

Future of the Financial Reporting Panel

November 2011

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TABLE OF CONTENTS

CONSULTATION PROCESS	II
FOREWORD.....	III
PART 1: BACKGROUND INFORMATION	1
The history of the financial reporting panel.....	1
Introduction	1
Establishment and purpose	2
Current FRP Procedures.....	2
The FRP's operations 2006-2011	3
Possible reasons for the underutilisation of the panel	4
Comparison to UK Financial Reporting Review Panel.....	5
PART 2: OPTIONS FOR THE FUTURE OF THE FRP	6
Maintain the Current Processes and Powers.....	6
Modification of the Referral Process.....	6
Repealing the FRP functions and closing the Panel	9

CONSULTATION PROCESS

Request for feedback and comments

The Government is seeking your feedback and comments on the issues considered in this paper, particularly on the outlined options and key questions.

The information will inform the Government's proposed approach on these issues and also assist in meeting the requirements of the Office of Best Practice Regulation.

While submissions may be lodged electronically, by post or by facsimile, electronic lodgement is preferred. For accessibility reasons, please submit responses sent via email in a Word or RTF format. An **additional** PDF version may also be submitted.

All information (**including name and address details**) contained in submissions will be made available to the public on the Treasury website unless you indicate that you would like all or part of your submission to remain in confidence. Automatically generated confidentiality statements in emails do not suffice for this purpose. Respondents, who would like part of their submission to remain in confidence, should provide this information **marked** as such in a separate attachment. A request made under the *Freedom of Information Act 1982* (Commonwealth) for a submission marked 'confidential' to be made available will be determined in accordance with that Act.

Closing date for submissions: Friday, 2 December 2011

Address written submissions to:

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FOREWORD



Financial reports prepared by companies and lodged with the Australian Securities & Investments Commission (ASIC) are a vital source of information for investors, Government and other stakeholders. Australia's adoption of International Financial Accounting Standards (IFRS) ensures that these financial reports are comparable, consistent and robust. Stakeholders can have confidence that they are prepared to international benchmarks and are an accurate reflection of an entity's financial condition.

ASIC regularly reviews these financial reports to ensure they are compliant with accounting standards and provide a true and fair view of a company's financial position and performance. When

ASIC disputes the compliance of a financial report, ASIC will endeavour to first resolve the dispute through direct negotiation with the entity concerned.

Where ASIC and an entity continue to disagree on the application of accounting standards and the 'true and fair' view requirement, the Financial Reporting Panel (FRP) provides an alternative dispute resolution mechanism. It alleviates the need for potential legal action between ASIC and the entity, which is often both a costly and lengthy process.

From July 2006, when the FRP was established, to August 2010, the FRP did not determine any cases. This lack of activity brings into question whether there is a need for the FRP going forward, and if so whether the current referral process should remain unchanged.

In August 2010, ASIC referred to the FRP four disputed financial reports dealing with a diverse range of accounting issues; the FRP determined these disputes in little over two months, demonstrating that, when referred a matter, it is completed in a timely, efficient and professional manner. The Government would like to thank the Panel members for their commitment to the FRP and the proficiency in which they resolved these disputes.

It is questionable whether buoyant economic conditions, adjusting to new IFRS and a lack of test cases are still compelling arguments for the ongoing lack of referrals to the FRP. Accordingly, this paper presents options that have the potential to improve the referral process, to ensure that relevant disputes are promptly referred to the FRP and that stakeholders are able to rely on timely and accurate financial reports. However, given the costs associated with maintaining an inactive body, it is appropriate that the Government also consider whether there is a continuing role for the FRP in the financial reporting framework.

The Government remains committed to a strong and robust corporate reporting framework and welcomes submissions on the proposals outlined in this paper.

The Hon David Bradbury MP
Parliamentary Secretary to the Treasurer

PART 1: BACKGROUND INFORMATION

THE HISTORY OF THE FINANCIAL REPORTING PANEL

Introduction

1. Prior to the establishment of the Financial Reporting Panel (the Panel or FRP), the only recourse for resolving disputes concerning the application of accounting standards or the true and fair view was through legal action between the Australian Securities & Investments Commission (ASIC) and a reporting entity. This was generally thought to be an unsatisfactory situation due to:
 - 1.1. judicial proceedings being lengthy and slow to resolve, resulting in the market being misinformed over an entity's financial reports for some time;
 - 1.2. judicial proceedings being costly for both parties; and
 - 1.3. the Courts lacking the appropriate accounting expertise to determine disputes dealing with the application of accounting standards.
2. In 2002, as part of the Government's reform agenda, the Corporate Law Economic Reform Program (CLERP) proposed a range of measures designed to enhance audit regulation and the general corporate disclosure framework. The measures recognised there was a need for an alternative dispute resolution body to make determinations where there are disputes between ASIC and a lodging entity on the application of accounting standards and other financial reporting requirements without having to proceed through the judicial system.
3. This body would be independent of both parties and would have the power to consider the dispute and make a ruling on the application of accounting standards in financial reports.
4. Public consultation, undertaken as part of the CLERP process, indicated broad stakeholder support for the establishment of a new body to serve as an independent dispute resolution mechanism in circumstances where a dispute between ASIC and a company regarding the application of accounting standards or the true and fair view could not be resolved through negotiation.
5. The Financial Reporting Panel, was established under the *Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Act 2004*. A body set up in the United Kingdom, the Financial Reporting Review Panel, also determines disputes relating to accounting standards, although its overall responsibilities are significantly different to the FRP.
6. The FRP was designed following a body (the Financial Reporting Review Panel) that was set up in the United Kingdom.

Establishment and purpose

7. The FRP formally commenced operations in July 2006.
8. The FRP's primary function is as originally envisaged, to resolve disputes between ASIC and a company, disclosing entity or registered scheme over the application of accounting standards in its financial reports.
9. The relevant legislation pertaining to the FRP is set out under Division 9 of Part 2M.3 of the *Corporations Act 2001* (Corporations Act) and Part 13 and Division 2 of Part 7 of the *Australian Securities and Investments Commission Act 2001* (ASIC Act).
10. The FRP was created to provide a more timely avenue for resolving disputed cases, as the Corporations Act requires the FRP to determine cases within 60 days of referral (with the option of a 30 day extension).
11. The role of the FRP is to consider whether or not an entity has correctly applied specific accounting standards in its financial report. The FRP is required to prepare a report stating whether, in the FRP's opinion, the financial report complies with the relevant financial reporting requirements.
12. Matters referred to the FRP are considered by experts in the field, facilitating more appropriate outcomes by addressing concerns about the perceived limitations of the courts to deal with complex technical accounting issues.

Current FRP Procedures

13. Disputes between ASIC and an entity concerning a financial report can be referred to the FRP by:
 - 13.1. 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 reason for doing so and any changes necessary to correct the financial report; or
 - 13.2. an entity, where ASIC has informed the entity that in its opinion the financial report does not comply with the Corporations Act and ASIC has consented to the referral to the FRP.
14. The referral must, amongst other things, include:
 - 14.1. identification of the relevant disputed financial reporting requirement(s); and
 - 14.2. the reasons for ASIC's or the reporting entity's opinion that the financial report does or does not comply with that requirement(s).
15. The FRP has the power to dismiss a referral at any stage.
16. Legal representation at proceedings is permitted only with the consent of the FRP.

17. At the lodging entity's request, the proceedings can take place in public. However, the Panel can direct part of the proceedings to take place in private or any publication to be restricted to protect the interests of any other person, or due to the confidential nature of any evidence.
18. A report of the FRP on whether a financial report complies with the financial reporting requirements of the Corporations Act is not legally binding on either party. However, the Court may consider the FRP's findings in determining whether the company complied with the relevant accounting standards.

The FRP's operations 2006-2011

19. The FRP's level of activity since its establishment has been considerably less than initially envisaged. Up until mid-2010, only one matter in July 2007 had been referred to the FRP for a determination. This case was resolved before the determination was made, as the entity changed its accounting treatment before the matter was heard.
20. During this period FRP members considered the steps that could be taken to promote public awareness of the Panel's role.
21. During August 2010, ASIC referred four cases to the FRP (BBX Property Investment Fund Limited, Sino Strategic International Limited, Oaks Hotels and Resorts Limited and ING Real Estate Entertainment Fund). The FRP concluded these matters in little over two months, with minimal expense to the companies and to ASIC. The FRP's written determinations were finalised and released publicly during October 2010 and published on the FRP's website.
22. These four referrals enabled the FRP to establish a profile in the market through the resolution, by independent experts, of the matters in a quick, efficient and cost effective way. ASIC's view on the application of the accounting standards in the financial reports was accepted in two of the four matters, and in the other two the FRP found in favour of the lodging entity's view.
23. The cases demonstrated the broad pool of technical knowledge possessed by Panel members as a diverse range of reporting issues were raised across the four referrals, including the treatment of gaming and liquor licences, valuation of 'trade dollars', treatment of management letting rights and accounting for reverse takeovers.
24. The FRP's determinations highlighted its potential and created significant business interest in its role, particularly in accounting and auditing circles. The cases, their outcomes, and their implications for financial reporting going forward have been actively discussed at many corporate reporting forums and covered in industry publications.

POSSIBLE REASONS FOR THE UNDERUTILISATION OF THE PANEL

25. Several factors may have contributed to the low number of referrals to the FRP.
26. *Australia's adoption of International Financial Reporting Standards (IFRS)*: From 1 January 2005, Australia adopted IFRS in place of the previously mandated Australian accounting standards. This required entities to change their basis of reporting and was a significant learning experience for many entities, which may have been more inclined to voluntarily change their accounting practices in response to accounting-related inquiries from ASIC rather than to seek resolution through the FRP.
27. *Existence of FRP provides 'deterrent effect'*: The existence of the FRP, and the perceived threat of a referral to it, including possible negative publicity, could be an incentive for companies to meet their reporting requirements, or to more readily accept ASIC's views on disputed matters.
28. *Lack of market recognition*: While the 'untested waters' of a referral may have been a factor in the absence of referrals in the FRP's first four years, four matters were publically determined in 2010. However, until a large listed company utilises the FRP process, the FRP's profile in the business community as an impartial dispute resolution organisation may remain limited.
29. *Economic conditions*: Generally favourable market conditions in Australia during a good part of the period following the establishment of the Panel may have resulted in a financial environment in which fewer companies may have considered adopting 'creative' interpretations of financial reporting requirements.
30. However, the buoyant economic conditions and the recent implementation of IFRS, which were stated in the 2006-07 FRP Annual Report as contributing to the lack of referrals, are arguably no longer relevant and may not provide compelling explanations for the underutilisation of the Panel.

Key Questions

Why do you believe the level of FRP referrals has been less than initially anticipated?

What factors do you believe may need to be addressed in order for the FRP to function more effectively?

COMPARISON TO UK FINANCIAL REPORTING REVIEW PANEL

31. The United Kingdom (UK) established the UK Financial Reporting Review Panel (FRRP) in 1990, which undertakes a similar function to the FRP. However, the FRRP is assigned a more proactive role in assessing financial reports than the FRP, so drawing a direct analogy may not be particularly relevant.
 - 31.1. The UK Financial Reporting Council (UK FRC) sources its own cases by reviewing financial reports, a function undertaken in Australia by ASIC through its annual review. The UK FRC reviews these cases through one of its six operating bodies, the FRRP. In 2009-10, the FRRP reviewed 308 sets of accounts. The FRRP is responsible for ensuring that the annual financial reports of public and large private companies comply with the requirements of the *Companies Act 1985* and relevant accounting standards.
 - 31.2. The FRRP can request directors to account for any apparent non-compliance with these requirements. This occurred in 146 cases in 2009-10. If the directors' explanation does not satisfy the Panel, it aims to persuade the directors to adopt a more appropriate accounting treatment. The directors may then voluntarily withdraw the reports and replace them with a revised version that rectifies the disputed treatment. The Panel may, under certain conditions, also accept other methods of corrective action, including the correction of the comparative figures in subsequent financial reports (three cases in 2009-10).
 - 31.3. Failing voluntary correction, the Panel can exercise its powers through a court order to ensure the correction of the accounts. To date, the FRRP has reached appropriate resolutions with companies without taking recourse to court action. If the matter concerns accounts issued under the UK Listing Rules, the Panel may report to the Financial Services Authority (FSA).
32. In Australia, the FRP is not required to undertake any of these actions, which are the responsibility of ASIC.
33. Involving the FRP more directly in financial reporting surveillance, in a manner similar to the FRRP in the UK, would be a significant policy change and would raise significant issues, as ASIC generally has the sole responsibility for administering the core statutory requirements of the Corporations Act. Additional bodies – such as the FRP – have been established to perform specialised functions where there could be an actual, or perceived, conflict of interest if ASIC held responsibility.
34. During 2008-09, the FRP conducted a strategic review of its operations. The FRP considered the possibility of seeking an expansion of its functions from the resolution of disputes to the surveillance of financial reporting practices in the market. However, these potential benefits need to be considered in light of the significant duplication with ASIC's work that might arise, and the possibility of perceived conflicts between the FRP's impartial dispute resolution function and its involvement in financial reporting surveillance.

PART 2: OPTIONS FOR THE FUTURE OF THE FRP

Option 1

Maintain the current processes and powers of the FRP

Option 2

Modify the referral process

Option 3

Repeal the FRP's functions and close the Panel

Maintain the Current Processes and Powers

35. Under this option, the FRP's processes and powers, as outlined in the previous section, would remain unchanged. Some stakeholders have stated they would prefer the FRP to remain to ensure companies retain the option of an independent body being able to make a ruling if negotiations break down without having to proceed directly through the courts. The FRP, by maintaining current practice, would remain reliant on referrals coming forward from ASIC, after it and a company have exhausted other avenues of resolution.

Key Question

Do you believe that the current process and powers of the FRP are effective and appropriate, and do not require any significant reform?

Modification of the Referral Process

Mandating a deadline for a dispute to be referred to the FRP

36. The FRP has a mandated 60 day limit (with the possibility of a 30 day extension) to decide referred matters but ASIC can take longer after the publication of a disputed financial report to send a referral to the Panel. ASIC requires this time to undertake reviews of financial reports, make enquiries of companies, obtain information and explanations, and attempt to resolve matters with companies directly.
37. Under this option, a deadline would be set for a dispute between ASIC and a lodging entity to be referred automatically to the FRP after a set time period has elapsed. For example, a 9 month time limit, following identification and notification of the disputed financial report by ASIC, would ensure that matters could be considered by the FRP within 12 months.
38. This reform presents a number of potential benefits.

39. The four rulings by the FRP in 2010 were transparent and efficient, but the proficiency with which the cases were completed was of limited value to the market and stakeholders, given the delays following the publication of the financial reports in question.
40. The delay in receiving a case raised the question of timely and appropriate disclosure and whether the market should be informed of the dispute. It is important for a dispute to be resolved in an expeditious manner to ensure any misstatement is not continued in future half and/or full year financial reports as this could mislead the market.
41. A deadline for automatic referral of disputes to the Panel might protect stakeholders through the quicker resolution of disputes, leading to the faster dissemination of market-sensitive information. This, in turn, would boost confidence in the integrity of the financial reporting function. A time limit may lead to more timely deliberation of disputed accounting treatments, an outcome which was a motivating factor behind the establishment of the Panel.
42. However, this option also presents a number of significant disadvantages. For example, it could compromise ASIC's surveillance function. ASIC undertakes a systematic annual surveillance program through which the majority of potential referrals would be identified.
43. A time limit could also have implications on the fairness and equity afforded to companies. Depending on the length and commencement of the time limit, an entity may not have adequate time to present its argument to ASIC, or ASIC may not have time to fully consider and investigate the matter, before the automatic FRP referral, which could make the dispute public. There may be insufficient time for the company and ASIC to discuss a matter or to consult, particularly where a matter involves complex transactions and accounting treatments. Any time limit would need to allow sufficient time for companies to respond and resolve the matter with ASIC directly, in the first instance.
44. ASIC also possesses information gathering powers, which the FRP lacks. A referral may be triggered before ASIC has fully completed exercising these investigative powers, which would only serve to limit the information available for the Panel to consider.
45. It is questionable whether there are likely to be any disputes that could be automatically referred to the FRP. It is only after the company has provided all necessary information and explanations to ASIC, and a matter has been adequately discussed between the company and ASIC, that a dispute becomes apparent.

Key Questions

Do you believe that disputes should be automatically referred to the FRP after a specified time period?

If so, what is an appropriate point for the period to commence, and how long should ASIC and the entity have to resolve the issue directly?

Allowing companies to refer matters without ASIC consent

46. The public consultation on CLERP 9 in 2003 also raised as an issue whether, in addition to ASIC, companies should be able to refer matters directly to the FRP for consideration, without ASIC's prior consent. Strong support was given for this as a company's interests would be affected by a decision of the FRP.
47. Allowing a company to refer without ASIC's consent would have been consistent with the policy that applies to the Takeovers Panel, under which any person whose interests are affected by the decision may make an application to the Panel.
 - 47.1. The Takeovers Panel was established in 1991 and heard only four matters the first decade of its operation. The Panel's powers and processes were then reformed; with a key change being the broadening of its referral powers to make it no longer entirely dependent on the regulator for sourcing its referrals.
 - 47.2. Following these changes the Panel has adjudicated over 300 matters over the subsequent decade, and is recognised in the market as effective and impartial in determining disputes relating to takeover transactions.
48. The requirement for ASIC consent was included in the Act to deter mischievous or frivolous appeals by reporting entities. However, it may have had the effect of deterring some soundly based referrals by introducing ill founded perceptions of ASIC control of the process, and may be an unnecessary hurdle that could be removed.
49. The FRP retains the power to dismiss a referral at any stage, so any frivolous or vexatious referrals may not be problematic if the requirement for ASIC consent were relaxed.
50. However, it is possible that this change would not have a material impact on the level of referrals, as under the current framework, no companies have approached ASIC for consent to refer a matter. Furthermore, both parties must first agree there is a dispute, by which time ASIC may also have decided to refer the case to the FRP regardless.

Key Questions

Do you believe that companies should be allowed to refer cases to the FRP without ASIC's consent?

Do you believe that such a change would have a material impact on the number of referrals coming forward?

Repealing the FRP functions and closing the Panel

51. It may be appropriate for the FRP to cease operations and for the relevant statutory provisions to be repealed as the volume of referrals has not met original expectations.
52. This would bring Australia into line with other countries such as the United States, Canada, Japan and New Zealand, where the court system resolves contested issues over the treatment of accounting standards in financial statements.
53. As it has been several years since Australia adopted IFRS, companies would now have a better understanding of the operation of these standards, and the functions of the FRP may be less relevant. Similarly, there would have been an expansion of the knowledge base of, and guidance issued by, the accounting and auditing professions, as well as the Australian Accounting Standards Board and IFRS Interpretations Committee.
54. The annual costs of the FRP are significantly less than a single major case proceeding through the Court system. Nevertheless, the FRP's ongoing costs should be a concern if coupled with a continuing absence of referrals.
55. A continuing lack of referrals would also make the retention and recruitment of appropriately skilled Panel members more difficult.

Key Question

Do you believe that the FRP's functions should be repealed and the Panel closed?