

Financial reporting requirements

Board performance

The *Corporations Act 2001* sets out statutory requirements for financial reporting. The main requirements are:

- To maintain financial records (s 286)
- To prepare an annual financial report and a directors' report (s 292)
- To have the financial report audited (s 301)
- To send the financial report, directors' report and auditor's report to members (ss 314–5)
- To lodge those documents with ASIC (ASX where appropriate) (ss 319–320)
- To lay those documents before the annual general meeting (s 317)
- To prepare a half-year report (s 302)
- To have the half-year report audited or reviewed by the auditor (s 309)
- To lodge the half-year report and auditor's report with ASIC (ASX where appropriate) (s 320)
- Financial statements – financial performance (profit and loss), financial position (balance sheet), cash flows, taxation returns, depreciation schedules
- General ledger
- General journal
- Assets register
- Computer backup
- Cash records – cash receipts journal, cash deposit books, cash payments journal, cheque butts, petty cash books
- Bank account statements, bank reconciliations and bank loan documents
- Sales/debtor records – sales journal, debtors ledger, list of debtors, invoices and statements issued, delivery dockets
- Work in progress records
- Job/customer files
- Stock listings
- Creditors records – invoices and statements received and paid, creditors ledger, unpaid invoices
- Correspondence, annual returns and ASIC forms
- Wages and superannuation records
- Registers – members, options, debenture holders, prescribed interests
- Minutes – directors and/or members meetings
- Deeds – trust, debentures, contracts and agreements, inter-company transactions

Financial records

All companies must keep appropriate and adequate written financial records (s 286) and these records must correctly record and explain its transactions, financial performance and position and allow for 'true and fair' financial statements to be prepared and audited.

The nature and form of records will vary from company to company but the Australian Securities and Investments Commission has suggested that the basic financial records that accountants would expect a company to keep include:

Who has to prepare financial reports?

All companies must keep appropriate and adequate financial records (s 286) but only some need to produce a financial report. Financial reports and directors' reports must be prepared for each financial year by:

- All disclosing entities incorporated or formed in Australia;
- All public companies;
- All large proprietary companies; according to s 45A, a large proprietary company is defined as meeting two out of three of the following criteria:
 - Has consolidated gross operating revenue of more than \$25M
 - Has consolidated gross assets of over \$12.5M
 - Has more than 50 employees;
- All registered schemes (s 292).

Financial reports must comply with accounting standards and regulations (s 296), however there are some exceptions for small proprietary companies and small companies limited by guarantee where there are specific member or shareholder directions (see s 296 (1A) and s 296 (1B)).

What are the key documents?

- Financial report for a financial year, consisting of financial statements for the year and notes to the financial statements;
- Directors' declaration that there are reasonable grounds to believe that the company is solvent and that the financial statements and notes comply with the accounting standards and give a true and fair view;
- Directors' report for a financial year;
- Auditor's report on the company's financial report for a financial year;
- Auditor's independence declaration;
- Half-year report where required;
- Auditor's audit report or review of the half-year report.
- Half-year financial reports only need be prepared by disclosing entities (s 302).

Small proprietary companies must produce financial reports only if:

- They are controlled by a foreign company for all or part of the accounting period and their profit or loss for the period is not covered by accounts of the foreign company lodged with ASIC (s 292(2));
- Shareholders holding 5 per cent or more of the voting shares in the company give it a direction to prepare financial statements and reports no later than 12 months after the end of the financial year concerned (s 293);
- ASIC gives a direction that financial statements be prepared (s 294).

What are the financial statements?

Australian accounting standards require companies to prepare statements of profit and loss and comprehensive income, financial position (formerly balance sheet), cash flows and changes in equity.

The Statement of Profit and Loss and Comprehensive Income may be in a single statement or set out in two separate statements. The statement of profit and loss summarises revenue generated and expenses (including tax expenses) incurred during the financial year. The statement of comprehensive income shows a more complete view of the company's performance, reflecting the change in equity of the company from transactions other than the effects of changing ownership interests, incorporating unrealised gains and losses due to changes in values during the period.

The Statement of Financial Position shows assets, liabilities and shareholder equity (equivalent to net assets) at a certain date. Assets and Liabilities may be split into current and non-current, (referring to those which in the normal course of events would be converted to cash/payable within the next twelve months and those longer term assets/liabilities) or in order of liquidity where presentation as such is more reliable and relevant. Details of specific types of assets and liabilities are contained in the Notes.

The Statement of Changes in Equity reports all changes to equity (including shareholder capital, reserves and retained profits) during the reporting period including changes as a result of owners acting in their capacity as owners (share issue, dividends) and total comprehensive income (net profit after tax and other comprehensive income).

The Statement of Cash Flows shows historical cash in and out over the financial year under the three broad categories of operating, investing and financing activities. They help provide an indication of the company's ability to pay its debts as and when they fall due, so is important when considering solvency.

“The Notes to the Financial Statements are often overlooked but are important when reading and understanding the four key statements above.”

The Notes to the Financial Statements include specific detail on the basis on which the financial reports have been prepared, the accounting policies which have been applied and assumptions that have been made in the preparation of the accounts. Any changes to accounting policies and new accounting standards which have been applied are included in the notes.

What is contained in the Directors' Report?

The Directors' Report contains information, as outlined in s 299 and 300, including:

- Review of operations;
- Significant changes in the state of affairs;
- Principal activities and any significant changes to them;
- New matters which will or might significantly affect future operations and therefore financial performance;
- Likely future developments;
- Dividends paid during the year plus those recommended or declared but not yet paid
- The name of each director and the period for which they were a director, the names of other company officers or partners in the firm which audits the company;
- Information on options and unissued shares;
- Indemnities and insurance premiums paid for officers and auditors;
- Operations subject to environmental regulations (only applicable to some companies).

There are differing requirements for the contents of the Directors Report depending on the entity type with the *Corporations Act 2001* separating requirements for public companies, listed companies (s 300A) and companies limited by guarantee (s 300B).

Public companies must include in their Directors Report:

- The name of each director, their qualifications, experience and special responsibilities;
- Each director's attendance of board and board committee meetings;
- Name of other officers and auditors plus the qualifications and experience of the company secretary.

There are also further special rules for listed companies as to information that must be included:

- The relevant interests of each director in shares, debentures, rights and options in the company plus any contracts with the company which will benefit them;
- All other directorships held by a serving director within the last three years;
- Amounts paid or payable to the auditor for non-audit services provided during the year by the auditor;
- A statement as to whether the directors are satisfied that the provision of non-audit services is compatible with the general standard of independence for auditors imposed by the *Corporations Act 2001* and the directors' reasons for being satisfied;
- Compliance with general standards of auditor independence;
- The auditor's declaration (s 307C) that there have been no contraventions of their independence requirements or codes of professional conduct in relation to the audit or the review;
- Any additional information needed to give a true and fair view and to include reasons for sharing this information and where it can be found in the accounts;
- A discussion of board policies for the nature and amount of remuneration paid to directors, the company secretary and senior managers;
- A discussion of the relationship between this policy and the company's performance;

- A discussion of performance hurdles which directors, the company secretary and senior managers must attain for remuneration purposes;
- Remuneration of each member of the key management personnel and details of certain elements of remuneration
- Details of AGM comments on the remuneration report and any associated resolutions
- Details of consultants who provided remuneration recommendations.

The additional general requirements for listed companies (s 299A) including any information that members need to make an informed assessment of the operations, financial position, business strategy and future prospects. This is the operating and financial review ('OFR') – sometimes referred to as 'management discussion and analysis' or 'management commentary'.

ASIC's Regulatory Guide 247 *Effective disclosure in an operating and financial review* (released in March 2013) provides guidance in relation to the following specific content:

- Operations, financial position, and business strategies and prospects for future financial years
- Use of the unreasonable prejudice exemption
- Presentation of analysis and narrative
- Integrated reporting

What are the half-year financial report requirements?

Only disclosing entities have to prepare a half yearly report (s 302). A disclosing entity must:

- Prepare a financial report and directors' report for each half-year;
- Have the financial report audited or reviewed and obtain an auditor's report;
- Lodge the financial report, the directors' report and the auditor's report with ASIC.

These obligations do not apply if the company is not a disclosing entity when lodgement is due. Lodgement is due within 75 days after the end of the half-year (s 320). Half year financial statements must comply with accounting standards and regulations (s 304).

What is director's responsibility in approving financial statements?

Directors' declaration

The directors' declaration is a declaration by the directors:

- Whether, in the directors' opinion, there are reasonable grounds to believe that the company will be able to pay its debts as and when they become due and payable
- Whether, in the directors' opinion, the financial statements and notes are in accordance with the *Corporations Act 2001*, including compliance with the accounting standards and providing a 'true and fair' view
- If the company has included in the notes an explicit and unreserved statement of compliance with international financial reporting standards – that this statement has been included in the notes

This declaration must be made in accordance with a resolution of the directors, specify the date on which the declaration is made and be signed by a director.

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If the company is a listed company, the directors must also declare that they have been given declarations by the chief executive officer and the chief financial officer whether, in that officer's opinion:

- The company's financial records have been properly maintained
- The company's financial statements and notes for the financial year comply with the accounting standards and give a 'true and fair' view

The directors' report must be made in accordance with a resolution of the directors. The *Corporations Act 2001* does not specify which particular director has to sign it, just that it be signed by "a director" (s 298 (2) (c)).

Considerations for directors in approving financial statements

The directors' approval of financial statements is a core responsibility. The Federal Court in the *Centro* case (*ASIC v Healey* (2011)) made it very clear that directors, in approving financial statements, must bring their own knowledge of the company situation to bear and cannot simply rely on auditors or management. If in doubt about anything in the financial statements, the directors must ask questions.

ASIC Information Sheet 183 'Directors and financial reporting', states that:

"You must read, understand and focus on the contents of the financial report. You must apply your own mind to, and carry out a careful review of, the financial report and directors' report, determine that the information they contain is consistent with your knowledge of the company's financial position and affairs, and ensure that material matters known to you, or that should be known to you, are not omitted.

In reading the financial report, you should:

- *Ensure, as far as reasonable and possible, that the information included is accurate;*
- *Question the accounting treatments applied; and*
- *Examine the adequacy of disclosures and whether any matters have not been disclosed that should be disclosed.*

When reviewing the financial report, you should inquire further into any matters revealed by that financial report."

Here, we would just draw attention to the comments of the ASIC Deputy Chair, Belinda Gibson, on this case (see 'What ASIC expects of NEDs', *Company Director*, November 2011):

"ASIC expects directors to have sufficient knowledge of the basic accounting concepts in a financial statement to enable them to carry out their responsibilities of monitoring and guiding management. If they do not

have these skills, they should get them. In the Centro case, ASIC did not argue directors needed to check the accuracy of figures or the accounting treatment in the company's financial statements. Nor did the Centro judgment decide directors must have knowledge of every accounting practice and accounting standard. However, some common accounting concepts must be grappled with. One is solvency and another is classification of debt as current or otherwise.

Directors must consider relevant information provided to them. They must ensure they have access to board papers and use the information gained in considering all matters put to the board. The Centro decision highlights that directors must review matters against their knowledge of the company, including knowledge obtained from different or earlier board papers.

Directors must be sceptical. ASIC expects board members to ask management questions and to challenge recommendations put to them. They must apply their minds to critically review the information given to them against their knowledge of the company. If the information is not consistent with that knowledge, they must probe management until they are satisfied. It is vital that directors do not uncritically adopt the work of management and advisers on issues of fundamental importance to the company.

Directors are expected to bring their expertise and experience to the board's deliberations on all matters. They cannot abdicate responsibility in areas where they have less expertise than others on the board. However, ASIC accepts that much of a company's activities must necessarily be delegated from the board to management and from management to employees.

Nevertheless, there will be some matters that cannot be delegated. One is where the director's opinion is required. Where an opinion is required by law – as in approving financial reports – directors must apply their own knowledge to the information provided and form their own opinion. This does not exclude relying on others to inform that opinion, but directors must provide the "final filter"."

Checklist for approving and adopting the financial report of a public company:

The following is a summary of the checklist provided by James Lonie ('Approving financial reports', *Company Director*, February 2013) for approving and adopting the financial report of a public company:

1. Do you have the necessary minimum financial literacy and basic knowledge of key accounting standards?
2. Ensure you have and maintain a basic knowledge about the company, its financial position and affairs sufficient to reach a reasonably informed opinion of the financial capacity of the company.
3. Are the company's risk and audit structures and processes appropriate for the company?
4. Review the nature and quantum of financial advice provided to you.
5. Ensure you have adequate time to review information.
6. Review the legal requirements for the financial statements and reports.
7. Do you have reasonable grounds to believe the company will be able to pay its debts as and when they fall due and payable?
8. Do not totally rely on management and the auditors (or other directors).
9. Regularly refresh your memory on your personal obligations as a director, especially relating to the accounts.
10. What significant accounting practices and standards apply? Have they changed?
11. Consider asset values.
12. Meet management and obtain all necessary sign offs (including sec 295A declarations where necessary).
13. Non-executive directors to meet auditors and obtain preliminary audit sign off.
14. Obtain a copy of the final financial statements.
15. Read and carry out a careful review of the financial statements.
16. Consider if the financial statements are consistent with your knowledge of the company's financial position.
17. Bring an open and enquiring mind, even in respect of matters outside your area of expertise.
18. Consider areas of high risk and subjectivity.
19. Do the financial statements present a true and fair view?
20. Consider changes to the financial statements and reports before passing the directors' resolutions. If changes are so significant they cannot be readily absorbed, arrange a later time for approval to allow review.

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