



**MARKET INTEGRITY - ISSUES RELATING TO
ASIC'S ROLE AND ACTIONS**

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Introduction

The current excitement in the market over high tech dot.com stocks has rightly received a great deal of attention in the media of late. With an increasing number of Australian individuals investing in a stock market buoyant with investor confidence and optimism, start up companies are no doubt finding it easier to raise funds. Even easier now, with the introduction of the CLERP Act and the liberalisation of the fundraising provisions. The same phenomenon is happening in the United States. Arthur Levitt recently remarked at the Finance Conference 2000 that the new, heightened optimism in that country is fuelling an almost unbridled culture of entrepreneurship, innovation and investing. But, he warned, “history has taught us that the greatest threat to continued prosperity is a loss of perspective”.

Attempting to inject some perspective in order to maintain market integrity is a good description of ASIC’s role and that is what this paper will be discussing today with particular focus on accounting issues. The Commission’s obligation in relation to market integrity is found in section 1 of the Australian Securities and Investments Act 1989:

“In performing its functions and exercising its powers, the Commission must strive to...maintain, facilitate and improve the performance of the financial system and the entities within that system in the interests of commercial certainty, reducing business costs, and the efficiency and development of the economy..... [and] to promote the confident and informed participation of investors and consumers in the financial system”

This paper will discuss ASIC’s role in maintaining market integrity and the actions taken by the Commission to achieve its stated obligations.

Focus on Accounting Issues

In response to anyone who has ever wondered why ASIC might have been created and why exactly accounting standards were ever given the force of law, and why now, ASIC oversees the adherence to those standards, I refer you to this country’s recent history. The very history that should be warning us to maintain some perspective. I’m speaking, of course, about the 1980’s which saw some of the biggest booms and busts in Australian history, where enormous empires were built not just on debt, but on creative accounting.

In his book, “Bold Riders”, journalist Trevor Sykes, talking about this period, writes, very relevantly,

“There will always be businesses going broke or going downhill for a host of reasons beyond their control.....It usually takes a combination of incompetent management and high debt. To the extent that the accounting profession collaborates by agreeing to paint false pictures of health in balance sheets, badly run companies will be able to grow larger and for longer periods and their ultimate collapses will hurt more people.”

Clearly we would all like to be confident that the Australian corporate climate has moved away from that period of overindulgence that was the eighties. Our confidence can be dented from time to time by episodes such as the dramatic turnaround in performance of a former blue chip like Burns Philp. In our report on that we quote (at paragraph 4.20) its own auditors reference to “achieving EBIT by aggressive accounting”. And I return later to some current issues concerning “hot stocks”. But the 90’s were a pale imitation of the 80’s in terms of the nature and extent of accounting issues. There has been a change in the corporate atmosphere, which is reflected both in the existence of the corporate regulator and in the development of self regulatory and highly professional organisations such as the Australian Stock Exchange, the Institute of Chartered Accountants in Australia, the Australian Society of CPA’s, the Australian Financial Markets Association, and the Investment and Financial Services Association.

However, the past generally (including the recent past) does inform the future and as corporate regulator we regularly remind ourselves that we were established to play a key role in the operation of the financial reporting system. It was considered that accounting standards needed to have legal backing so that compliance with them could be ensured by the operation of an effective regulator and we remain very committed to monitoring and enforcing compliance with accounting standards and other requirements of the law. We know that the community has this expectation of us because there have been times over the period of my tenure as chairman that we have been asked to be, and be seen to be, more active on these matters. We believe that consistent and high quality financial reporting is the key to inspiring confidence and fostering market integrity. We think and hope you share this belief.

Nevertheless, ASIC is acutely aware that corporate regulation does not exist in a vacuum. We are therefore concerned to remain sensitive to the ramifications of our actions and objectives in the business community. We acknowledge that investors expect a certain level of protection, market participants expect that we will not be too bothered by trivial or technical breaches, and the business community expects a certain degree of business facilitation. We operate against a canvas coloured by the interaction of these expectations. I am confident that we are increasingly able to reconcile those expectations within our regulatory strategies and that we will succeed in maintaining a climate of compliance through a careful balance of consultation, guidance, assistance, education and law enforcement. This applies to other units and programs within ASIC, and it certainly applies to our accounting program.

ASIC’s Statutory Role and Responsibilities

ASIC’s role in the financial reporting system is not well understood even now. A brief outline of the organisation’s brief and how it fits with other agencies such as the Australian Accounting Standards Board and the Urgent Issues Group follows:

The Corporations Law prescribes that financial reports must:

- comply with accounting standards;
- show a true and fair view of the company’s financial position and performance (in some cases this may necessitate including information in addition to that required by standards); and

- not be misleading.

The Corporations Law imposes on ASIC several responsibilities and obligations with regard to financial reporting. Firstly, we are responsible for monitoring and enforcing compliance with financial reporting requirements of the Law, including the accounting standards.

We are regularly involved in applying the requirements of standards to the specific facts and circumstances of particular companies, as part of our work in vetting prospectuses, takeovers, conducting investigations and responding to complaints and enquiries. In matters such as these, our role necessarily involves interpreting financial reporting requirements, and is the same interpretive role as we play in “enforcing” other components of the Corporations Law. I know we are sometimes criticised for daring to interpret Accounting Standards, but no-one can apply such standards without forming a view as to their meaning; nor can we enforce them without doing so. As Philip Howard said in 1994, “Law can’t think, and so law must be entrusted to humans, and they must take responsibility for their interpretation of it.”

Secondly, we have powers to exempt companies from the requirements of Accounting Standards and other provisions of the Law, and to modify the application of the Law. These powers are designed to enable us to facilitate and improve the performance of the financial system and the entities within that system in the interests of commercial certainty, reducing business costs, and the efficiency and development of the economy.

Relationship Between ASIC and the AASB

The AASB is a statutory body established under the ASIC Act which is empowered to make accounting standards that are not inconsistent with other requirements of the Corporations Law. The fact that accounting standards are developed as delegated legislation by the AASB means that they are not the exclusive product or province of the accounting profession, and that they operate in the context of the Corporations Law.

The AASB standards are a central part of corporate and securities regulation. Because entities have a statutory obligation to comply with them, their practical significance is equivalent to legislation.

Since the Corporations Law requires all disclosing entities, public companies, large proprietary companies and registered schemes to prepare a financial report in accordance with the accounting standards, it follows that the AASB has the power to make accounting standards for all these bodies.

ASIC is in full support of the AASB’s standard setting process. Both agencies share information and regulatory concerns.

We keep the AASB informed of concerns about accounting practices that come to our attention in our activities, and we ensure that the Board is aware of the views that we have on their proposals for new standards and revisions to existing ones, from our perspective as market regulator. Contributions that we make of this type are given in the context of the Board’s own due process for developing standards and are directed to the Board and its staff. Our contributions are but one of the many the Board receives and it is the Board’s

responsibility to consider all of these in making its final decision on Standards. Sometimes views we provide to the Board emerge in the public arena. For example, we have been questioned on them by parliamentarians during Senate Estimates Committee hearings. But in those forums, and in any other, we make very clear that our role is **not** to make standards - that is the task of the AASB. Our role is to contribute to the development of high quality standards as one of the ways we promote market integrity generally, and to enforce the individual Standards made by the Board.

Although ASIC does not have authority to establish or veto accounting standards, ASIC does have the power to exempt you from them or modify them, in particular cases in order to facilitate the operation of the financial market, just as it has power to modify certain other provisions of the Law. We do not have to be satisfied that compliance would make the report misleading, be inappropriate in the circumstances, or impose unreasonable burdens; so don't ask every time you don't like the practical effect of a standard.

Further, ASIC develops policy on applying financial reporting requirements of the Law in new and problem areas. For example, last year we were responsible for developing the transitional reporting requirements of building societies, credit unions and friendly societies. And recently we have issued guidance to explain the implications that flow from the law as a result of the Parliament's decision to disallow a part of the accounting standard dealing with acquisitions of assets.

And yes, I did say, ASIC does not veto accounting standards. It is true that ASIC's views in opposition to two paragraphs of the new AASB 1015 were quoted by those in the Senate moving (successfully) for disallowance of those paragraphs. But it was the Senate which disallowed them, and not at the behest of ASIC.

Relationship Between ASIC and the FRC

The Financial Reporting Council (FRC) is a relatively new body, its membership having been announced by the Treasurer in September 1999. The FRC is the peak body responsible for the broad oversight of the accounting standard setting process for the private, public and non-profit sectors. It comprises key stakeholders from the business community, the professional accounting bodies, governments and regulatory agencies. ASIC is one of the bodies invited to nominate individuals to be considered for membership of the FRC by the Treasurer. Our Chief Accountant is a member. It's key functions are to advise the Government on the accounting standard setting process and the development of international accounting standards, and to determine the broad strategic direction of the standard setter, the AASB.

The legislation formally establishing the new accounting standard setting arrangements came into effect on 1 January 2000. The nine members of the AASB other than the Chair were formally appointed by the FRC on 15 February 2000 but as yet the Treasurer has not yet appointed the Chair of the new AASB.

Functions of the FRC include approving the AASB's priorities, business plan, budget and staffing arrangements, determining its broad strategic direction, and giving it advice or feedback on matters of general policy and the Board's procedures.

Relationship Between ASIC and the UIG

The UIG is a separate and distinct entity to ASIC, being established in 1995 by the accounting profession as an authoritative body to address contentious accounting issues that fall within a particular set of criteria.

The UIG was established to support the operation of the Australian Accounting Standards Board and to provide guidance on urgent financial reporting issues, with the principal objective of avoiding the development of divergent or unsatisfactory financial reporting practices in areas not dealt with, or not dealt with specifically, in Accounting Standards. I usually describe the UIG as dealing with the gaps and overlaps.

Whilst UIG consensus views did not have the force of law, they were mandatory for members of the accounting professions.

Under the new standard setting regime, the role and composition of the Urgent Issues Group has changed and its current status is at present, uncertain. The FRC has agreed that the UIG which has now been established as a committee of the AASB should continue its work for the time being under its existing Charter, pending review by the AASB and advice to the FRC.

ASIC actively participates in the UIG process and the Commission's Chief Accountant, Jan McCahey, participates in meetings as an official observer. In several instances, we have referred to the UIG for consideration issues that are not dealt with adequately by accounting standards and as a result are receiving divergent treatment in practice.

While UIG rulings have no authority under the Law, ASIC has given authority to the UIG consensus views by supporting them as being necessary to adopt in order that financial reports show a true and fair view. In some instances, we have used our enforcement powers to force companies to comply with them.

You will observe that I have succeeded in describing the UIG's role without suggesting that it is the interpreter, far less the sole interpreter, of accounting standards. The UIG's role is highly important, but it is not the same as ASIC's, in particular, it cannot displace our role as enforcer of the standards.

It has been put to us that the reason that the UIG was established was to avoid an accounting matter ever being taken to the Courts to be resolved. I should address this because it's certainly not the understanding that ASIC had at the time the UIG was established and not our current understanding. Indeed it would not be possible for ASIC to discharge its obligations under the Law if this were the case.

ASIC supported the establishment of the UIG to support the standards setting activities of the AASB. ASIC supports the role played by, and operations of the UIG, however, it has not "committed in advance" to all rulings that might be made by the UIG.

While we have supported the activities of the UIG and referred matters to it, and considered it to be an important component of the financial reporting framework, there have also been occasions where we have found ourselves to be in dispute with an entity about a particular

treatment it has adopted and we have determined that it is a matter which should be resolved by us and the entity in the context of the Law. Importantly, the UIG was not established to deal with the facts and circumstances of individual entities and inevitably the discussions we have with entities do entail their individual facts and circumstances. It has also been the case that after we commenced a process to resolve the issue with an entity, that the entity has referred the issue to the UIG for review. In these circumstances it is most unlikely that we would defer our attempts to resolve the issue while the UIG deliberates the matter.

Relationship Between ASIC and IOSCO

The International Organisation of Securities Commissions has a wide and diverse membership comprising more than 160 member agencies from all continents. In addition to almost one hundred securities regulators, IOSCO members include the operators of equities and derivatives markets, securities industry associations and international finance institutions. This year ASIC, as the “ordinary” member of IOSCO for Australia hosts the 25th Annual IOSCO Conference from 14 to 19 May in Sydney.

ASIC is very excited to be a part of that as it will help us to improve our international profile, and our performance. The conference will provide, in the public sessions from 17 to 19 May, a good opportunity to hear the issues of financial market regulation debated by the world’s leading practitioners.

One issue likely to come up is the question of IOSCO recognition for the purpose of cross-border listings and offerings (those words are important!) of a core set of international accounting standards, proposed by the I.A.S.C. ASIC will participate in that decision but it is not the same as deciding whether the core set should be adopted domestically. At the risk of labouring the point, ASIC is not the standard setter domestically.

Without pre-empting any decision that IOSCO might make on whether IOSCO would endorse IASC accounting standards, I can say that members of the Technical Committee appreciate very much the efforts by the IASC and those who have assisted it over the last 5 years or so to improve and make more comprehensive its body of accounting standards.

How we Undertake our Role

Under the Law we are given the responsibility of being both an enforcer and a business facilitator. So, our activities on accounting matters are sometimes directed to just business facilitation, sometimes to enforcement, but often times an individual activity may focus on both functions.

A proportion of our activities will always be a reaction to being sought out by company representatives, their advisers and the public, and this is something which we will continue to encourage.

In our day to day activities we are regularly reviewing compliance matters - responding to written or oral complaints or queries in relation to published financial reports or prospectuses, reviewing draft prospectuses, and dealing with enquiries from companies and their advisers.

We provide advice and guidance on technical accounting questions, and we respond to complaints about financial reporting and auditing practices.

We are regularly involved in interpreting the requirements of accounting standards in their application to the specific facts and circumstances of particular companies, as part of our work in vetting prospectuses, takeover matters, conducting investigations and responding to complaints and enquiries.

We also respond to requests to use our powers to exempt companies from the requirements of accounting standards and other provisions of the Law, and to modify the application of the Law. As I mentioned before, these powers are designed to enable us to facilitate and improve the performance of the financial system and the entities within that system in the interests of commercial certainty, reducing business costs, and the efficiency and development of the economy.

Our national team also develops policy on applying reporting requirements of the Law in new and problem areas. The Practice Note we issued following the introduction of the Company Law Review Act in 1998 is an example of that. The amendments made to the Law at that time introduced requirements for companies to disclose in directors reports details of remuneration paid to directors and executives. A key objective of our Practice Note 68 is to explain how we would interpret the requirement of the new Law, in terms of whose remuneration needs to be disclosed and what components would be included in the amounts of remuneration disclosed.

We have always carried out these reactive functions, and this will continue, but over the 18 months we have increasingly devoted resources to more proactive activities where we are able to focus on our business facilitation and enforcement (light hand) at the same time.

We have been actively promoting a culture of financial reporting compliance. We are doing this through a number of channels, including:

- surveillance of company financial reports where we target particular issues which concern us for reviews;
- providing open lines of communication:-

We have used public forums, media releases, and journal articles to promote awareness of our activities. In these we have emphasised the need for a culture of compliance to be developed, and we have encouraged the business community to address the accounting aspects of transactions they are contemplating at an early stage. We strongly encourage company directors to ensure that management takes difficult financial reporting issues to their advisers for discussion prior to finalising an accounting treatment, and to us for discussion where the issues are potentially

contentious.

In all of our efforts to promote a compliance culture we see ourselves working closely with accounting firms and corporates and we are very willing to spend time with them resolving accounting issues prior to financial reports and prospectuses being lodged with us. Time taken on this liaison with us at an early stage invariably avoids difficulties that can arise if companies become “locked into” an accounting treatment we are uncomfortable with.

- Moving the focus of companies and their advisers away from a “clever reading” of words towards the spirit and intention of the requirements:-

In some of the dealings we have with companies we have put to us phrases such as “show me the words that say I can’t do this” or “I know that’s what the Standard actually says or means, but it wouldn’t be commercial for me to do that, so the words can’t apply to my circumstance”. For example, in recent times it has been put to us that companies are reluctant to follow our interpretation of the requirements of the Law regarding disclosure of executive’s emoluments because the black letter of the Law can be read as requiring a lesser standard of disclosure.

Our view, and it is supported by the CLERP reforms, is that both the black-letter and the spirit of the standards and the Law should be complied with and in all our efforts to promote a culture of compliance we are making very clear that we are expecting to have fewer and fewer conversations which focus on a clever or smart reading of the Law.

Enforcement

The contravention of accounting standards is a breach of the Law. ASIC’s statutory responsibilities as a law enforcer in the financial reporting context are sometimes of particular interest to groups such as the Group of 100, and our actions are sometimes viewed as being contentious.

The accounting standards are designed to promote consistent and comparable financial reporting, and ASIC is prepared to litigate to enforce accounting standards where it believes that a failure to comply may result in the market being misled. However, as a matter of general practice we go to some lengths to endeavour to settle disagreements without reference to the Courts.

Indeed, there are several publicly known examples where we have reached agreements with companies on how they will amend their financial statements and the accounting treatments reflected in them.

In 1998 **St George Bank Limited** agreed to adjust its accounting for the acquisition of Advance Bank so as to comply with accounting standards and the UIG’s ruling on restructuring costs. A significant write down of goodwill was involved.

Also, in 1998 **Novagen Limited** agreed to make additional disclosure to the market concerning write downs it had made to certain intangible assets because our view was the disclosure of the reasons for the write downs in the financial statements were potentially misleading.

North Limited agreed to amend in its 1999 accounts its method of accounting for revaluations of forestry assets and recognition of sales revenue to comply with accounting standards.

In 1999 **Brisbane Airports Corporation** agreed to amend its policy of amortising its right to operate the airport using a variation of the inverse sum of the years' digits method to the straight line method because only this method was acceptable to us. We took action in the Victorian Supreme Court against **Australian Pacific Airports Corporation** in order to require the company to change its method of amortising its right to operate the Melbourne and Launceston airports to the straight line method. Again, we were able to settle that action because the company agreed to amend its accounting treatment.

Also last year, **Seven Network** was forced to revise its accounts after ASIC objected to the treatment of its foreign exchange losses. Seven did not include unrealised foreign exchange losses and gains on the investment in its profit and loss statement which had the effect of dramatically altering reported earnings. In addition Seven capitalised the interest on the borrowings relating to the investment in MGM. ASIC took the view that this was not an appropriate accounting treatment and that the consolidated profit after tax was overstated by several million dollars. Seven also recorded certain treasury costs in the year prior to the one in which they were incurred. Seven Network undertook to amend its accounting treatment and gave us certain undertakings in relation to paying dividends.

In carrying out our role as a law enforcer, it is inevitable that circumstances will arise where we and a company cannot agree on how the requirement of the Law apply to their facts and circumstances. In these instances, one of the possible outcomes is that one of us may seek declarations from a court as to the appropriate treatment.

In the early 1990s **QBE Limited** took action of this sort against the ASC. QBE sought relief from an accounting standard which required it to measure investment assets at market value and record movements in value in the profit and loss account. QBE preferred to smooth market value movements into the profit and loss account over 7 years. The ASC refused relief from the accounting standard. QBE challenged that decision in the AAT and the Federal Court. The ASC decision was upheld on appeal.

More recently companies in the **Incat** group appealed our decision not to grant them relief from having to lodge their financial statements on the public record. Our decision was upheld in the AAT and the Federal Court.

On the other hand, we have commenced legal proceedings against some companies in our efforts to have them comply with accounting standards. For example, in 1996 we took action against **Orbital Engine Limited** in the Federal Court to prevent it from adopting an accounting treatment which would have involved writing down the value of its technology assets to an amount far below their recoverable value so as to avoid the need to amortise

those assets. The action was settled by the company agreeing to adopt the accounting treatment required by the accounting standards.

In 1998 we challenged **Media Entertainment Group Limited's** policy of recognising sales when contracts to screen advertising were signed. After we had commenced action in the Federal Court, MEG agreed to amend their policy and lodge revised accounts.

We still have Court action in progress against **Pacific Matrix Limited** on matters involving non-compliance with accounting standards regarding asset recognition and valuation and its claims to be a going concern.

In seeking a declaratory judgement from a Court, ASIC is not taking punitive action. It is not our practice to take action seeking to punish directors relying on proper professional advice about financial reporting obligations. This refers to advice proffered and relied on in good faith, with the intention of facilitating compliance with the law. I am not referring to advice obtained from compliant advisers. Seeking and then relying on the advice I am referring to, represents a legitimate endeavour to comply by the clients. Opinion shopping is the opposite; and where we identify that, we might indeed need to take such action against directors.

My brief review of actions we have undertaken shows that we are successful in meeting our objective to ensure that the market is well informed and confident in the quality of financial reports. We have not lost a Court action we have been involved with on an accounting matter. Nevertheless, before I cause heart failure around the room, I repeat: ASIC is primarily concerned to correct errors and inadequacies in the financial statements. This is usually achieved by seeking declarations from a court as to the appropriate treatment if we and the company cannot agree, but only after we have gone to some lengths to settle our disagreements.

Current state of the market - high tech stocks, and intangibles

A particular matter which is the focus of ASIC's attention currently and we expect it to be for the next while is the state of the market. I mention this because as well as it being a focus for us generally, it is certainly a focus for our accounting activities.

Internationally, commentators have focussed on the extent of the divide which appears to be growing between the new economy and the old; the high tech stocks, and the rest. This is reflected in the disparate performance of the Dow Jones index, the indicator of performance on the New York Stock Exchange and widely regarded as reflective of the old economy, despite the recent inclusion of stocks such as Microsoft; and on the other hand, NASDAQ, the home of the new economy, high tech stocks, exemplified by amazon.com. There are occasional wide swings, but the general trend has been for the former blue chip old economy stocks to wilt in price in face of the burgeoning internet related stocks in particular.

Australia has its own version, with our unitary market, the ASX (although that changed last Tuesday with the relaunch of the Newcastle Exchange). The index of the performance on the ASX, has been reaching record heights not because of a general strengthening of demand for

leading stocks, but because the outstanding performance of one stock has caused it to become even more important in the calculation of that index - which in turn has further increased the demand beyond what the so-called fundamentals would have required.

From the regulator's perspective, we face endless challenges in a market that has the capacity for such rapid change and where activity is increasingly at variance with accepted rules of market behaviour. How do you regulate a market place which does not behave in ways which have been observed for decades - where stocks that report increased earnings go down in price; where price-earnings multiples look like one day cricket scores rather than table tennis score sheets; where as US SEC Chairman Arthur Levitt said several weeks ago, "are some of today's companies really worth 1000 times nothing?"

What does the well-intentioned market regulator do in response? Clearly, it is no part of our role to talk the market down. Others with a more general remit to monitor and supervise the economy may talk of irrational exuberance, to little apparent effect; but I have less call to be judgemental. But there are several basic messages which a market regulator can and should repeat.

1. There is a relationship between risk and return. The high returns some folk are presently deriving from the markets are due to the higher risk - and losses will follow eventually.
2. You can minimise those losses by following the old rules; spread your risk. Too many Australians who now hold shares, hold shares in one or a handful of companies. That cannot be sensible.
3. We will do what we can to help protect investors. For example, ASIC and the ASX have a major campaign underway to improve the disclosure practices of listed companies which will bite hard on dot.coms which try to manage information, the way old economy stocks many years ago, tried to manage reported earnings. As a result of that campaign, on average, 3 - 4 referrals per week are being received from the ASX and responses have been sought from companies whose share price has fluctuated. At this stage no enforcement action has been necessary but the campaign has certainly had a positive educational impact. Companies are looking closely at their corporate governance arrangements to ensure they are complying. A greater number of trading halts, prior to a price sensitive announcement being made, have been observed since the campaign commenced.
4. Do not speculate with money you can't afford to lose. Borrowed money is top of that list - that's why ASIC issued a release urging caution with respect to margin lending; an activity only to be engaged in by consenting adults.
5. ASIC will continue its role of ensuring that accounting standards are complied with in the financial reports of companies engaging in high tech activities. New economy does not mean new accounting.

Deferred Expenditure and Intangible Assets

The largest numbers that seem to be appearing in the financial reports or prospectuses of these companies are to be found alongside descriptions such as "intangible assets" or "deferred expenditure". In some cases the numbers are very large indeed. It won't surprise you then that we are very much continuing our efforts to ensure that companies comply with the accounting standards dealing with such matters. Our guiding principle is not that intangible assets are not in some sense real, and are therefore to be ignored; it is that they

must be recognised for what they are, and amortised, like every other asset, in the absence of some compelling reason not to do so.

Amortisation of intangible assets has been a focus of our surveillance reviews since early 1999. During 1999 it had been put to us that we had overstepped our role or authority in flagging this as an issue of concern. However, it is now evident that there is acceptance that existing Australian standards require intangibles to be amortised, even though many would wish that the rules could be changed. We are now seeing much more widespread adoption of this treatment in financial reports and prospectuses. Nevertheless, we remain of the view that the relevant accounting standard is not always being applied in a robust way in practice and we are continuing our educative and enforcement activities directed to achieving better financial reporting. For example, we have applied our powers to formally require some companies to provide to us detail supporting and substantiating their policy of not amortising intangible assets such as licenses.

Non-amortisation concerns us for several reasons:

- In many cases the values recorded for the assets are very large and the financial effect of not amortising is to materially overstate company profits.
- In many cases the difficulty of reviewing the recoverable value “in use” of intangible assets means that such reviews cannot be relied on by themselves to ensure that the values of the assets are not overstated.
- Very few intangible assets last for long periods. Most of us can identify examples such as the brand names - Coca Cola and Johnnie Walker, but these seem to be the exception that proves the rule.
- The international financial markets view amortisation as being the appropriate accounting treatment for intangible assets and companies which do not adopt this treatment are likely to be marked down as a result or their cost of capital will be increased. The international financial press seems to regularly refer to Australians as cowboys in this regard.

Our position on amortisation can be summarised as follows. Intangible assets must be amortised. It is unlikely that we would ever accept a claim that the life of an intangible is unlimited. Companies must be able to substantiate the periods over which the assets are amortised as being reasonable estimates of the useful lives of the assets, taking into account factors such as technical and commercial obsolescence. In the high tech area it goes without saying that we would expect the periods chosen to be quite short.

In the intangibles area the other matter which concerns us, and particularly so in the context of the current state of the market, is whether the amounts variously described as intangible assets or deferred expenditure of one type or another actually do qualify for recognition as assets in a company’s balance sheet. Of course if the expenditure does not meet that test it must be recorded as an expense. The test for recognition of these amounts as assets in balance sheets is not met just because money is spent on building a business that is going to provide benefits to shareholders in the future. Expenditure of this sort has traditionally been viewed as building the goodwill of the business and there has been a prohibition on

recognising it as a separate asset until its value is established in an external transaction for the sale of the business. The emergence of the high tech stocks or the branching out of an established business to establish a high tech component does not change the accounting rules about what is an asset.

From time to time we have heard claims that the old rules just don't work for these new businesses or new assets and we need to look at the rules differently. Based on some of the conversations we have heard, we suspect that some would prefer that the new rules would include the following guidance:

- The larger the amount of money you spend the more likely it is you can record it as an asset.
- If you can afford to treat costs as an expense do so, but if you can't record them as an asset instead.

It goes without saying that the current rules do not envisage such thinking. If it emerges that accounting standards are changed to make more liberal the tests for what can be recorded as an asset, then we will expect companies to follow those new rules and we will enforce those rules. For the time being though, we remind companies of the need to focus closely on the existing requirements, as it is these that we will be enforcing.

Conclusion

ASIC's interest in accounting issues is keen and significant; and it will continue. Our reactive functions - especially those which involve us responding to enquiries and complaints are undertaken conscientiously and we strive to ensure that we are consistent and fair in our dealings. I have not even touched here on our role in disciplining auditors, and liquidators, or indeed on insolvency generally - all of which have important accounting aspects. Particular emphasis must be placed on the fact that we are being proactive as well as reactive on accounting matters. Our current proactive focus though is promoting a compliance culture, not for compliance sake but to ensure that investors have confidence that consistent and comparable information is made available in financial reports. In all our efforts to promote high quality financial reports, we see ourselves working closely with the corporate community; we welcome close contact with the Group of 100, we share a common objective of ensuring investors get credible and useful information about their investments, and wish you well in your endeavours.