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By email: smallptycompanies@treasury.gov.au

Dear Sir or Madam

SUBJECT: Facilitating crowd-sourced equity funding and reducing compliance costs for small business

CPA Australia strongly supports the Government's objective to encourage greater access to crowd-sourced equity funding (CSEF) by a significantly wider range of Australian businesses.

It is clear that in an internationally competitive environment where other jurisdictions are making it easier for innovative businesses to access finance through CSEF and other funding models that maintaining the status quo is unacceptable.

To the extent that it is appropriate we support a 'light touch' approach to regulation which also balances shareholder and investor protection concerns.

Also important to the success of CSEF is that its regulatory regime must also encourage the establishment of secondary markets where investors can trade their investments.

CSEF framework and public companies

We welcome the outline of the key elements of the Government's CSEF framework for public companies setting out the key elements for issuers, intermediaries and investors.

Our overarching view is that the proposed framework is appropriate, and we look forward to seeing further details when the draft legislation is released in the coming months.

We also support the Government's comments regarding the need for investor education and welcome the opportunity to assist the Government in achieving this outcome in due course.

Extending crowd-sourced equity funding to proprietary companies

CPA Australia is supportive of the Government's initiative in exploring whether CSEF could be extended to proprietary companies. However we recognise the tensions that invariably exist between the objective of enabling CSEF by proprietary companies and the current framework relating to sound economic policy, the conduct of corporate regulation and shareholder/ investor protection.

These tensions will remain irrespective of whether or not the proprietary company 50 non-employee shareholder limit is changed. Such a move strikes at the very basis of the reasons for Australia's corporate law distinction between public and proprietary companies, and risks creating classes of shareholders with uncertain and potentially conflicting rights.

Our view is that if proprietary companies are permitted to access CSEF, it would be appropriate that they be subject to additional transparency obligations that would be comparable to public companies accessing CSEF. This is necessary to provide an appropriate balance between the financing needs of business and investor protections. Unfortunately this would inevitably have regulatory burden consequences.

Disclosure requirements for CSEF

In our view, companies eligible to raise funds through CSEF should be required to prepare financial reports that are General Purpose Financial Statements (GPFS). GPFS are designed to meet the information needs of users who are unable to demand financial information that meets their specific information needs. Investors in companies raising equity funds through CSEF are likely to fall into this category of financial information users.

Further, it is also our view that such financial reports should be subject to an annual audit. Assurance provided on the financial reports by an independent and qualified auditor is likely to provide a degree of comfort and some mitigation of risk that investors are likely to be exposed to and will also support the establishment of secondary markets.

We also note that a separate "financial reporting framework" project exploring the calibration of financial reporting and audit requirements for different types of entities, including those falling within the scope of Corporations Act is currently under way. It is imperative in a deregulatory context for any financial reporting and audit requirements imposed through the CSEF regime are consistent and aligned with other reporting and audit requirements that may eventuate.

We therefore submit that CSEF be limited to public companies in the first instance, but private company access be subject to further consideration once we have a better idea of the success of the Government's current CSEF proposal for public companies.

Appropriateness of the shareholder limit for proprietary companies

From our recent discussions with the Government and Treasury regarding employee share schemes, it has become apparent that the 50 non-employee shareholder limit for proprietary companies can be deleterious to the efficient funding and operation and growth prospects of modern innovative firms. Accordingly we are supportive of this limit being increased to, say, 100 as discussed in the consultation paper.

Proprietary companies enjoy a variety of advantages across a range of aspects of corporate governance. These advantages are premised on the company being closely held. Anything other than a relatively modest change to the limitation on non-employee shareholders places at risk this inherent safeguard which protects such shareholders and preserves the integrity of the company.

If the shareholder limit for proprietary companies was to be increased and some public companies become eligible to be registered as proprietary companies, any such benefit should not be denied to existing public companies. Some accommodation would seem necessary in Part 2B.7 of the Corporations Act 2001 in terms of both an enabling mechanism and the operation of safeguards.

Reducing compliance costs for small proprietary companies

Making an annual solvency resolution

The solvency resolution is an important reminder to directors of their duties towards creditors, which are manifest in avoiding insolvent trading and the capacity to place the company under external administration.

Business failure and unsecured creditor protection are critical matters of policy, and, often, complex areas of the law. Treasury will be aware of the Productivity Commission's recent deliberations on the adequacy of business recovery emphasis within the existing external administration part of the Corporations Act 2001. Though a relatively small component, the question of whether to maintain the solvency resolution or not should not be considered in isolation from the wider reform agenda.

CPA Australia strongly urges that the proposal to remove or modify the annual solvency resolution be considered in the context of the interaction of s286(1) and s588E(4) of the Corporations Act 2001, which can be paraphrased to say that where a company fails to keep financial records it is presumed to have been insolvent throughout such period. Similar rules apply in relation to the retaining of financial records for a period of seven years. The solvency resolution compels directors to seriously consider these requirements which are immutable. Moreover, the removal or modification of the solvency resolution would seem to contradict a long line of case law dealing with the duty of care and diligence which emphasises a positive obligation of inquiry by directors into matters of company solvency.

We see also as highly important, educative measures which address the nature of solvency related obligations and, in this context, it is evident that amongst a significant element of the business community

there is little appreciation that the legal test of solvency is cash flow, rather than balance sheet based. Compelling the making of the solvency resolution will at least, in part, direct attention to this critical matter.

On the matter of timing of solvency declarations, this should remain aligned with the cycle of annual financial reporting as it is these records upon which the director applies an assessment and forms an opinion.

Steps to ensure the preservation of corporate value, and thus negating the risk to unsecured creditors in the face of corporate insolvency, should not be unduly influenced by notions of burden on companies and their directors. The solvency resolution is significant amongst a range of measures which direct attention to a critical set of obligations which protect interests impacted by business failure and which avoid abuse of the corporate form.

Maintaining a share register

A share is a form of property – a chose in action – which vests with the holder a particular set of proprietary rights. As a form of incorporeal property a share's value is validated by the recognition and enforceability given to it by the law. Evidence of the existence of the property, and the legal or beneficial ownership, is vital. It is in this context that CPA Australia maintains that a share register informs an important part of this recognition. Moreover, development of changes in these requirements needs to be mindful of the interaction with Chapter 2F of the Corporations Act 2001 and, in particular, the types of orders (s233) which a court can make, a number of which directly affect share capital and ownership.

CPA Australia draws attention to s140 of the Corporation Act 2001, which aside from other relationships, renders the company constitution (and where appropriate, the replaceable rules) as having effect as a contract between the company and each member, and as between each member. The maintenance of a share register, in some form, is an important complement to these fundamental relationships, particularly where the company is of a proprietary type and the shares are not readily tradable.

Facilitating the execution of documents

CPA Australia's view is that the costs alluded to in the consultation paper are primarily driven by external factors. As part of gaining some background context, it might be worthwhile for Treasury to consider a consultation conducted by Commonwealth Attorney-General's Department in 2012 exploring possible reform of Australian contract law. This review examined, amongst a range of issues, the possible shift to codification of common law rules, possibly along similar lines to USA Restatements, as a means of making the law more accessible.

CPA Australia gives its general support to the types of reform suggested in questions 26 and 27 of the consultation paper. Doubtless there will be drafting challenges in effecting these changes in Part 2B.1 of the Corporations Act and any reforms should not to in anyway undermine 'indoor management' rules in Part 2B.2, which are vital to the protection of external parties and the efficient execution of commercial transactions.

Post implementation review

An appropriately implemented CSEF regime for business will be beneficial to the growth of Australian businesses. However, to monitor the risks associated with such an initiative we propose that the regime be subject to a post implementation review once it has been operational for at least three years.

If you have any questions regarding the above, please contact Dr John Purcell, Policy Adviser ESG on (03) 9606 9826 or via email at john.purcell@cpaaustralia.com.au .

Yours faithfully

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