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**Risk + Governance = Reward**

## **RISK AND RESPONSIBILITY**

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Commissioner  
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## RISK AND RESPONSIBILITY

*An address by Professor Berna Collier, Commissioner, Australian Securities and Investments Commission to the Institute of Chartered Accountants in Australia CA Conference, Surfers Paradise, 27 April 2002*

Thank you for inviting me to join you today.

The theme of this morning's panel session is "Risk and Responsibility." Rather than cut too much into discussion time, I will speak only for a few minutes on issues which are of particular relevance to this theme from ASIC's perspective, and then hand you over to my fellow speakers before we commence our panel discussion.

First, let me say that in reflecting on this topic, I thought it would be more appropriate from the regulator's perspective to concentrate on the *responsibility* aspect, as it is the assumption of responsibility by corporate officers and advisers where appropriate that particularly concerns ASIC in this context. As the regulator primarily responsible for monitoring the financial system and protecting consumers in the financial services context, ASIC takes a keen interest in maintaining compliance with the law by corporations and corporate officers, and ensuring that investment can take place in an informed market. To that extent, it is important that corporations comply with the *spirit* as well as the *letter* of the law – avoidance of corporate responsibility in circumstances where clearly responsibility should be assumed, is itself a practice to be avoided.

One example of this I will be discussing briefly is in the context of continuous disclosure by listed companies. The auditor debate both in Australia and overseas has also raised issues of the extent to which corporate management genuinely accepts responsibility for initiating a meaningful auditing process, as distinct from technical compliance with requirements. I will also touch on this briefly in this paper.

Second, as the corporate regulator we are empowered by the *Corporations Act* and the *ASIC Act* to take action in circumstances where a corporate failure or investor loss has occurred in circumstances justifying either civil or criminal action by us. Let me hasten to add that ASIC recognises that a corporate failure does not inevitably imply a failure of corporate governance in an organisation, or fault warranting regulatory intervention. It is inherent in our free enterprise system that directors of a company

may cause the company to assume risks which, in hindsight, were unwise. Indeed the law takes this into account – the statutory enactment of the “business judgment rule” in section 180 *Corporations Act*, providing a defence to directors where they have made a reasonable decision which they rationally believed to be in the best interests of the company, acknowledges the inherently risky nature of commerce. However having said that, the law also recognises that directors of corporations cannot automatically hide behind the corporate veil where the company has been trading whilst insolvent (section 588G) or the directors have otherwise breached their duties to the company of, for example, honesty, care and skill (sections 180-184). ASIC has not hesitated to take action against corporate officers where warranted, as, in particular, our activities during the last twelve months have demonstrated. I will be turning to a few examples of our enforcement action shortly.

Third, we are constantly monitoring market activities with a view to identifying systemic problems, and acting to prevent problems developing where possible. Identifying. Our complaints directorate, which receives and analyses corporate complaints from members of the public, and our issuing of stop orders in relation to fund raising documents, are two examples of this activity. An additional recent illustration is our response to the dissolution of the accounting firm Andersen in the wake of the Enron collapse, and I will look at this particular example in this paper.

By way of setting the scene for this morning, let me speak very briefly address each of these topics as I have outlined.

### **Compliance with the Law**

The example I have given as an instance of corporations relying on technical interpretations of the law and, arguably, avoiding their responsibilities under the law, is in the context of continuous disclosure. The responsibility of listed companies to disclose information required by ASX Listing Rule 3.1 has been the subject of ASIC investigation during the past year on at least two occasions, and those who read last weekend’s press may be aware of a third ASX referral in this context to which we attending. One example to which I would like to refer you was in respect of WMC Ltd, where we investigated following an ASX referral relating to price movements in WMC shares and speculation as to the possible takeover of WMC by Alcoa Inc in

October 2001. It transpired that there had been discussions, however following an ASX query on 12 October 2001 WMC had responded that it did not need to make an announcement. Five days later in response to a specific ASX query, WMC responded that it was in takeover discussions with Alcoa. ASIC investigated whether there had been a breach of the law. We were advised by senior counsel that, although there was an arguable case that WMC had breached the listing rule, it was questionable whether there was any effective remedy available to ASIC under the *Corporations Act* in these circumstances.

It was disappointing where companies appear to take a narrow and technical approach to its disclosing obligations in this case. The Chairman of ASIC, David Knott, is on the record as commenting

“The efficacy of Australia's continuous disclosure rules depend in large part upon the willingness of our corporate community to observe their spirit and purpose. Failure to do so undermines public confidence in the disclosure regime and will increase pressure for more prescriptive disclosure obligations.” (*ASIC Media Release 02/79* 7 March 2002)

Continuous disclosure is an interesting meeting of risk and responsibility in perhaps a different context to that which we are discussing today – namely the *responsibility* of companies to adhere to the Listing Rules, while coupled with the seeming reluctance of companies in some circumstances to *risk* or otherwise threaten confidential commercial negotiations by prematurely revealing sensitive information to the market. Surely however the answer must be in the nature of the requirements of Listing Rule 3.1 itself. The rule requires that once an entity is or becomes aware of any information concerning it that a reasonable person would expect to have a material effect on the price or value of the entity's securities, the entity must immediately tell ASX that information. Unless the carve-out in the Listing Rule applies, the company must comply with the rule.

The listing rules in relation to continuous disclosure are backed up by Chapter 6CA *Corporations Act*. You may also be aware that ASIC has publicly stated it will be seeking the power to impose administrative penalties on companies which fail to comply with continuous disclosure obligations. We are currently working on this

proposal and anticipate putting a confidential submission to the Parliamentary Secretary to the Treasurer before June 30 this year.

### **Corporate collapses**

The last eighteen months have seen a number of corporate collapses, with corporate activities investigated and officers being brought to account where possible. Three of the more well-known examples of this activity are :

- HIH Ltd, where we have separate investigations running concurrently with the investigations of the Owen Royal Commission. You may be aware that on 14 March 2002 we obtained judgment in the Supreme Court of New South Wales in a civil penalty action for breach of duty against former HIH Insurance Limited director Mr Rodney Adler, former HIH Chief Executive Officer Mr Ray Williams and former HIH Chief Financial Officer Mr Dominic Fodera. I understand Mr Adler is appealing Justice Santow's decision.
- One.Tel, where on 12 December 2001 we announced civil proceedings against Messrs Rich, Keeling and Silberman, and former chairman Mr John Greaves. ASIC is seeking declarations of contraventions, bannings, and damages of between \$30 million and \$50 million in compensation for the reduction in One.Tel's value over an eight-week period from 30 March 2001 to 29 May 2001. This matter is due to go to trial mid-year.
- Ansett, where we are currently undertaking work to look at issues including the identity of persons who suffered damage as a result of any failure by AIZ to keep the market informed. We will be in a position by 31 May to decide whether we will take further action. Depending on the outcome of our inquiries, the public interest may be served by the commencement of a representative action for damages against AIZ in relation to the level of its financial disclosures. We are, however, reserving our rights in relation to any action we may take in this matter until all aspects of the investigation are concluded.

I reiterate the view of the Commission as expressed by the Chairman and the Deputy Chair on other occasions that we are not reliving the 1980's, and that the collapses

which took place last year do not appear to represent a systemic failure of corporate governance in Australia. It is the nature of our free enterprise system that businesses will fail, for reasons not necessarily associated with culpable behaviour of the board or the management. Having said that, the law requires corporate officers – and I will focus in particular on directors in this context – to assume responsibility for the actions of the company because of their position in the company. It is important that ASIC takes action, and we have done so, where a corporate collapse is linked with conduct which is culpable. This is important not only because of the need to preserve the integrity of the law, but also to send a message to the market place that unlawful conduct will not be tolerated.

### **Monitoring and responding to the market**

I will conclude this paper by briefly referring to the role of the regulator in monitoring and responding to market developments.

One example I have already given is the response by ASIC to complaints we receive from investors or others in relation to corporate activity. Let me first observe that we assess every complaint we receive, however we cannot, and never will be in a position to, investigate every complaint. Further, we cannot be everywhere, all the time, investigating all companies in Australia. If I may again quote the ASIC Chairman in Senate Estimates Committee on this point, “there seems to be some belief that somehow a securities and corporate regulator can get behind the accounts, can walk into the company and go through the records and find out what has been going on and uncover side letters. This is something an official regulator simply cannot do.” Indeed – given the nature of our society, I suspect that we would see strong resistance from all aspects of corporate Australia if we suggested we ought to be given such a power. Having said this, we aim to assess all complaints within 28 days of receipt, and will often adopt a public assistance role to resolve complaints, which we have found achieves an effective regulatory outcome in 40% of cases. In addition, we are proactive in issuing stop orders on fundraising documentation where necessary – we have focussed recently, for example, on fundraising documents that do not have a minimum subscription amount or underwriting and forward-looking financial statements in prospectuses which in our view must be made on a reasonable basis and

where companies required disclose any material assumptions they make in calculating the statements. This is an important activity in the context of consumer protection – it is critical that investors be in a position where they are assuming the risks associated with investment in as informed a manner as possible.

We take a similar view in relation to our consumer education strategy – a recent aspect of which has related to cold-calling of consumers from, in particular, Thai boiler rooms.

Finally, I would like to mention the current debate concerning auditors in the context of risk and responsibility. Auditors remain under the spotlight in light of developments in the last twelve months, including the HIH matter, the US company ENRON, and the report prepared for the federal government by Professor Ian Ramsay. The Federal Government invited submissions in relation to the Ramsay report until 15 March 2002, and I understand that the matter has recently been referred to a joint parliamentary committee for further consideration.

Late last year we conducted a survey of the Group of 100 – Australia’s largest companies – seeking information concerning their relationship with their auditors. Sixty-seven of the surveyed companies responded, and we released the results of the survey on 16 January 2002. Notwithstanding the limited conclusions which can be drawn from the survey because of the response, support can be drawn for the following propositions:

- the provision of non-audit services by audit firms to their Australian clients is widespread, at least in respect of major corporates. Almost all the respondents had used their auditors for the provision of other services, in particular tax advice;
- audit firms are earning substantial fees for non-audit services – on average almost 50% of the total fees earned by audit firms from clients related to non-audit services;
- processes for dealing with potential conflicts of interest require attention, as it appeared that most companies lacked robust processes for ensuring that the independence of the audit was not prejudiced by the provision of non-audit services;

- rotation of audit partners remains inconsistent – less than half of the respondents required it – and rotation of firms is almost non-existent;
- most companies do not monitor investments in their securities by their auditors' superannuation funds;
- only a few companies of the companies surveyed had former audit firm's partners on their Board or as senior executives
- the vast majority of respondents had an audit committee in place with appropriate operating guidelines.

We anticipate a response by the federal government to the Ramsay report in due course. Many of proposals in the Ramsay report, if adopted, would require legislation or regulation. Accordingly, ASIC will not finalise its view on potential regulatory measures until the government's position on the Ramsay report becomes known. Because of the importance of the issue, however, particularly in light of the Andersen collapse, we do have a policy to cater for circumstances where Andersen wishes to resign as the auditor of a company, and the company wishes to appoint a substitute auditor. We have developed this approach because of the special circumstances currently existing, and in acknowledgement of time pressures facing companies because of the imminent approach of the end of financial year. The essence of this policy is :

- in order for the auditor of a company to be removed the company must resolve to do so at a general meeting after special notice has been given to the auditor and ASIC : section 329 *Corporations Act*;
- an auditor may apply to resign, to take effect at the next annual general meeting of the company, however the resignation is subject to ASIC consent. The auditor may apply to ASIC to resign before that date if exceptional circumstances are demonstrated : section 329 *Corporations Act*. An example of exceptional circumstances is the failing health of the auditor;
- ASIC considers that the present circumstances in respect of Andersen is also “exceptional circumstances” for which ASIC will consent to the resignation of Andersen as auditor before the next company AGM.



However we will need to be satisfied that the proposed replacement auditor can adequately carry out the audit function; further any conflict of interest in the auditor carrying out the auditing function will be considered by us on a case by case basis.

Developments both in Australia and overseas within the last eighteen months have shown that although investment can be a risky business, responsibility for corporate activities is not confined to a narrow group but can extend past the board of directors to individual directors, executives and advisers. I will now hand you over to my fellow speakers, who represent two of these groups.