

Corporations Law Simplification program

Small Business

Proposal to Simplify Proprietary Companies

Task Force  
March 1994

Simplification Task Force  
Attorney General's Department  
Barton ACT 2600

# **PROPRIETARY COMPANIES PROPOSAL FOR SIMPLIFICATION**

## **The proposal**

This proposal simplifies the rules relating to proprietary companies on:

- financial reporting
- minimum number of members
- minimum number of directors
- annual general meetings
- reservation of names.

In putting forward this proposal, the Task Force has taken into account a number of approaches which have been advanced over the last decade to make the conduct of small business easier. Further background on the development of the proposal appears at page 7.

## **Practical benefits**

The proposal will have significant practical benefits for proprietary companies.

- Financial reporting requirements will be reduced for most companies to the minimum level appropriate for investor and creditor protection
- All proprietary companies will be able to pass a resolution if all members sign a minute of the resolution
- A sole trader will be able to incorporate without the need to involve a second member or director
- There will be no requirement to hold annual general meetings
- There will be no requirement to restrict the right to transfer shares
- It will no longer be necessary to reserve a company's name.

Future simplification projects may extend to public companies some of the reforms advanced in this proposal for proprietary companies.

## **Access to the Law**

At present, provisions on proprietary companies are scattered throughout the Corporations Law, making it difficult for owners of small businesses to find out about their rights and obligations under the Law. Creating a special part of the Law to deal with proprietary companies will improve accessibility to the Law. This part will bring together:

- key provisions on proprietary companies
- summaries of, or signposts to, other general provisions of less importance to the day-to-day operation of proprietary companies (such as the winding up provisions).

## **Other requirements affecting businesses**

The proposal results from one of the Task Force's 7 initial priority projects. Other priority projects which will also have particular practical benefits for small business are:

- register keeping requirements
- annual reporting requirements
- company meetings
- company names.

The Task Force hopes to release proposals in these areas soon. The proposals will ease burdens for small business. The Task Force will be looking at other issues of particular concern to small business

(such as the corporate constitution and company deregistration procedures) in selecting new priorities later in 1994.

This proposal does not deal with the issue of fees payable by companies to the ASC. This issue is connected with moves to achieve cost recovery for the national companies and securities scheme and these fees are set by Government in the Budget context. However, the proposal will lower overall costs for small businesses through reduced paperwork and reporting obligations.

## THE PROPOSAL

Proposal	Issues for consideration
<p><b>Access to the Law</b></p> <p>1. A special proprietary company area will be created within the Corporations Law to improve the Law's accessibility to small business. This area would contain:</p> <ul style="list-style-type: none"> <li>• key definitions and other provisions</li> <li>• summaries of, and signposts to, other relevant areas of the Law.</li> </ul> <p><b>Incorporation</b></p> <p>2. Proprietary companies will be established in accordance with current rules (including a maximum of 50 members), except that:</p> <ul style="list-style-type: none"> <li>• reserving a company name will be optional</li> <li>• there will no longer be a requirement to restrict the right to transfer shares.</li> </ul> <p><b>Minimum number of members</b></p> <p>3. The minimum number of members for proprietary companies will be one.</p> <p><b>Minimum number of directors</b></p> <p>4. The minimum number of directors for proprietary companies will be one.</p> <p>5. Where the law currently requires a director to disclose conflicts of interest and make disclosures to other directors, a sole director will be required to make these disclosures by recording them.</p> <p>6. On the death, mental incapacity or bankruptcy of a sole director who is also the sole member, the personal representative or trustee of the director will be able to appoint a director.</p>	<p>Should there be a maximum number of members? If so, what should be the maximum?</p> <p>Should the form of the prohibition on public fundraising be based on the current 'offer to the public' test or should it be more closely aligned to the prospectus provisions? Should a company lose its proprietary status if it breaches this prohibition? If not, what should be the sanction?</p> <p>Should there be an alternative to the present requirement for a memorandum and articles, such as a founding statement? If so, what should be the content of the founding statement? If articles are to be dispensed with, what rules should govern relationships within the company?</p> <p>Should the name 'proprietary company' and the abbreviation 'Pty Ltd' be retained?</p> <p>What methods of recording would be appropriate, eg book, computer records?</p> <p>Should disclosure to members also be required (if the director is not also the sole member)?</p> <p>Should there be a specific provision enabling a court challenge of such an appointment?</p> <p>Should the legal representative be required to apply to the court rather than having a power of direct appointment?</p>

Proposal	Issues for consideration
<p>7. If a company has only one director, that director may be appointed as secretary. A sole director who is also a sole secretary will be able to seal company documents if that capacity is stated when the documents are sealed.</p> <p><b>Annual general meeting</b></p> <p>8. Proprietary companies will not have to hold an annual general meeting.</p> <p><b>Other meetings</b></p> <p>9. In the case of a company with a sole director or shareholder, where the Law requires a director or shareholder decision, no meeting will be required, but the decision must be recorded.</p> <p>10. All proprietary companies will be able to pass a resolution without holding a meeting, if all members sign a minute of the resolution. (This mechanism is presently only available to exempt proprietary companies under section 255.)</p> <p><b>Financial reporting</b></p> <p>11. All proprietary companies will be required to maintain the accounting records that would enable annual accounts to be prepared.</p> <p>12. A 'small' proprietary company will only have to prepare annual financial statements under the Corporations Law for its members if members holding at least 5 percent of the share capital so require.</p> <p><i>For the distinction between 'small' and 'large' companies, see paragraph 17.</i></p> <p>13. A 'large' proprietary company will have to prepare annual financial statements in accordance with relevant accounting standards, have them audited, lodge them with the ASC and send them to members.</p> <p>14. A 'large' proprietary company will not be required to lodge accounts if the company has been an exempt proprietary company, continues to qualify as an exempt proprietary company and has continued to have its accounts audited.</p> <p>15. If a proprietary company is controlled by a foreign company which does not lodge consolidated accounts in Australia, the proprietary company will be required to prepare</p>	<p>Will this provide sufficient protection for those dealing with the company?</p> <p>Should a shareholder have the right to request a general meeting, or are existing requisition powers sufficient (see section 247)?</p> <p>What methods of recording would be appropriate, eg book, computer records?</p> <p>Should a single member or a different percentage of members have this power?</p> <p>Should the rights of members to inspect records under section 319 of the Law be enhanced?</p> <p>Should companies which have entered into cross guarantees with all other companies in their group have an exemption in relation to the preparation and lodgement of accounts? Conversely, should companies in a group without cross guarantees have to prepare and lodge individual accounts?</p>

Proposal	Issues for consideration
<p>and lodge accounts.</p> <p>16. The ASC will have a discretion to direct a 'small' proprietary company to:</p> <ul style="list-style-type: none"> <li>• prepare financial statements</li> <li>• have financial statements audited</li> <li>• lodge financial statements</li> <li>• send financial statements to members.</li> </ul> <p><b>Small and large company distinction</b></p> <p>17. A proprietary company will be a 'small' company in relation to a financial year if it satisfies at least 2 of the following criteria:</p> <ul style="list-style-type: none"> <li>• the combined gross operating revenue of the company and its controlled entities for the financial year is less than \$10 million</li> <li>• at the end of the financial year, the combined gross assets of the company and its controlled entities are less than \$5 million</li> <li>• at the end of the financial year, the company and its controlled entities together have fewer than 50 employees (calculated as full time equivalents).</li> </ul> <p>Assets and revenue will be calculated in accordance with prevailing accounting standards.</p> <p><b>Directors' reports</b></p> <p>18. Reduced requirements relating to directors' reports (which are currently applicable to exempt proprietary companies under section 304) will apply to all proprietary companies preparing statements, so that directors will not have to supply in the directors' report:</p> <ul style="list-style-type: none"> <li>• a review of operations</li> <li>• changes in the state of affairs</li> <li>• after balance date events</li> <li>• future developments and results.</li> </ul> <p><b>Auditors</b></p> <p>19. An auditor of any type of proprietary company will be able to resign without having to obtain the ASC's consent (as is the case for exempt proprietary companies under section 329).</p>	<p>Should there be criteria for the exercise of this discretion? If so, what criteria would be appropriate?</p> <p>Are there better criteria to identify 'small' and 'large' companies? For example, should all proprietary companies with less than a certain number of members be small companies? In particular, are the dollar amounts and numbers of employees appropriate?</p> <p>Should small proprietary company subsidiaries of public companies be treated as 'large' companies?</p> <p>Apart from financial reporting (see paragraphs 11 to 16) should any other distinctions be made in the regulation of 'small' and 'large' companies?</p> <p>Should this exemption be confined to 'small' companies?</p>

Proposal	Issues for consideration
<p><b>Liquidators</b></p> <p>20. A members' voluntary winding up will not need to be carried out by a registered liquidator (exempt proprietary companies already have this exemption under section 532).</p>	

## **DEVELOPMENT OF THE PROPOSAL**

### **The private company**

The need to ease the regulatory burdens which the Corporations Law places on small business was highlighted in the 1992 report of the Joint Parliamentary Committee on Corporations and Securities, which recommended the creation of a new corporate structure, the private company. The Committee rejected the approach reflected in the Close Corporations Act 1989.

The Task Force agrees with the Parliamentary Committee's conclusion that the laws regulating small business need to be streamlined. However, submissions received in response to the Committee's report indicated a significant level of concern regarding some of the proposed features of the private company - in particular:

- the limitations on the powers and capacities of the private company, such as its inability to act as a trustee or a holding company or to issue more than one class of shares
- the requirement for a minimum of 2 members and 2 directors
- the absence of a requirement to keep accounting records.

If the restrictions on the capacities and powers of the private company were removed, there would be little distinction between a private company as proposed and other proprietary companies. The Task Force agrees with submissions suggesting that it would be better to simplify the existing regulation of proprietary companies. This would achieve the benefits of the private company proposal without adding to the length or complexity of the Corporations Law.

Most importantly, it would reduce the burden of regulation for existing as well as new companies. Small businesses currently operating as companies face many of the same regulatory burdens as large, public companies. The proposal to create a new corporate structure of the private company would not have assisted these existing businesses unless those meeting the restricted criteria for a private company went to the trouble and expense of applying to change their status.

### **Annual accounts requirements**

If the private company proposal is not taken up, the crucial issue is the basis for distinguishing between companies for the purposes of financial reporting. Should the Corporations Law require annual accounts to be prepared, or should it be left to companies to prepare them as a sensible management tool or for taxation reasons? If they are required, should they be available to the public through lodgement with the ASC?

In preparing this proposal, the Task Force considered the advantages and disadvantages of three approaches to achieve appropriate levels of accountability for small business. These are based on distinctions between:

- exempt proprietary companies and non-exempt proprietary companies
- reporting entities and non-reporting entities
- small and large companies.

#### *Exempt and non-exempt proprietary companies*

The Corporations Law presently requires all companies to prepare accounts, but exempt proprietary companies do not have to lodge them with the ASC. Exempt proprietary companies must either have audited accounts or lodge 'key financial data' including current assets, non-current intangible assets and non-current liabilities.

Key financial data is commonly regarded as serving little or no public purpose as it is often unreliable and is provided up to 7 months after it is current.



The present basis for requiring non-exempt proprietary companies to lodge full accounts appears to be that these companies (which are ultimately wholly or partly owned by public companies) should be accountable in a public manner. However, this approach:

- turns on complex and somewhat arbitrary concepts, expressed in a 'black-letter' style
- is inaccurate, in that very large companies, in which there may be a substantial public interest (because, for example, it has a large number of creditors), can be exempt, while quite minor enterprises might be non-exempt
- has been overtaken by the recent introduction of more rigorous rules for the consolidation of accounts which cover proprietary company subsidiaries of public companies
- is not used in other countries (the United Kingdom once had such a distinction, but abolished it in 1967).

#### *Reporting and lodgement non-reporting entities*

A second approach would be to require preparation and of accounts by companies meeting the criteria of the accounting concept of 'reporting entity':

A 'reporting entity' is an entity in respect of which it is reasonable to expect the existence of users dependent on general purpose financial reports for information which will be useful to them for making and evaluating decisions about the allocation of scarce resources (see accounting standard AASB 1025).

While this establishes a consistent rationale for identifying companies in which there is a public interest:

- it is too vague and uncertain for companies, users and regulators for a central role in legislation
- no other country has adopted it.

#### *Small and large proprietary companies*

The approach favoured by the Task Force is to draw upon the rationale underlying the reporting entity concept, but to use more objective criteria to identify companies to be required to prepare and lodge accounts. It does this by establishing the categories of 'small' and 'large' proprietary companies.

This approach uses criteria based on assets, operating revenue and number of employees to identify 'large' companies. A company would need to be 'large' on 2 of the 3 proposed criteria before being required to prepare and lodge accounts. The Task Force understands that most proprietary companies would be 'small' when measured against the test proposed.

This approach:

- provides a simple and objective test
- in most circumstances, results in no practical uncertainty of operation
- concentrates reporting requirements on the more significant companies
- is analogous to approaches in comparable overseas countries.

Removing entirely the requirement to lodge key financial data, and focussing the requirement to prepare and lodge financial statements on large companies, will reduce the current burden on most companies.

In addition, recognising a need not to disrupt established commercial arrangements, those existing large exempt proprietary companies, which elect to continue to have their annual accounts audited, will not need to lodge those accounts.

The existing ASC discretion to grant relief from the accounts and audit provisions (section 313) will also remain.