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SUBMISSION TO A SENATE INQUIRY INTO THE CORPORATIONS AMENDMENT (CROWD-SOURCED FUNDING) BILL 2015

It has been acknowledged by the Government that Australian start-ups and small businesses can't actively access retail investors due to significant upfront and ongoing compliance costs and red tape.

The Explanatory Memorandum states that "any regulatory framework needs to balance reducing the current barriers to crowd sourced funding ("CSF") with ensuring that investors continue to have an adequate level of protection from financial and other risks, including fraud, and sufficient information to allow them to make informed decisions." BDO fully agrees with this as a principle.

Having reviewed the draft legislation "Corporations Amendment (Crowd-sourced Funding) Bill 2015" BDO makes the following observations:

1. The requirement to become a public company is likely to be daunting and costly to start-ups and small business.
2. BDO would welcome CSF as an investment option for all types of company, not only start-ups and small business.
3. The draft legislation does address the facilitation of secondary securities trading after the CSF Offer.
4. It may be more appropriate for some level of independent financial procedures to be performed in relation to CSF Offer Documents and ongoing financial reporting, rather than imposing an audit once $1 million has been raised.
5. The investment cap only applies when the same intermediary platform is used.

1. <u>Requirement to be a public company</u>

The Government has acknowledged in the Explanatory Statement that the higher reporting obligations associated with being a public company may be too expensive for a small business. It has proposed a number of exemptions and deferrals of these obligations for companies seeking crowd sourced funding.

However there remain additional burdens on a CSF Company compared to those of a proprietary company. The key proposed additional requirements of a CSF Company are to:

a) Prepare a CSF Offer Document. We consider this to be appropriate, and an important step in communicating aspects of the company to investors.
b) Have three directors and a company secretary. We consider this to be appropriate.
c) Lodge a constitution. We consider this to be appropriate.
d) Publish financial reports online, audited once $1 million has been raised. Please see further discussion of this requirement below.
e) Provide a cooling off period of five business days. While a cooling off period would typically apply in high pressure selling scenarios, we do not consider that this will be restrictive for CSF Companies.
f) Cap individual investments in a CSF Company via an intermediary platform at $10,000 per 12 month period. Please see further discussion of this requirement below.

The requirement to be a public company may act as a significant deterrent to many businesses, and in particular to start-up companies. Further, all public company reporting requirements will be applicable to CSF Companies after five years, including to prepare audited financial reports that are sent to shareholders and hold an AGM. Depending on the industry in which the company operates it would not be unreasonable for a business to take many years before it is profitable and able to meet the public company reporting burdens. To impose such a deadline is likely to be daunting for potential CSF Companies and restrictive for many.

2. Limited to start-up and small business

An aim of the legislation is to provide opportunity to mum and dad investors to invest in business in Australia, in addition to the current investment opportunities available to them of the stockmarket and property. However by restricting CSF to companies with less than $5 million in assets and less than $5 million in annual turnover, this limits those opportunities available to potential investors to start-ups and very small businesses.

Start-up companies typically present more risk to investors and, while 'Mum and Dad' investors may wish to invest in private Australian businesses, many may prefer a lower risk investment than start-up or very small businesses.

BDO would welcome CSF as an investment option for larger companies, including current larger proprietary companies.

3. Secondary securities trading

It is noted in the Explanatory Memorandum that CSF investments may be largely illiquid, reducing the ability of investors to exit their investment. However the draft legislation does not address the facilitation of secondary trading of securities after the CSF Offer has been made. We envisage that this should be facilitated by the original intermediary platform.

The communication facility to be provided by intermediary platforms is only referenced in terms of the CSF Offer. It does not reference any requirements of information or disclosures to be communicated by CSF Companies and the intermediary platforms on an ongoing basis. This is important both for the ongoing information of investors, and to facilitate secondary trading to improve the liquidity of investments.

4. Independent financial procedures

It is proposed in the draft legislation that financial reports will be required to be audited after the CSF Company has raised $1 million. However if there is a perceived risk that is addressed by audited financial reports then it would be appropriate for investors to be provided some protection from this risk regardless of the number of other investors in the company or amount raised.

BDO considers it to be more appropriate to require some level of assurance to be given from an independent party to all offer documents made to the general public. It may be appropriate to determine a size threshold for which CSF Offer Documents require limited assurance and above which reasonable assurance is required.

In respect of ongoing financial reporting the graded level of assurance approach adopted for public companies limited by guarantee in the NFP should be considered whereby below a certain size no assurance is required, then for smaller companies a limited level of assurance is required, and above a specific size threshold reasonable assurance is required. Such financial procedures should be at level that does not burden the CSF Company with significant cost, but provides investors with some level of assurance (below that of an audit).

For example, a review (limited assurance) could be performed of the CSF Offer Document by an auditor. This provides a lower level of comfort than an audit (reasonable assurance) but is designed to bring significant matters affecting the financial report to the auditor's attention.

The level of ongoing audit and review procedures could be determined based on thresholds, such as are currently applicable to Not for Profit organisations in Australia. Further, to ease the level of reporting for smaller CSF companies, a differential reporting regime should be considered. This could include allowing entities that are below a certain set threshold to apply a reduced disclosure regime and for micro CSF companies to apply a simplified reporting framework. This could be such as the International Accounting Standard Board's IFRS for small and medium-sized entities ("SMEs") or a modified reporting arrangement as is done in the UK under FRS 102, which provides for the exclusion of disclosures in the financial reports that relate to matters that would be irrelevant to an SME.

Any reporting requirement should clearly include reporting on related party transactions and going concern.

5. Individual investment cap

The draft legislation includes an investment cap to limit an investor's exposure to a single company. However this cap has been applied, not to a single company, but to the intermediary platform. The cap does not take account of investments made in the issuer company via other platforms. This may encourage CSF Companies to offer further securities (within the other time and value restrictions) via alternative platforms to circumvent the cap.

In addition, the investment cap seems arbitrary as $10,000 may be an insignificant amount for some and a life changing figure for some. It is of more importance that appropriate disclosures and sufficient information is provided to investors. We would like to see this $10,000 cap increased, if not for all then at least for most investors.

Summary

There are a number of limitations to the draft legislation that will likely not result in achieving the goals of allowing 'Mum and Dad' investors to invest in Australian businesses, or start-ups and small businesses being able to access crowd sourced funding.

It is not clear from the draft legislation, or the explanatory memorandum, what the Government perceives to be the risks to investors in CSF Companies compared with public companies and proprietary companies, and therefore it cannot be logically followed how the draft legislation is seeking to address these risks.

Neither is it clear why the required level of investor protection is perceived to increase after five years, and therefore full public company reporting requirements become applicable at this time.

The focus of the draft legislation appears to be on trying to amend the current legislation to allow a limited level of CSF, but the law as it stands is too restrictive for this to be effective.

BDO would prefer to see a focus on identifying the risks to investors, and then addressing how to mitigate these through legislative changes where possible, and most importantly on ensuring that investors have sufficient information to make their own informed decision

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