THE VICTORIAN BILL TO AMEND THE COMPANIES ACT

By G.R. Hindle

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The Provisions Relating to Accounts

On November 25th, 1970, a bill to amend the 1961 Companies Act was given its first reading in the Victorian Parliament. This bill introduces provisions with respect to the disclosure of substantial shareholdings in companies, re-enacts the accounts and audit requirements, re-enacts take-over requirements and makes numerous miscellaneous amendments.

The history of the bill is as follows. In 1967, the Standing Committee of Attorneys General made public a preliminary working draft Bill to amend the accounts and audit requirements of the uniform Companies Act. The Attorneys-General set up the Company Law Advisory Committee in 1967 to study the draft, hear submissions and make recommendations on this and other matters for the protection of investors. The Committee consisted of Mr. Justice Eggleston, Mr. P.C.E. Cox, an accountant, and Mr. J.M. Rodd, a solicitor, and their findings were published in a series of reports. The Bills presently before the Victorian and N.S.W. Parliaments embody most of the recommendations of the Committee. The N.S.W. Bill was intended by the N.S.W. Government to become law in October, 1970, but opposition from various groups resulted in its deferral. The Victorian Attorney-General, Mr. Reid, said that the second reading of the Bill would take place in March, 1971 and he invited interested parties to submit views on the Bill and to study the Committee's reports. The Institute of Chartered Accountants and the Australian Society of Accountants have combined to make comments but only a small proportion of these comments are presently available. The Institute of Directors are also making comments. If passed, the Act will probably first affect accounts for the year ending June 30, 1972.

The implications of the Bill are very great. The article is concerned only with the provisions relating to accounts and sets out what appear to me to be the main additional requirements. While falling short of ideal, I feel the requirements are very valuable additions and will allow the investment community to analyse more readily the position of a company. The Bill provides for nearly all of the additional disclosure in two amendments.

1. S 162 which considerably enlarges the matters to be stated in the directors report; and
2. The Ninth Schedule which increases the items to be disclosed in the profit and loss statement, the balance sheet and the accompanying notes.

1. The main additional matters to be stated in the directors report are: -

i) The principal activities of the company in the course of the financial year and any significant change in the nature of the activities during the period.

ii) The profit or loss of each subsidiary excluding minority interests.

Comment: All company accounts are presently available for inspection at the Company Registrars Office in the state of incorporation upon payment of a $1 fee. However, on company visits some executives have reacted as though this was not information available to shareholders. In other cases executives have said that the subsidiary company results are meaningless. This provision could lead to a simplification of company structures.

iii) The names of subsidiaries bought or sold during the year, the consideration paid or received, the net tangible assets and any minority interest.

Comment: Most surprisingly, the accounting bodies say they see no point in this.

iv) Any additions to shares and debentures stating the purpose of the issue and the amount, and the term and rate of debentures.

v) Where the company is a subsidiary of another company, the name of that company and the country of its incorporation.

vi) Whether any post balance date event is likely to affect substantially the results of the next succeeding year.

vii) Whether directors are aware of any circumstances which would render the current asset values misleading.

2. The main additional matters to be disclosed under the amended Ninth Schedule are: -

i) The amount of profit or loss (not netted) arising other than in the ordinary course of business.

ii) The amount of interest on all borrowings, (formerly only interest on fixed term borrowings).

iii) The amount of bad debts written off.

iv) Total emoluments of directors in full time employment, excepting their salaries as employees.

v) Auditors fees for services other than auditing. e.g. accounting, consulting, tax returns.

vi) Where the actual and prima facie tax provision differs or but for compensating items would differ, by more than 15%, the difference must be explained including an amount for the major items.

Comment: Where tax is less than 40½% of pre-tax profit or more than 54½%, and if there are no offsetting items, the requirements come into operation. If there are offsetting items the provision may come into operation with a tax provision of between 40½% and 54½% of pre-tax profit. A similar AASE listing requirement has not been enforced.

vii) Any provision for future tax as distinct from the provision for tax on the current year's income.

viii) The amount of work in progress.

ix) Where more than one method is used in valuing assets such as stock and work in progress a separate total is to be shown in respect of each method used.

x) The amount of the holding company's investment in each subsidiary and the percentage of the capital held.

xi) Unearned income, (income to be earned on existing contracts continuing beyond the end of the current year), is not to be included in gross debtors unless deducted subsequently. The method of calculating unearned income must be stated.

xii) Where land is held for resale, the land cost, the capitalised development expense and the capitalised rates, taxes and interest must be shown separately.

The disclosure of sales

The most significant omission is that the Bill does not require disclosure of turnover though the original draft did require disclosure of "gross revenue or gross sales", a statement of the "method or basis of calculation" and "amount of sales to related corporations".

The Eggleston report notes that, (i) the U.K. Act requires this with exceptions for banking and discounting companies and where sales are less than ₤50,000. (ii) in the U.S., the SEC requires a breakdown of sales by product group where a group comprises 15% or more to total sales (since changed to 10% more).

The report states that: -

"The Committee considers that the question of compelling disclosure of turnover is a major question of policy on which the final decision must rest with the Minster.......... While we do not regard such disclosure as a major weapon for the protection of investors, we feel that as such disclosure has not proved harmful where adopted, and may in many cases be helpful in enabling investors to exercise sounder judgement as to the value of investments, the balance is in favour of introducing some such requirement...........We would favour a flexible provision, requiring the company to give a figure of the money amount of turnover, gross revenue or gross income, which will give a true and fair view of the gross money value of the company's activities for the year, together with an explanation of the method adopted in arriving at the figure.........If turnover figures are to be fully informative, they should be subdivided according to major fields of activity, but this could not be recommended in the absence of some flexible machinery for adjusting the obligation to the circumstances of particular companies or types of company".

Desirable additional disclosures

In my view the following matters would be very desirable additional requirements:

i) The disclosure of sales.

ii) The disclosure of adjusted earnings per share and adjusted dividends per share on average capital.

iii) A five year summary of significant items, particularly capital, shareholders funds, current and long term liabilities and assets, sales, pretax profit, tax, after tax profit, dividends, and adjusted earnings and dividends per share.

iv) A ruling that profits and losses on disposal of non current assets be excluded in determining net profit.

v) The disclosure of lease payments and lease committments for the coming year.

The Proposal for a Companies Commission

The Eggleston report recommended the establishment of a Companies Commission whose functions would be: -

a) to grant exemptions from -

    i) The legislative provisions as to accounts in cases where compliance would impose unreasonable burdens or result in the supply of misleading on inappropriate information;

    ii) specific requirements such as disclosure of substantial shareholdings and other statutory requirements (e.g. as to prospectuses) in cases where on further examination of the legislation this is considered necessary;

b) to issue general orders giving companies of a defined class power to omit specified information required by the Act or to present their accounts in a different form from that required;

c) to alter or add to the requirements as to accounts and the director's report;

d) to perform the duties at present carried out by the State's Companies Auditors Boards;

e) to undertake tasks at present carried out by the State's Companies Registrars in cases where they could more conveniently be performed by a single body.

Perhaps the main reason for proposing the Commission was because of the inherent difficulties in prescribing requirements which in all times and circumstances are applicable and fair to all companies regardless of their size, value and shareholding. A Commission would for example be necessary to make decisions on matters such as the reporting of sales by major fields of activity. The Commission would be able to develop a fund of knowledge on the practical operation of the legislation and be able to give prompt and authoritative advice to governments on desirable amendments. There would be also administrative advantages in relation to matters such as registration of auditors and liquidators operating in more than one state and prospectuses requiring registration in more than one state.

The Bill does not provide for a Commission and instead provides that State Registrars may grant relief from compliance with specific disclosure requirements where he believes that compliance would render the accounts misleading or inappropriate or would impose unreasonable burdens on the company. The Eggleston report proposal seems a classic example of a good idea whose time has not yet come.

Disclosure required by the U.S. Securities and Exchange Commission

The most disclosure minded Australian companies appear secretive by the disclosure standards required under the SEC regulations. These regulations virtually take the place of the Australian Companies Acts disclosure requirements. However, the SEC regulations only apply to companies whose shares are widely held and traded. Thus the Howard Hughes group of companies has a net worth which can only be estimated as being between \$1.4 and \$2.0 billion. It should be noted that New York Stock Exchange listing requirements presently call for a profit of more than \$1,200,000 and a capitalisation of more than \$12,000,000 though some present issues and American Stock Exchange stocks are smaller. In Australia, the accounts of the smallest public company and B.H.P. must meet the same requirements and are both filed for public inspection at The State Registrar's Offices.

The SEC regulations govern the form and content of information filed with the SEC. The filings may be inspected at branch offices or purchased but many brokers use abstracts and manuals compiled by bureaux such as Standard and Poor.

While the details filed must be reconcileable with the published accounts to shareholders, the published accounts are usually little more detailed than Australian accounts. The main difference is that U.S. accounts show sales, adjusted earnings and dividends per share, more comparative financial data and seldom show the holding company accounts.

While the Australian Companies Acts have separate provisions for banks and insurance companies, the SEC has separate provisions for companies in the exploratory, promotional or development stage, management investment companies, unit investment companies, non life insurance companies, life insurance companies, banks, utilities and property development companies. In addition to financial information, reports are required of management dealings in the stock (insider trading), the background and salaries of senior management, details of agreements such as lease and financing contracts and details of companies taken over.

The regulations set out the items which must be shown in the balance sheet and profit and loss statement and in seventeen supporting schedules. The balance sheet items are similar to the Ninth Schedule requirements though the profit and loss disclosure requirements are more detailed. The items required include sales, cost of goods sold, operating revenues, operating expenses, selling general and administrative expenses, provision for doubtful debts, interest, non-operating income, special items and taxes.

The supplementary profit and loss statement must show the amount charged to profit and loss and to other accounts (i.e. capitalised) and the following items; cost of goods sold, operating expenses, maintenance and repairs, depreciation and amortization, taxes other than income tax, management and service contract fees and rents and royalties.

Other supplementary schedules give details of balance sheet and other items such as debt, investments, capital and options and plant and equipment. Most are very detailed. The real estate schedule must show for each state in which property is held, farms, residential, apartment and business, and unimproved property and for each item, the encumbrances, the cost, the market value, the annual rents and interest, taxes, repairs and net income.

The objective of the SEC is effective disclosure with a minimum of burden and expense and this calls for a constant review of the practical operation of the rules and registration forms. If experience shows that a particular requirement is ineffective or unduly burdensome in relation to the benefits, modifications are considered and industry representatives are extensively consulted. In addition the SEC normally gives advance public notice of proposals for the adoption of new or amended rules or requirements and invites comments. Exemptions from some of the disclosure requirements are made in certain circumstances, and in particular to smaller companies.

It is certain the U.S. disclosure standards applied to Australian stocks would, in respect of over two thirds of listed companies be a waste of effort, as there is not enough investor interest and accounting and analytical manpower available. There would however, be benefits flowing from the general improvement in the quantity and quality of business information.

REVIEW

21 POPULAR ECONOMIC FALLACIES

By E.J. Mishan (Pelican) 1971

Whilst some of the economic fallacies discussed are specifically related to circumstances in Great Britain (for example those concerning taxes, the common market and the pound) others are of equal concern in Australia. In any case the author's logical approach is always of interest.

The debunking of the following five fallacies could well be made compulsory reading for all politicians, businessmen and journalists in this country -

Increased Taxation Adds to Inflation,
A Tax on Land Raises its Price,
The Country Needs Immigrant Labour,
Faster Economic Growth Checks Inflation,
Economic Growth Enriches Society.

Some of these fallacies are so widely accepted that little progress is likely to be made towards their elimination, and not everyone will accept without qualification the reasonings of the author in particular areas of concern to them. However the book is clearly written and its study should help all readers to attain a wider view of current economic controversies.