs have no impact on the company's solvency; and
- proposed section 254T(2) was not the subject of widespread public consultation.

Although we remain of the view that the new test for the payment of dividends requires reconsideration, we do not wish to hinder the passage through Parliament of the other important reforms included within the Bill. As such, we recommend that:

- (a) section 254T be immediately deleted from the Bill (this would allow companies to pay dividends so long as the company does not trade whilst insolvent);
 - (b) if recommendation (a) is not feasible and the government considers it necessary to insert additional safeguards into the Act, then at least section 254T(1)(a) and section 254T(2) be immediately deleted from the Bill (this would allow companies to pay a dividend so long as the company does not trade whilst insolvent, the payment of the dividend is fair and reasonable to company shareholders as a whole and it does not materially prejudice the company's ability to pay its creditors);
 - (c) if neither of the above recommendations can be implemented within the current timing for the passage of the Bill, immediate consideration be given to amending the test for the payment of dividends in the Spring sitting of Parliament (we note that pursuant to this approach small businesses will face an increased red tape burden until the provision is rectified).
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AUSTRALIAN INSTITUTE
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We would be grateful if the issues raised in this letter could please be re-examined as a matter of priority. We believe there will be growing opposition to sections 254T(1)(a) and 254T(2) as the details of the sections become known to affected parties.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'Rob Elliott', with a long horizontal flourish extending to the right.

Rob Elliott
General Manager Policy

cc Mr Mark Sewell, Manager Corporate Reporting and Accountability Unit, Treasury