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JOINT COMMITTEE ON CORPORATIONS AND FINANCIAL SERVICES

Reference: CLERP (Audit Reform and Corporate Disclosure) Bill

TUESDAY, 16 MARCH 2004

SYDNEY

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JOINT COMMITTEE ON CORPORATIONS AND FINANCIAL SERVICES

Tuesday, 16 March 2004

Members: Senator Chapman *(Chair)*, Senator Wong *(Deputy Chair)*, Senators Brandis, Conroy, Murray and Mr Byrne, Mr Ciobo, Mr Griffin, Mr Hunt and Mr McArthur

Senators and members in attendance: Senators Brandis, Chapman and Conroy

Terms of reference for the inquiry:

To inquire into and report on:

The exposure draft bill, CLERP (Audit Reform and Corporate Disclosure) Bill, and relevant matters.

WITNESSES

Committee met at 9.13 a.m.

GILBERT, Mr Richard, Chief Executive Officer, Investment and Financial Services Association Ltd

O'REILLY, Mr David, Senior Policy Manager, Investment, Investment and Financial Services Association Ltd

CHAIRMAN—I declare open this public hearing of the inquiry into the exposure draft of the Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Bill 2003 and relevant related matters. The committee expresses its gratitude to contributors to this inquiry including those who will be appearing as witnesses before us today. To date the committee has received almost 60 submissions but would welcome, and is still accepting, additional submissions.

Before we commence taking evidence may I reinforce for the record that all witnesses appearing before the committee are protected by parliamentary privilege with respect to the evidence provided. Parliamentary privilege refers to the special rights and immunities attached to the parliament or its members and others necessary for the discharge of parliamentary functions without obstruction and fear of prosecution. Any act by any person which operates to the disadvantage of a witness on account of evidence given by him or her before the parliament or any of its committees is treated as a breach of privilege. I also state that unless the committee decides otherwise this is a public hearing and, as such, all members of the public are welcome to attend. The committee will be holding additional public hearings for this inquiry on Thursday, 18 March 2004 in Melbourne and also during April on dates yet to be determined.

I welcome witnesses from the Investment and Financial Services Association. This is a public hearing and so the committee prefers all evidence be given in public, but if at any stage of your evidence or response to questions you wish to respond in private you may request that of the committee and we would consider such a request to move in camera. We have before us a written submission from IFSA, which we have numbered 44. Are there any alterations or additions you wish to make to the written submission?

Mr Gilbert—No, Mr Chairman.

CHAIRMAN—I now invite you to make a brief opening statement, at the conclusion of which I am sure we will have some questions.

Mr Gilbert—Thank you for allowing us to be here today. We do have a rather lengthy opening statement which I would like to table and perhaps just briefly allude to it in my opening remarks.

CHAIRMAN—Yes, you may table that.

Mr Gilbert—IFSA generally supports the proposal outlined in the CLERP 9 package of legislation. IFSA represents Australia's funds managers—70 of them, in fact—who invest beneficially, on behalf of nine million Australians, superannuation and managed funds

investments. We play a leading role in developing corporate governance guidelines for funds managers and companies, and to that end we appear here today.

It is worth going through some of the more salient issues contained in the bill. The first one is the expanded Financial Reporting Council. We support generally that issue but we do have concerns about the funding arrangements. We believe that FRC funding should not be raised by voluntary contributions but, if it is a core element of our financial system, it should be funded through normal government funding arrangements. Secondly, IFSA supports a strong auditing regime but notes the relatively small market for auditing services in Australia. The auditor independence requirements are extremely broad and do not appear to accommodate the proper management of conflicts of interest that can arise—and we will say more about that as we go through the evidence. We support generally the additional auditor reporting requirements. We support the financial reporting requirements in schedule 2.

IFSA acknowledges and supports the proposal to enable the incorporation of audit practices and the introduction of proportionate liability for economic loss or damage to property for misleading or deceptive conduct from the ASIC Act 2001 and the Trade Practices Act 1974. We support the expanded remuneration disclosure requirements for directors and executives. In that regard, we advise the committee that we played a leading role in 1998—and I think that Senator Conroy was the proposer of those amendments—to ensure that at least the top five executives in companies had their salaries and remuneration transparently disclosed. Generally we believe that has worked well but we think there is now scope to expand that, and we support that.

We also support the more recent changes to the legislation in relation to non-binding resolutions on remuneration. I would also like to say that IFSA and its fund manager members believe that in the context of all these changes it is important that there be shareholder activism. That is absolutely critical, and we maintain and uphold those principles. I think that going forward you will see more than has happened, although we say that there have been dramatic improvements in activism and involvement. So to that end we do not see any value in mandating proxy voting. We would also advise the committee that the Association of Superannuation Funds also opposes mandating of proxy voting and, in relation to that, it made a submission to the OECD on 5 December 2004 expressing a similar position to IFSA's. They are the most salient points we would like to make to the committee and with your permission I would like to table our opening statement.

CHAIRMAN—There being no objection, that is received. With respect to the last issue you raised, the mandated voting of proxies, that would include mandating institutions being required to vote. Could you just enlarge on your reasons for that?

Mr Gilbert—Basically, our most recent survey—

Senator CONROY—Just before you do, could I just clarify that there is no proposal by anybody to mandate institutions, only super funds. So there is no proposal, and never has been a proposal, to mandate institutions voting.

Mr Gilbert—I guess the point I am making is that in a general sense this has been raised in the US and, under Sarbanes-Oxley, managers were or are required to disclose.

Senator CONROY—They have got to disclose—a mandated disclosure, not mandated vote.

Mr Gilbert—In terms of the general vote or the community issues, it is about whether people have to vote. As to which parties, there is debate about that, I think, and I think Senator Conroy's point is well made. In terms of our position, we say that voting is already happening in very high numbers, very high proportions. Our most recent survey shows 90-plus per cent voting activism on the part of managers. That was verified by a KPMG survey, which I think we included in our submission. So we do not think that there is any need for black-letter legislation here, basically—that is our position.

Senator CONROY—One of the criticisms—certainly it has been made in the press, but I am not sure it is one that you have made—of the proposal on mandating voting is that it will lead to a mentality of 'tick a box' and therefore the quality of the vote is compromised. Do you have any views on that?

Mr Gilbert—I think that is a valid question. In relation to small managers—and this is one of the reasons we are not in support of tight, black-letter rules—this market is a vibrant capital market of about 70 funds managers and it has sitting around the edges probably 30 or 40 what we call 'boutique' managers. We believe that black-letter requirements will put up a very substantial barrier to entry to some of those new players. So it will be the new players and the small players that will resort to 'tick a box', and I think that would be quite detrimental. Intelligent voting is much better than unintelligent voting, and intelligent voting has got to be a matter between the funds manager and the institution—the super fund—via proper disclosure and a proper relationship in terms of the flow of information. So there is a real danger that if you have a black-letter system you will diminish voting intelligence quite substantially.

Senator CONROY—I think there are two instances where resolutions were withdrawn, and I think your members deserve credit in both those instances—News Corp and Harvey Norman. I have said on the public record—and I am happy to say it again on the public record—that IFSA deserve huge credit for the role they played.

Mr Gilbert—Thank you.

Senator CONROY—Other than those two instances, could you tell me of any instance where a vote proposed by management was defeated? I think the number is zero. In other words, 100 per cent of resolutions proposed at company general meetings by management were passed. It seems to me that, for an argument about intelligent voting and 'tick a box', it is a little incredible that 100 per cent of resolutions are passed. If a 100 per cent pass rate is intelligent voting, what would be the difference with the 'tick a box' approach?

Mr Gilbert—What you have to realise—and I think our survey shows this—is that he relationship between the funds managers and listed companies through investor relationships is a very critical one. I think you will find that companies know what the market will bear before they decide to go through the expense and the formality of putting up resolutions that are going to get knocked out. In the last four or five years I think the large publicly listed companies—and, for that matters, the medium-sized ones—have gone to great lengths to make sure that the funds management community will accept what they are putting up. There is nothing more ignominious than putting up a motion that is going to be knocked out or withdrawn at a meeting.

In the two instances that you referred to—and I thank you for giving the funds managers proper credit there—the negative press and the opprobrium which accumulated as a consequence of that indicate firmly why companies have to think hard before they put up a controversial resolution.

Senator CONROY—My point is, though, that whether or not there is mandated voting for superannuation funds, as opposed to fund managers, there is no change to that investor relationship in the negotiations and discussions that go on beforehand. It goes on now. Unless you are suggesting to me that this mandating of voting for super funds would affect the behaviour of fund managers in that they would stop talking behind the scenes to boards—I do not think you are suggesting that—then the role you play in helping them understand what the market thinks, which is a vital role, would not change. So I am trying to understand this criticism of mandating super funds—not fund managers—when 100 per cent of resolutions that are currently proposed are passed.

Mr Gilbert—It is not the super funds that are voting; in most cases, the way the capital market works, the super fund signs a standard investment management agreement, which clearly has in it a term that says there has to be a constructive relationship between the funds manager and the listed companies and the funds manager and the super fund, the ultimate beneficiaries, in relation to corporate governance. There is a very high level of interchange of information between the large and major super funds; it is already there. In relation to the smaller ones I think it is happening. We do not believe that there needs to be any legislative intrusion on those two sets of relationships. We believe it is happening fairly well. If you look at the Australian capital market failures, funds managers were not involved—as I think I have said before to this committee—in those high-profile corporate failures.

Australian funds managers hold about 25 per cent of the capital market, not 33 per cent as others say—that is expanded quite unnaturally by the inclusion of overseas investors. We have an ASSIRT survey which shows that. If you look at that 25 per cent holding in the ASX, you will see that the funds managers invariably were not involved in those high-profile corporate failures that stimulated this CLERP 9 package of reforms. So we say the relationship is a quality one right now and we believe that to intrude on that would be an unnecessary intervention in a number of respects.

Senator CONROY—So your position is firmly that there should not be any mandating of voting for organisations that have nothing to do with you?

Mr Gilbert—The lack of proxy voting is institutional, so the parliament has to work out whether overseas institutions should be made to vote, whether it wants foreigners more involved in the Australian capital market to the extent that they can tick boards and what have you, because they have a high holding.

Senator CONROY—But given you are saying everyone is voting, what is the difference?

Mr Gilbert—I am saying that funds managers vote.

Senator CONROY—To a degree the chair was setting up a straw man by asking you about funds managers being mandated to vote, which is not a proposal that anyone has made.

Mr Gilbert—In the US it has.

Senator CONROY—I do not think Senator Murray has gone that far. I wish he was here to speak for himself but I do not think so.

CHAIRMAN—In the conversation he had with me I thought he was suggesting that.

Senator CONROY—I am trying to understand why IFSA have such a passionate view on what fundamentally has nothing to do with you, given that your argument is: we are already voting. All that is required—

Mr Gilbert—The package does have something to do with us because it has the disclosure point in it too.

Senator CONROY—You were not asked about disclosure. I am happy to come to disclosure. What I am talking about at the moment is the mandating of voting and I am trying to understand why IFSA have such a passionate view. You are saying you are already voting effectively, just about as much as is possible.

Mr Gilbert—What we have a passion for is an efficient capital market, and a capital market that is not overburdened with black-letter regulations. We have just been through the FSR set of reforms. All funds managers have had to get new licences and go through those processes. We are continually under attack for being expensive. And here we are putting a layer of administration which is probably not going to add once cent of value to a system that is already working quite well.

Senator CONROY—But if you are already voting all the time and you have got the systems in place for it, it seems strange to me that you are now arguing a cost issue when in fact you are already, you say, doing the job. How can there be an extra cost for a job that you are already doing?

Mr Gilbert—If the parliament decides that this voting be mandatory—

Senator CONROY—For super funds.

Mr Gilbert—yes—who is going to pay the fines? Is it going to be on the superannuation funds, is it going to be on the fund members, is it going to come off the returns? All of that is going to detract from the efficiency of our capital market. Who is going to check it? The funds managers and the super funds will have to pay for ASIC to have a team of people to go out and audit these things and they will find out exactly what we have found in our KPMG verified survey—that 93 per cent of people are voting.

Senator CONROY—The point is that you are already doing it, so there should not be any costs.

Mr Gilbert—I think I have answered the question, Senator.

Senator CONROY—I think you have thrown up a few furphies, Mr Gilbert, if I can be unkind to you for a moment in this love-in we have been having so far this morning. I am just trying to understand why it evokes such passion on the funds managers' side. I understand the passion about the disclosure issue for funds managers—and I will come to that in a tick—but in terms of opposing a proposal to do with people who have nothing to do with your organisation you seem disproportionately passionate.

Mr Gilbert—Just as we have commented on the bill in relation to auditors: no direct contact with us but certainly an integral part of an efficient capital market.

Senator CONROY—I will come to the funds managers issue in a minute but I just want to run through some other issues. The chairman kicked off that question so I thought I would engage you in that. Your submission states that IFSA supports the CLERP 9 proposal to increase the disclosure requirements for executive remuneration to the top 10 executives—currently it is the top five. The BCA submission says that this proposal would ratchet up executive salaries. In light of this would you disagree with the BCA that such disclosures would ratchet up salaries?

Mr Gilbert—We disagree with that. There is already a market for information out there for executive salaries. It does not take much to go to a headhunting company and find out what people are being paid, and the media can do that. So we do not see that as a critical barrier.

Senator CONROY—The BCA's submission argued that we should not only reject these proposals but should go further and overturn the 1998 amendments. You kindly mentioned my involvement in that, so I will equally as kindly mention that IFSA were the driving force behind those amendments and certainly again deserve a lot of credit for sticking to your guns in the face of opposition at the time—and continuing to stick to your guns. But the BCA's proposal actually suggested doing away with the individual disclosures because at the time they felt that there would be kidnappings. I did ask the BCA the other day if there had been any kidnappings they were aware of at this stage after five years of the legislation being in force. The good news was that they could not think of any. The BCA would like to reverse the 1998 changes. Do you have any views on that?

Mr Gilbert—I think that would be a dramatically negative result. Our blue book upholds that. How can you benchmark management performance if you do not know what the package is? Like it or not, high-level salaries drive company results. So we are not in the game of capping salaries; but, equally, we are in the game of benchmarking salaries against performance. We think that if it was not there that would result in a lot of market misinformation, and it needs to be upheld.

Senator CONROY—Your submission says that IFSA supports the proposal in the CLERP 9 bill to give shareholders a non-binding vote on the remuneration report. I suggest that the BCA were passionately opposed to this, and I am sure you have read some of the commentary publicly. They believe that it is almost as evil a proposal as the original one to individually list. I just wondered whether you had any thoughts on that.

Mr Gilbert—A non-binding vote is moral suasion only, but we believe that moral suasion is important and that signals should be sent to boards. If this is a way of canvassing shareholder

opinion then we support it. We unequivocally support the non-binding vote provision. It is a good measure.

Senator CONROY—What about the idea that it could become binding in reality or that there are legal implications—are you aware of any of those sorts of problems in other jurisdictions where they have similar proposals?

Mr O'Reilly—No. We have seen that the government has got advice from the Attorney-General on the matter indicating that it would not be legally binding.

Senator CONROY—You have seen that advice? That has not been tabled to the committee.

Mr O'Reilly—I have not seen the advice, but I have seen the summary report.

Senator CONROY—That is interesting. Maybe we could chase the government down and get the summary, without getting the actual advice. Hugh Morgan and the Business Council of Australia are very passionate about their belief that there are legal implications. So if we have government advice on it we could get a summary.

Mr Gilbert—What I would say is that, ultimately, remuneration is the province of the board. To that end, the board binds itself; it is not the shareholders binding the board.

Senator CONROY—Sure. But, as I am sure you have heard me say previously, I am a bit of a fan of CalPERS and have been following the debacle to do with the New York Stock Exchange where the chairman of CalPERS said, 'We have got the snouts out of the trough; now we want to find out who filled the trough.' That is where the role you play is so important: in finding out who has been filling the trough and wanting to ensure that there is accountability to shareholders. I think Adam Smith first raised the issue that if you put an intermediary, an agent, in between you and your money then it is always a good idea to keep your eye on the agent. It is rare for Adam Smith to be quoted by the Labor Party—

CHAIRMAN—I am glad to see that you are eventually learning, Senator Conroy.

Mr Gilbert—I think the invisible hand of markets is a very positive thing.

Senator CONROY—The invisible hand of markets is good, but, particularly in the case where you empower an agent to act on behalf of your money—

Mr Gilbert—So you are referring to fund managers there, are you?

Senator CONROY—No, boards. I am saying it is the boards that are the agents on behalf of shareholders. Shareholders put their money into these companies and the boards are the shareholders' agents. So ultimately there is a need, which Adam Smith acknowledged in the 1700s, for there to be that accountability mechanism. This is a proposal to try and empower shareholders, but as we are in agreement I will not labour the point any further. The previous Parliamentary Secretary to the Treasurer, Mr Ian Campbell—who is well known to you—said that the government would require up-front and real-time disclosure of executive contracts. I am sure you have seen the *Hansard*—or possibly you were even a witness to it.

Mr O'Reilly—Yes.

Senator CONROY—The CLERP 9 bill fails to implement this requirement. However, the ASX listing rules were changed in May last year to require disclosure of material parts of a CEO's contract. In your view, should the requirement to disclose executive contracts in real time and up front extend beyond the CEO to other directors in senior management?

Mr O'Reilly—It is a difficult question. I think we would need to think about it a bit more in terms of that type of disclosure.

Senator CONROY—Would you take that on notice? The committee is going for another month or so, so you will have time to look at that one and come back to us.

Mr O'Reilly—We will take it on notice.

Senator CONROY—I want to talk about an existing provision in the Corporations Law. Sections 200B and 200G and related sections state that 'shareholder approval for retirement benefits is only required where the payout exceeds the amount prescribed by the formula'. It is probably little known to most of us but there is a formula in the Corporations Law about termination payments. For example, a director can obtain a retirement package without shareholder approval of up to 3.5 times their average income, if they have been with the company 3½ years; five times, if they have been with the company five years; and seven times, if they have been with the company for seven years. This can lead to some extraordinary amounts of money. It is an existing formula within the Corporations Law. In your view, should these types of payments be approved, given the quantum that is involved?

Mr Gilbert—I think the main thing is that they should be disclosed. We are against putting limits on any sort of remuneration.

Senator CONROY—I was not suggesting there was a limit. This formula says that at some point there is a threshold, which currently requires a vote of shareholders. I am suggesting that, if you look at the formula, you will see that those thresholds are extraordinarily high. If someone has been with the company even for five years and their average salary is $3 million, that is $15 million in a payout that you guys do not get to vote on.

Mr Gilbert—We would be somewhat questioning any formula with any limit because it fails to recognise the size of companies, the size of the investment that the company might be making in certain projects. Our point is that going down that track is generally not productive.

Senator CONROY—But it is currently in the Corporations Law.

Mr Gilbert—It is, yes. I guess disclosure of the termination packages is better at the commencement of the contract.

Senator BRANDIS—Do you think it is very important to draw a distinction between that part of a remuneration package which is not directly performance related and those bonuses and other elements of the remuneration package which are performance related?

Mr Gilbert—We would want the whole package.

Senator BRANDIS—I am not suggesting that both should not be disclosed, but I was inviting you to comment. One hears these large figures thrown around, and quite often the point is not made that the lion's share of it is performance related, as a function of share price or whatever.

Mr Gilbert—Provided there are appropriate hurdles and benchmarks, I think that is a good way of remunerating and a good way of disclosure. I think it leads to a more efficient capital market, which is the result we desire.

Senator CONROY—Could you advise the committee of IFSA's position on equity value protection schemes—that is, should companies be required to disclose whether or not they allow their directors and executives to hedge against the drop in the value of their options to neutralise the risk element of their salary package? On the one hand there is the point that you and Senator Brandis made about performance hurdles. But if they have found a way to disconnect the alignment because of these protection schemes, should that be disclosed to shareholders so that shareholders know?

Mr O'Reilly—Certainly in this area our position is that there should be disclosure generally: investors need to know what is happening in terms of packages. In terms of equity value protection schemes—

Mr Gilbert—I think the same principle applies. Investors need to know: it could govern behaviour and, to that end, it should be known to the market.

Senator CONROY—Okay. Currently a number of companies do not—in fact, I do not know of anybody who discloses whether their executives are doing it or not—although I am aware that it goes on in a number of companies. What can we do about that? Do we need to amend the blue book? Does parliament need to say that it is mandatory to disclose so that shareholders are aware?

Mr Gilbert—Could we take that on notice?

Senator CONROY—Yes.

Mr Gilbert—It is a good question. But I think you understand the thrust of our point, that if it is material to the behaviour of a senior manager then it should be material to the market and known to the market.

Senator CONROY—Can you advise the committee of IFSA's position on non-recourse loans? Under the accounting standard AASB 1046, loans of greater than $100,000 will need to be disclosed but they will not be part of the remuneration report and therefore will not be voted on by shareholders. I am interested in your view on non-recourse loans, and also on the issue that it is not currently proposed for them to be within the remuneration report, which would be voted on, and whether they should be.

Mr O'Reilly—We will take it on notice.

Senator CONROY—I am happy for you to do that. We may need to call you back.

Mr Gilbert—It would be our pleasure.

Senator CONROY—The ASA has advised the committee that they are concerned about a resolution passed by Boral in October 2003 which nullifies the 100 shareholder test in relation to the proposal of certain types of resolution for debate, and that an amendment should be made to ensure that the Corporations Act takes precedence over provisions in a company's constitution. I think I have written to you about this issue. Does IFSA have a view on the resolution passed by Boral?

Mr Gilbert—We do not generally comment on individual companies. IFSA are not an analyst company; we have responsibility for corporate governance principles. Our point about voting at companies is that it should be conducted in such a way that it does not cost shareholders substantial sums in order to have a particular issue brought up or not. Our position is that if somebody wants to call for a resolution or call a meeting there should be quite a substantial number of votes that they need—it should not be a small number. What is our level, Mr O'Reilly?

Mr O'Reilly—It is 100 or five per cent in terms of the current law.

Mr Gilbert—Our position is that, once a meeting is called, a smaller number should be required to put something on the agenda. That is basically where we stand.

Senator CONROY—Corporations Law, as it stands, says that 100 shareholders can list a resolution to amend the constitution.

Mr O'Reilly—That is right.

Senator CONROY—Boral have—I will use layman's terms, as opposed to some of the lawyers in the room—contracted out of that requirement.

Mr O'Reilly—The law also permits that.

Senator CONROY—It is a debatable point whether the law permits that. There are some legal opinions that it can, but there is an interpretation issue.

Mr O'Reilly—I would just be reading off the legislation, but yes.

Senator CONROY—Are you a lawyer, Mr O'Reilly?

Mr O'Reilly—I am.

Senator CONROY—Okay. In your view, the Corporations Law be contracted out of on a current reading of the law.

Mr O'Reilly—When you say that Corporations Law can be contracted out of—

Senator CONROY—As I said, that is my layman's terms as a non-lawyer.

Mr O'Reilly—In terms of the company constitution, the constitution can provide for increased hurdles when it comes to amending that constitution, recognising that the constitution is the basic document that people invest on the basis of in terms of their rights and responsibilities.

CHAIRMAN—It is a replaceable rule, isn't it?

Mr O'Reilly—No, it is not.

Senator CONROY—That is actually the point: it is not a replaceable rule—that is the very issue. That is actually the way you should do it, if you were going to go down this path. So if a company proposed to say that you do not have to disclose your executive remuneration unless you get a five per cent vote of the company's shareholders requesting it, would that be—

Mr O'Reilly—It cannot be contrary to the law. I have not looked at the provisions for some time.

Senator CONROY—No, it is an additional step: you do not have to disclose it, except if five per cent of shareholders request it. This is a lawyers' picnic. Frankly, I think the legal profession do themselves no service with this sort of picnic—but my views on lawyers are well known to all of you, so I will not bore you with them. You can now add conditions to a whole range of the elements that are in black and white in the Corporations Law in a whole host of areas. If this is allowed to stand unchallenged, this opens up one of the worst attacks on shareholder rights that this country has seen.

Mr O'Reilly—In terms of amending the constitution itself, that seems to be what the law permits.

Senator CONROY—This is a parliamentary committee that is looking at amendments to the law which will stop this.

Mr O'Reilly—I believe the focus in our response to you was more along the lines that, in the requirements for people to be able to call meetings, the 100-member test is too low.

Mr Gilbert—Yes.

Mr O'Reilly—That five per cent would be—

Senator CONROY—But what I am talking about here is specifically the proposition about listing resolutions for discussion.

Mr Gilbert—We say that once a meeting is being held through a reasonable threshold—of, say, five per cent—which is not going to be expensive to the shareholders at large, then we are happy with 100 members to put something on the agenda.

Senator CONROY—Thank you. I appreciate your attendance. Hopefully we will get your views on a couple of those other things and maybe we will call you again.

Mr Gilbert—Thank you. We will come back to you on those things.

CHAIRMAN—Thank you.

Proceedings suspended from 9.46 a.m. to 10.03 a.m.

ADAMS, Professor Michael Andrew, Assistant Director, Centre for Corporate Governance, University of Technology Sydney

CHAIRMAN—Welcome. The committee prefers that all evidence be given in public, but if at any stage of your evidence you wish to respond to questions in private you may request that of the committee and we will consider moving in camera. We have before us a written submission from the UTS Centre for Corporate Governance, which we have numbered 21. Are there any alterations or additions you wish to make to the written submission?

Prof. Adams—No, thank you.

CHAIRMAN—I now invite you to make a brief opening statement, at the conclusion of which I am sure we will have questions.

Prof. Adams—It is a pleasure to be invited to make an address in support of our submission. I am sure the last thing you wanted was to have another review or for me to repeat all the things that have been said. At the outset I would like to say that the Centre for Corporate Governance was established in late 2002 with the specific purpose of combining cross-disciplinary aspects of corporate governance. What I mean by that is that most of the research done in Australia focuses on the legal regulation and, although as a professor of corporate law I feel that is valuable, sometimes we miss the point in terms of the accounting role, the economics role, the finance role and, particularly with my colleague Professor Thomas Clarke, the management role. That was the fundamental premise on which the university established the centre and we are already engaged in a major research project with the Australian Research Council in the area of board performance, which there is obviously a connection to here.

Our submission falls into two parts. The first part deals with schedule 1 of the draft bill, which in fact was drafted by one of our members, Professor Donald Stokes. As a lawyer, I certainly do not feel qualified to comment on any specific questions relating to schedule 1, which relate to the accounts audit aspects. Unfortunately, Professor Stokes is not available today, but I am sure he would take questions at another time, if the committee felt there were parts of that part of the submission that were important. I would like to comment on the other schedules, particularly in respect of the enforcement parts of schedule 4 and also in respect of continuous disclosure and the disqualification of directors.

Please put my comments on CLERP 9 in the context that I have been commenting, writing, studying, researching and publishing since we went to a federal corporate law system. I hope I have been able to take, through the various forms, a consistent approach in the analysis of both the simplification task force and its original changes. In fact, I put in a number of submissions there and have done so for the various parts of the task force. I have also been part of the debate at various levels in respect of corporate law and economic reform programs since 1997.

You would expect any academic to have a watching brief in making sure that we do not change laws unnecessarily. As has been reported in the media, the impact of the Financial Services Reform Act, which, of course, came in last week, has been huge in terms of compliance costs. Even though I am an academic, in speaking to people in the business environment—and

certainly speaking to law firms and a range of other stakeholders—the message is that we cannot ignore the impact of cost and changing laws. This will, according to my calculation, be the 27th major change in legislation just to do with the Corporations Act in the last decade. That is a phenomenal degree of change. Part of that, of course, is created by the economic environment and part of it is keeping up with the developments on a worldwide stage. But some of it I think we have to take as—and this, I assume—the parliamentary joint committee's inability to step back and actually see that these reforms are the right reforms at the right time and we are not just changing for the sake of change. That will come up as a specific item in a moment.

Please refer to page 11 headed 'Schedule 4: Enforcement', the schedule referring to the draft bill. The point I particularly wish to make is that, in putting in this submission, great care was taken not to blanketly say yes or no. Where we could say we agree in principle et cetera, we have done so, to make it clear, but where we feel that there are some technical drafting things, we make suggestions. I hope the committee found the submission a helpful way forward.

Moving to the first specific issue, 'Part 1: Protection for Employees Reporting Breaches to ASIC' clearly in principle encouraging people—and I am afraid I hate the Americanism 'whistleblow', but I guess it now has a clear connotation—to inform on suspected breaches of the Corporations Act is obviously a very sensible way forward. However, I have some questions with respect to the protection of employees and the basic test—and, in fact, whether the law will actually achieve what it sets out to do. More specifically, clause 1317AA—the actual disclosure provisions—tries to achieve one particular thing, but it is our belief that it will not necessarily achieve that particular aspect. In other words, it will not particularly encourage people to whistleblow. In fact, the evidence, certainly from overseas—I am afraid I do not have the specific research but I am aware of research—indicates that there is an overall reluctance to inform on employers because of the obvious consequences. There are a number of case studies which actually show on a broader platform that whistleblowers often have problems—their careers are destroyed, they have a problem with alcohol and there are high divorce rates. There are some very strong correlations that these people end up suffering.

If we are going to encourage such a thing—in principle, obviously nobody wants to know if there is a contravention of the law—there has to be the appropriate protection, and our submission gives some ideas on where that may fall short. Probably the most practical one relates to the role of ASIC and the way it handles complaints. This is something we have written about previously, and on page 13 of our submission we provide some statistics and a reference to some more detailed pages.

I do question whether ASIC really has the resources to handle a flood of complaints. The ASIC annual report for the financial year 2002-03 shows that of the 8,708 cases they handled only five per cent were investigated, 66 per cent were resolved in terms of information—we do not really know what that means, and it is never explained—and a further 29 per cent were not resolved at all; they were just looked at. In other words, ASIC is already very busy dealing with these issues, and that excludes the 5,251 referrals that ASIC receives through its external administration process—liquidators et cetera. They already carry a heavy burden and, in our opinion, are not yet resourced to deal with those things.

We did make one suggestion which may be worth considering—if not now, at some future time. The Chartered Secretaries Australia put forward a proposal for a corporations panel based

on the takeovers panel model to resolve some of these complaints, and so take them out of ASIC's hands. That is something that may be worth exploring in the future—and I would be happy to talk a little more about that.

On a more technical basis, I turn specifically to clause 1317AA1(e). It has a test of disclosure based on good faith. Now that is obviously a technical argument. I can understand why it has been drafted, and certainly the explanatory memorandum gives a rationale. It would be my opinion and the centre's opinion in debating this that that particular hurdle unfortunately could destroy disclosure in terms of it being based not on merit but on denial of any sort of protection, because the employee, for example, has fallen out with the employer. There is no doubt that the test should relate to whether there has been a contravention and an honest belief that the disclosure is not vexatious. We have vexatious litigants; it goes without saying that we do not want people complaining just for the sake of complaining. However, in relation to the state of mind of the person doing the whistleblowing, a natural barrier would be set up if we were to say to them, 'You did this for the wrong reason', even though there is a contravention. They will not be protected in legal actions and, as such, ASIC will not be informed. So we would see that as quite a strong barrier, rather than looking at the merits of any complaint or alleged contravention.

I have two more main summary points to make, and then I will be very happy to try to elaborate on them. The next one is in respect of part 2— disqualification of directors—which appears on page 16 of our submission. The disqualification of directors is an important tool, because obviously if somebody is hurting the corporate world it seems appropriate in many ways to remove them from their ability to do further damage. The provision that has been in place for a good many years, now called section 206D, was a five-year disqualification—and I would like to stress this point—based on contravention. If somebody has contravened a number of times, the court has the power to increase that disqualification. Just a mere three years ago it was increased to 10 years. It could be argued, of course, that that brings a deterrent factor into play and that directors will take more serious note of that provision. However, in our opinion, the application to increase it to 20 years is not supported by any evidence whatsoever. It is what we would call a random numbers theory—that is, somebody has said, 'Twenty sounds like a good number, so let's increase it to 20 years.' Nowhere can we find a substantial basis for that.

To add to this, as a researcher we went back and checked all the recent case law to see whether there were any discussions and, to the best of our knowledge, there is no evidence whatsoever to say that even the increase from five years to 10 years has had any marked impact on directors. We also checked the enforcement issue—that is, has it actually occurred—and there is no case law. The only reference to it is that now very famous case Adler v. ASIC, which is cited at page 17, where the 20-year disqualification was imposed based on the previous five years but over the number of breaches and the court felt that a 20-year disqualification was most appropriate. Even then the judge was only referring to 206D in passing. My basic point is that I feel that there has not been a demonstrated benefit in increasing it to 20 years. The 10-year disqualification appears to be adequate until we have some more substantial research. The same argument is then applied to what is to be section 206BA, which is the automatic disqualification.

My last comment is about civil penalties. Again, I can understand the need to send out an important message to corporate Australia. However, a mandatory changing of the civil penalty provisions for corporations—clause 1317G(1B), which is to increase the $200,000 limit for a civil penalty to $1 million for the body corporate—is based on the criminal provision in 1312,

which is a multiplier of five, because companies cannot be sent to jail. Again, there is a very good rationale in criminal law why that is to be applied. It also fits into the Commonwealth Criminal Code. However, in my opinion it seems to be very strange that the civil penalty regime—and I emphasise the words 'civil penalty'—has now been heavily blurred with criminal law, and that throws up confusion. Civil penalties were introduced in 1993 in corporate law as a hybrid of civil criminal law, and I think there is clearly a place and I think the ASIC, Adler, Williams, Fodera case demonstrates their importance. However, if the CLERP 9 bill ends up accepting this increase to the $1 million corporate penalty that really does blur aspects of the civil and criminal law.

My last point here is that I still see no rationale for financial services civil penalties—those that relate to chapter 7—being distinguished from the rest of the corporations schemes or penalties. It appears to be an unnecessary confusion and it applies an ambiguity. If a corporation breaches one provision it only has to pay $200,000 but if it happens to fall into the financial services area it pays $1 million for possibly the same contravention, and I am thinking particularly that the area of misleading or deceptive conduct could be an example.

The comments on remuneration of directors are well articulated, and I am happy to come back and answer questions on that. My last comment will relate to continuous disclosure. The continuous disclosure debate has been a major and important issue. I am still not convinced that the rationale for companies not listed on the Stock Exchange having to disclose information in the way that is expected is a particularly effective regime. Research into those companies often shows that they do not comply. Whereas, for a listed entity, the ASX listing rules work to a certain level of harmony. We know from a matter of practicality that the ASX does make phone calls to the company to find out about rumours and to try to get a response to keep the market informed. In our opinion, the ASX does a very good job on that basis. Obviously, there are hiccups from time to time when the information is ambiguous in terms of a takeover or a major announcement when a company is not at a point at which it wishes to make that announcement. That can be a timing issue, as we can imagine.

However, to move to an infringement notice regime where ASIC actually can fine virtually on the spot—as I have put at page 23—challenges, I think, separation of powers, and Montesquieu's theories which are what responsible government was based on. It possibly goes against the interpretation in the High Court on section 71 of the Australian Constitution and I honestly believe that it will not benefit corporate Australia and the integrity of the markets to have this particular provision. To then also remove the appeals to the Administrative Appeals Tribunal seems an erosion of some fundamental legal rights which we go on to articulate. Thank you for the opportunity to explain some of the highlights of our submission.

CHAIRMAN—Thank you, Professor Adams.

Senator BRANDIS—I am a bit interested in the 'good faith' issue. Is good faith defined in the bill or in the act that the bill amends?

Prof. Adams—No, it is not. It is actually left to be more of a common or—

Senator BRANDIS—Let us say you have a whistleblower or someone who is thinking about being a whistleblower and they are aware of disclosable information but they are motivated by

malice towards the company. Your point, as I understand it, is that the fact that they might be motivated by a collateral or even malicious purpose does not mean that the facts of which they are aware do not exist. It does not mean they do not know those facts and therefore it does not mean those facts should not be revealed by them.

Prof. Adams—That is correct. If you believe that there is an alleged contravention, to gain the protection of the legislation when you make a complaint to ASIC, when you inform and, using an Australian expression, when you dob on your employer—and this is really what we are talking about in terms of whistleblowing—there is a good faith test; that is, your motivation must satisfy a common test.

Senator BRANDIS—On ordinary concepts, an act which was motivated by malice or which was motivated by some collateral purpose would not be an act done in good faith.

Prof. Adams—That would be my interpretation.

Senator BRANDIS—That would be mine too. You said before that you thought the test should be an 'honest belief'. I am inclined to agree with you about good faith, but don't you think that might be setting it a bit low? What about 'honest and reasonable belief'?

Prof. Adams—Yes, I think the emphasis—and then the committee could look at formulating an appropriate test—is very much based on the merits of the contravention. In other words, from what the—

Senator CONROY—The motivation behind it.

Prof. Adams—No, not—

Senator BRANDIS—The relevant state of mind is what the whistleblower knows and whether he honestly and, I would say, reasonably believes that to be true. His motive, as opposed to his knowledge, should not be the issue. As I understand it, that is your very point.

Prof. Adams—That is correct.

CHAIRMAN—Is there adequate protection against vexatious or fabricated allegations?

Prof. Adams—I believe there is and I think ASIC, in that sense—other than my earlier resource issue—will be able to discern. When they receive, they will have to weigh those types of things into effect.

Senator BRANDIS—If there is an honest and reasonable test, that would cover any circumstances in which there was a vexatious complaint, wouldn't it?

Prof. Adams—Because then it could be knocked out on the basis that it was not reasonable.

Senator CONROY—I think that is a great point. Hopefully we can engage the government in some discussion on that, Senator Brandis. I want to talk about the non-binding vote. You are particularly critical of the non-binding vote. I will let you describe it in your own words. We

have just had the investment groups in front of us, who are passionate supporters of this, and I am aware that shareholder groups are passionate supporters of this. Can you outline your concerns with it?

Prof. Adams—In my summary I did skip over the remuneration of directors, and it is quite appropriate to look at it. In my opinion, it is a conflict between the two provisions that have been drafted in the bill, the first being clause 250SA, which is the requirement that the chair of the annual general meeting gives reasonable opportunity for listed companies, in particular, to engage in debate and accept questions.

Senator CONROY—Have you ever been to a company's annual general meeting?

Prof. Adams—Yes, I have attended a number, and people do ask questions. I do not think this is the way the debate is formed—the overall merit of whether AGMs in the 21st century is the appropriate mechanism—but that is the system we have at the moment and we are not looking to reform the whole of annual general meetings. There are opportunities, and I think the majority of chairs do take the opportunity to engage. We have to be realistic in terms of the realities. The number of shareholders that turn up is often a very small fraction of the overall shareholders in listed entities, and a few parties often hold substantial shares in terms of proxy voting.

So 250SA makes a lot of sense to me in terms of the chair having the opportunity to discuss questions. I feel that the problem with the draft provision 250R(2) is that it does not really address the issue. If anything, it could create an environment of expectation when clearly the board has the power, in fact, to completely reject that outcome. Time, money and effort could be spent to address this particular area, but my feeling would be that the overall impact would not be a change from the position we have at the moment—and the overall benefit would not be there at all.

Senator CONROY—You mentioned time, money and effort. I would be interested in hearing you define that a bit more. Again, I come back to the point that the main proponents of this are actually shareholder groups. You seem to dismiss, and I am not using that term in a pejorative sense, their desire for it as irrelevant—to use your words, it is as useful as a chocolate teapot. I am interested in those two points and how you respond to them. If you were sitting on our side of the table and you had the investors and the shareholder groups sitting there saying, 'We want this because we believe,' how would you respond? Notwithstanding your view that it is ultimately building up an expectation that could be dashed, they are saying, 'Well, we want our expectations built up.'

Prof. Adams—I am not surprised that the submission has been made and the item put forward to have this. The reality is, I guess, that it comes down to a fundamental view in respect of management and shareholders, and what those expectations are. I can imagine that a lot of annual general meetings could end up turning into a major debate on particular issues, and that dialogue is very important and there is no doubt that that is required. However, then to go to a vote on one very specific issue, a vote which is non-binding—in other words, they are not really exercising their powers—to me would cause greater frustration.

You mentioned the time factor. I think annual general meetings in particular would become a lot longer. They would become more costly in terms of the preparation time prior to the meeting

and during the meeting. It could even be argued, to a certain extent, that management time may be diverted in terms of the direction of questioning—which one assumes would already have been picked up in the questioning aspect. To have a resolution and then to decide that the board are not going to be bound by it could cause market confusion. I really feel that will not benefit corporate Australia overall. As to the rationale behind why it is wanted, I guess that is for them to put forward. I am not really in a position to agree. As I said, obviously if it goes through as a provision then it will be something that a body such as the centre will evaluate—in other words, we will need to look at a couple of rounds of annual general meetings to carry out some sort of evaluation.

Senator CONROY—Are you familiar with the GlaxoSmithKline vote where a remuneration report was rejected and the board came back with what was viewed by shareholders as a more reasonable proposal? Do you not take some comfort that maybe it is not as pointless—not as much of a chocolate teapot—as you may feel?

Prof. Adams—I think there have been some results, even within Australia. A few years ago you may recall that Westpac had some issues in respect of options for their directors, and there was a lot of debate without this sort of provision. An experienced chair there was able to work on some refinements, come back and say, 'We are listing to what our shareholders are saying.' In other words, they were using the provisions of dialogue and discussion without the non-binding provision. To rerun history in terms of the Westpac annual general meeting—and obviously I am hypothesising here—I do not think the outcome would have any different with these changes. The ability to have an open debate and discussion about a particular issue is of value, but I am still not convinced of the value of going to a formal voting mechanism and then having the vote non-binding.

Senator CONROY—I am a bit of a fan of CalPERS, which I am sure you have heard of.

Prof. Adams—Yes.

Senator CONROY—There was a very recent example of what could loosely be described as corporate excess at the New York Stock Exchange. CalPERS was instrumental in some of the shareholder revolt there. It was not just about Grasso getting paid too much and eventually losing his job. The quote, which I am fond of repeating, is from the chairman of CalPERS who said, 'We've got the snouts out of the trough, now we want to know who filled the trough.' To me that is a modern day way of describing Smith's theory of the agent, when you put an agent between you and your money. In this sense, it is the boards that are the agents. You have to keep an eye on them. I see this as fulfilling the task of keeping an eye on the agents. Do you accept that?

Prof. Adams—It is one mechanism. I am well aware of the role of the Californian pension funds. They are very powerful indeed—as, of course, in Australia the large super funds are also given a very strong opportunity to monitor and feed back. I am not convinced that this particular provision will actually achieve those outcomes. If parliament passes this provision then I think it will be our job to monitor and review it accordingly.

Senator CONROY—Moving on to some strong language in your submission—'greenmail'. Accusing ASIC of greenmail if this proposal were to go through is a big call. In your view, is

this unconstitutional? You make reference to your concern about it—I am genuinely fascinated by whether or not you think it crosses the line.

Prof. Adams—The reference to greenmail is very much in brackets—akin to, equivalent of—rather than actually accusing ASIC in any shape or form. I think it puts us in a very difficult position. Continuous disclosure as an area has been ambiguous. I have had the pleasure of chairing a number of different, big, public discussions with various stakeholders in this area and the same thing comes through every time, which is that it is not black and white. In fact, one of the best examples I was given of the recent confusions would be a company listed in Australia and in New Zealand. In Australia, a company can use the short-term suspension. In other words, if we are about to do an announcement and we are not sure what the market is, we can apply to the ASX and say, 'Look, we're in this strange period, can you effectively suspend us for a short period?' The market interprets that as we are about to do an announcement but we do not feel there should be any sort of market manipulation or opportunity to insider trade in that period. It is very reasonable and very sensible. I believe New Zealand does not have that provision and as such the New Zealand market for a dual listed company could well be suspended. There they will see that as a disciplinary matter. It will send out a totally different message et cetera, all for an ambiguous continuous disclosure call.

There are a number of companies which fall into that category. We are not talking about the 1,500 companies that are on the Stock Exchange. Obviously, there are only a dozen or so that fall into this category, but they are our major players and we need to be aware of them. To put ASIC in a position where—and pages 22 and 23 of the bill have added some emphasis; it plays such a crucial role at all three levels—it is judge and jury in this particular area and has the ability to determine whether a civil or criminal action occurs and can say, 'If you don't comply, we're not going to have it reviewed through the AAT,' which has been a very appropriate mechanism in many areas with many skilled staff, I feel exposes ASIC to a tremendous amount of power which has an instant impact.

I can use an analogy concerning the use of a stop order. If somebody is putting together a prospectus or some other financial document, a lot of work and effort goes into it and, of course, it should be checked and reviewed by the relevant parties. If there is some ambiguity and a stop order is then issued there has always been a review mechanism that says, 'Let's commercially judge this, go through the relevant arguments and make a decision.' In view of the way this legislation is drafted, with infringement notices, I think it would be a very dangerous move to go down that route. ASIC would be in itself in a difficult position and, yes, I do believe that it potentially goes against the Constitution.

Senator CONROY—In terms of what is being attempted here it is to try to ensure that the market is open and fully informed and to avoid, if you like, trading while the market is not fully informed or insider trading. Do you think that is an achievable goal? Do you think it should be an achievable goal? Is it something that you would think is a worthwhile pursuit?

Prof. Adams—The answer is, yes, without doubt, the market has to be fully informed and it is appropriate. I believe that Australia has a very good system. The continuous disclosure mechanisms we have are of world class. We have examined the United States system and the British system, in particular, and they have some fundamental flaws. Ours is better because of the existing legislation. I guess what I am saying here is that we are making a change, and I can

understand the policy reasons as to why we would appear to want to strengthen the laws, but the reality is that the laws are working very effectively, from my point of view and on our measures. There is not a fundamental breakdown in the provisions and there is not a fundamental breakdown in the law. As such, I cannot see the benefit of putting this additional burden in.

Senator CONROY—You say you do not think there is a breakdown in the law. When you see AMP pay $100,000 to charity because ASIC say, 'We don't think you have kept the market fully informed,' AMP accept that and yet the fine is a donation to charity, do you think that leaves people scratching their head as to whether or not we actually have laws that work? Okay, they have paid an amount of money, but they had to pay it to charity because ASIC did not think they could make it pay through the courts. Have you any thoughts there? Is there a flaw somewhere to get to a situation like that?

Prof. Adams—I do not think there is. I think it reflects that, first, continuous disclosure as a concept and a mechanism is going to be based around a corporate entity making a decision in its processes. We now know that a large number of corporate entities have a small committee, usually involving the CEO, a compliance officer—a company secretary type person—and somebody actually directly involved, who have to come together and make a judgment call on a particular business decision. We also know that continuous disclosure laws have been used to manipulate the market by forcing somebody to disclose. In other words, if one competitor believes either a takeover is likely to occur or a major tender, it has been known that rumours can be started to try to flush out and to try to get an opinion, which could be to the disadvantage of the tender or the parties doing negotiations. So there is a negative side.

Certainly my experience of speaking to the people who have to make that judgment call is that they do it appropriately and it is weighed up. If the ASX picks something up through its surveillance and monitoring mechanisms it will make a very practical phone call—and it is usually a phone call, I believe—to say, 'We are hearing this. Have you got an opinion?' That decision is then to disclose to keep the market informed. It is then resolved with ASIC in a particular case—and I am unaware, obviously, of the detailed provisions of AMP. It is certainly part of the process of ASIC's existing powers. I am sure the committee is aware of the use of enforceable undertakings—the mechanism where an individual does not admit liability but agrees that they will enhance their practices and, if necessary, make other adjustments on a compliance issue. This has been a very effective tool. My argument here is that to make it a criminal fine takes it into a whole new round. The ambiguities I have suggested still exist. At what point to disclose is not always an easy decision. There are very important timing issues. I think the relative punishment that can flow from it is virtually inequitable and unfair.

Senator CONROY—I am sure you are aware, because I know you follow this, that it is ASIC that essentially put up their hand and said, 'We believe the law is fundamentally flawed. We are unable to achieve outcomes.' Even Martha Stewart did not go down for insider trading; she went down for lying. There are clearly issues around insider trading all around the world. ASIC have put up their hand and said, 'We think the law is flawed. We think there is no point in taking people to court—it is too costly and too cumbersome. Three months later you might get an admission and the market has moved on.' It is a live market problem, I guess, that ASIC are trying to deal with, by saying, 'Because of a live market, it is very hard to go through.' I use the word 'cumbersome' pejoratively, but it can drag out over many months, if not longer. They are looking for a more rapid response to try to keep the market fully informed. Are ASIC, in your

view, just wrong? Are they not using the powers they currently have correctly, are they just overstating their case or are they just gun-shy?

Prof. Adams—It is my opinion that ASIC have very strong powers, which are required. I think their effective use—and I am now speculating—is a question of their resources. As we know from the HIH royal commission, there are a lot of matters which flow and they are stretched on other matters in terms of their resources. My opening statement in respect of the Financial Services Reform Act is important here: there are many staff tied up in the licensing regime and the enforcement which flows from that—it is phenomenal. It is still our premise that this particular provision would be an extension of their powers and we are not convinced that it will improve continuous disclosure. In fact, it will put ASIC in the difficult position of having to use this pretty heavy-handed criminal sanction without necessarily getting a better outcome. I think enforceable undertakings, as one particular example, are a very useful method—that is, if they feel they can do that reasonably expeditiously.

Senator CONROY—Those are all of my questions. I would have happily asked Professor Adams about some of the other issues to do with accounting, but, as he has indicated, it was a joint submission really. I will not take up his time. We might get the other professor in and have a chat with him.

CHAIRMAN—In relation to the whistleblower issue, my understanding is that, in a similar context, reports to the ACCC can be made anonymously. Under this legislation they cannot be made anonymously to ASIC. Do you see that as a drawback or is it important that people in this context do have to identify themselves?

Prof. Adams—That is a very good comparison in terms of the ACCC, its authority and how it operates. I think there are some benefits in the person coming forward being identified and being able to elaborate and verify their claims to a certain extent. We mentioned earlier that if they have an honest belief, and possibly a reasonable belief, that there has been a contravention then it would enable ASIC to test that at that level. If it is anonymous then obviously it is difficult in terms of surveillance. We have already provided you with figures—and the ASIC annual report also mentions this—that ASIC would be very stretched in their ability to investigate and analyse a large number of complaints, if that is what was to occur. That could be a problem there. Certainly that gets around the issue of the individual wishing to disclose their particular position, expect they are an employee. They would be aware of the consequences of informing on their employer.

CHAIRMAN—How do you draw a distinction between that and the modus operandi of the ACCC? Is it a different context in which they are operating in terms of being able to follow through without the detail?

Prof. Adams—Yes. Without necessarily being an expert on the ACCC, I would imagine that a number of their complaints would probably have a greater consumer focus. Here they are more likely to be an employee. That is quite a different status. Someone who has had bad dealings with a shop is going to be in a different position to somebody who has worked there for 20 years and seen inappropriate behaviour. In the HIH royal commission Justice Neville Owen articulated the role of culture and corporate compliance, and that fits in here too. It would be a very big

thing for someone to come forward, but to make it anonymous, I think, could have its own issues.

CHAIRMAN—Thank you very much for your appearance before the committee, Professor Adams. Your evidence has been very useful in our inquiry.

Prof. Adams—Thank you very much indeed.

[10.48 a.m.]

COLEMAN, Mr Michael John, National Managing Partner, Risk and Regulation, KPMG

FISK, Mr Adrian, Partner, Department of Professional Practice, KPMG

CHAIRMAN—Welcome. Do the representatives of KPMG have any comments to make on the capacity in which they appear before the committee?

Mr Coleman—In our structure, I am responsible for ensuring that we comply with all aspects of corporate law in Australia and with our auditing standards. I have also been involved with the Institute of Chartered Accountants and CPA Australia in helping to put their submissions together.

Mr Fisk—I have also been involved in our submissions along with the institute on CLERP 9.

CHAIRMAN—The committee prefers that all evidence be given in public, but if at any stage of your evidence or in response to questions you wish to respond in private you may request that of the committee and we will consider such a request to move in camera. We have before us the written submission from KPMG, which we have numbered 33. Are there any alterations or additions you wish to make to the written submission?

Mr Coleman—No.

CHAIRMAN—I invite you to make a brief opening statement, at the conclusion of which we will move to questions.

Mr Coleman—On behalf of KPMG I would like to welcome the joint committee's inquiry into the CLERP 9 bill. KPMG, in conjunction with the profession, provided submissions to the committee on 17 November 2003 at the exposure bill stage. On 4 December the government introduced the CLERP 9 legislation incorporating a significant amount, but not all, of the technical improvements that submissions suggested should be considered. KPMG believe that the CLERP 9 legislation supports both the intent and substance of the HIH recommendations and supports the principles based approach to achieving CLERP 9 objectives—those objectives being to promote transparency, accountability and shareholder rights. We recognise that confidence in financial reporting needs to be restored and enhanced. As a result we have been working with industry, government and other stakeholders to achieve this.

One of the things that KPMG have done to try and achieve this is establish the Audit Committee Institute, which is a virtual institute providing a range of resources, including publications and forums, designed to facilitate the exchange of views and insights on audit committee best practice and process, as well as introducing a number of topics of interest to boards and audit committees generally. KPMG were also the first accounting and auditing firm in Australia to have an independent review taken of key aspects of our audit practice. This review was conducted by Professor Keith Houghton and Professor Ken Trotman. We are very happy to say that their response to that was very good.

In addition to that, KPMG are very aware of the action that has been taken by the accounting profession, in particular IFAC, in trying to enhance overall understanding and awareness of the financial accounting issues that are important out there. Professor Ian Ramsay was a participant in a study that was undertaken by IFAC. That study reported in July 2003. The report highlighted that the process of improving financial reporting generally was a process that required the contributions of a number of contributors—accounting firms, audit firms, directors, management and the whole of the analyst community—and that improvements in financial reporting were not the sole responsibility of any one particular party. It is important that the legislative and professional response to restoring that confidence be managed to ensure an outcome that is both in the public interest and beneficial to Australia's capital markets.

Following the detailed review of the exposure bill draft, KPMG, the institute and CPA contributed to the overall submission by the profession. We suggested some technical improvements to the bill. The improvements that were suggested were quite significant and very detailed. The government adopted a number, but not all, of those technical improvements. In particular, KPMG supports certain CLERP 9 initiatives to enhance and strengthen the role of the independent auditor, not the least of which is the general auditor independence test that was originally recommended by Professor Ramsay, as well as a definition of 'immediate family members' that makes sense, the importance of rotating lead audit engagement partners, and the issue of cooling-off periods—it is appropriate to have cooling-off periods, but of a sensible length. We understand the process behind having an expanded section 311 of the Corporations Law, and we do really support the establishment of a financial reporting panel.

However, to make the bill truly workable, we think that two other things need to be considered. To the extent that there is a limitation on audit partners joining the board or management of an audit client, we think that it should only apply to those partners who have been involved in the audit, not all partners in the firm. We are also very concerned about the impact of the review or rotation of audit and review partners—it needs to take into account that in some of the smaller capital cities and in rural and regional Australia it will be difficult to achieve all of this.

Overall, we are committed to demonstrating our independence in the new future through the foundations provided under CLERP 9, including a strong, principles based approach to independence and the increased disclosure of non-audit services to audit clients. We are very happy to attend and to respond to questions about the audit at company annual general meetings. It is already a policy of ours to attend annual general meetings, so putting that in law will not change the way in which we deal with those things. We also are very happy to confirm to the board that we are independent; we already do that as a matter of policy. We are very happy to subject ourselves to an appropriate level of oversight of the auditing profession. I hope that that expands on our submission. I am more than happy to answer any questions.

CHAIRMAN—Thank you very much, Mr Coleman. Do you have anything to add, Mr Fisk?

Mr Fisk—No.

CHAIRMAN—You refer to the one size fits all nature of the CLERP legislation, which is an issue of concern I have had with the overall financial services reform approach. Beneficial as it might be, I think there are areas where one size does not fit all—in particular, you referred to the

small and medium enterprise sector. Can you enlarge on what you might see as perhaps some detrimental effects that CLERP 9 might have in that area?

Mr Coleman—In particular, I think there are a large number of entities that are concerned about the requirements, for example, to have an audit committee and what size enterprise should require an audit committee. As you will no doubt be aware, there are 1,500 listed entities in Australia, but when you actually think about the top 500, by the time you get to 500 we are down to companies that have very small market capitalisation. As a result, some of the very specific rules that will be included in here for all public companies may not appropriately apply to those smaller entities. To the extent that the CLERP 9 legislation will expand to all companies, those companies that are not listed entities, I think that we need to be conscious of the fact that there is a significant administrative cost around complying with all of the issues that are in CLERP 9 and we have to recognise that a lot of the issues that have led to the provisions that are in CLERP 9 reflect issues that have occurred overseas in listed public markets, not unlisted markets, with small enterprises. So I think it is horses for courses—making sure that we are dealing with the rights sorts of entities.

CHAIRMAN—Would you introduce a size test in relation to some of these requirements?

Mr Coleman—I am not sure what you mean by a size test, to be honest.

CHAIRMAN—The CPA submission refers to the United States and the United Kingdom legislation, where the capital size of the company is used to differentiate it.

Mr Coleman—Yes, I think that that is an appropriate differentiation, not only in relation to CLERP 9 itself but also in relation to some of the financial reporting aspects of entities. You have only to look at the financial statements of some of the larger entities to realise that for a small enterprise the reporting obligations are significant and onerous.

CHAIRMAN—The committee made a recommendation on this some time ago which is still lost somewhere in the bowels of government decision making.

Mr Coleman—I can understand that sometimes it is difficult to come up with the right sort of test, because it can be related to the number of employees, it can be related to the size of the entity or it can be related to the size of the balance sheet. But, at the end of the day, it makes a lot of sense to make allowances for the size of our marketplace. Other marketplaces make allowances for that. In most of the European Union, there are allowances that are made for entities that are below certain thresholds and they do not have to comply with all the rules.

Senator CONROY—Accounting standard AASB 1046, 'Director and executive disclosures by disclosing entities', sets out the requirements for disclosure of remuneration under the accounting standards. In addition, companies will be required to disclose the information set out in the regulations. The draft regulations have not been released, but we understand that disclosure will be based on the accounting standards. Your joint submission says that it will be confusing for users and preparers of financial statements to have different disclosures in different locations. How do we overcome that problem?

Mr Coleman—In my opinion you just have only one requirement: the requirement that is included in the accounting standard. If you do have a requirement in an accounting standard and in a regulation, you will always have issues to do with interpretation, and the things that you might disclose in one place might be different. I do think that financial statements are lengthy enough and potentially confusing enough to the uninformed as it is, without having the same sorts of words being used to describe slightly different, or even significantly different, numbers.

Senator CONROY—If we follow that through, though, and we only required disclosure under the accounting standard, some of the additional disclosures would not be made. An example is the basis upon which remuneration packages are calculated and how this relates to fulfilments. How would you overcome that? Would you import everything into the one accounting standard, because the accounting standard has been done on a different basis to the Treasury reg and the Treasury reg is broader? How do we overcome that? Or are you just saying, 'Don't worry about the ones that aren't included in the accounting standard'?

Mr Coleman—On my understanding of the philosophy behind these disclosures, it has been agreed that it is appropriate that the accounting standard should deal with all those types of disclosures. If for some reason there is a view that the accounting standard is not giving the appropriate disclosures then submissions can be made to the Accounting Standards Board.

Senator CONROY—So you would like the parliament to make a submission to the Accounting Standards Board asking it to disclose what we currently think should be disclosed.

Mr Coleman—I think it would be an appropriate approach for the parliament to make that sort of submission. It really is very important that financial statements are as clear as possible. As someone who has been involved in auditing financial statements, I have been conscious of the fact, under previous regimes where there have been uncertainties about the way in which you might define certain words for accounting standard purposes and under the legislation, that it is much better to have it all in the one place.

Senator CONROY—Disclosures made under the accounting standard are not subject to the non-binding vote. How do you propose to overcome that problem? The non-binding vote is one of the things that will definitely go through, because all three parties are supporting it.

Mr Coleman—Just because the disclosure is included in the accounting standard—I am not a lawyer of course—

Senator CONROY—Thankfully. I am grateful for that, don't worry!

Mr Coleman—I am not a lawyer so I would not want to stumble into areas that I do not know enough about, but I would have thought that if the disclosure is included in the financial statements then the non-binding vote is related to whether or not you accept the report that is included there. I would hope that the report upon which the non-binding vote is taken will be based on the numbers that are provided in the financial statements in accordance with an accounting standard.

Senator CONROY—Could you advise the committee on how the IFAC rules differ from the requirements in CLERP 9? There have been some submissions earlier that we should go for the IFAC rules rather than CLERP 9.

Mr Coleman—Do you mean the IFAC rules in relation to auditor independence?

Senator CONROY—Yes.

Mr Coleman—I do not think that they are fundamentally different. I think that they are along much the same sorts of lines. CLERP 9 as it stands at the moment—correct me if I am wrong, Adrian—has no specific prohibition on the provision of non-audit services by an auditor. In the same way, the IFAC rules have no specific prohibition, but the IFAC rules say that an auditor and whatever group of parties is governing the enterprise should consider what is called a 'threats and safeguards approach'. In other words, you identify a threat to independence and you satisfy yourself that certain safeguards are in place. The safeguard that CLERP 9 proposes would be put in place is full disclosure of the non-audit services as well as a statement by the auditor to the board that the auditor is satisfied that any non-audit services that have been provided have not impaired the auditor's independence. That is followed up as well by a confirmation by the directors that there has been no service provided.

In many ways, I think this deals with Senator Chapman's issue of the impact on the smaller enterprise. A lot of smaller enterprises have been concerned that if we progress fully down a path where companies feel inhibited in using their auditor to provide non-audit services, then where you have a small enterprise where the audit fee might be as little as, say, $20,000 or $30,000, there is a concern that the non-audit services may on the face of it appear to be very high. But provided that the directors and the auditors are satisfied that they are not auditing their own work, that they are not actually creating a problem, then, again, the provisions that are in CLERP 9 seem to me to make a lot of sense.

Senator CONROY—Are there any services that you believe an audit firm should not provide?

Mr Coleman—Provided you comply with the safeguards and threats approach that is included in the professional standard, no. But F1, which is the professional standard on auditor independence, says that there will be certain circumstances where it is hard to imagine that any safeguard could avoid that threat. So to a very large extent the use of the F1 standard leads you into an environment where you have to be satisfied before you do provide certain services that you are not causing an independence problem.

Senator CONROY—Given that you just said you do not think there are any.

Mr Coleman—Under certain circumstances. As I said, the standard—the professional statement, I think it is—actually says that in some instances it is unlikely that the safeguards that you could put in place would ever obviate the threat to independence.

Senator CONROY—Help the committee: what would be that sort of circumstance?

Mr Coleman—One circumstance would be where an audit firm is providing a valuation of an asset and that valuation is included in the financial statements. It is very hard to imagine that a valuation that has been prepared by the auditor could be done with a sufficient degree of independence for the auditor to—

Senator CONROY—It would be unlikely, if you have provided the number, that you would ever argue: 'Here's the number I provided. Now let me audit it. No, I agree with myself!'

Mr Coleman—KPMG policy prevents us from undertaking that work. But it is possible, even with that circumstance, for the directors to have some sort of safeguard in place. For example, they may have a valuer on the board and that—

Senator CONROY—Do many companies have valuers on their boards?

Mr Coleman—Yes. I would have thought that real estate companies probably do. So there might be circumstances where the board, either through internal or other resources, might feel that they can get a second check on those sorts of numbers. That is the expectation of F1: that there will be circumstances.

Senator CONROY—In the case of valuations it seems fairly clear cut. What are the other areas where there are conflicts that F1 is alluding to?

Mr Coleman—I cannot remember all of them, off the top of my head, but valuations is certainly one area. There is a general acceptance in this marketplace that the external audit firms should not provide internal audit services. Again, I believe that there is a very good argument that it is possible for you to provide internal audit services.

Senator CONROY—Tell me what it is.

Mr Coleman—Internal audit services are often perceived by companies to be related to the question of whether or not that entity has controls in place. If the internal auditor were providing a role that involved, say, the approval of disbursements, then in that particular instance I think it would be inappropriate for that internal audit service to be provided by the external auditor, because the external auditor needs to consider that process. There might be other instances where an internal auditor is providing management assist services. The concept of internal audit in this day and age has expanded significantly.

Senator CONROY—I have banged my head on a desk when trying to have that discussion with a number of people, saying, 'Tell me what it is?' It has just mushroomed.

Mr Coleman—Internal audit is as broad or as narrow as you wish it to be.

Senator CONROY—Exactly.

Mr Coleman—Personally, I think a blanket prohibition on the provision of internal audit services by an external auditor is not really rational. Despite that, we all accept that the provision of internal audit services is the sort of service that many perceive is inconsistent with external audit and, as a result—

Senator CONROY—On that point, if you set up the risk management controls and then you are called in to audit the risk management controls it would seem hard to think that you would be overly critical of your own work.

Mr Coleman—I think that is all to do with perception, and I think the professionalism of auditors should overcome that issue. But, as we all know, independence has two legs to it: perception as well as reality. My own personal view is that auditors are professional enough to deal with the issue that you are concerned about. Sometimes those issues arise, mainly due to perception. Again, it depends on the nature of the risk management system—for example, the risk management system that is in place is related to compliance with CO_2 emissions. That does not work its way through to the financial statements, so it is not something that has anything to do with the numbers that appear in the financial accounts. Again, under those circumstances, I think you can put in place safeguards to deal with it.

Senator CONROY—Let us talk about risk management systems at the moment. An organisation is auditing the company, it audits its risk management systems, the senior partner or lead partner goes across to work for the company in various risk managements, the same accounting firm keeps the audit function. Do you think any conflict or perception of conflict can arise there?

Mr Coleman—Again, I think you have to make a distinction between what an audit, the financial statements and the entire risk management processes are all about. I am sorry if I am going to be stating the obvious to you, but the audit of financial statements is all about whether the financial statements have been prepared in accordance with accounting standards and whether they present a true and fair view.

Senator CONROY—But an audit also looks at risk management systems.

Mr Coleman—The auditor has to take account of the risk management systems that are in place.

Senator CONROY—That is what an auditor does, though. Part of their job is to look at the risk management systems.

Mr Coleman—Not the entire risk management system. There is nothing in the audit report of the financial statements that says that the auditor says the risk management process is appropriate.

Senator CONROY—But surely there has to be some test. The auditor looks at a set of numbers—

Mr Coleman—Prepared via a system.

Senator CONROY—prepared via a system. They have to have confidence that the system that is delivering the numbers is robust.

Mr Coleman—I think that is the very important distinction that we need to make: the auditor needs to be satisfied that the system that is in place to produce the numbers in a financial statement is appropriate.

Senator CONROY—You have to stress test it. Isn't that what a robust system does?

Mr Coleman—I will extend that comment. Firstly, you are dealing with systems that produce the numbers. The financial statements are materially correct, having regard to the numbers that are presented. Obviously, every auditor is very aware of the fact that the financial statements have to be prepared, having regard to an understanding of the financial reporting systems that are in place, having regard to the company's compliance with accounting standards and having regard to the materiality of certain numbers. So within that context, yes, the auditor does take account of the risk management systems but in no way, shape or form does a financial statement auditor give a sign-off that their risk management systems are perfectly accurate and in place.

Senator CONROY—If they are unhappy with the risk management system, do they have an obligation to say so? Does it lead to a qualification? Is this a sin of omission here?

Mr Coleman—The question is who you would report to and how material the weakness is.

Senator CONROY—We know that some boards have been asleep at the wheel. Things can be reported to boards and they just do not notice them.

Mr Coleman—If there are weaknesses then quite clearly the auditor, through what is typically called a management letter, will refer those weaknesses to management. If the weakness is considered to be significant and may have an impact on the financial statements then the auditor will report that to management.

Senator CONROY—Would they report that to the audit committee?

Mr Coleman—It depends on the materiality; it depends on how significant the issue is. Again, it is very important to remember that the financial statements are a set of numbers that have to be read, taking the financial statements as a whole. Something that might be material in one entity is not necessarily material in another, and something that is material at a point in time may not be material at another point.

Senator CONROY—That is a fair point. Does it disappoint you if issues are reported to the audit committee and nothing seems to happen? Have you ever experienced that?

Mr Coleman—In a long career—I have been an auditor for 34 years—audit committees are a reasonably new animal. They have probably only been around for about 10 years.

Senator CONROY—They are a relatively new phenomenon.

Mr Coleman—There have been plenty of times when management and/or boards have not necessarily agreed with my view. Typically, under those circumstances, if I have been satisfied that there has not been a material impact on the financial statements as a result of that, then it is management's business to run the business. My job is to do an audit of the financial statements

and draw things of which I have become aware to their attention. Over time, if those issues become more significant or if they are not being resolved then ultimately I will take it further.

Senator CONROY—You might even write to the chair and find that that is ignored as well. Putting aside the debate about whether the cooling-off period should be two, three or four years, people now seem to be comfortable with the concept that there should be a cooling-off period. Whose job is it to enforce this? I am wondering how this will work out there in the real world. If a lead partner decides to move across to a company that they have been auditing, is it your job to say, 'No, you can't do that; you're breaching the cooling-off period'? Is it the board's job or the management's job to say, 'No, you can't hire them'? What obligation do you think you will have at your end to say, 'No, you can't do that'?

Mr Coleman—Having regard to employment law, it is very difficult for us to prevent somebody from going somewhere where they think that they should go.

Senator CONROY—This can work in two ways: the company could say either, 'No, we're not taking the person', or 'We're taking the person and you've lost your audit.'

Mr Coleman—That is already happening.

Senator CONROY—It is possible for either of those two things to work in compliance with the law. I am trying to understand how you cope with it.

Mr Coleman—At the moment we do not have that situation in the law. It will be in the law should CLERP 9 be passed in its current form. I would expect that we would be in a position where, if a partner of ours was to leave us and within 12 months that partner decided to take up a board position at an audit client, then quite clearly we would have two options. Either we would hope that that person did not take up the board position until the cooling-off period was over or alternatively we would have no option but to resign. However, you also have to take into account that we cannot just resign from an audit willy-nilly; ASIC would have to approve it. I am not entirely sure how it would work. I am hoping that, in a practical sense, we will all be aware of the issues—

Senator CONROY—I am trying to work out how it will work in the real world for you. It must be taxing your mind a bit.

Mr Coleman—Yes, it is, but it is an environment that already exists in other places. As you are probably aware, it operates in the United States.

Senator CONROY—Sure. I think you indicated general support for a cooling-off period concept, certainly for board positions. Do you think that applies to when partners move across into senior management roles?

Mr Coleman—If it involves a role where the person who leaves the firm is involved in those critical systems that lead to the preparation of financial statements then I do think it makes a lot of sense for it to apply at that level as well. But I do not think it should necessarily apply willy-nilly across the whole range.

Senator CONROY—Corporate Governance International—one of the previous witnesses—has suggested that an auditor of a parent company should not audit a subsidiary company of the parent company. Do you think there is any conflict there or is that just being overly sensitive?

Mr Coleman—I am not even sure I understand the point—I do not know whether or not you do, Adrian. I am just trying to think it through: parent company A has a subsidiary B and Corporate Governance International has said—

Senator CONROY—Their belief is that KPMG should not audit both of them. They are on both ends of the transaction.

Mr Coleman—That is an impossible situation, because the auditor in Australia is responsible for the consolidated financial statements.

Senator CONROY—It could be that there is an overseas parent company.

Mr Coleman—An overseas parent and a local subsidiary?

Senator CONROY—Yes.

Mr Coleman—Again, my own personal preference as an auditor is that my firm audits all the companies that form a part of the consolidated group, simply because I have a responsibility for signing an audit opinion on the financial statements for the group as a whole—the consolidated accounts. Certainly under Australian law, if I am auditing the books of the parent and I am also providing an audit opinion on the consolidated accounts, I have to satisfy myself that the accounts of the subsidiary are okay. So I would actually prefer to do the audit. I do not understand their point.

Senator CONROY—I think the point they are making is about unlisted companies—an unlisted company that has a subsidiary.

Mr Coleman—So the parent is unlisted and the subsidiary is listed?

Senator CONROY—Yes.

Mr Coleman—It is not an environment that we find all that often in Australia. It is probably something that you see more often in Asia where there is usually a strong family relationship and a listed company may be an offshoot of the parent—

Senator CONROY—I think the next example will get more to the substance.

Mr Coleman—I am not sure that I understand the problem.

Senator CONROY—They also suggest that the auditor of a company should not audit another company if there are major transactions between the two companies.

Mr Coleman—I presume you are saying in that instance that they are separate entities; there is no ownership interest between the two but there is a major transaction between the two.

Senator CONROY—Yes, totally separate ownership.

Mr Coleman—The same firm should not do it or the same people should not do it within the same firm?

Senator CONROY—I think they are suggesting the firm rather than the people. I guess that comes down to an argument about Chinese walls.

Mr Coleman—I am sorry if I am going to be a bit obtuse here. But it seems to me that, if you follow that rule in a world where only four large accounting firms have the capacity to do that, you could very quickly find yourself in a position where you have not got the entities or audit firms that have the capability to do it. It is fine just between two. Again, with transactions between the two, there would be rules and procedures within the firms, I am sure, to make sure that there was not a crossover and Chinese walls. Surely you would have different engagement partners involved—and, again, that adds another dimension to it.

Senator CONROY—Your joint submission says that you support the disclosure of the amounts paid to auditors of both audit and non-audit services. The CLERP 9 bill does not define what non-audit services are.

Mr Coleman—Yes, that is right.

Senator CONROY—Can you advise the committee which non-audit services will be subject to the requirement that dollar amounts are disclosed? We have been talking about F1. The bill does not give any guidance; it just talks about non-audit services.

Mr Coleman—That is right.

Senator CONROY—How are you going to implement that on a practical level?

Mr Coleman—The existing accounting centre gives some guidance.

Mr Fisk—It talks about those that are not as a result of the financial statement audit. That causes complexity in that, if you have the audit services as those relating to the audit engagement of the financial statements only and then you have a whole lot of other services that may be performed for a whole lot of other reasons which would be excluded—for example, in a highly regulatory environment where we would provide audit reports to regulators—those things would be included in non-audit services.

Senator CONROY—Is there a consolidated place where we are going to be able to find this?

Mr Fisk—The total amount of services will be disclosed under the accounting standards, but the definitions of non-audit services versus audit services will result in things that are purely audit work ending up in the non-audit services area.

Mr Coleman—Interestingly, Australia led the way in the disclosure of non-audit services. I think it was the 1961 Corporations Act that required the disclosure of services for audit and for

other. All that has happened in recent times is that there has been a call for the disclosure of other to be expanded, so there is a greater disclosure of that.

Senator CONROY—I want to touch on something that is sensitive for you, but I want to draw on the generality of it rather than go into the individual circumstance. In light of the SEC's investigation into NAB and Australian accounting firms, the question for Australia is whether we want to have lower standards of auditor independence than the US. Last week Roel Campos—who was visiting—justified the more stringent requirements in the US by saying that it was a privilege for companies to raise capital in the US and access the low cost of capital and liquidity that exists there. I would argue that a similar argument can be made for companies here in Australia. Do you agree that we have lower standards than in the US?

Mr Coleman—No.

Senator CONROY—What percentage of your clients pay more for non-audit services than for audit services?

Mr Coleman—I do not have that sort of—

Senator CONROY—That is okay. We are happy for you to take it on notice and get back to us if you can. I do not want you to send off somebody who is able to do it for a week to work it out. If it is relatively easy to calculate, could you let us know.

Mr Coleman—I do not know that we can do it, but there are plenty of marketplace analyses that have been done of public listed entities.

Senator CONROY—The Australian Shareholders Association have advised the committee that, in their view, there is a potential motivation for auditors to compromise on auditing services in order to maintain the work flowing from non-audit services. Would you agree with that?

Mr Coleman—No. Again, I do not agree simply because—

Senator CONROY—'No' is fairly definitive, so I was hoping you would expand.

Mr Coleman—I do believe that the auditing profession is just that—a profession. It is highly professional. It does not allow those things to interfere. A very large number of academic studies have been done that have been unable to suggest any link between the provision of non-audit services and audit failure. It is one of those statements that are made by people, without having any empirical evidence to back it up.

CHAIRMAN—So you would not accept the argument that audit services are used as a loss leader by accounting firms to get other, more lucrative work?

Mr Coleman—Every service provided by any professional adviser is, at the end of the day, provided in a market environment where you have to compete with others to provide those services. Sometimes price is a part of the debate. Certainly, I am not aware of any situation where there has been an audit undertaken at a fee to try to lead into other work, simply because the risk of getting the audit wrong is too great.

Senator CONROY—You are not the first to put the argument to the committee, or to me directly: 'Trust us. We wouldn't possibly want to damage our professional reputation by doing anything other than what was completely obvious.'

Mr Coleman—You also have to recognise that it is the cost to us of professional indemnity insurance and the cost to us of litigation if we get it wrong.

Senator CONROY—Anderson's made those arguments very passionately before they were wiped off the face of the corporate world. The 'trust us' argument did not seem to save them and they maintained that case very strongly, right up until they vanished. Keith Alfredson has made a submission to this inquiry. You may not have seen it, so hopefully I will try to explain it sufficiently so that you will be able to assist the committee.

In relation to 'true and fair view', he rejects the joint parliamentary committee's recommendation that the directors' report should set out the directors' reasons why compliance with accounting standards would not result in the financial statements giving a true and fair view. He says that the financial reports must stand alone and that to include the same information in the directors' report, which is not audited, will lead to unnecessary duplication and possible confusion. Do you have a view on that?

Mr Coleman—I would certainly agree with Keith that it should not be in the directors' report. I agree with him that the information should be included in the financial statements. If directors do believe that the financial statements prepared in accordance with the accounting standards are not going to present a true and fair view, then they should include that sort of information in a note to the accounts, not in the directors' report. So I agree with Keith in that regard.

Senator CONROY—The joint submission says that the role of the FRP should be expanded to include a role for adjudication on issues prior to publication of the financial reports. Could you advise the committee why this pre-publication role is required?

Mr Coleman—I am sure you have read the HIH royal commission report by Justice Owen. The HIH royal commission report recommended that there should be some sort of mechanism to deal with issues such as that. If the financial reporting panel has the opportunity to consider contentious issues, particularly issues where there can be different interpretations of accounting standards or different ways of dealing with complex issues, I think it would be very useful to have some sort of panel to approve those things in advance. It is always a complex area, though. If you do give a pre-approval, it is probably the same as the tax office giving a private binding ruling.

Senator CONROY—I was just going to talk about private binding rulings and where that has led the tax office—which is ultimately to disaster.

Mr Coleman—It is difficult to actually consider all of the circumstances. A reporting panel that has the capacity to opine in advance has to be sure that it is opining in advance on all of the facts, and it has to be very aware that it is in fact—

Senator CONROY—They would almost have to come in and do the audit themselves.

Mr Coleman—That is one of the difficulties of doing it. But the practical issue that we are all going to have to deal with, if the financial reporting panel is put in place and it has a capacity to form a view after the event about whether or not a set of financial statements have been prepared in accordance with an accounting standard, is that it would be useful to have some sort of guidance. So a pre-panel would be useful, but really only in those very difficult and complex cases where there is a clear lack of certainty.

Senator CONROY—Do you think that panel might be able to help us work out what a lease is? Given the combined wisdom of—

Mr Coleman—As I said, I have been in this game for 35 years. I think the first accounting standard on leases was issued about the same time I started in the profession, and there has been a lot of debate around the topic since. They may be able to give us some guidance.

Senator CONROY—Is that a no?

Mr Coleman—We will argue until the cows come home about whether or not a lease is an obligation. Legally, in Australia, a lease is not a liability. I think I am straying into the legal area, but I have actually got an opinion there.

Senator CONROY—I forgive you.

Mr Coleman—As I understand it, the legal opinion is that you only have an obligation in relation to a lease each time you are due to pay it.

Senator CONROY—It just seems the principle has been subverted by the legal view there.

Mr Coleman—No, because the accounting standard tries to make a distinction between a finance lease and an operating lease. A finance lease—

Senator CONROY—I keep asking people to explain to me the difference, and I am still struggling.

Mr Coleman—I think it is pretty simple. If you go and hire an Avis car, you have use of that car for a week, two weeks or something like that, you pay whatever you pay and you give the car back at the end of that time, that is clearly an operating lease because you have only got the use of a facility for a short period of time. But if you enter into a lease transaction that you keep paying lease payments on, say—

Senator CONROY—A jumbo jet.

Mr Coleman—Let us use the car example again, because I think it still works. You have bought a car, you know what the market price is of the car on the day that you first get usage of it, and you lease it over a period of time. At the end of that period of time, if you pay a guaranteed amount of money you can buy the car and it becomes your property. Under those circumstances, that is a finance lease because you are financing the purchase of the car.

It gets complicated—even with the car—where you have an option to purchase the car at the end of the lease or you just give it straight back to the person who has leased it to you, or where you have not been purchasing it but you have been using it over a period of time and you have been paying a certain amount of money for its usage. If you do that for two weeks or three years, it is hard to make a distinction. That is why it is a complex area. That is why it is not something that you can have specific rules about. Interestingly, the United States has a very specific rule in relation to whether something is or is not a finance lease. In the United States you find lease transactions crafted in such a way that they just fit within or just outside those rules.

Senator CONROY—David Tweedie seems to have a very firm view on what a lease is.

Mr Coleman—Yes, that is right. But a lot of other people have very firm views about all sorts of things.

CHAIRMAN—Professor Adams from UTS—our previous witness—said that the bill does not consider variations in auditor competence and industry expertise. This is in relation to mandatory rotation of audit firms.

Mr Coleman—Is he proposing that it should happen?

CHAIRMAN—No, he is raising a concern about it. He says that, if mandatory rotation forces rotation beyond the top two local industry experts, sometimes clients will lose the industry expertise they have come to rely upon and are prepared to pay for and others will be expected to pay more for competence they do not require. Do you think that is a likely outcome of rotation requirements?

Mr Coleman—If we are talking about the rotation of lead audit partners and review partners, to a large extent the rotation requirements do make it more important for accounting firms to be of a certain scale so that they are able to have the depth of competence to enable rotation to occur. If you are taking that concept in isolation and talking only about smaller companies, then I think it does become a real problem.

CHAIRMAN—The UTS submission—of which Professor Adams was a part—suggests that the auditor rotation ought to be left in the hands of boards and audit committees to decide.

Mr Coleman—I would agree fundamentally with that. In fact, a study was completed recently in the United States by the Office of the Comptroller of the Currency. That report was promoted by the so-called Sarbanes-Oxley legislation. My understanding of that report is that it came up with much the same conclusion: auditor rotation is something that should be left in the hands of boards and audit committees. But, as a matter of course, KPMG in Australia do enforce partner rotation with our listed clients. Our reason for enforcing it is that we believe the marketplace expects that to occur.

CHAIRMAN—How do KPMG manage the potential risk to auditor independence? An audit partner might derive a significant proportion of their income from one client.

Mr Coleman—An individual partner?

CHAIRMAN—Yes, an audit partner.

Mr Coleman—The reality of the size of our firm is that that is not the case. The reality of the size of our firm is that there is no one partner who has a significant share of the remuneration that comes from one client. When you get to the very large clients, you may see one partner's signature on a set of financial statements but there may be a very large number of partners supporting that person. So you would not actually find one audit client representing a significant part of one partner's remuneration.

Senator CONROY—We had a discussion with Deloittes about this last week. We asked them: if a partner had one of the really big companies, say, a bank, would that partner have other clients? They felt that in the case of a company that large—it could be BHP—it would be unlikely that the partner would have any other major clients, although they may do a small amount of other work. Is that not the case with your company?

Mr Coleman—No, that is the case. But what I am saying is that, on a job of that size, that partner would be supported by a large number of other partners. The fact that that individual's remuneration—

Senator CONROY—Your views on remuneration would help us add to our discussion with Deloittes. Given that the entire amount of money that a partner drags into the general company pool is from one income stream, it becomes critical for them to maintain that stream of income—because I am sure it is the case in every company that, if you do not drag in an income, you are ultimately going to struggle to hold your place. Does your company use a pool where everyone's money is put in and money is doled out to the partners on the basis of the general level of the pool or on the proportion that a partner brings in? How does remuneration work in your company?

Mr Coleman—I have not come here prepared to discuss the remuneration system. As a private partnership that is proprietary issue.

Senator CONROY—That is a fair response. You might want to respond to the general question.

Mr Coleman—In general, the partner remuneration system is a pool system. In general, partners are remunerated based upon a series of competency levels. Within our firm we have nine competencies against which we are assessed. There is a rigorous assessment process annually, and partners' remuneration annually is based upon how they fit that. Without doubt, a partner who is dealing with a very large entity has been selected to deal with the audit of that very large entity because of, amongst other things, their technical competence and their ability to understand and to grapple with the issues. So the partner is not remunerated directly on the basis of the fees that they bring in.

Senator CONROY—But it is a component. In a general sense, it would be silly to say that it does not matter how much money they bring in.

Mr Coleman—Correct. But there is a heavy focus on technical competence.

Mr Fisk—Generally, those engagements would have a reviewing partner who would be outside that engagement, and they would also be subject to our internal review processes to ensure that they are doing an appropriate audit.

CHAIRMAN—Maurice Blackburn Cashman raised a concern in their submission about proportionate liabilities. They said that applying proportionate liability will unfairly shift the burden from parties who have been found guilty of some wrongdoing to the plaintiff who has not been found guilty of any wrongdoing. They suggested that it should be abandoned altogether or, failing that, the bill should follow the Queensland legislation that applies proportionate liability only to claims exceeding half a million dollars and enables plaintiffs to claim the contribution owed by an insolvent defendant from other liable defendants. What is your response to that proposition from Maurice Blackburn Cashman?

Mr Coleman—Personally I am passionately in favour of proportionate liability. I think the corollary to the argument that is there that says that a guilty party is somehow saved from liability is fallacious. The alternative is joint and several liability, and joint and several liability has had the unfortunate response over the years of apportioning most blame for corporate failures, or certainly the cost of paying for corporate failures, to the auditing professions. That is simply because, when a company fails, often the only person left standing is the auditor, notwithstanding the fact that largely most people do admit that the failure of a company is not the failure of an auditor; the failure of a company is to do with things such as the strategic direction of the entity and the types of things they did and it is largely to do with management. So I passionately support the introduction of proportionate liability.

Senator CONROY—I want to ask about the CEO-CFO sign-off.

Mr Coleman—Which is a sign-off to the board.

Senator CONROY—Yes. The CLERP 9 bill requires the sign-off to the board on the financial accounts; however, the ASX corporate guidelines and the approach taken in the US go much further. Both require that the sign-off by the CEO-CFO should say that the statement is founded on a sound system of risk management and internal compliance and control which implements the policies adopted by the board. Let us put aside audit committees and boards that are asleep. In your view, should the CEO-CFO sign-off on the CLERP 9 extend to sign-off on the company's risk management procedures?

Mr Coleman—If you do not mind, I will just make an expansion on that particular topic. Firstly, in Australia typically boards will already be receiving some sort of a sign-off from CEOs and CFOs about the financial statements. It is, in my opinion, pretty rare for a board or an audit committee to accept the financials without some sort of sign-off. The extension that you are talking about is whether or not the CEO and the CFO should sign off on the risk management processes. As I attempted to describe a little earlier, you need to make a distinction between the processes that are designed to arrive at the financial statements and the entire risk management structure. The ASX corporate governance guidelines at the moment do in fact ask that the sign-off in relation to the risk management processes by the CEO and the CFO be across the range of risk management processes. I think that is going to be an extremely difficult thing for CEOs and CFOs to do, because you are talking about the entire range of risks. On one interpretation you are talking about all the risks within the entity.

The United States has actually introduced a concept of a CEO-CFO sign-off in relation to risks, but it is the narrow interpretation of that risk management system that actually gives rise to the preparation of the financial statements. If you actually narrow it to the point where you are talking about the risk management systems related to the preparation of the financial statements, I think that is the sort of thing that a CEO and a CFO can reasonably be expected to do. However, I would highlight the fact that in the United States marketplace, even though the Sarbanes-Oxley legislation became law in July 2002, they are struggling with how to actually achieve it and on many occasions now—I think two or three occasions—they have extended the time during which that needs to be done. So I do think this area is worthy of consideration. I think for us to introduce it into the legislation at this point in time might be difficult, but I think it is certainly something that would be worthy of attention after we see how it works in the United States.

Senator CONROY—It is a 'complier explain', so it is irrelevant really; it is a sort of voluntary code. Thank you.

CHAIRMAN—As there are no further questions, we thank you very much for your appearance before the committee.

[11.49 a.m.]

DUNSFORD, Mr Geoffrey Alan, (Private capacity)

CHAIRMAN—Welcome. The committee prefers that all evidence be given in public but if at any stage of your evidence or responses to questions you wish to respond in private you may request that of the committee and the committee will consider such a request to move in camera. We have before us your written submission, which we have numbered 2. Are there any alterations or additions you wish to make to the written submission?

Mr Dunsford—No, I do not.

CHAIRMAN—I invite you to make a brief opening statement, at the conclusion of which we will have some questions.

Mr Dunsford—Mr Chairman and senators, I have made a relatively short submission. I made it in response to a request from the research officer and that appeared to have come as a result of a letter I wrote to the newspapers on the subject of the valuation of assets and liabilities for the purposes of financial statements. Since the submission is relatively short and, I like to think, reasonably clear I only want to add a few comments to that.

My proposals are simply that companies disclose the current market values of their assets and liabilities in a form which enables comparison with those values which have been adopted for the balance sheet—that is, the statement of financial position. This proposal is not revolutionary. It was indeed suggested at various times during the development of the international accounting standards for financial instruments.

Unfortunately, in my view, the IAS proposals were watered down significantly, such that effectively the latest proposals under the international accounting standards really do not provide sufficient information in this regard. For a start there is a watering down for the purposes of statements, going from market values to fair values. Then, having decided ‘fair value’ which means something a little bit vaguer than ‘market value’, it was made possible for organisations to adopt their own definition of fair value, as opposed to one which really conforms to a prescribed standard.

I have accepted that fair value may in fact be necessary in any proposal that might be put forward along the lines of that which I have in my paper here. But I would like to see ‘fair value’ simply meaning market value or a value—

CHAIRMAN—Nearest approximate.

Mr Dunsford—Nearest approximate: that kind of value. In other words, the focus would be something which reflects a current valuation as opposed to a historical valuation or, for that matter, a particular valuation that has been developed like amortised value or something like that, which is artificial.

Senator BRANDIS—Why shouldn't it say 'true value', that formula in financial statements that an auditor's report is a true and fair value of—

Senator CONROY—Historic cost is a true value; that is the point.

Senator BRANDIS—Or true current value then.

Senator CONROY—True current value means market value.

Mr Dunsford—I accept that you could develop expressions, and all that really matters is that those expressions are given proper definition in any legislation. I have used the expressions 'market' and 'fair' values because they had been developed within financial circles and it seemed to me that following through on those definitions was the purpose, but I can fully support alternatives.

CHAIRMAN—Are you aware that the 'true and fair' new amendments have been dropped from the bill?

Mr Dunsford—No, I am not.

CHAIRMAN—They were in an exposure draft, but they have been dropped.

Mr Dunsford—From the CLERP 9?

CHAIRMAN—Yes.

Mr Dunsford—Is that right? I was unaware of that.

Senator CONROY—They were going backwards fast. Soon it will just be: pick a number, add your mother's age, and that will be the valuation!

CHAIRMAN—Do you have any theories as to why that might have occurred?

Mr Dunsford—Off the top of my head, I can only think that the problem with true and fair view is that it is not adequately defined; that accounting standards have always walked away from attempting to define it. It may well be that the government may take the view that to have two standards—in other words, an accounting standard and a true and fair view standard—may be conflicting. I have to say that I think that is a lot of nonsense, but I suspect that may well be the argument.

CHAIRMAN—So you do not think there is necessarily any inconsistency between an accounting standards view and a true and fair view?

Mr Dunsford—I think there is a definite conflict.

CHAIRMAN—There is?

Mr Dunsford—There is a conflict between true and fair view and accounting standards, in my view, and to avoid the conflict—

CHAIRMAN—Is that because one is based on historic values and one is on current, or are there other areas of conflict?

Mr Dunsford—Historic values are only one part of the standards. The standards have in fact developed further than that but, even so, they still do not provide sufficient information to be able to make genuine judgment of solvency of a company.

CHAIRMAN—If I am interpreting your suggestion correctly, you are saying that a true and fair value should be obtained by giving a current value to all the assets and liabilities.

Mr Dunsford—That is right, yes.

CHAIRMAN—Would that necessarily give a true and fair value of the company as a whole, as an ongoing operating concern?

Mr Dunsford—It would give a true and fair view as far as the balance sheet and statement of financial position are concerned. There is a separate issue of what might be termed 'ongoing profitability' of the company. It is appreciated that if one defines a balance sheet in terms of current values we then have profit numbers which are volatile. Certainly analysts might have some difficulty in attempting to work out or estimate, if you like, the profitability of the company. I do not personally think that is an objection, or sufficient objection. It is quite possible to break profit down into those numbers which might be termed 'according to accounting standards' and, separately, the element which is simply caused by moving from the accounting standards valuations to market values. Having that said, I am not actually recommending or even suggesting that the profit and loss statement changes at all. I am suggesting there is simply a note to the accounts to enable analysts and interested parties to be able to make better judgment of the solvency of the company.

Senator CONROY—Adam Smith has already got a bit of a run this morning, but I think even Adam Smith said, 'The value of something is whatever you can sell it for, and anyone who tries to tell you different is having a lend'! That was back in the 1700s. I can only agree with you there, and you have some interesting people who support you—although I do not know that Adam Smith was an accountant. That is probably why he is ignored.

Mr Dunsford—Yes, I think that is probably right. I am an actuary.

Senator CONROY—I know you are a fan of his, Senator Chapman. I want to address the issue of valuations you have just been talking about. Jacques Chirac is the reason that the IASB has watered down—

Mr Dunsford—It was Jacques Chirac, was it?

Senator CONROY—Yes, it was Chirac. The French banks nobbled Chirac and Chirac nobbled the standard on financial instruments—and it is not even sure that Chirac and the French banks will cop the watered-down version. I think a valuation method involving multiplying by

Keith's handicap, which is a significant number, may give a better valuation process! Australia currently does not have a financial instruments standard at all. Is taking any standard better than no standard?

Mr Dunsford—I do not agree with that, no. I would say that the general principles are better than having an inadequate standard.

Senator CONROY—So what should we do, if we are on this path where we are going to adopt, mindlessly, international standards?

Mr Dunsford—That is why I put the proposal in the way I did. In other words, okay, we accept whatever standard is necessary for the purposes of development of the profit and loss account and the balance sheet, the statement of financial position and financial performance; but, as far as the notes to the accounts are concerned, my view is that it would not be difficult to accept the idea that there should be some further information that the Australian government believe that it is necessary for shareholders to see.

CHAIRMAN—So this should go in the notes rather than in the actual balance sheet and statement?

Mr Dunsford—It just goes in the notes, yes—that is right; not necessarily changing the international accounting standards at all. I think it is worth reflecting that the life insurance industry and the general insurance industry have very much focused on market values of assets and liabilities in terms of judging capital adequacy. It is a shame in the case of HIH that those standards were not in place at that time. But the life insurance standard has been in place now for many years and indeed within the industry the principles had been adopted for some years before that. Maybe it is just my life insurance background, but it seems to me that you cannot judge the solvency of any company unless you actually have market values.

Senator CONROY—Adam Smith would agree with you! What is your background, Mr Dunsford?

Mr Dunsford—My most recent full-time job was as chief actuary of the MLC.

Senator CONROY—So you are an actuary and an accountant?

Mr Dunsford—I am not an accountant, no.

Senator CONROY—One of Justice Owen's recommendations related to alternative accounting treatments. Justice Owen did the royal commission into HIH. He said the following:

> Where alternative accounting treatments are reasonably open from the reading of an accounting standard and the difference between those accounting treatments is material, the impact of the position taken by the reporting entity should be explained in the audit report.

Do you have any views on that? Do you agree?

Mr Dunsford—It is hard to disagree. It all sounds very sensible.

Senator CONROY—Keith Alfredson, who is the former head of the AASB, has made a submission to the inquiry where he rejects the recommendation of the joint parliamentary committee—it is a different committee to us—in relation to true and fair view that the directors' report should set out the directors' reasons why compliance with accounting standards would not result in the financial statements giving a true and fair view. He says that financial reports must stand alone, and that to include the same information in the directors' report, which is not audited, would lead to unnecessary duplication and possible confusion. Any thoughts?

Mr Dunsford—I think that is a reiteration of, or an alternative way of putting, my earlier statement. As I have suggested in the proposal here, if the market values of assets and liabilities were included as a note to the accounts I would have thought that would be within the bounds of the way in which the international accounting standard has been developed and certainly I would have thought it would be acceptable to observers, even if not necessarily acceptable to every company listed on the Stock Exchange.

CHAIRMAN—Professor Bob Walker is appearing later today as a witness. He has said that he believes the bill should define a 'true and fair view' to the formulation given in the 1984 green paper to a true and fair view and the reporting obligations of directors and auditors. This was a purposive definition that emphasised the need for the true and fair view to ensure that people who might reasonably be expected to refer to the accounts could derive information from them that was relevant to investment decisions they made. Would you advocate a definition such as this in addition to the proposal for comparative tables you have made in your submission?

Mr Dunsford—I am intrigued by the observation: 'Accounts will not be true and fair unless the information they contain is sufficient in quantity and quality to satisfy the reasonable expectation of the readers to whom they are addressed.' That comment could be made in relation to international accounting standards and companies that may be using those standards. Consequently, it could be possible to interpret the need for a true and fair view to in fact require some further information. I think I am supporting what Bob Walker is saying.

CHAIRMAN—What is your view in relation to auditor rotation? Do you have a view on that?

Mr Dunsford—I have no view.

CHAIRMAN—The other issue is the provision of non-audit services. The bill proposes to allow auditors to provide non-audit services provided that details of and fees paid for non-audit services are clearly specified in the directors report and also that the directors' reasons for being satisfied with the provision of those services are compatible with auditor independence.

Mr Dunsford—Again, I have no real view in the sense of a quick statement one way or the other. I could talk on the subject for the next 10 minutes if you wanted me to, but I do not think that would be useful. In any case, I have not really studied those issues in sufficient depth to be able to make a comment that would be valid for this inquiry. I would make the general comment, though, that certainly as a result of audit failures in the past, actions may need to be taken along the lines that have been suggested. But there are a range of views and suggestions.

CHAIRMAN—Mr Dunsford, thank you very much for appearing before the committee. It has been very helpful to us.

Mr Dunsford—It has been a pleasure.

Proceedings suspended from 12.06 p.m. to 12.39 p.m.

FARRELL, Ms Kathleen, Immediate Past Chairman, Corporations Committee, Business Law Section, Law Council of Australia

GOLDING, Mr Greg Ray, Member, Law Council of Australia

KEEVES, Mr John Storrie, Chairman, Corporations Committee, Business Law Section, Law Council of Australia

CHAIRMAN—Welcome. The committee prefers that all evidence be given in public—and this is a public hearing—but if at any stage of your evidence or responses to questions you want to respond in private you may request that of the committee and we will consider moving in camera. We have before us a written submission from the Law Council, which we have numbered 24. Are there any alterations or additions you wish to make to the written submission?

Ms Farrell—No.

CHAIRMAN—I now invite you to make an opening statement, at the conclusion of which we will have some questions.

Ms Farrell—The Law Council of Australia was created in 1933 as the peak national body for the legal profession. Its members are the law societies, law institutes and bar associations of the states and territories. The Law Council's mission is not only to represent the legal profession at a national level but also to promote the administration of justice, access to justice and general improvement of the law. Many of the Law Council's submissions to government are prepared by, or with the advice of, various specialist committees such as the Business Law Section, of which the Corporations Committee forms a part. I think that is a useful context for the remarks that we will now make.

The Corporations Committee's focus is the Corporations Act and the activities of the various bodies whose functions touch on the administration and the operation of markets. The members of the Corporations Committee are primarily private practitioners expert in corporate law in Australia but there are also academics. Our operations are much assisted by observers from ASX and ASIC attending our monthly meetings.

The submission which was lodged with you in 2003 was endorsed by the Business Law Section, not the Law Council of Australia. That means it has not actually gone to all the constituent bodies. It is a product of the expert Corporations Committee group. The remarks that we will now make fall into that category as well.

I will move to the bill as it was introduced into parliament. There are a range of areas where the bill has varied from the exposure draft, where clearly Treasury has taken notice of a number of the submissions that were made. The primary focus of the remarks that we would like to make today concentrates on the areas either that remain of concern to us or that come out of the changes.

The prime areas that we would like to touch on are accounts and audit, continuous disclosure, infringement notices and remuneration. With regard to the accounts and audit area, first we would like to flag that the Corporations Committee of the Law Council remains opposed to giving audit standards the force of law. We consider that they remain areas of judgment that are not really appropriately backed by law, and we do not see that that will assist the efficiency of markets or, necessarily, at the end of the day their integrity. That is probably one of the main contextual remarks that we will make.

The second is that, as a result of giving audit standards the force of law, the adoption of international accounting standards and the very detailed provisions that have gone into the law to deal primarily with independence, I foresee, particularly in the implementation stage, that there will be a big need for administrative support from ASIC in helping people to sort through the implications for their companies. Some of those implications, I think, are going to require modifications of the law to assist.

At the moment the modification power that exists for accounts and audit is quite narrow. It is narrow in two ways. The people who can apply for exemptions are the directors, the company and the auditor. As a result of the independence standards in particular, individuals are going to be quite affected. I will give you an example. Say I am the CFO of a company. I have recently been employed by PricewaterhouseCoopers and I go to work with a company of which PricewaterhouseCoopers is not the auditor. Within six months a company which is audited by KPMG, for whom I used to work, takes over my company. Without some assistance, both KPMG and the individual—and, presumably, the company—may have breached the independence standards of the new legislation. To resolve it, the individual will have to leave, presumably without compensation. If the takeover only occurs within six months then probably the right answer is that he or she should leave. If that happens at the end of a year and 11 months, it seems the wrong answer that that person should have to leave. There should be some scope for modification at the insistence of the person who is affected—who, at the moment, could not make an application; the company would have to do it.

The other area in which the accounts and audit modification power is very narrow is section 342. It creates a threshold which is different from the other modification powers that have to be overcome. For the efficient operation of these sections and to recognise something of the new world that we are going into, ASIC's modification power needs to be revamped and significantly widened in this area. I will give you another example because it demonstrates this issue quite well. There is a new requirement for CEO/CFO certification. Say a company loses its CFO for whatever reason and manages to secure someone who is very good about a week before certification is required to be given. The truth is that that person's certification is no use to the board, because they have not been with the company long enough to know. As a matter of law they will have to give it to comply with the new section 295A and they have no standing to apply for it under the section as it stands. Again, efficiency and commonsense would say that that person should not have to sign the certificate in that circumstance, and it would be bizarre for the company to have to wait a week to appoint the person. That is a minor and detailed example. We will see much bigger ones as time moves by.

That is primarily on the accounts and audit area. The next area we would like to move on to is continuous disclosure. Because the remarks that we are going to make are about infringement notices as well, I would like to say that we regard the continuous disclosure provisions as

incredibly important and central these days to the efficient operation of the market. We regard both timely disclosure and proper enforcement of the provisions as critical. For that reason the Corporations Committee has supported both increasing the penalties that apply to breaches of this law and extending liability to people who are 'involved in the contravention'. Primarily, that means corporate officers. It can in other circumstances also mean professional advisers. Our support for the extension to people who are involved in the contravention has been founded on a qualification, which is that there should be a due diligence defence for people who have tried their very best to ensure that timely and adequate disclosure has been made but who for some reason have failed. We were delighted to see the Treasurer's announcement on 16 February that the government may move amendments in the Senate to provide a due diligence defence and we ask that the committee support that.

We consider it critical for two reasons. Firstly, it will actually promote compliance because it will encourage people to put processes in place—and sometimes you need carrots as well as sticks to get people to comply. Secondly, it is fair. It is fair because the damage that can be done to an individual officer by a failure to disclose in a timely way for which they are liable can be completely devastating. So investors can lose too, but investors generally will not lose to anything like the same extent. Conventional wisdom is that you should spread your investments, and that is a message that I think should be encouraged rather than discouraged in the market. We ask that you support the direction that the Treasurer has indicated that the government would go in that area.

The Treasurer did not mention this, but I wish to flag that we would also seek a carve-out for the provision of professional advice. Our submission deals with this. One of the provisions of the Corporations Act dealing with association carves out, from who an associate is, the people who give professional advice. We think that this is an equivalent sort of area. Let us say you are a well-paid lawyer earning $600 an hour and somebody rings up and says, 'Here is a set of circumstances; what is your advice?' and you give that advice in an hour. It seems an incorrect assignment of risk that for $600 you potentially carry a $600 million liability. That just seems a wrong assignment of risk.

Senator BRANDIS—When you talk about professional advisers in this context, you are not including auditors performing the audit function, are you?

Ms Farrell—No, not at all. We are talking about a situation where someone says, 'I have got X problem; here are some facts; what do you think?' Unless the advice is always going to be disclosed—which you do for your protection—then you are potentially running a risk. Properly given advice by a professional—not a person who is conspiratorially trying to evade disclosure but somebody who is just giving professional advice—should have a proper carve-out from liability in that area.

Senator BRANDIS—Do you suggest an amendment in your submission to deal with that?

Ms Farrell—Yes, we do. It is along the lines of section 16(1)(a), which is the carve-out from the associate's provision. That also supports the development of compliance systems, because if professionals cannot readily give advice then the corporate officers who have their compliance system are doing it on their own. I think that is not a good policy outcome either.

The next area that we wanted to touch on was financial reporting—CEO and CFO declarations. This is an area that we had originally suggested to the government should be incorporated into the Corporations Act. It follows the Sarbanes-Oxley model. The CEO and CFO declarations are a very good idea. They assist in bridging the link between management and the board. Obviously, boards cannot know to sign accounts unless management has given them some level of assurance along the way.

We do think that there should be a minor language modification to the way the certification is required and that that should be to have the certification based on their knowledge after due inquiry. Once you have more than three or four people in an organisation—and certainly once you have 300 or 3,000 people in an organisation—it is very unlikely that a CEO or CFO will have been doing the book entries and all of those sorts of things. When we suggested to the government that this provision should be put in, we expected that people would do the work of coming up the line with certifications—from the bottom up—so the CFO and CEO would be in a position to do that. That is an inquiry, and it is on that basis that the person would give the certification. At the moment, that sort of qualification is not in the law, and we think it should be there.

Similarly, we think that, where reliance on a person down the line has been reasonable but that person has obfuscated and the declaration turns out to be wrong, it should not be the CEO's or CFO's problem any more than it should be the board's, unless they have been put on an inquiry. So deliberately hiding the lower levels should not cause the CEO or CFO to be put in a wrong position as a result. Again, a precedent for that in the law is section 189 of the Corporations Act, which allows directors to delegate and reasonably to rely on people to whom they do delegate.

The third thing in this area is that we think the declaration should relate not only to full-year reports but also to half-year financial statements. Basically, the board has to form a view that the accounts are true and fair at both times that they put them out, and so we think that the backup of the CEO/CFO declarations should occur at both points. That is an area of expansion that we think should be there.

There are two other very brief points in this area. Firstly, we are quite concerned about the issue of the funding of the Financial Reporting Council. It has been getting lots of jobs under this legislation and the issue of funding is still not clear. In the past, in this sort of area the industry, particularly the accounting area, has been looked to for some level of funding. I think that this is a public purpose and that it is a proper call on government funding. Particularly in the period of the next, say, three to five years while we figure out whether or not all this works, funding should not be an issue; they should have really clear and proper funding.

The other area is the financial reporting panel. We had submitted that companies as well as ASIC should be able to report an accounting issue to the financial reporting panel to have a determination made. We note that in the legislation, in the bill that went to parliament, there is a requirement for ASIC to consent before an issue can go to the panel. There are some times when I think that is not good enough. I have seen live examples of where an accounting issue has not been resolved between ASIC and a company. When that company wants to issue a prospectus or do some other public thing, suddenly the issue that has been festering for ages can become a trip-wire on whether it should be able to issue its prospectus or do its takeover or some other act like that. I think it is appropriate to have a body like the financial reporting panel that can get those

sorts of issues cleared up. Even though the determinations are not necessarily binding, it is a body that, in essence, can hear both sides of this argument. We think it goes this way and allows a path to be found. In that context, I think it should not wholly be up to ASIC as to whether or not that issue goes before the panel. Again, I appreciate that budgetary and other constraints may be the reason why there is some sort of funnel, but I am not sure that ASIC alone should be the funnel through which that issue is directed.

Remuneration is the second to last issue, and I am sure it is one close to most people's hearts. The first issue is a technical one. The amendments that have been made to section 300A require disclosure for a number of the highest-paid people, both at the group level, which we absolutely support because we think it makes sense that you cannot structure it around the disclosure, and at the listed company level. We think a requirement for disclosure at the listed company level where there is a group is not very sensible. It just leads to serendipitous reporting, potentially of a janitor—he is the only person employed there, so he hits the top five. If this provision were limited to group reporting, it would catch everyone, including highly paid people who are in the listed company, but it will not lead to some silly reporting which can derive just from where someone happens to be employed. We ask that reconsideration be given to that drafting.

I think it is fair to say that the Corporations Committee did not much like the shareholder vote on the remuneration report, but it would also be fair to say that it is not one of those issues that we are going to say to you should not happen. We are delighted that there was an amendment made in this area that indicates that the vote is non-binding both on the directors and on the company, which we thought was required at a technical level.

We thought it was appropriate, however, to put a marker in the sand here to comment on what we see as an unhealthy trend towards shareholder intrusion in management issues. Companies, trusts and the sorts of listed entities that we are dealing with are important employers of people and a source of the assets that will fund the retirements of each of us. It is really important to absolutely every Australian that they can behave efficiently and with a clear management focus. That is not possible if, in essence, you are taking a referendum on issues which should be the province of management. We accept that remuneration has hit a level of public notoriety. Whether or not people like it, that issue will be the subject of shareholder votes. But we would be concerned if this were taken as a precedent for, in essence, requiring referendums on a whole range of issues that are more properly the province of management. We ask that you bear that in mind as proposals come forward.

Because this is a popular issue, I think there is some velocity around how much you get shareholders to do. I think shareholders should be active, they should be monitoring the accounts of their company, they should be questioning management and they should be exercising their votes in appropriate cases. I think that is their proper function, and corporation management should be allowed to get on with the job. The other side of that, though, is that we would not support compulsory shareholder voting, particularly at the institutional level. There is a whole range of difficulties for people like trustees in getting instructions. I think you lower the general quality when people are required to vote. The information that I have seen from IFSA would indicate that generally Australian shareholders of Australian domestic entities, as opposed to foreign shareholders, are increasingly exercising their vote. I think that the focus that has been given politically to shareholders exercising their vote has been warranted. I think it has been a

good spur and an important spur to get people doing it. But I think the next step of making it compulsory is something that should be taken with extreme caution.

I do want to address one other thing in the remuneration area: limits on the remuneration of non-executive directors and the proposal that has been put forward that ASX Corporate Governance Council's recommendations with respect to non-executive directors not getting options bonuses and the like be translated into law. The Law Council is represented on the ASX Corporate Governance Council. I have been its representative on that council, so I have been party to the deliberations of the ASX Corporate Governance Council. I think it is fair to say that the council aims to be current with the issues that are facing companies and markets. Its members come from very diverse backgrounds. What the ASX Corporate Governance Council came out with in its recommendations are things that each of us is happy to stand behind. But almost all of them represent some level of compromise. If, just because the ASX Corporate Governance Council says something, the government thinks it is appropriate to enact it into law, I think it will chill the deliberations of the ASX Corporate Governance Council, because it makes the decisions that it makes truly much more irrevocable and it makes the council much less light-footed than it needs to be. So that area is one which we would prefer to leave to the ASX Corporate Governance Council rules rather than go into law.

The last issue I want to address relates to infringement notices. You will not be surprised at all that the Wool Council of Australia does not agree with the proposal to adopt infringement notices. In fairness, I think 'infringement notice' is a very benign term for something that is less benign. While we have some issues of detail, the in-principle issue for us is whether or not administrators should have a fining power and whether or not, in the context of our constitution, which has a clear separation of powers, that is an appropriate thing to do.

Senator BRANDIS—Are you going to offer a view on the constitutional legality of infringement notices?

Senator CONROY—We heard from a professor who said he believed they were actually unconstitutional.

Ms Farrell—I think it will be an interesting discussion with the High Court at some point. Clearly, a number of the measures that have been taken, which do make this regime cumbersome, have to be there in order to accommodate at some level the constitutional framework, but we have several more concerns. You only have an obligation to continuously disclose something if that piece of information is material to the market, so it beats me how you can ever have a minor contravention in this area. The threshold issue is: was the information material?

Senator BRANDIS—Is it your point that once you establish the information is material then materiality is an absolute?

Ms Farrell—You have not breached the law if it is not material.

Senator BRANDIS—Quite. So if it is not material the issue does not arise—

Ms Farrell—Should not arise.

Senator BRANDIS—Should not arise. And, if it is material, there is no matter of degree within the concept of materiality?

Ms Farrell—I guess there is always a matter of degree depending on how much someone intended to do it and whether or not it was part of a pattern of conduct—is it a broader fraud or did someone in essence just stuff up? So, yes, there is room for a difference in penalty, but for it to be taken seriously I think you have to have already crossed the threshold where there has been a failure to disclose. The second point is that the Attorney-General's Department has put together a very sensible set of guidelines about when you use an infringement notice regime. Basically, that set of guidelines involves relatively minor offences with a high volume of contraventions—which I do not think continuous disclosure falls into—where a penalty must be imposed immediately to be effective. If anyone thinks that these fines are going to happen immediately then they have misconceived the process.

The intention is that they be used in minor areas. You have to have an investigation in the first place to figure out whether or not you are dealing with a minor contravention or a serious contravention, so it is not going to happen in the immediate way that it happens when you drive through the camera on Windsor Road at 100 kilometres an hour and two days later you have an infringement notice. That will not happen in this area. It is also an area where only strict or absolute liability offences should be involved. This is absolutely an area where a mental element is involved. You have to have intended to do it, you have to have applied your mind to whether or not the information was material or you have to have been completely reckless as to whether or not it was material.

Senator BRANDIS—Why can't you just have been negligent? Why can't you just have failed to direct your mind to a matter which the legislation obliges you to direct your mind to? I do not understand why you say that.

Ms Farrell—You can have, but an appropriate area under the Attorney-General's guidelines for infringement notices is an area where you are in essence dealing with strict liability, not an area that involves negligence of that kind or a failure to apply your mind. Someone actually has to gather the evidence, which is very detailed evidence about what your process was and what the information was, and apply a judgment to it.

Mr Golding—The other point to make there is that ASIC is required to form a view that there has been a contravention to issue the infringement notice. It has to have that basis of belief. That takes you back into the offence. The offence, as recast two years ago, applies the criminal code. A straightforward application of the default fault elements of the criminal code to that particular section requires intention or recklessness for the five elements of conduct that make it up, so as a matter of law we can tell you that recklessness and intention are the requirements that ASIC must impose and the legislature has chosen a standard that is not negligence in this area.

Ms Farrell—The last element under the Attorney-General's guidelines is where the physical elements of the offence are clear-cut. Clearly in this area they are not clear-cut. So it is unsurprising that, when the Australian Law Reform Commission came to review this as part of the review of the Commonwealth civil penalties regime generally, they recommended against it. On that basis, if you decide in your recommendations to go with this legislation and if the parliament decides that they really must go with this legislation, we ask you to put a sunset

clause in it. I do not think that request should be viewed as something that will be asked for as a matter of course. This area is really quite anomalous. Seeing how ASIC deals with it and the public's reaction to it over time is, I think, something that should properly be tested. The Treasurer has indicated that there will be a review after two years. We think the parliament should have to reaffirm that they really want to do something as anomalous as this.

I guess our other reason for talking about this as strongly as we have—and it is not out of distrust of ASIC; this is not directed at a particular regulator—is directed at the principle that this sort of technique should not be applied more widely and should not be applied again in the area that ASIC administers, although ASIC has asked that this be extended to the insider trading regime in one of their submissions to CAMAC on insider trading. I think this really needs to be road-tested before people accept that it has a proper place. I think I have said enough. You probably have some questions.

CHAIRMAN—Thank you very much. Do your colleagues have anything to add?

Mr Keeves—No.

Mr Golding—No.

Senator BRANDIS—I wanted to explore two points with you. The first is your first submission that the audit standards should not have the force of law. That is a pretty core policy point in this bill, as you know. I do not quite understand the point you were making in your oral submission about that. Why is the discretion or judgment in the application of the audit standards any different from, for instance, the generic obligations of directors and officers under the Corporations Act, under which a breach of the director's or officer's duty may be constituted in any one of an endless variety of ways, most of which you could say involve an exercise of discretion or judgment as well?

Ms Farrell—That is true. I suspect there are some people sitting in the room who can answer that question better than me since they are accountants, and I am proud to say that I am a lawyer.

Senator CONROY—Let us not have any professional—

Ms Farrell—The concern is this: in order for something to have the backing of law you need to be able to express with clarity what the obligation is in order to breach it.

Senator BRANDIS—That is an ideal standard, but you know as well as I do that for a lot of important laws that is just not the case.

Ms Farrell—That is a really undesirable outcome and, I guess, not a standard to be applied.

Senator BRANDIS—Quite. But surely you accept that some laws have to be expressed in a fairly generic way.

Ms Farrell—Yes.

Senator BRANDIS—Including the provisions of the existing Corporations Act about directors' duties.

Ms Farrell—Yes, they do; they have to be expressed in a generic way. Auditing standards, though, are a mixture of quite express areas which say that you have to do things in a certain way and others areas of judgment. An area of judgment is not something which can inherently be breached.

Senator BRANDIS—Then why is there a problem?

Ms Farrell—Why do you have a law around something that you cannot enforce? I think it is very important that each time parliament produces a law it is a law that has a consequence if you fail to meet it.

Senator BRANDIS—The auditing standards prescribe minimum obligations—

Ms Farrell—Yes, they do.

Senator BRANDIS—so as long as it could be said that that minimum obligation had not been satisfied there could be a breach. The fact that above that minimum obligation the auditing standard by its own terms provided for a range of ways of going about it or provided for a discretion would not matter as long as one could be confident about what the minimum standard was.

Ms Farrell—It matters in two ways. Firstly, it will make auditors significantly more conservative, not necessarily in a good way. Secondly, it means that if you want to depart from the standard you do not do it in accordance with professional standards. You are going to have to get an exemption from ASIC, for instance, to move beyond.

Senator BRANDIS—Aren't they going to do this anyway? I have just been looking at the bill. Clause 307A basically obliges the auditor to conduct the audit in accordance with the auditing standards. That is the source of the obligation. Clause 336 identifies the auditing standards that attract that obligation. Were an auditor to perform an audit in a manner that fell short of that auditing standard, leaving aside any quasi-criminal liability under this legislation, that auditor would presumably expose himself or herself to a negligence action. The first thing you would ever allege if you were going to sue an auditor for negligence is that they failed to perform the audit in accordance with the prescribed standard. If that is right then isn't any auditor for that reason, irrespective of any obligation arising from this bill, going to comply with those minimum auditing standards anyway? There will always be a point at which that judgment is going to have to be made in a contentious case.

Ms Farrell—There are two things. Certainly the auditor who fails to comply with auditing standards may well be exposed to a negligence action, and that is true today in the event that a relevant loss can be traced to that failure.

Senator BRANDIS—That is why I do not see why this imposes any greater burden on a competent auditor. It might impose different consequences but I am not sure that it imposes a

greater burden on an honest and competent auditor than they will already expect of themselves under the general law.

Ms Farrell—It is a question of flexibility in the application of professional judgment. If you want to go beyond something that looks like it might be the law, you are going to have to get a modification from it, whereas as we stand there will be professional standards that apply to how you go about dealing with the departure from an auditing standard, but you will not have breached any law in appropriate cases.

Senator BRANDIS—Won't you ordinarily qualify the audit?

Mr Keeves—Could I add that I think the answer is that a departure from the standards presently might be, prima facie, a departure from what is appropriate or might expose the auditor to negligence, but if there were a good reason or excuse why the standard was not applied then that would be the answer. If they are given statutory backing without the qualification of flexibility, that is an undesirable outcome.

Ms Farrell—I guess we are unconvinced that this is going to lead to better audits.

Senator BRANDIS—It may not lead to better audits.

Ms Farrell—Then why do it?

Senator BRANDIS—It may not lead to better audits but it may impose superadded consequences to unsatisfactory audits.

Ms Farrell—It may, but I think the price of doing that is constraining all audits—

Senator BRANDIS—Up to a certain minimum standard.

Ms Farrell—and that leads to inefficiencies not only for the professional and for the companies that are audited but also increasingly now for ASIC as a regulator.

Senator BRANDIS—One other small point rather took my fancy this morning when Professor Adams was giving his evidence. On a completely different subject, he made a point about the protection of whistleblowers provision, which is proposed section 1317AA. If you look at section 1377AA(1)(e)—it is at page 181 of the bill—you will see that one of the requirements to protect a whistleblower is that the disclosure be made in good faith. Professor Adams's point was that that is too high a threshold to attract protection, because a piece of material information can be honestly communicated by a whistleblower, albeit that the whistleblower may be acting maliciously or for a collateral purpose but, if the information is true and relevant, that should not strip the whistleblower of protection. That seemed sensible to me, and I suggested to Professor Adams that maybe it would be better to require a test of honesty and reasonableness so that the whistleblower has to have an honest and reasonable belief in the truth of the fact which he discloses. What do you say about that?

Ms Farrell—I would support that, but I would add to it a requirement that the disclosure relate to a serious contravention. Recent events have demonstrated to us the importance of

whistleblowing in a whole range of places. If you look at Enron you will see that the whistleblowing, importantly, had to go way beyond the company. If you look at NAB you will see that there was effective whistleblowing within the company. If we are talking about whistleblowing to a regulator then it is important that we are not just adding to the already 8,000 or 9,000 complaints that ASIC gets every year through a whole range of avenues, of which it can already only deal with the more serious. So what the whistleblowing provision should be asking people to do as a threshold is to consider honestly and reasonably whether what they are going to complain about is something important or something that is not important but is just a niggle and a nuisance—and, frankly, a nuisance to everyone, not only to ASIC but ultimately to the company as well.

Senator BRANDIS—Could we say 'honestly, reasonably and not vexatiously'? That would deal with niggling, nuisance driven complaints, wouldn't it?

Ms Farrell—I do not care if it is not honest if it is about something serious.

Senator CONROY—What is a breach of the law that is not serious?

Ms Farrell—Honestly failing to keep part of a book properly.

Senator BRANDIS—Clearly, entirely technical noncompliances.

Ms Farrell—Ongoing failure to keep your books and records properly is quite a serious thing because you have no idea what you are doing with your business but, say, failure to keep one of your registers properly is not. It is an example which is very hard to see in a whistleblowing context but it is an example of what should be treated as a relatively minor breach, which no-one should really care about, of a law that is there for a serious purpose.

Senator CONROY—You mentioned some A-G's guidelines. Are they publicly available?

Ms Farrell—Yes, they are. I am happy to give them to you.

Senator CONROY—If you could supply them or the committee could track them down, that would be very helpful.

Ms Farrell—The other reference to them is in Australian Law Reform Commission report No. 95 at paragraphs 12.23, 12.38 and 12.60, which deal with the fining proposal.

Senator CONROY—'An unhealthy trend of shareholders' intrusion in management issues'—what a fascinating concept. Hugh Morgan would be proud, and if you want to line yourself up there that is cool by me.

Ms Farrell—That would be for the first time.

Senator CONROY—That just makes my job easier. Are you aware of recent academic studies showing that there is no relationship whatsoever between the performance of a company and the pay that an executive is receiving?

Ms Farrell—I have seen research that suggests that, yes.

Senator CONROY—A number of times you have mentioned—and I have half quoted it—the province of management. Can you give me a definition of 'province of management'?

Mr Keeves—I think the history of corporate law will show us that certain matters have been found to be properly within the province of management. It really is a matter for the shareholders, as part of the constitution, to decide what things are delegated to directors and what things are retained within the remit of shareholders. But there are certain practicalities, such as the need to hold a shareholders' meeting and inform shareholders, which means that it is only logically possible to have substantial decisions made by shareholders. You cannot run a company with all the day-to-day management decisions made at a shareholders' meeting.

Ms Farrell—I will give you an example. Let us say I am an advertising company and I own a golf course in the Hunter Valley which is worth 0.0001 per cent of the assets of the company. While it has been a nice thing to have and we have taken clients there and all of those sorts of things, we decide it is not a core asset, because we are downsizing. I think that is a proper management decision. The fact that some shareholders who might have thought it was nice to go to the company's golf course from time to time did not think it should be sold I think is irrelevant in that context and they should not really have a say about it.

Senator CONROY—That explains where the Business Council got their sale of assets argument.

Ms Farrell—No, they did not actually.

Mr Golding—It is a very profound issue that you are raising. John Keeves has mentioned the 300 years of corporate history that says there is a division of the board and the shareholders and that the role of shareholders is to meet at a general meeting, appoint the board, ask questions and not make decisions in relation to the management of the company. It also has very respectable academic support, including a landmark analysis of corporations. The proposition of the separation of management from the board and shareholders is a profound theme that underpins the structure of Corporations Law, and that is why the Corporations Committee is quite passionate about this. It is not a question of supporting Hugh Morgan in a political sense. We really do feel that this is a very significant underpinning of the modern corporation. If you want to remove the management of corporations from boards and put it into the hands of shareholders, as Ms Farrell says, that raises very profound practical issues as well. It is not a matter of politicking on our part; it is a very significant underpinning.

Senator CONROY—I want to test you on a couple of these things. Is the logging of old growth forests the province of management, or should shareholders have a view on what their money is being used for?

Ms Farrell—Shareholders should have a view on that. But I do not think—

Senator CONROY—Should they seek to impose it on management?

Ms Farrell—I think they should seek to impose it, as Greg Golding just said, through the removal of the board. I think that talks to what the body of shareholders think—not what one or two shareholders think—and not what people who do not have any significant investment in the company, who have only gone out and bought 10 shares for the specific purpose of running a political agenda, think.

Senator CONROY—Do you think those poor schumcks at BHP who objected to Ok Tedi a few years ago could possibly have had a point a few years down the track, because it cost the company billions of dollars to clean up the mess? Maybe if those ratbags had had a bit more support, they might have got their message across a bit quicker?

Ms Farrell—Can we go back three steps? I have no problem with those people raising that sort of issue at an annual general meeting. I have no problem at all with it being a topic of discussion. I think it is a proper topic of discussion if that is the business of the company and you have genuine ethical or other concerns—particularly commercial—about what your company is doing. But I think there is a context in which for you to do it. At the end of the day, if what a company had to do was run with what every group of five or six shareholders thought on an issue, it would never do anything—in the same way that parliament, at the end of the day, takes a vote and says, 'That is the way we are going.' You cannot hold a referendum on every issue that comes through.

Senator CONROY—You mentioned 300 years of case law. I would like to take you back about 300 years to when a bloke called Adam Smith defined the concept of an agent in charge of your money. He gave the sage advice at the time that you might need to keep an eye on somebody because they will not always necessarily act in your interests. Was that good advice?

Mr Golding—Adam Smith continues to be highly relevant today in terms of policy.

Senator CONROY—He does.

CHAIRMAN—I am glad to see that the Labor Party agrees.

Mr Golding—I would like to make the point that we understand that community expectations change. You gave the examples of old-growth logging and Ok Tedi as issues that modern boards should consider when making decisions. However, to elevate the role of the shareholder to the determinant is fundamentally inconsistent, I would think, with Adam Smith's view of the world and 300 years of case law. If you change that calibration, it would have a very profound impact on the way the modern corporation is structured.

Senator BRANDIS—Mr Golding, since when has it been the law that the board is the agent of the shareholder?

Senator CONROY—I did not suggest that it was.

Senator BRANDIS—I thought that is what you were suggesting.

Senator CONROY—No, I was just asking whether that was sage advice.

Senator BRANDIS—Because it is, in fact, not the case as a matter of law that the board is the agent?

Ms Farrell—It is always sage advice to watch the cash.

Mr Keeves—I would like to add that, going back to original joint stock company and its precursors, at that point the board may well have been agents of the body of shareholders or whatever they happened to be. I think that, as a matter of law at this stage, that proposition is incorrect.

Senator CONROY—I am using an economic concept I guess rather than a legal concept. I wanted to roll forward 300 years to a couple of other people who have sage advice on this. One of those people is Warren Buffet. He has described the conduct of management in recent years as piracy—and this is not the management of companies that have failed; I need to make that point because people often think, 'Yeah, he's just talking about companies that have failed.' Warren is not talking about companies that have failed; he is talking about piracy of companies that have been quite successful. In fact, I think he has even used the term 'looting' of public moneys. My favourite comment is that made by the chairman of CalPERS, an organisation you may be familiar with. He made this point in relation to the New York Stock Exchange debacle. He said, 'Yes, we have got the snouts out of the trough,' that was the removal of Richard Grasso. He continued, saying, 'Now we want to know who filled the trough.' Is that sage advice?

Ms Farrell—A proper question.

Mr Golding—We are dealing with extreme situations however. I point out that Warren Buffet, who is known and loved by millions of people, is famous for his colourful language.

Senator CONROY—I am not denying that.

Mr Golding—He is also the largest single investor in the Coca-Cola company, for example, and that company has just paid its CEO $12 million for the last year.

Senator CONROY—A company that is going out backwards.

Mr Golding—Views will differ. It has been a good investment for Warren Buffet. I do not know, but I suspect that he believes Mr Daft has done a good job in the circumstances.

Senator CONROY—Mr Daft is leaving, I think.

Mr Golding—Yes. Mr Daft received the $12 million payment in question. To put everyone in together from the CEO of Macquarie Bank, who has grown that company thirtyfold over 15 years, through to Mr Grasso, whose circumstances are different, and to tar all CEOs with the same brush—and to bring the debate on executive compensation to the lowest common denominator as a result—would be a policy mistake, we believe.

Senator CONROY—Thank you for your thoughts on that. If I can perhaps put it in a slightly less colourful way to Mr Buffet, I would describe the situation of the last few years as the greatest transfer of wealth between shareholders and management in the history of corporations

over 300 years. It is the greatest amount of money that has moved from one side of a ledger to another side of a ledger. I go back to Adam Smith and say that I think he was dead right.

Mr Golding—Can I take Macquarie Bank again, one of Australia's success stories, I think people would say. It is one of the only listed investment banks in the world. It has to pay its executives by reference to global salaries of financial services investment banks. Regarding the CEO, the most closely read page of their annual report—

Senator CONROY—I always enjoy hearing comparative wage justice arguments from the corporate end of town. Norm Gallagher championed it for many years. I am sure that the chief of the Macquarie Bank would sign up to it.

Senator BRANDIS—What were you saying, Mr Golding?

Mr Golding—I was trying to make the point that the CEO of Macquarie Bank has driven his bank from a share price in 1995 of about $5 to a share price now of $30. In another example, the CEO of the Commonwealth Bank has driven his share price from $5.40 at IPO in 1992 through to $30 today.

Senator CONROY—A $7 million payment just for staying in the job for 10 years.

Mr Golding—I am just pointing out that the returns to shareholders are the other side of the ledger.

Senator CONROY—Just to hang around for 10 years you get $7 million. It is a gift.

CHAIRMAN—I think Mr Golding is suggesting that he might have done more than hang around, given the increase in share price.

Senator CONROY—That is not performance related, Mr Golding. Length of tenure is not a performance indicator.

Senator BRANDIS—I think, Mr Golding, that Senator Conroy is going back about 300 years before Adam Smith to the medieval notion of the just price.

Senator CONROY—I am afraid I am not quite as much of the student of history as you, Senator Brandis. Length of service is not a performance criteria.

Mr Golding—Research shows that the average tenure of CEOs in Australia is now approximately four years.

Senator CONROY—Mr Murray has done that. God knows what he is going to get for hanging around for another seven years.

CHAIRMAN—Let us move on to Boral.

Senator CONROY—I did not want to raise Boral. I have spoken to Mr Keeves about it previously. I am not sure if the committee has had a chance to look at it.

Ms Farrell—The Corporations Committee has supported the government's proposal to move to five per cent.

Senator CONROY—No; I was talking about a slightly different angle—Boral's capacity, on legal advice, to introduce a constitution which adds extra components to the Corporations Law. I am talking about being allowed to list—with 100 shareholders—a constitutional resolution. The Boral constitution fundamentally changed that—and the controversy around it, to say the least. Do you have any thoughts about that? Just so you understand my view—and I am sure you do already—this seems to be an effective way to contract your way out of the Corporations Law. I am not a lawyer, as I am sure you are all aware, so that is my lay term for it. If you have had a chance to consider it, good—I raised it with Mr Keeves recently—but if you have not had time, that is cool.

Mr Keeves—It is not a matter that has been considered formally by the committee, so I guess any thoughts that can be shared today cannot be regarded as fully considered. But I think the issue is that a company has had inserted into its constitution an additional requirement that if shareholders wish to propose a constitutional amendment it either has to have a certain level of support or it needs to be recommended by the board. I think that is correct.

Senator CONROY—Yes, and it is if five per cent or the board agrees.

Mr Keeves—The effect of that is, for that constitutional amendment to be considered, it needs to have the support of five per cent of the members because if the board should not approve it, the meeting would not be competent to pass the resolution. I understand that the matter has been raised with ASIC, and their view is that what Boral has done in that situation is valid and works. I see that as a fairly isolated issue. It is not a question of companies being able to contract out of the Corporations Law generally. It is simply that in that particular example a company has changed its constitution to add an additional requirement—which it is certainly entitled to do, I think under section 136. It has been clear law for some considerable time that whilst there may be a general right on the part of shareholders to ask the directors to convene a meeting if the thresholds are reached—

Senator CONROY—It is not about the 100 shareholders calling a meeting; this is about listing a resolution for discussion and vote.

Mr Keeves—The point I was getting on to make was that if the meeting cannot validly pass the resolution, for whatever reason—it might be outside the competence of the meeting or there might be an additional requirement which will not be fulfilled—then it is a waste of time and effort to—

Senator CONROY—Can you explain to me the concept of 'not validly passing' the resolution? I have heard that before and I do not understand the particular angle.

Ms Farrell—I can give an example.

Mr Keeves—Perhaps I can answer the question directly and go back to a point we made earlier about the separation between the board and the shareholders. There are certain matters which are, if you like, delegated to the board and there are certain matters which are retained or

given to the shareholders. If the shareholders purport to pass a resolution which goes outside their authority or power, it is of no effect. To call a meeting to consider a resolution that would be of no effect—

Senator CONROY—They have not called the meeting. This is listing it on the agenda of an annual general meeting.

Mr Keeves—The point is the same because if it is listed on the agenda for an annual general meeting, yes, there is a forum but the resolution can be of no effect, so it is nonsensical.

Senator CONROY—If 51 per cent of shareholders had voted for a resolution then why is it invalid?

Mr Keeves—In the general case, if it goes outside the power or the authority of the shareholders—

Senator CONROY—If they have the power to amend the constitution, which is clearly inscribed in the Corporations Law—or are we suggesting that an AGM does not have the power to change the constitution?

Mr Keeves—There are a number of examples of companies that have additional provisions in their constitutions that require additional things to happen in order for there to be constitutional change. You may be familiar with some of the regional banks. After they were, in some cases, converted from building societies and listed on the Stock Exchange, they had ownership restrictions in their constitutions and those restrictions were entrenched so a change to the restrictions would require something extra. One example I can think of that required—

Senator CONROY—They were set for policy reasons by the government of the day.

Ms Farrell—Not in all cases.

CHAIRMAN—ABB Grain?

Mr Keeves—ABB Grain is a familiar example, but I was thinking of some of the banks that have gone from building societies.

Senator CONROY—I was thinking of St George. The policy restriction on who can buy them has a sunset clause—that was government.

Mr Keeves—I cannot think of the name of the act but there is an additional piece of federal legislation which does impose a shareholder restriction on banks in any event. I am not sure that the constitutional restrictions on shareholdings were anything other than a transitional measure so that the banks would have an opportunity to prove themselves as independent organisations. I do not believe they represent a policy of themselves.

Senator CONROY—The Corporations Law currently states in black and white—black-letter law, to use a favourite phrase of many—that 100 shareholders can list a resolution for debate if

they are amending the constitution. Do you think that the policy intent of parliament has been carried out by adding extra constraints?

Mr Keeves—I will respond to that in a roundabout way. If there was overwhelming support for the constitutional amendment sufficient to have it passed, that is to say, 75 per cent of the members present were voting, it is highly likely that you would get your five per cent. As a practical matter—

Senator CONROY—I am talking about the principle here rather than the practicality.

Mr Keeves—Perhaps I am too practical.

Senator CONROY—You are a lawyer.

Mr Golding—There is a serious issue here. Shareholder democracy is an important thing. The Law Council embraces it. However, the idea that a small number of shareholders can come along and call meetings of companies—

Senator CONROY—They can sack a director. They can move a resolution and sack a director—with 100 members. Expect it next year and expect this debate to roll on as boards attempt to strip shareholders of their powers.

Mr Golding—The proposition that boards are trying to strip shareholders of their powers is—

Senator CONROY—That is what has happened; 100 shareholders can no longer list a resolution to amend the constitution.

Mr Keeves—Can I add that the example you give in relation to the removal of directors, Senator Conroy, would not be affected in the same way by section 136. So I believe it would not be possible for a company to do the same thing that has been done with the particular constitutional amendment issue that we have discussed in relation to the removal of the board member.

Senator CONROY—I guess I am hoping to find where you think the boundary is. At the moment I am looking at it saying, 'Oh my God; there is no boundary.'

Ms Farrell—I have one comment on a shareholder democracy point. For that sort of provision to end up in the constitution in the first place, the members will have to have voted for it. My issue of principle—

Senator CONROY—Shareholder democracy is not 51 per cent rules.

Ms Farrell—It normally is.

Senator CONROY—Not when it overturns the Corporations Law.

Ms Farrell—I guess on this issue I am less concerned than you on the basis that I really do not support 100 shareholders, often not for a proper purpose, being able to convene a meeting. I am very, very concerned—

Senator CONROY—This is not about convening a meeting. This is the furphy that was used to trick people into not thinking about it and why they had voted for it—because everybody thought that is what they were voting for. When you raise it with fund managers and ask why they voted for that they say, 'Oh, no; we don't want people calling a meeting unless it is required.' It is not about a meeting; it is about the existing requirement that they can list a resolution.

Ms Farrell—Can we take this outside the Boral context for a second. The Corporations Committee has put to government before that it regards the annual general meeting as an important venue for shareholders to be able to speak, that it would support provisions that assist people in putting matters on an agenda which are there for a proper purpose—that is, for a purpose relating to how the company is being run and questions that are being asked about that. It does not support the resources of a company being misapplied in the course of a year by unnecessary meetings, in particular for purposes which are often not corporate purposes.

Senator BRANDIS—You use the word 'purpose'. As long as the item of business is related to the affairs of the company, wouldn't that be enough?

Ms Farrell—I think the five per cent threshold is important in that context for deciding whether or not enough people care about it, to use the—

Senator BRANDIS—I am not disagreeing with you about that. I just want to make sure I understand what you are saying. You are not saying that it is an improper purpose simply because the motive of the people raising the issue is improper—it might be a political, cultural or social motive. As long as it relates to the affairs of the company, it is okay.

Mr Keeves—As long as it is a matter that is within the authority of the shareholders.

Senator BRANDIS—Yes, of course.

Ms Farrell—If you attend any of the banks' annual general meetings, for instance, there is a goodly chance that at least half of the issues that get raised are not about shareholding but about the terms of a term deposit that their grandmother has been getting et cetera.

Senator CONROY—Are those issues being raised in the form of resolutions?

Ms Farrell—Sometimes; but often a lot of the meeting time is taken up. Many chairmen take the view—and I think it is a responsible view—that even though that is time consuming for everyone there, as long as the proper business of the meeting is being done in terms of getting directors voted on and other business issues that have been added to the agenda, it is an appropriate venue for people to spend a little bit of time—

Senator CONROY—The history of this, just for the record, is that a string of resolutions were sought to be listed for the AGMs to do with health and safety. You may disagree that it is

not fit and proper for that to be discussed. You may have your view. I have a view as well. So that everyone is aware—just in case you were not—I went to the Boral AGM as a proxy to debate this issue. The board ruled that these resolutions did not fall within your definition. The resolutions were then crafted in a way such as to get on the agenda and they will be crafted in such a way next year. They were about sacking directors and moving for dismissals—if people follow advice—

Ms Farrell—That is certainly a proper purpose.

Senator CONROY—for failing to have adequate health and safety practices in their company. Unfortunately, truck driving is a pretty tough industry and people die. There is a whole range of issues that revolve around that. As I said, I was there. Dr Moss, who has now been appointed by NAB as a friend of the shareholders—something that is entirely entertaining for the majority of the people in this room—was quite happy to talk at length about health and safety issues and took many questions from the floor. That, I think, was in accord with your interpretation that this was fair and reasonable. But to suppress debate by not allowing resolutions in the first place invites actions in a different direction as well, and this, ultimately, is self-defeating.

CHAIRMAN—We are considerably over time.

Senator CONROY—I would be very keen for you to put in a supplementary submission on this, because I am genuinely interested in where the boundary is. At this stage, I am looking at this and thinking, 'Oh, my God; they can change anything they want by contracting out.' So I would be interested if anyone has time—

CHAIRMAN—I will let Mr Keeves respond. I am just wondering how many more questions you have.

Senator CONROY—It is just follow-on discussion, but I appreciate the time constraint that you are drawing to our attention.

Mr Keeves—There are two points. It gets back to the point of what is properly within the boundaries of the shareholders' authority. I would expect that, with the example to which you refer, it would have been a good faith decision. Had a resolution been passed, it would have been ineffective. Therefore, it was not a proper matter to—

Senator CONROY—Ineffective in the view of the board. This is a circular argument. Eight to 10 years ago people said it was ineffective and it should not be the business of an AGM to discuss Ok Tedi, yet shareholders are billions of dollars worse off because people refused to discuss Ok Tedi.

Mr Keeves—The second point I want to make is that perhaps we should take up your invitation to provide a supplementary submission on this.

Senator CONROY—I am happy to progress it that way. Thank you very much.

CHAIRMAN—I would like a very quick response on the features of the takeover panel that you think makes a desirable model for the financial reporting.

Ms Farrell—Primarily that is about the need for supervision. The original proposal dealing with the financial reporting panel had the Financial Reporting Council, in essence, supervising a very small number of people on it and suggesting that they could be part time or full time. Unless they are full-time members they will have conflicts. I am a member of the takeovers panel. The number of members on the panel varies between 38 and 46. On any given day finding three members who are not conflicted and who have time when you are dealing with part-time members can be really quite difficult.

Senator CONROY—How do you maintain the arguments for the structure currently? It allows you to keep up with real time developments because you have people with the experiences, it is all happening and it is the melting pot. To go full time you remove them from the melting pot—isn't that right?

Ms Farrell—That is right. I am suggesting you probably do need a wider representation. I think that is a good thing, anyway. The takeovers panel has no specific provision in the legislation for its secretariat.

Senator CONROY—These people just keep turning up.

Ms Farrell—But there are, in essence, two full-time people who are paid by Treasury and a number of secondees who support the work of the takeovers panel. I think that sort of model—rather than the Financial Reporting Council having a supervisory role in relation to it—and a full-time panel is preferable. I think it keeps people much more current, and you get a better community feel for it.

Mr Keeves—Kathy is a member of the panel, and I think the Corporations Committee would generally regard the takeovers panel as having been very successful and having done its job very well.

Senator CONROY—It enjoys calling people in.

Ms Farrell—Not in my experience.

Senator CONROY—I am aware that some journalists—

CHAIRMAN—There being no further questions, I thank each of you for your appearance before the committee. It has certainly been very valuable. We have run considerably over time, which indicates the standard of your contribution to our deliberations.

[1.55 p.m.]

SPATHIS, Mr Phillip, Executive Officer, Australian Council of Superannuation Investors Inc.

WALKER, Professor Robert, Adviser, Australian Council of Superannuation Investors Inc.

CHAIRMAN—Welcome. The committee prefers that all evidence be given in public but if at any stage of your evidence or responses to questions you wish to respond in private you may request that of the committee and the committee will consider such a request to move in camera. We have before us your written submission, which we have numbered 5. Are there any alterations or additions you want to make to your written submission?

Mr Spathis—No.

CHAIRMAN—I invite you to make an opening statement, at the conclusion of which I am sure we will have some questions.

Mr Spathis—Thank you. I will make some general observations and then I will go to some of the specifics in relation to the submission. The Australian Council of Superannuation Investors was formed in 2001 and comprises 30 superannuation funds with over $65 billion in investments. Essentially, we assist super funds to monitor the corporate governance practices of companies in which they invest. Super funds take an interest in relation to corporate governance issues in listed Australian companies for a very straightforward reason: 44 per cent of super fund investments of around $518 billion are tied up in listed Australian companies. It is therefore not an exaggeration to say that the success and long-term viability of publicly listed companies directly impact on the value of super fund investments. Therefore, the retirement income of Australian workers is directly affected by the success or failure of these companies.

It is fair to say that up until the last few years super fund trustees have not been active in this area. For example, super funds have considered voting to be either too costly or too complex and therefore trustees have not been adequately monitoring the companies in which they invest. In addition to that, trustees have not been adequately monitoring those parties who have a responsibility in the area, such as fund managers, and whether or not these fund managers have voted on their behalf. But things are changing and we are working with a number of superannuation funds to develop a policy framework to ensure that they do behave like shareholders and get involved in voting and constructive dialogue with the corporations in which they invest.

Let me put on the record that ACSI welcomes the reforms contained in CLERP 9. However, we cannot simply rely on the law alone to improve corporate behaviour, although legal mechanisms are critical to ensuring that community expectations are clearly spelt out. We are committed to long-term profitable companies and, as long-term investors, we support the CLERP 9 measures because they are consistent with strengthening company disclosure requirements that should be supported by properly skilled and motivated boards and executives.

We do not consider that our involvement in corporate governance issues should be regarded as somehow meddling in the affairs of companies. We do not intend to appoint ourselves as quasi regulators, de facto company directors or shadow directors. Shareholders cannot manage a company. They know very little about what goes on behind the closed doors of a board and they have limited opportunity to examine the day-to-day management of the company. Therefore, investors rely on good corporate governance practices and regulations to raise their confidence about the company.

It is difficult to say whether Australian companies are at the forefront of corporate governance compared with their international counterparts. We can fairly say that our best run companies would in fact be amongst the best in the world. Australia's worst, though, may not be as bad as the worst failures in the US. But, given Australia's experiences with HIH, One.Tel, Pasminco, Harris Scarfe and, more recently, the National Australia Bank, we should not get too carried away with comparing ourselves too favourably.

Whilst legislative reform in CLERP 9 will definitely raise the standard, we would add that recent experiences would indicate that adherence to high standards can slip, especially during a growth phase of the business cycle. It is during this phase that the protection of shareholder interests can come second to the advancement of executive interests. Having said all that, we think that boards of listed companies would need to recognise that, in order for trustees of superannuation funds to hand over large amounts of capital to the company, this capital must be managed in the best interests of shareholders. To paraphrase what Justice Owen of the HIH royal commission said, many directors really need to reacquaint themselves with the whole meaning of fiduciary obligations towards shareholders.

Having said that as an opening statement, I will refer to some specific aspects of the CLERP 9 submission. In relation to accounting and audit issues and the Financial Reporting Council, we support the expanded role of the FRC. We submit that there should also be included on it representatives of investors and other users of financial statements. In relation to auditor rotation, we generally support the provisions on auditor rotation. On matters in relation to non-audit work, we do have concerns regarding the provision of certain non-audit work being undertaken by auditors themselves. Our specific concerns relate to the continuing possibility for auditors to undertake valuation services for entities whose financial statements they are auditing. We are concerned about the provision of executive recruitment for audit clients where as auditors they will be required to assess the quality of the financial information produced by those same executives. We are also concerned about the provision of accounting services that could result in a situation where auditors are in effect auditing their own work.

In relation to incorporation, we have on page 7 of our submission a range of questions that we believe should be considered in the context of the proposal to allow auditors to incorporate. On auditors' interface with AGMs, we submit that 'reasonable questions about the audit' should also extend to 'the basis upon which the financial statements have been prepared'. With regard to the expansion of auditors' duties, we would also recommend that the obligation of auditors should also extend to reporting to ASIC if auditors have identified instances where executive directors or other officers have entered into transactions that were not directly authorised by the board or audit committee or go beyond the authority of those executives. In relation to chapter 2, on financial reporting and the treatment of true and fair accounting, I would invite the committee to

draw on the experience and knowledge of Professor Walker, who has done some extensive work in this area for the NCSC and other bodies.

I will now turn to remuneration issues, make some general observations and then home in on the proposals that are contained in CLERP 9. We want to commend the federal government, and the opposition for that matter, on the proposals that relate to remuneration policy and practice. These proposals, in our view, are not radical by any measure. We call on the federal government to implement the recommendations of the HIH royal commission that recommended all regulatory requirements relating to directors' remuneration 'be reviewed as a matter of priority to ensure that together they achieve clear and comprehensive disclosure of all remuneration or other benefits paid to directors in whatever form'. When the report of the HIH royal commission was released, the Treasurer committed the government to adopting all the recommendations. The proposal to extend reporting requirements for directors and executives must not fall short of this commitment.

Corporate governance failure should not simply be reduced to problems and defects in our regulatory and accounting systems. Remuneration policy has a critical role to play in this regard. We need to understand what motivates some executives and directors with regard to remuneration and, in the worst-case scenarios, understand how remuneration can in fact be a driver for some directors and executives, and their advisors for that matter, to shade the truth and stretch the veracity of accounts. We supported statements made by ASIC last year that described 'endemic factors at play: an outbreak of management greed, the failure of boards to put a brake on excessive and structurally unsound remuneration practices and the many commercial pressures that influence management and board to focus on short-term pay-offs'. Shareholders are simply looking for improved disclosure of these remuneration practices that will give them a better understanding of the extent to which, if at all, remuneration is linked to performance. Our call for improved disclosure on remuneration has occurred against a backdrop of some huge and obscene payouts that clearly bear no relationship to performance and in many cases are perceived in the community to be a reward for mediocre performance or, in some instances, a reward for failure.

It is unacceptable, in that environment and in the context where—as the previous speaker mentioned—the average tenure of a CEO is four years, that we continue to bear witness to successive CEO and executive payouts over the last two years alone that have varied between $4 million and at least $33 million. This has unequivocally shaken the trust of shareholders. This also begs the question as to whether some directors have in fact lost control of this aspect of the remuneration debate and have become captives of remuneration consultants who themselves have a vested interest in ratcheting up the price of executive labour.

Having said that, ACSI welcome the improved disclosure of remuneration across the corporate group. We note that the details to be contained in the remuneration report will be prescribed in regulations. Whilst such reports will clearly build on the section 300A disclosure requirements in the Corporations Act, at the very minimum the following information needs to be disclosed: (1) primary benefits, including base remuneration, cash and other incentives; (2) equity compensation; and (3) post-employment benefits. We are concerned that adherence to section 300A disclosure has been less than satisfactory in a number of listed Australian companies over the last few years. Therefore, the proposals must ensure that adherence to these provisions

entails disclosure of the nature and amount of emoluments of board members and senior executives.

In addition to this it is integral that the remuneration reports clearly outline and explain the relationship between remuneration policy and company performance. We are concerned about this lack of linkage. There are a number of studies that were undertaken by Westpac governance service, the New South Wales trades and labour council and us that have found a negligible link between the size of fixed and variable remuneration outcomes and company performance. Having said that, we do not object to executives and directors of well-run, efficient and acceptably profitable companies being well rewarded. As shareholders, we are therefore challenged to apply reasonable levels of scrutiny on these pay arrangements.

I will say a few words on the non-binding remuneration reports. We reject the assertion that improved disclosure on remuneration of directors and executives coupled with the non-binding vote on remuneration reports will have a ratcheting-up effect on executive pay and that such a proposal will turn on its head the role of boards, directors and shareholders. We essentially see the non-binding vote as a mechanism and an outlet for shareholders to apply a practical focus on company policy on remuneration and to scrutinise their reasonableness against acceptable performance hurdles. We do not consider that there will be an avalanche of no votes in this regard. This has essentially been the experience in the UK. At page 17 of the submission we outline the lowest levels of positive support in relation to a range of remuneration reports that were submitted in the UK. Only one such report, the GlaxoSmithKline report, was voted down. In fact, information that we have received from PIRC shows that the average opposition recorded against remuneration reports at the all-share companies in the UK was around four per cent.

We are curious that a number of organisations that have made submissions that reject this proposal for a non-binding vote have basically called on shareholders to use the section 249 100-member rule provisions to be able to vent their frustration with remuneration policies.

Senator CONROY—Good luck!

Mr Spathis—It is these same groups that are actually calling for the abolition of this specific provision. Having said that, from an investor point of view we have been impressed with the quality of the remuneration reports that have been tabled in the Australian context. We commend organisations like BHP Billiton and Brambles in relation to the quality of the remuneration report that shareholders in Australia were able to vote upon as a consequence of their dual listed arrangements. We commend this committee to peruse the contents of these reports. What we can add to that is some of the experiences of shareholder groups in the United Kingdom. The 2003 annual review of Pensions Investment Research Consultants, PIRC, states that ‘disclosure with the new regulations has improved but key elements remain obscure at a significant portion of companies’. It goes on to say that the preamble to the new combined code stresses the importance of remuneration reports that are clear, transparent and understandable to shareholders, and that PIRC regards the current complexity is a significant barrier to accountability.

So on this issue of complexity we stress that remuneration reports need to be user friendly. To this end we would refer you to page 14 of our submission that contains the US SEC disclosure

table on remuneration that has been utilised in the US since 1992 to provide information to shareholders on exactly what is being done 'at their expense'. Such a table could be presented to summarise compensation and benefits paid. The committee should ensure that CLERP 9 proposals avoid proposing the kind of report that the US abandoned in 1992 as uninformative and difficult to interpret.

Voting on remuneration issues is not such a novel idea. Shareholders currently have the opportunity to vote on resolutions by simple majority in relation to equity grants for board members. We believe that in the context of reforms being proposed in the CLERP 9 package the shareholder approvals should be by special resolution that is 75 per cent majority. We also support submissions made by the ASA and CGI that all equity based remuneration schemes could be approved by shareholders prior to the implementation. Such requirements for shareholder approval were required under the ASX listing rules up until mid-2002. In the absence of their reinstatement in the listing rules we would seek that they be included in the CLERP 9 package of reforms on remuneration disclosure and reporting.

In relation to shareholder participation provisions in CLERP 9, we support the various recommendations on electronic distribution of information. But we would also stress that we need to consider more specifically the systems and the processes that would underpin electronic proxy voting as a means to improve levels of voting in the Australian context. I refer to the Myners committee in the United Kingdom: that is worth perusing and considering in the UK jurisdiction, given that the sorts of issues that are relevant there are not dissimilar from those in the Australian jurisdiction. I might just leave it at that.

CHAIRMAN—Professor Walker, do you have anything to add?

Prof. Walker—I can add some comments about the remuneration issue. I was very impressed to hear the President of the Business Council of Australia, Hugh Morgan, comment on television recently when asked about executive remuneration that he thought this was a matter for the market. I would take the view—

Senator CONROY—We are trying to make him meet the market.

Prof. Walker—I take the view that a core function of government is to ensure that markets are fully informed. Having been on the other side of the table—in the boardroom—trying to assess remuneration, I have had negotiations with remuneration consultants who have standard methodologies which involve arraying what the market is paying to executives and senior executives in particular industries—and the methodology is fairly standard: it looks at the size of corporation, its turnover, its employees and so forth and identifies the quartile or percentile the organisation is in with pay rates in relation to other organisations—and I have put to the remuneration consultants: 'How much of that remuneration is bonuses as opposed to base salary?' They do not know, because it is not reported. This accounts for the way in which, by reference to what the market is currently paying, which may incorporate bonuses, other organisations then have to meet that market. So it has a ratchet effect. Unless you have full disclosure about the composition of remuneration arrangements, you have an ill-informed market. As I said, I think it is a responsibility of governments to ensure that the market is fairly informed.

Secondly, the existing disclosure requirements do not cover that. Possibly because of ambiguities in accounting standard 1034, which relates to disclosure of executive remuneration, there is a need, I think, for government intervention to ensure greater clarity. Again, I endorse the proposals set out, that Australia does not need to reinvent the wheel: it can pick up the format of disclosure adopted in the US in 1992. That would depict very clearly what the situation is with executive remuneration.

The next point I would like to address concerns the true and fair view, for I was essentially invited to do so by Mr Spathis. Treasurer Costello has said that financial markets in Australia did not face the same problems as those in the US because we had principle based regulation in Australia in accounting. I dispute that. In the submission we pointed out that there are anomalies in the Corporations Act at the moment. The rules guiding the issue of prospectuses and the content of prospectuses very clearly state that they are intended to inform prospective investors in securities. That is the basis upon which people evaluate the quality of a prospectus. The rules in relation to takeover documents suggest that a part B statement should provide all that information which is necessary for shareholders to make judgments as to whether to accept or reject a takeover bid.

When it comes to financial reporting there is no such statement. We have a requirement for financial statements to provide a true and fair view without what I think is the necessary step of saying that that means providing information which will enable investors or prospective investors to make decisions about whether they sell or hold securities. Until we establish that principle in the Corporations Law we are likely to continue to see people playing games with accounting standards to try to reflect the best possible result consistent with the incentives they face either through bonus or incentive schemes or anything else. It seems to me that that is an important principle.

That was debated, I might add, 20 years ago. I was the principal author of the corporate reporting forms developed by the NCSC in 1984 and published in a separate green paper. This particular green paper dealing with reporting obligations of directors was distributed as a discussion paper. It was systematically endorsed, I think, by all public sector auditors in Australia but opposed by the accounting firms that perhaps saw some risks associated with their liability if that were implemented. However, I just point out that since that time the Commonwealth has taken over the Corporations Law and introduced a purposive style of drafting throughout the Corporations Act. We now have that purposive style of drafting introduced in relation to a statement of the principles. The principle based reporting requirements are for prospectuses and takeover documents, but not for annual reports, and it seems to me that that is anomalous.

CHAIRMAN—Tell me how ACSI actually differs from ASFA, the Association of Superannuation Funds of Australia in terms of your role, how you are structured and whom you represent.

Mr Spathis—ACSI only represents superannuation funds and has a very specific charter to basically educate and provide research for those superannuation funds on external corporation governance issues that impact on their investments. ASFA—and I am not speaking for them—have a broader, more encompassing role in relation to super funds, fund managers and the investment community that relates to superannuation funds.

CHAIRMAN—In relation to the true and fair issue, Mr Dunsford gave evidence earlier this morning in which he supported the same principle. His view was that the true and fair description should be contained in the notes to the accounts rather than in the accounts themselves and in that way they would not, in a sense, conflict with accounting standards. The accounts themselves could be done according to accounting standards, but in the notes to the accounts you would have the information that would give the true and fair description. Is that a position you support or is your position a bit different?

Prof. Walker—That is Mr Dunsford the actuary?

CHAIRMAN—Yes.

Prof. Walker—I think that is unduly restrictive because there may be circumstances where one needs to go beyond notes and actually provide supplementary financial reports in order to ensure that accounts are not misleading. In essence, the true and fair view requirement at the moment is viewed as unenforceable. I cannot recall anything beyond a magistrate's court where anyone has ever initiated any prosecution using those true and fair provisions. It seems to me not very useful to have provisions in there which are so vague that representatives of regulators are on record as saying that it is not worth bothering to enforce them because the other side will just wheel out lots of experts saying that they would have interpreted accounting standards in exactly the same way.

I am arguing that a more purposive style of drafting, embodied in the Corporations Act, would indicate that it is the responsibility of those preparing accounts to make sure they are not misleading. It is possible to comply with accounting standards to the letter and still provide reports which are misleading. I think that is evident when you look at, say, the collapse of WorldCom—a large proportion of the assets listed in the financial statements of WorldCom were things that could not be sold. They were recorded as assets because that is allowed under accounting standards, yet it was quite misleading to describe any of those assets in that way.

The same could be said of many other corporate listed companies. I notice, for example, that the National Australia Bank is proposing to write $300 million off capitalised software. I have just done some calculations, and it may amuse the committee to learn that there are 51 million methods of accounting for software in terms of accounting standards, ranging from capitalising the lot to writing the lot off, with many variations in between. All of those would be consistent with accounting standards but, if that software is a dud and does not run and it is unlikely that organisations will generate cash flows from applying it, then it makes no sense to keep it and record it as an asset.

CHAIRMAN—What Mr Dunsford was suggesting—it might go further than your approach—was that financial statements should contain information about the current fair market values of assets and liabilities in a form which enables comparison with the values given in the statement of financial position: that is, the balance sheet. He is saying that it needs to be separated out from the account.

Prof. Walker—To my mind the question of whether anything that you cannot sell should be recorded as an asset is contentious.

CHAIRMAN—He will not agree with that.

Prof. Walker—I do not think this committee necessarily wants to take on the international accounting profession just now so, working within the context that we do have this system of accounting that is adopted internationally and that does recognise assets as things that you pay money for, using historical cost base derived methods for measurement, it seems to me that an overarching requirement that financial statements should not be misleading allows people to then supplement what is in the published financial statements with explanations to remediate any risk that they may mislead.

Senator CONROY—Thanks very much for that contribution. Your submission supports the CLERP 9 requirement for auditors to attend the AGM of a listed company and to answer reasonable questions about the audit. However, your submission says that you are concerned about situations where the chairman of a public company has refused to allow questions to be put to the auditor about the appropriateness of the accounting policies adopted by the company. Your submission says that a chairman's standard response is that the choice of accounting policies is the responsibility of directors and management. You may have been aware of a very fascinating discussion we just had with the Law Council about what is the responsibility of directors and management. In their view, just about everything is and shareholders can rack off. In your view will company chairmen be able to use the same excuse in spite of the new provisions in the CLERP 9 bill?

Prof. Walker—I had that experience with Western Mining some years ago. At the time I was chairman of the Australian Shareholders Association. I was concerned that Western Mining had issued misleading information to the market as evidenced by the fact that one newspaper said that they confounded their critics and had a great result and another said that they had a lousy result. I invited ASIC to have a look at this. They did in fact issue a joint press release with Western Mining and Western Mining promised never to do it again.

But as I rocked up to the annual meeting, I sought to ask questions. The chairman, Sir Arvi Parbo, refused to allow me to ask questions of the auditor. I was just flatly rejected. Even though I said, 'You've got legal counsel here. Read the Corporations Law'—because at that stage it did provide for shareholders to ask those questions—I was flatly rejected, my microphone was turned off and I sat down. I had asked a totally legitimate question. There is no provision for chairmen who wish to conduct themselves in that way to be subject to any sanctions. So that is basis of my personal experience.

Senator CONROY—So your concern would be that under these new provisions that could still happen?

Prof. Walker—Regulations are only good to the extent to which they are administered by regulatory authorities. They have improved since the 1980s, when I often used to reflect that if the role of government was to ensure that markets were fully informed we were not doing a good job. I recall how one could go to the smallest casino in Australia—I think it is in Launceston—and have two government regulators observing a two-up game. At the same time, we had 1.5 people working for the National Companies and Securities Commission oversighting financial reporting to the market and the conduct of securities trading. It seems to me that the balance was not quite right. We have come some way since then.

Senator CONROY—Your submission says that to overcome the problem the bill should be amended to require the auditor to answer questions about 'the basis upon which the financial statements have been prepared.' Do you think that is necessary to actually deliver the intent?

Prof. Walker—I do and did. I have had that experience at company meetings where I have asked questions of auditors about why they chose to report in a certain way, and they have said that was the decision of directors: they would not engage in any qualitative discussion about whether they agreed with those accounting choices or not. Indeed, the whole conduct, I think, of company reporting at the moment is very deficient in relation to the level of compliance with accounting standard AASB1001 on the disclosure of accounting policies—Mr Reilly in the background nods his head—which essentially requires companies to disclose the key choices they are making in accounting, because that has an impact on the nature of the numbers and, many would say, the quality of reported earnings. Yet in practice about 80 per cent of what gets reported is just quotes from accounting standards; they are not disclosing the policies they are adopting at all—whether they are capitalising software or writing it off or whatever. These are pretty basic deficiencies in our current reporting framework and it is not something that our regulators—either the professional bodies or ASIC—have really addressed.

Senator CONROY—A previous witness suggested that Warren Buffett gets around this by asking the auditor, 'Would you have prepared the accounts in this way?' Is that too smart a question or is that not going to get the answer that you need?

Prof. Walker—Mr Henry Bosch, the former Chairman of the NCSC, advocates that audit committees should ask the auditors the following question: where in the range of accounting standards from conservative to ambitious would you rate these accounting policies?

Senator CONROY—I cannot find anybody publicly to tell me what an aggressive accounting practice is. I have found lots of people who will chat with me off the record, but I cannot find anybody anywhere who can define what an 'aggressive' accounting practice is.

Prof. Walker—There are a number of synonyms. Some use the word 'creative' accounting, and accountants are essentially very creative people. Others suggest that there are those which are pushing the boundaries of accounting standards. Generally they involve capitalising expenditure which otherwise should be written off; retaining asset valuations which are overstated relative to their inherent worth and relative to current market values or the cash flows they are generating; and at times understating obligations—such as the failure of many corporations in Australia to disclose their obligations in terms of defined benefit superannuation schemes—and possibly other areas. So it is possible within the repertoire of accounting standards to pick particular methods which maximise reported profits—at least in the short run, because in the long run they come around.

I have given the example recently of some of the wine companies. People are expressing dismay about the sudden reversal in the fortunes of some of our leading wine producers, but you need to look carefully at their accounts over a period. Southcorp generated 49 per cent of its reported profits by revaluing grapevines, which are not saleable assets. The difficulty with that is that, having revalued them upwards under accounting standards, you then have to write them down over a period. This is perfectly acceptable in terms of Australian accounting standards, but I think it is a joke, because one cannot sell a grapevine.

CHAIR—And keep producing.

Prof. Walker—That is right. You cannot separate them from the land on which they grow. Those who purport to value grapevines are making predictions about the future productivity of their horticultural practices, future incidents of pestilence and disease, future climatic conditions, changes in taste—chardonnay versus riesling or whatever—competition overseas and foreign currency movements: out of all that they arrive at a value and put it in the financial statements.

I think some of our accounting standards are distinctly unsound, but it seems to me that full disclosure of the financial impact of adopting some of these accounting standards would be more informative to readers. The only way in which I was able to identify the impact of some of these accounting policies on, say, wine producers was by sitting down for several hours, going through a succession of notes and doing some calculations. It is not something that the average analyst seems to do.

Senator CONROY—One of the suggestions I have been kicking around and considering moving as amendments is the suggestion that auditors be required to opine in their audit report to the annual general meeting about any differences between their views on what accounting practice should have been undertaken as opposed to what management has done. Do you think that would be helpful to shareholders in gaining this ability to understand what has gone on in the accounts?

Prof. Walker—I think it would be a modest incremental reform. I am not sure that one should expect great disclosures about this, because experience suggests that auditors and finance directors negotiate outcomes. There is a book recently published by the Institute of Chartered Accountants in England and Wales called *Behind Closed Doors* which contains a series of case studies on negotiations between finance directors and auditors about the content of accounts and how they should be presented, and I think what this demonstrates is that there is a degree of negotiation going on which affects the outcome.

Senator CONROY—But is that unreasonable? I understand the point you are making, but if audit firms were here now would they say, 'Of course that is what would happen. That is normal'?

Prof. Walker—They would probably also say, 'You counsel those who are directors and we come along and audit, so if the directors have chosen a particular accounting technique then we cannot really disagree with them much as long as it is within the repertoire of techniques available under accounting standards.' In practice, many auditing firms actually do write up the books at the end of the year. It is often not a case of the directors making the choice of accounting methods; it is often a case of auditors actually being engaged in part to do the adjusting entries and finalise the accounts. Often, as we say in the submission, that is okay, if it is a small private company; but it is something that you would not, I think, expect of the major listed companies.

Senator CONROY—The CLERP 9 bill also only requires disclosure of non-audit services and a statement that they do not compromise audit independence. Your submission suggests that certain non-audit services should be prohibited. Could you advise the committee which non-audit services should be prohibited and why they should be prohibited?

Prof. Walker—I think one was addressed in Mr Spathis's presentation, and that was the question of executive recruitment. Some big accounting firms engage in executive recruitment for clients and then, I think, they are inherently compromised. If they assist in engaging a chief financial officer or a senior executive and are subsequently looking at a set of accounts which report on their choice's performance, I think they are inherently compromised immediately.

Another situation arises where there is no prohibition in the accounting profession's ethical rules of an accounting firm doing a due diligence. I will have to check on this for listed companies, but I have encountered cases where an account auditor has done a due diligence on a proposed acquisition by a company, said it was a good buy, then passed opinion on accounts which talked about the assets being at valuation. The valuation was their own valuation. At the time I looked at this, that was okay provided they did not say it was an independent valuation, which I find extraordinary. I just do not think that it is appropriate for accounting firms to provide valuation services for clients they audit. These are very specific areas of accounting practice which really do inherently compromise the independence of auditors.

On the other hand I have no problem, contrary to Sarbanes-Oxley, with auditors doing certain work on internal controls and what might be described as internal audit work. I am a third-generation chartered accountant—I say that just to emphasise that we can reproduce.

I grew up in the days when auditors did a lot of detailed checking of all transactions. Nowadays the work involves assisting internal controls and walking through systems and doing detailed substantive testing on a limited range of transactions. But there are circumstances where it is desirable for companies to engage auditors to do far more audit work than what is the bare minimum to prepare a statutory report. Indeed, one of the suggestions in the submission is that it should be open in the Corporations Act for shareholders to elect what kind of work they should do, over and above the statutory minimum.

I have had experience on boards where, because of some problems, we found it desirable to bring in auditors to do far more detailed internal reviews—looking at data integrity problems and the like—than would be necessary to do the audit. Why did we bring them in?—because they knew the systems. They could walk in and do the job, and we wanted it done quickly, to sort out a problem. That kind of internal audit work I do not think should be prohibited. Indeed, I think auditors being asked to do far more detailed work than the bare statutory minimum should be encouraged. If it is a case of requiring shareholders to vote on it, so be it.

Another area where auditors could be called upon to do more relates to related party transactions. I recall 20 years ago that proposals that the Corporations Law be amended to require disclosure of related party transactions were greeted with dismay by the professional bodies at the time, and by many people in commerce and industry, but now I think it has come to be accepted. Many of the things we read in the financial press about revelations of unacceptable corporate conduct flow from the fact that we now have some insights: the market is now better informed about what goes on. It seems to me that rather than simply requiring auditors to report on related party transactions, it would be open for them, for example, to be engaged by shareholders to report to them about when they thought arrangements were fair and reasonable and whether it was appropriate to make loans at this interest rate or to sell assets of a certain sort to directors and the like.

Senator CONROY—We have had a number of the major accounting firms before us, like Farr, and they essentially said to us, 'We would not dare damage our reputation by engaging in these conflicts. We believe we can manage these conflicts—trust us.' In your experience, would it be being a bit hopeful, if the committee were to trust them?

Professor Walker—I must say, I was astonished to read that a number of staff were seconded to work for National Bank's auditors, KPG, for 18-month periods. I found that quite astonishing—to send a third generation accountant. I thought that was compromising the independence of the auditor quite considerably. I would like to hear more about the background to that. I do not want to contradict myself in relation to what I said earlier about how there are occasions when you could engage the firm to do certain work, but if you are actually bringing cohorts of staff in to do certain work of an unspecified nature, I have concerns about that.

Senator CONROY—In light of your comments, do you believe that the CLERP 9 bill is sufficient in terms of non-audit services or do you think there need to be amendments?

Professor Walker—I think we are suggesting some amendments, particularly those prohibitions that are listed on pages 5 and 6 and 7 of the report.

Senator CONROY—In light of mention at the SEC investigation into an Australian accounting firm, the question for Australia is whether we want to have a lower standard of audit independence than the US. Are you comfortable with Australia's standards being lower than the US in this regard—in these conflicts?

Professor Walker—Certainly not. There is no need to reinvent the wheel on areas of corporate governance. Many people say that American corporate governance is unduly geared towards serving the interests of one group of stakeholders—namely shareholders—and not having regard to other stakeholders, as you would expect to find in Germany or even in elements of our Australian law, implicitly. Nevertheless, I think some of their requirements have merit, and why reinvent the wheel and go for a lesser standard than Australia?

Senator CONROY—We had Deloittes before us last week and we asked them about this issue. I said 'How are you going to cope with companies that are listed or raise capital in the US and that you're the auditor for?' They said, 'We've got about 15 clients that fall into that category and we just won't tender for any work with them, other than audit.' But in Australia it's business as usual—because they are the one company that did not seriously separate their consultancy business out. Does that seem a strange attitude?

Prof. Walker—I have to say whenever I have been on a board I have made it a policy that any auditor that is engaged is not to provide anything other than audit services, with those minor exceptions about additional auditing. It is a principle that I have found is worth adhering to. It is not shared universally in the community obviously.

Senator CONROY—Your submission states:

... ACSI considers that because of the significant responsibilities of a Chairperson, it is not generally acceptable for the Chairperson of a listed Corporation to have the same high level responsibility in a similar position with another listed Corporation.

Why should a person be prevented from chairing more than one listed company?

Mr Spathis—It goes to the issue of the capacity of that chairperson or director to be able to discharge their responsibilities. As was highlighted in the New South Wales Supreme Court in the last year in the ASIC v. Rich case, the responsibilities of a chairperson are more than just those of a symbolic gatekeeper in relation to the way the board ought to deliberate and deal with issues that come before it. The chair has a significant responsibility: the onus rests with them to ensure that all relevant information is made available for the board to make an informed decision about specific issues. We would have concerns with a chairperson who would stretch themselves in a way that did not give them the opportunity, resources and capacity to focus on what is a complex and highly responsible role. It really goes to issues of capacity and resources. It may not be necessarily applicable in every case to have a hard and fast rule that a chairperson should not sit on more than one or two boards or whatever or a director should not sit on more than three or four boards. The boards themselves have some responsibility and an onus to firm up on a view about—

Senator CONROY—Do you think you are being unfair? Mark Rayner did a great job on Pasminco and NAB.

Mr Spathis—I do not think I am being unfair at all, given the nature and the onus of responsibilities of chairs and directors.

Senator CONROY—You are suggesting that there may be grounds where it does happen. Where a person who chairs one company is proposed to chair a second company, should there be a non-binding vote at an AGM to obtain the shareholders' views?

Mr Spathis—We would support something along those lines. At the moment what we would do in those instances is engage with the company and ascertain what capacity the chair has in relation to discharging their proper responsibilities to that company. We would look for an expansive response from the board in relation to that. However, if over time we find an unsatisfactory response to that effect, we would think a non-binding vote along those lines would be reasonable. ACSI provides a voting alert service to a number of our superannuation fund subscribers. This issue does form an automatic trigger in relation to the capacity for chairpersons to deal with these issues. Being a trigger, we then take it upon ourselves to understand the specifics of the company and to engage with the company to understand what their thoughts and views are in relation to resources to be able to deal with these things.

Senator CONROY—Hugh Morgan and the BCA have had a bit of air time recently on some of these issues. They have advised the committee that they do not support the CLERP 9 proposal to increase the disclosure requirements for executive remuneration to the top 10 executives. They argue that this would ratchet up executives' salaries. Do you have any views on that argument?

Mr Spathis—We reject that unequivocally. It is the sort of argument that organisations used when the section 300A disclosure provisions were introduced. Unlike back in 1998 when section 300A was introduced in relation to improved disclosure, I would have to say that shareholders, both individual shareholder groups like the ASA and the institutional investors, have really turned their mind to utilising that information disclosure section and actually putting some

pressure and onus on these companies to deal with finding the link between pay and performance. I think that many boards have more or less become captive to the arguments that have been put forward by remuneration consultants that somehow, to be able to recruit the best executives on an international scale, you have got to pay them international type salaries. I guess it goes to that issue that you raised of comparative wage justice.

Senator CONROY—It was a marvellous argument. I have heard it expressed many times in my life.

Mr Spathis—I thought enterprise bargaining had done away with that.

Senator CONROY—I thought so too. The whole purpose is to focus on the enterprise, growth of the enterprise and productivity.

Mr Spathis—Notwithstanding that, I think that the amendments that have been proposed will give us—

CHAIRMAN—That is about comparative wage justice. This is about paying market rates.

Mr Spathis—Which market are we talking about?

Senator CONROY—That is right. Let us make one up as we go: 'Here's a world market—great!' We have done brilliantly at the NAB with a world competitive CEO who has done brilliantly!

Mr Spathis—We have exported about $20 million worth of shareholder wealth in some specific instances when these company directors have failed. But the point is that we do not begrudge good salaries and we do not begrudge reward that is based on long-term performance and on appropriate triggers and really good measures. ACSI argues for the utilisation of both absolute and relative measures that should form part of the trigger that should then kick in share option arrangements or share incentives or even bonus arrangements. We are not against that stuff as long as it is properly disclosed and there is a clear nexus between performance and pay.

Senator CONROY—Both you and the professor have said there is no need to reinvent the wheel and that there is a table that the SEC have promulgated—it is a very good table as it gets the message out simply—yet we are going down a different path. Is the table that AASB 1046 outlines close to that or is it not worth while compared to what you could have if you were not trying to reinvent the wheel?

Prof. Walker—One of the difficulties is that the accounting standard requires disclosure of remuneration which is received or due and receivable. It does not, in my experience, encompass deferred compensation which may be contingent on certain performance hurdles being met in the future. It has been drafted in that way.

Senator CONROY—You do not think that was an accident?

Prof. Walker—There has been some degree of watering down of the disclosure provisions when they have been transferred from schedule 5 of the corporations regulations to accounting

standard AASB 1034, but that may have been incidental. But at the end of the day I think the SEC has identified this as an area where one needs to separately report deferred compensation items which might not pass the threshold test for recognition as a liability under current accounting concepts. Secondly, there is some controversy about whether the issue of options should be recognised as an expense or not. The accounting standards are going to resolve that issue, but the total covers all those things. I think that putting that format out essentially places the onus on registrants, firms registered with the SEC, to fill the forms in fully and comprehensively, whereas the kinds of disclosures that are contemplated by CLERP 9 would permit generalised waffle to be provided which might conceal more than it reveals.

Senator CONROY—And compulsory versus voluntarily?

Prof. Walker—Compulsory disclosure, I think. We are talking here about accountability, and I do not think you compromise requirements for accountability. To be able to form a company with limited liability, to be listed and to attract public investment is a privilege, and I think the 19th century ideals, that with that go some responsibilities to be fully accountable to the community, have some merit.

Senator CONROY—ASX corporate governance guidelines say that non-executive directors should not be provided with retirement benefits other than statutory super. Your submission also says that NEDs should be prohibited from receiving options. Should the CLERP 9 bill prohibit options of retirement benefits other than statutory super?

Mr Spathis—We support the ASX guidelines and we support the guidelines in relation to these specific matters. There are many companies that still pay retirement benefits and there are still some companies that provide share option arrangements in that regard. The reason we do not support share option arrangements, for example, applying to non-executive independent directors is that that essentially introduces a regime of remuneration that is not dissimilar to that which applies to managers. In terms of the role of a director, who must oversee practices that apply to executives and that motivate the executives to do what they do, we do have a concern with a remuneration system that is similar with regard to both and that could provide for similar sorts of incentives for certain behaviours arising out of that. We do support a part of directors' remuneration coming in the form of shares. However, we do not support that converting to share option arrangements that are applicable to executives.

Senator CONROY—As you are aware—and most people are completely unaware of this—existing section 200G of the Corporations Law states that shareholder approval for retirement benefits is only required where the payout exceeds an amount prescribed by a formula. For example, an executive director or director can obtain a retirement package without shareholder approval of up to 3.5 times their average annual income if they have been with the company for 3.5 years, five times for five years and seven times for seven years. In your view, should these types of payments be approved by shareholders?

Mr Spathis—I can feel a strengthening of section 200G coming on. We would support a move along those lines.

Prof. Walker—I have had the experience with a financial institution where such agreements were entered into by the chairman without members of the board being aware of them. In effect,

this involved substantial payments through obligations which were not separately disclosed in the accounts. I asked a question of the chairman at the annual meeting and I was referred to the auditor.

Senator CONROY—And you were on the board?

Prof. Walker—No, I was not on the board; I was a member. I asked questions and the auditor said that he was unaware of any such arrangements. Yet later on, when there was a change of board and I was brought in as an adviser to an audit committee, we found that these arrangements did in fact exist.

Senator CONROY—The auditor must have been doing a good job!

Prof. Walker—It is very difficult to sack an auditor under the Corporations Law, but let me say that this institution subsequently called audit tenders.

Senator CONROY—Finally, the previous Parliamentary Secretary to the Treasurer, Ian Campbell, said that the government would require up-front and real-time disclosure of executive contracts. The CLERP 9 bill fails to implement this requirement. However, the ASX listing rules were changed in May last year to require disclosure of material parts of a CEO's contract. In your view, should the requirement to disclose executive contracts in real time and up front extend beyond the CEO to other directors and senior managers?

Prof. Walker—It would not hurt. I think similar requirements exist with the SEC requirements. That list in our submission identified the basic reporting requirements, but I believe there still are requirements for real-time disclosure of these transactions in the US. If the home of democracy can cope with that, I cannot see why the Australian system could not.

Mr Spathis—We would refer you to a UK Department of Trade and Industry study that looks specifically into this issue entitled *Payment for failure*. It was published earlier this year and deals with those bills under consideration.

Senator CONROY—Thank you very much.

Prof. Walker—When I said 'the home of democracy' I meant to say 'the home of capitalism'!

Senator CONROY—Yes.

CHAIRMAN—Could you give a brief response to what you think is a desirable mix of members for the Financial Reporting Council and what appointment mechanisms ought to be in place?

Prof. Walker—One of the views expressed in the submission is that there should be greater representation of investors. ACSI represents major investors in Australia—bodies such as the Australian Shareholders Association—and individual investors. There are some aspects of the Financial Reporting Council's activities which bemuse those who look at the world through the lenses of prospective investors in company securities. As one who has looked at the Financial Reporting Council's web site to try to comprehend the rationale for some of their decisions and

directives to a standards board, I must say I have been bemused by the rationale or the lack of explanation of what they are doing. So it seems to me that any efforts made to widen representation and to make it more representative to the stakeholders it is intended to serve would be beneficial.

CHAIRMAN—On the issue of auditor rotation, which you support, what is your response to the claims by both large and small audit firms that mandatory partner rotation does not take into account that some audit firms are not large enough to meet the requirements and may be driven out of business as a result?

Prof. Walker—First, if they are not large enough they probably should not be auditing major listed companies. So you might qualify that rule and restrict it to situations where companies are inviting public investment. However, I think that is overstated because what we are likely to see is greater movement of audit work between firms. If you cannot rotate your partner you might shift firms. The same amount of work is just going to go around, and it is a matter of quality attracting the most work, I suppose.

CHAIRMAN—Thank you, Mr Spathis and Professor Walker, for your appearance before the committee today.

[2.56 p.m.]

HAMILTON, Ms Karen Leslie, Chief Integrity Officer, and Chair, Corporate Governance Council, Australian Stock Exchange Ltd

CHAIRMAN—Welcome. The committee prefers all evidence be given in public, but if at any stage of your evidence or answers to questions you wish to respond in private you may request that of the committee and we will consider such a request to move in camera. We have before us the written submission of ASX, which we have numbered 48. Are there any alterations or additions you want to make to the written submission?

Ms Hamilton—No.

CHAIRMAN—We invite you to make an opening statement and then we will move to questions.

Ms Hamilton—Thank you. It will be a very short statement. Thank you for the opportunity to appear today before the committee. ASX strongly support the directions taken by the CLERP (Audit Reform and Corporate Disclosure) Bill 2003 to enhance audit regulation and the general corporate disclosure framework. We particularly support—although we understand supporters are few—the introduction of an infringement notice regime to facilitate effective enforcement of continuous disclosure contraventions.

As a licensed market operator and clearing and settlement facility provider, ASX has a clear interest in the effectiveness of our regulatory infrastructure to support the vibrancy of Australia's capital market. The liquidity and depth of our market is dependent on transparency; the quality and depth of information available to market participants; efficiency, including the economic cost of transacting in that market; and the integrity of that market. Australia has had in place a sound regulatory framework to support these three fundamental pillars and, as a result, our market has outperformed most markets worldwide in currency adjusted terms in the last two years.

That acknowledged, we are not well served if our framework remains static and does not respond to evolving market conditions and investor concerns. ASX considers that in responding to these conditions and concerns the CLERP bill takes a balanced and pragmatic approach which, as a result, will deliver important enhancements to our regulatory infrastructure. This will promote continued investor confidence in our market while not unduly impeding the ability of our companies to create value through entrepreneurialism, innovation, development and exploration.

It is appropriate in that context to reflect on the size of our market and our companies. As at 31 January we are the ninth largest world capital market, at 2.11 per cent of the MSCI free float index. Corporate disclosures in the form of company announcements to the market have increased by 120 per cent and, with them, market liquidity has moved from some 34 per cent to more than 80 per cent in the last decade.

The market capitalisation of domestic equities listed on ASX has grown from approximately $198 billion in 1992 to $777 billion at 31 December 2003; 7.7 per cent of domestic companies represent 85.5 per cent of domestic market cap. Within the S and P ASX All Ordinaries Index are included companies with market capitalisations in the following dollar ranges: top 100, more than $1.07 billion; 100 to 200, more than $307 million; 200 to 300, more than $125 million; 300 to 400, more than $59.8 million; and then a drop—400 to 500, more than $5.7 million. As at 31 December 2003, 33.5 per cent of listed companies had a market capitalisation of less than $10 million. In other words, although strong, our market is small as are the majority of our public companies. It is for this reason that we have to ensure we get the balance right, to achieve the appropriate balance between sufficient prescription in the law to regulate the fundamental requirements that ought underscore the adoption of the public company persona and shape the integrity of corporate reporting while allowing the disciplines of the market to cost effectively and expediently shape appropriate behaviours. ASX believes the right balance has broadly been struck in the CLERP 9 bill.

Senator CONROY—I will start by congratulating ASX for its strong support of the infringement notice power in the face of what I know is a concerted campaign to do it over.

Ms Hamilton—Indeed.

Senator CONROY—I would like to discuss the relationship between the ASX and ASIC. Could you take the committee through the steps taken by the ASX when you have a concern about a potential breach of continuous disclosure—what happens?

Ms Hamilton—The first thing that would happen is a full and frank conversation with the relevant company. There is a fairly intense effort at ASX pre 10 a.m. every trading day if we are concerned that there is an issue about the level of disclosure in the market. Our primary focus would be to get the disclosure result for the market. If we formed a view that the market was uninformed, that there was an asymmetry of information, we would move to suspend trading in the security. But we would not normally treat suspension of stock as a punitive measure against the company; it is really a market efficiency measure. If, following getting that disclosure result, we had concerns that the company was in breach of the continuous disclosure regime we would make a referral to ASIC.

Senator CONROY—So what is ASIC's role once the ASX has identified this potential breach? What happens next?

Ms Hamilton—They would investigate and form a view as to whether there was sufficient evidence to support prosecution in respect of that breach.

Senator CONROY—In your experience does ASIC take action each time a referral is made from the ASX?

Ms Hamilton—No. Often they will conclude that there is insufficient evidence to support a prosecution. There have been concerns, I believe, that the legislative framework does not well support the taking of enforcement action, and we have raised in our submission the issue with section 674, I think it is, which borrows from the insider trading notions, which we believe does not well serve effective prosecution.

Senator CONROY—Do you support the ASIC infringement power in the CLERP 9 bill—the one that is in there now, as opposed to what was talked about earlier?

Ms Hamilton—Yes, we do. One of our concerns—the devil is always in the detail—was that there be an appropriate level of consultation between ASIC and ASX. We were very concerned that, absent that, there was a possibility that administration of the continuous disclosure regime could be fragmented, resulting in uncertainty for the corporate sector, which we considered to be inappropriate. That has now been addressed. Other concerns that we had went to how the issue of publicity was going to be addressed, what protections might apply to individuals against personal liability, given our own experiences of trying to get people to stand in the space and be responsible for continuous disclosure.

Senator CONROY—Have you had a look at the FSA in the UK and their ability to impose fines? Have you drawn on some experience from the UK?

Ms Hamilton—We have looked at overseas models, and I think that is probably what guided ASIC in believing that an infringement notice regime was an appropriate addition to its enforcement armoury.

Senator CONROY—Before issuing a notice, ASIC is required to consult with the market regulator, and this is you in almost all cases. In your view, why is that consultation necessary prior to the issuing of a notice?

Ms Hamilton—Just to make sure that there is a good understanding of whether there has been a breach or not. I think it would be inadvisable if ASX had had discussions with that company and formed a view that the carve-outs legitimately applied and ASIC were to take a contrary view. ASIC must, at the end of the day, have the right to do so, but I think it makes more sense for there to be consultation before the step of issuing an infringement notice is taken so that they can be quite clear on the grounds and likelihood of success of taking that step.

Senator CONROY—There is an argument about whether ASIC should be able to publish an infringement notice they have issued. I am left scratching my head when I think about this one. I am presuming that ASIC issuing the notice at least privately to the company is a material matter and therefore actually would require disclosure under the continuous disclosure laws. Maybe I am just being too black and white on it. At the moment, as you would know, in the bill they are not allowed to until after the fine is paid at the end of the process. Do you think the market is going to be fully informed if ASIC have given them a notice and then it is a secret?

Ms Hamilton—I am not sure that it is a material matter in that acceptance of a fine does not amount to admission of contravention.

Senator CONROY—But we have only got there because you have looked at it first—

Ms Hamilton—Yes.

Senator CONROY—and you have come to the conclusion that there is an issue that you have not been able to resolve satisfactorily. You have referred it to ASIC, and ASIC have moved on it. So you have actually already made the judgment that it is an issue.

Ms Hamilton—We have, but you need to bear in mind that that is often an instinctive judgment. We are not equipped with powers of investigation so we have not been able to trawl through files.

Senator CONROY—So these full and frank conversations are just a bit of a chat.

Ms Hamilton—No, the full and frank conversations are very important, but we have to accept that it does not amount to a full-blown investigation where we look at files and are able to make final determinations on how speculative the information was, whether the carve-out legitimately applied and the timing of knowledge by the entity of that information.

Senator CONROY—Sure. One of the arguments for the infringement power is the deterrent effect.

Ms Hamilton—Yes.

Senator CONROY—Do you think the deterrent effect works as well if it is months before you find out what has happened? Is the market being kept well informed along the way?

Ms Hamilton—I think we do need remedies that deliver a quick message to the market. I think that in most instances of concern about a contravention of the continuous disclosure regime, though, that redress is probably provided by the media because they are usually all over it and so it is in the papers.

Senator CONROY—Yes, I appreciate that it is always hard. It is going to be entertaining to see ASIC stand there and say, 'No, we are not really doing anything,' when they have issued a notice. I am looking to seeing Jeff Lucy standing there looking like an idiot on national television as he tries to pretend that nothing is going on. This will become a farcical way to engage in market regulation—where, on the one hand, you have referred something off and, as you say, the media are all over it, and, on the other hand, you have ASIC denying anything is going on because they are not allowed to say that it is going on. It is hardly going to lead to a well-informed market.

Ms Hamilton—I think the market will be informed by what they see, irrespective of what might happen in relation to the particular infringement notice outcome.

Senator CONROY—This bit was a relatively recent inclusion. You signed up to the infringement power notice under the original model.

Ms Hamilton—Yes, we did.

Senator CONROY—This is a relatively recent change to the suggestion.

Ms Hamilton—The publicity provisions?

Senator CONROY—Yes.

Ms Hamilton—I think we are between a rock and hard place. There is obviously a lot of concern about the due process inherent in all of this and a lot of nervousness about that. I think naming and shaming is a very powerful incentive, a very powerful tool. But with that comes the concern that, unless we address those concerns about due process, no lawyer in the country is ever going to advise their client to participate in the infringement notice regime—they would rather take their chances in the courts. So we are trying to find a balance here in addressing those concerns about due process and still having some form of quicker redress in respect of a contravention.

Senator CONROY—My concern about this is your concern—that is, you are trying to keep the market informed and you are going to have this ridiculous process off on the side that is a secret. It is just going to be a joke. But I guess that is up to us to debate on the floor of the parliament. Your submission states that you support the proposal in the CLERP 9 bill for the CEO and CFO to sign off to the board on the financial accounts, but that the ASX corporate government guidelines go much further than the CLERP 9 bill. The ASX guidelines require that the sign-off by the CEO and CFO should say that the statement is founded on a sound system of risk management and internal compliance that implements the policies adopted by the board. In your view, should the CEO and CFO sign-off on the CLERP 9 extend to a sign-off on the company's risk management procedures?

Ms Hamilton—I certainly believe that the two go hand in hand, but whether it is necessary to go to the extent of enshrining that prescription in the law I am not so certain.

Senator CONROY—Won't this create an inconsistency between what people have to do and what people do not have to do?

Ms Hamilton—Certainly from the signs we are seeing of early take-up of the council guidelines that is what companies are doing. I would be concerned if there was an inconsistency. If companies—

Senator CONROY—There will be if the law goes through as it stands at the moment—you have one standard and the legislation has a different standard. It is going to be hard for you to go and say, 'We want you to do this.'

Ms Hamilton—I wonder how you can effectively do the one without the other, but certainly I would not stand opposed to the law being so modified.

Senator CONROY—Okay. Some of the earlier witnesses, I think before you arrived, were saying that this section is the hardest for people to comply with, in their experience. It might have been the Law Council that was saying this. The one you just sign off is causing grief and it is one that is going to have to be revisited. I know you have experienced enormous resistance to all of this but have you noted any greater resistance to this one than to the others.

Ms Hamilton—Certainly we were hearing more concern. There are a number of areas which have attracted more commentary; this is one. I do not think it was a concern with the notion of sign-off. It was more about understanding the parameters of that sign-off—what was actually required. So the council and the Group of 100 have published additional guidance better

describing to companies what the parameters of that requirement are and how they might go about satisfying it. I think that will alleviate the concerns in that space.

Senator CONROY—The Shareholders Association and CGI have recommended to the committee that equity based remuneration schemes for employees and executives should be approved by shareholders by special resolution in accordance with the old ASX listing rules which were removed in July 2001. Can you advise the committee why the ASX removed the requirement for shareholders to approve equity based schemes?

Ms Hamilton—We did not consider that was an appropriate matter to be trapped in the listing rules of a particular market operator. If it were considered sufficiently important then it should be in the law. We wanted to be consistent also with the provisions of the law in that regard. That is why it was removed. It was subject to public consultation at the time.

Senator CONROY—You would not have a problem if it were put into the Corporations Law?

Ms Hamilton—If we believe that is an appropriate requirement then the appropriate home is the Corporations Law.

Senator CONROY—I can only assess from those answers that you do not believe it is an appropriate requirement.

Ms Hamilton—I am not sure that it is. I certainly am a firm believer that we do need shareholder approval of those plans and that is certainly a recommendation of the council. Whether we need to go further and enshrine special resolution requirements in the law, I am not so sure.

Senator CONROY—Your submission raises concerns about the role of the FRP and you say:

ASX is concerned that the FRP will be effectively an arbitration panel but its findings will not be binding, either by statute or election, on either party.

Could you advise the committee of your concerns and how they should be addressed?

Ms Hamilton—I think we would like to see an expanded role for the panel in terms of providing binding decisions and in being able to lend certainty to financial reporting rather than being a dress rehearsal for a court process.

Senator CONROY—In your experience—and you may not be able to answer this or you might need to go away and seek some advice—how many referrals would you expect would be made to an FRP each year by ASIC and by companies themselves? Do you have any experience with that?

Ms Hamilton—I do not have a feel for that. I would rather take it on notice.

Senator CONROY—Could you advise the committee of the ASX's preferred model for funding for the FRC and why there is a failure of it to obtain corporate donations?

Ms Hamilton—We would like to see it funded by government.

Senator CONROY—You have nailed just about every one of my questions, Ms Hamilton, in record time. I am just about done. The CLERP 9 bill—I haven't nailed them all; my apologies for getting your hopes up!—requires the preparation of an operating and financial review. The explanatory memorandum says that the G100 guidelines may be used for the purpose of satisfying the legislative requirements. Your submission states that the provision should be more specific and it should require a list of topics to be discussed. What sort of topics?

CHAIRMAN—I will thank you in advance for your appearance, Ms Hamilton—I will have to leave very shortly.

Senator CONROY—We are almost finished.

Ms Hamilton—I do not have a hit list of topics. It was really an expression that some structure should be given to MD and A reporting and enshrined in the law. Our concern is that it has been a relatively useless form of reporting in terms of being a valuable tool to shareholders. We actively support better reporting in that space. We have tried to achieve that through listing rule modification and support for the Group of 100 publication, but we still see room for substantial improvement in that area.

Senator CONROY—Some commentators have said that the proposed section 299A can only be interpreted as including an obligation on public companies to report on significant environmental and social matters that could impact on a company's future financial prospects—for example, climate change and greenhouse emission issues. In your view does section 299A require disclosure of environmental and social matters?

Ms Hamilton—I would need to have a look at that.

Senator CONROY—Sure. Despite having you completely at my mercy, as we have been abandoned by everybody else, I have finished. Thank you very much.

Committee adjourned at 3.16 p.m.