CHARTERED ACCOUNTANTS
AUSTRALIA + NEW ZEALAND

31 August 2015

General Manager
Financial System and Services Division
The Treasury
Langton Crescent
PARKES
ACT 2600

Via email: smallptycompanies@treasury.gov.au

Dear Sir/Madam,

Facilitating crowd-sourced equity funding and reducing compliance costs for small businesses consultation paper

Chartered Accountants Australia and New Zealand welcomes the opportunity to provide a submission to Treasury on the *Facilitating crowd-sourced equity funding and reducing compliance costs for small businesses consultation paper* (Consultation Paper). Our key points are below and Appendix A provides our detailed submission including responses to the questions. Appendix B includes more information about Chartered Accountants Australia and New Zealand.

Key points

- We support the rapid introduction of the CSEF framework for public companies.
- We don't consider changes to the proprietary company shareholder limits are warranted.
- We support access to CSEF for proprietary companies and the proposed transparency obligations. We recommend this is implemented within the existing proprietary company framework as changes to specific limits for CSEF would create unnecessary complexity.
- We do not support the removal of the requirement to pass a solvency resolution. However we do consider that offering flexibility over the timing of annual solvency resolutions could help to reduce the administrative burden on small proprietary companies.
- We do not support the removal of the requirement to maintain a share register. However we do consider that modification of the requirements could remove duplication and reduce the associated compliance burden.

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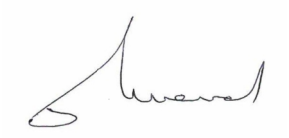
Should you have any queries concerning the matters discussed above or wish to discuss them in further detail, please contact me via email at: rob.ward@charteredaccountantsanz.com; or telephone (612) 9290 5623 or Karen McWilliams via email at karen.mcwilliams@charteredaccountantsanz.com or phone (612) 8078 5451.

Yours sincerely



Rob Ward AM FCA
Head of Leadership and Advocacy

Appendix A

Responses to questions

CSEF Framework for public companies

We support the rapid introduction of the CSEF framework for public companies. However, we are concerned that the CSEF framework for public companies exempts them from the requirement to hold an AGM. In our previous submission we noted that the AGM requirement was an important process to protect retail investors and provide them with the ability to communicate with the issuer. We recommend this be reconsidered, especially in light of the technology which could enable the AGM to be held virtually. This would reduce the cost, but still provide retail investors with access to the company management.

We consider education of investors to be critical to the success of the CSEF regime. They need to be provided with adequate information to understand CSEF and the risks attached to that form of investment. This should be a key element in the CSEF framework for public companies for intermediaries and investors.

We recommend that the CSEF framework for public companies is reviewed after 2 years to identify any changes that might be needed to ensure an appropriate balance between protecting investors and enabling issuers to raise funds is maintained. Additionally, this review should apply to any changes made in relation to proprietary companies and to identify whether additional changes, such as shareholder limits are warranted.

Appropriateness of the shareholder limit

1. Should the law be amended to increase the permitted number of non-employee shareholders in a proprietary company and what would be an appropriate limit? Or do companies with more than 50 non-employee shareholders have a sufficiently diverse ownership base with limited access to information or ability to influence the affairs of the company to justify the greater governance requirements currently placed on them?

Whilst the 50 shareholder limit has been in place for some time, we consider it to still be appropriate for proprietary companies. The limit is to ensure the proprietary company remains closely held and to protect shareholders given the limited access to information and influence they have. We don't consider a limit such as this would need to change over time.

We also note that as the focus of this consultation is on crowd-sourced equity funding, key stakeholders with an interest in proprietary companies may not be party to this consultation. For example, some organisations that we discussed this Consultation Paper with were unaware that changes to proprietary companies were included within it. Therefore, the feedback on this Consultation Paper on shareholder limits may not represent all relevant perspectives.

2. What are the benefits and risks? For example, would raising the limit expose risks to shareholder protection?

Raising the limit would expose risks to shareholder protection as a greater number would not have access to information about the company. Further, increasing the number of non-employee shareholders could also complicate the process should the company wish to explore investments from angel or venture capital investors in the future. We understand that in general a small shareholder base is more attractive to these types of investors.

3. Have there been changes to market practice or the broader operating environment such that shareholders and investors now have greater access to management or information about a company's performance? What are the ways by which management now remains accountable to shareholders or shareholders otherwise have access to information about a company?

We acknowledge that the internet and social media have increased available information about companies and the accountability of management. However this information does not generally extend to the performance of proprietary companies. Additionally, there are no guarantees over the quality and balance of information available through these channels.

4. If the shareholder limit were increased, how should the law treat public companies which become eligible to be registered as proprietary companies but have issued shares under a disclosure document?

Re-registering existing public companies as proprietary companies would reduce the information available to existing shareholders. We don't consider this to be an appropriate option unless the shareholders agreed to it. However, this highlights the consequences of increasing the limit suggested in question 1.

<u>Small scale offerings and other exceptions to the disclosure requirements</u>

5. Should the law be amended to increase the 20 investor limit and/or the $2 million cap? What would be an appropriate limit? Should the $2 million cap be linked to increase in line with the consumer price index (CPI)?

We don't consider the 20 investor limit should be increased. This exception has no disclosure requirements as it is to be a close personal offer. The $2 million cap could be reviewed to ensure it is still at an appropriate level and ongoing CPI increases could be appropriate. However, we note other thresholds for companies are not normally subject to CPI increases, such as the small/large test for proprietary companies.

6. What are the benefits and risks of increasing the 20 investor limit and/or the $2 million cap? Who would benefit or bear the risk? Could there be unintended consequences from altering these limits, for example in terms of the definition of a sophisticated investor?

The benefits of increasing the caps would mainly be for the company, who could access more shareholders or more funds. The risk would be borne by the investors as they would not have any formal offer document and with increased numbers may be less familiar with the company.

7. Could other exceptions to the requirement to issue a disclosure document provide benefits to small proprietary companies if amended?

Please see our response to questions 9 and 10. We consider this to be an appropriate exception.

Increasing flexibility in capital raising

8. Would increasing the shareholder limit for proprietary companies and/or expanding the small scale offerings exception to the disclosure requirements provide small proprietary companies with sufficient additional flexibility to raise capital?

In our response to questions 9 and 10, we support allowing CSEF for proprietary companies, within the existing limits. We also note that proprietary companies still have access to crowd funding as a source of finance. Given the risks associated with CSEF for investors, ie that the company may fail or that a future equity restructure may render their investment worthless, many investors may be willing to just fund a start up through the existing crowd funding mechanisms.

Crowd-sourced equity funding

9. Should proprietary companies be able to access CSEF? What are the implications for the corporate law framework of permitting proprietary companies to do so?

We are not opposed to proprietary companies accessing CSEF within their existing shareholder limits. However, we note it may cause complexity and confusion as it goes against the nature of proprietary companies (ie closely held). Please see our response to question 10 below. The corporate law framework needs to be amended to enable them to raise money via the CSEF mechanisms up to 50 non-employee shareholders and the tailored CSEF disclosure document.

10. If the shareholder limit is not changed for all proprietary companies, should proprietary companies be able to access CSEF?

Yes, as per our response above.

If so, should the shareholder limit be changed specifically for proprietary companies using CSEF? What are the benefits and risks of this approach? Would the benefits outweigh the additional complexity of increasing the shareholder limit for a subset of proprietary companies?

We don't consider the limit should be changed specifically for proprietary companies using CSEF. This would result in complexity and confusion. Additionally, it would increase the number of shareholders of the proprietary company, no longer making it closely held. However, due to the limited reporting requirements of proprietary companies, there would not be adequate protection mechanisms for investors nor access to information.

It could also cause confusion for investors. CSEF intermediaries would have a mix of public and proprietary companies offering shares but the ongoing disclosure requirements for each type of company are different. Until CSEF is in place for public companies and demand from investors can be assessed, we don't consider there is sufficient evidence of the demand from investors for CSEF in proprietary companies to warrant changes of this complexity. As the paper notes, a consequence of the CSEF regime for public companies may give access to a wider pool of potential investors for proprietary companies. This should form part of the 2 year post implementation review we have recommended.

If the shareholder limit were to be increased only for proprietary companies using CSEF, is 100 non-employee shareholders an appropriate cap?

As per above, we consider this to be an unneeded complication to the corporate law framework.

11. Should any increase in the shareholder limit solely for proprietary companies using CSEF be temporary, based on time and size limits? What are the benefits and risks of this approach? If the increased shareholder limit is temporary, what arrangements should apply when a company is no longer eligible for the higher shareholder limit (owing either to the expiry of the time limit or exceeding the caps on company size)? Should it be required to convert to a public company? Or should it have the option to conform with the general proprietary company obligations, including the non-employee shareholder limit?

As per above, we consider this to be an unneeded complication to the corporate law framework.

12. If permitted to access CSEF, should proprietary companies using CSEF be subject to additional transparency obligations when raising funds via CSEF?

If proprietary companies use CSEF, they should prepare a tailored CSEF disclosure document for the purposes of the issue.

Do you agree with the proposals for annual reporting and audit? Should these be implemented by requiring proprietary companies that have used CSEF to comply with the obligations of large proprietary companies? Should any other obligations apply?

In our submission to the earlier discussion paper, we noted that financial statement audits and AGM requirements were important processes to protect retail investors and provide them with the ability to communicate with the issuer. We therefore support these additional requirements for proprietary companies raising funds through CSEF. These financial reporting and auditing requirements would also enable businesses to develop good financial processes and controls as well as its financial history, which would be invaluable for future funding requirement such as IPO or venture capital.

Given the Government has committed to introducing a CSEF framework for public companies that will include certain reporting exemptions, what are the benefits of permitting proprietary companies to use CSEF when they would be subject to additional transparency obligations? Do you agree that these obligations should be permanent?

Proprietary companies would have access to a wider range of investors through CSEF but in accessing this wider group, there would need to be additional transparency obligations. These obligations should be permanent as otherwise investors would lose access to information, potentially at a critical time for the company's success.

13. Do you consider that an annual fundraising cap of $5 million, and eligibility caps of $5 million in annual turnover and gross assets, are appropriate for proprietary companies using CSEF? If not, what do you consider would be appropriate fundraising caps and eligibility criteria?

We support using these same eligibility caps as for public companies using CSEF. However, as the paper notes, the annual fundraising cap is significantly above the maximum that could be raised within the shareholder limits. Therefore an annual cap of $2 million, aligned to the small scale offering would be more appropriate.

14. Are there any other elements of the CSEF framework for public companies that should be amended if proprietary companies were permitted to use CSEF?

No specific comment

Making an annual solvency resolution

15. Should the requirement to make a solvency resolution be removed or modified? Is there a more effective way to remind directors of their obligations? For example, would aligning the timing of the resolution with tax or other obligations with fixed timing reduce the regulatory burden?

We do not support the removal of the requirement to pass an annual solvency resolution. The duty of company directors to prevent insolvent trading is seen as a fundamental requirement under Corporations Law and in the absence of any requirement to prepare and lodge financial statements, offers some degree of comfort to shareholders, creditors, employees and other stakeholders that the company is solvent. We consider that the risks of removing this requirement would far outweigh any administrative benefits.

We do consider that allowing companies the option of changing the timing of annual solvency resolutions to align with tax or other reporting obligations could help to reduce administrative costs associated with convening meetings of directors, drawing up financial information, etc. One way to achieve this would be to give more companies the option to change the date of their annual review.

16. What is the extent of the burden imposed on small proprietary companies to make the resolution, in terms of time and/or financial cost?

The time and cost involved in passing a solvency resolution will vary from company to company. However as noted above, we consider that the risks of removing this requirement would far outweigh any administrative benefits.

17. What is the value to directors of the annual solvency resolution in reminding them of their ongoing solvency obligations?

As a fundamental duty, we consider it important that directors are not only reminded of their ongoing solvency obligations, but that they also carry them out.

18. Would removing the requirement to make a solvency resolution be likely to increase rates of insolvency or business failure among small proprietary companies? Would unsecured creditors be exposed to increased risk? Are there other risks associated with removing the requirement? Could the risks be mitigated adequately by ASIC reminding directors periodically (say, annually) of their duty to prevent insolvent trading by the company? Are there other ways to mitigate the risks?

Business failure, negative cash flows, difficulties accessing funding and insolvency are all risks associated with small businesses and start-ups. We do not consider that simply reminding directors of their duty to prevent insolvent trading would be effective in mitigating those risks.

Consideration should be given to requiring directors to notify ASIC of both positive and negative solvency resolutions. This could be done in a way that does not increase the administrative burden on companies, for example by moving the annual statement process online and requiring directors to declare that the information held by ASIC is correct and that the company is solvent/not solvent. An online declaration could potentially replace the requirement for a separate solvency resolution to be passed.

Maintaining a share register

19. What is the extent of the burden imposed on small proprietary companies to establish and maintain a share register, in terms of time and/or financial cost?

No specific observations on time or cost, however we agree that there is duplication, particularly for small proprietary companies with less than 20 shareholders.

20. What is the value to small proprietary companies of maintaining a share register? Would companies need to maintain similar records even if the law did not require them to?

Aside from enabling the public to ascertain the status of the company and who is involved in it, maintaining a share register helps a company manage its own dealings with its shareholders. Companies would need to maintain similar records even if the law did not require them to.

21. Should the requirement to maintain a share register be removed for small proprietary companies with up to 20 shareholders, given that ASIC's records duplicate the information in the share register of such companies?

We do not support the removal of this requirement. As companies would need to maintain similar records in the absence of any legal requirement, we do not consider that removal would have any practical benefits. However, we do consider that the regulatory burden could be reduced by removing duplication.

22. If the requirement were removed for small proprietary companies with up to 20 shareholders:
How could share ownership be transferred? Could transfer take effect via a different mechanism, such as on notification to ASIC or on acknowledgment from the company?
How would shareholders be able to ascertain the identity of the other shareholders of a company? Would it be reasonable to require shareholders to obtain the information from ASIC (including paying the required fee)?
Are there other situations or circumstances where small proprietary companies with up to 20 shareholders need to have an up-to-date share register?

We do not support the removal of the requirement to maintain a share register.

23. Alternatively, should the requirement for small proprietary companies to maintain a share register be modified? If so, how? For example, should small proprietary companies with up to 20 shareholders continue to retain a share register but no longer be required to notify ASIC each time shareholder details change?

We consider that modification of the requirements could be a practical and effective way to remove duplication and reduce the associated compliance burden. Removing the requirement to notify ASIC of changes in shareholder details, similar to the requirements for public companies, is one option. We do not consider that this should be restricted to companies with less than 20 shareholders, but separate consideration may be needed for other groups, such as foreign-controlled small proprietary companies.

24. Would removing/modifying the requirement to maintain a share register be likely to increase the risk of minority shareholder or property rights disputes for small proprietary companies? Are there other risks associated with removing the requirement?

With modification of the requirements, we do not consider that the risks would significantly increase as anyone would still have the right to inspect and/or obtain a copy of the company's register of members.

25. Does the current law cause problems and/or increase compliance costs for sole director/no secretary companies and their counterparties in executing documents? What is the extent of the burden imposed on sole director/no secretary small proprietary companies in terms of time and/or financial cost?

No specific comment.

26. Is it appropriate to amend the law to specify that a company with a sole director and no company secretary may execute a document without using a common seal if the document is signed by the director or with a company seal if the fixing of the seal is witnessed by the director? Are there any risks associated with this approach? Are there any alternative approaches?

No specific comment.

27. Is there an issue regarding split execution? What is the extent of the burden imposed on small proprietary companies in terms of time and/or financial cost? What are the benefits and risks of specifying in the law that split execution is acceptable?

No specific comment.

28. Is there an issue regarding the execution of deeds by foreign companies? What is the extent of the burden imposed on small proprietary companies in terms of time and/or financial cost?
Should the UK approach be adopted in the Corporations Act? Should a similar approach be taken to other bodies corporate? What are the benefits and risks?

No specific comment.

Completing and lodging forms with the regulator

29. Could any forms which are used by small proprietary companies and prescribed by the Corporations Act or Corporations Regulations be removed, amended or streamlined to reduce the compliance burden? How much time/money would it save you?

We do not have any observations on specific forms, however do note that other regulatory bodies such as the FMA in New Zealand make greater use of online applications and features to streamline reporting and notification processes.

Other ways to reduce compliance costs

30. Are there any other requirements under the Corporations Act which impose unnecessary compliance burdens on small proprietary companies? What is the extent of the burden in terms of time and/or financial cost? How could the burden be reduced?

No specific comment.

Appendix B

Chartered Accountants Australia and New Zealand

Chartered Accountants Australia and New Zealand is made up of over 100,000 diverse, talented and financially astute professionals who utilise their skills every day to make a difference for businesses the world over.

Members of Chartered Accountants Australia and New Zealand are known for professional integrity, principled judgement and financial discipline, and a forward-looking approach to business.

We focus on the education and lifelong learning of members, and engage in advocacy and thought leadership in areas that impact the economy and domestic and international capital markets.

We are members of the International Federation of Accountants, and are connected globally through the 800,000-strong Global Accounting Alliance and Chartered Accountants Worldwide which brings together leading Institutes in Australia, England and Wales, Ireland, New Zealand, Scotland and South Africa to support and promote over 320,000 Chartered Accountants in more than 180 countries.