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Official Committee Hansard

JOINT COMMITTEE ON CORPORATIONS AND FINANCIAL SERVICES

Reference: CLERP (Audit Reform and Corporate Disclosure) Bill

THURSDAY, 11 MARCH 2004

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JOINT COMMITTEE ON CORPORATIONS AND FINANCIAL SERVICES

Thursday, 11 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 Chapman, Conroy, Murray and Wong

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 4.06 p.m.

MUNCHENBERG, Mr Steven, Director, Policy, Business Council of Australia

CHAIRMAN—I call the committee to order. Today the committee continues its public hearings regarding its 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 relies heavily on public participation in its inquiries and expresses its gratitude to those who have contributed to this inquiry. To date, the committee has received 58 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 this 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 public 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.

May I also state that, unless the committee should decide 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 Tuesday, 16 March in Sydney and Thursday, 18 March in Melbourne. There will be further public hearings held in Melbourne and Sydney during April on dates yet to be determined.

The committee prefers all evidence to be given in public. As I indicated a moment ago, this is a public hearing. However, 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 the committee will consider such a request to move into camera. The committee has before it a written submission from the Business Council of Australia which we have numbered 20. Are there any alterations or additions you want to make to the written submission?

Mr Munchenberg—There are not.

CHAIRMAN—I now invite you to make a brief opening statement. I hope you keep that to five to 10 minutes. At the conclusion of that, I am sure there will be some questions.

Mr Munchenberg—Thank you. I will be brief. The Business Council of Australia welcomes the opportunity to appear before this committee. As I am sure the committee is aware, the council represents many of Australia's largest corporations. Specifically, the members of the Business Council are the chief executives of Australia's largest companies. Between them, BCA member companies provide jobs for nearly one million Australians, including a quarter of a million in rural and regional areas. Company revenues exceed $300 billion annually and our members account for over a third of all new business investment. Business Council member companies also generate a substantial share of total output profits and tax revenue in Australia. Strong growth in corporate tax revenue over the past two years, for example, has helped government produce the larger than expected budget surpluses.

The big business sector represented by the Business Council is therefore a major contributor to Australia's current prosperity. This must be borne in mind when we consider new regulation over that sector. Will this new regulation enhance businesses' contribution to Australian prosperity, or will it result in risk averse companies more concerned with legalistic compliance than with driving successful business strategies? When considering the bill before the committee, we should also ask: would the additional regulation in the bill, or the amendments that have been proposed, have prevented an HIH or One.Tel? Probably not. That is not because this regulation does not go far enough but because companies will always fail. When there is a downturn in markets, companies with weak business strategies or poor management will be found out. If those companies have breached existing laws, they should be and are prosecuted under those laws. But these companies will always be a small minority. What we must avoid is overregulating the bulk of companies because of the sins of the few.

The Business Council are not opposed to regulation per se. We accept the bulk of the changes in this bill. We do, however, oppose regulation which is driven merely by a sense that something must be done without regard for the need or consequences of that regulation. We are opposed to regulation for regulation's sake. We are concerned that superficially appealing proposals may in fact have adverse consequences. Let me give a few examples before finishing.

The government's bill proposes a non-binding shareholder vote on executive remuneration. At one level, this may seem reasonably innocuous. The Business Council itself has supported increased transparency, issuing its own detailed best practice guidelines on executive remuneration. At another level, however, the proposal undercuts the very basis of limited liability companies, where shareholders delegate day-to-day decision making to their elected boards. As a matter of principle, it is difficult to see why shareholders should ratify a board's decision on executive remuneration but not ratify a range of other decisions that have as much or more impact on their shareholdings' value.

The ALP has proposed requiring companies to produce graphs that compare remuneration with past company performance and shareholder return. Again, superficially, this seems reasonable, but it presupposes that there is or should be a simple, direct link between past performance and current remuneration. This says nothing about the company's current strategy or the complexity and challenge of delivering future growth in shareholder returns. Such a proposal only serves to encourage a short-term view by punishing those companies that are making hard investment decisions now for greater growth in shareholder wealth in future.

The Australian Democrats have proposed going further, requiring all executive contracts above a certain level to be approved by shareholders. This increases the risk for a successful executive moving from one company to another. What happens if the executive's remuneration is rejected by shareholders? They can hardly go back to their old job. The consequence of the Democrat proposal would be a significant increase in golden hellos as executives price the risk of their remuneration being rejected into their packages. This is an example of where regulation that may have a superficially popular appeal can actually have the opposite consequence to that desired.

It is easy to be dismissive of the Business Council's views by pointing to recent corporate collapses and excessive payouts to dismissed executives. This approach, however, is dishonest. The vast majority of corporations have robust corporate governance regimes in place. The vast

majority of executives earn competitive remuneration for complex jobs under intense market and public scrutiny.

Finally, this bill must be considered in light of developments since the corporate collapses of 2001. We have seen a comprehensive response from the investor and business communities through the ASX Corporate Governance Council principles and recommendations. These principles and recommendations have already had a major impact on companies and their governance structures. We are also seeing significant changes in how directors and executives in larger corporations are being remunerated to reflect differences in the stock market today from the long bull run of a few years ago. The business community has heard the concern about corporate governance and has responded. We now look to legislators and regulators to recognise those responses and allow them to take effect before adding further layers of regulation upon Australian businesses.

CHAIRMAN—Thank you very much.

Senator MURRAY—I want to ask you this question first, Mr Munchenberg. With regard to the focus the Business Council of Australia has in its submission—I accept your qualifications; it does not mean to say you do not have views on other areas—if the government did not accept it, it would require the Democrats and Labor to combine to reject or alter some of the provisions of that bill.

Mr Munchenberg—Yes.

Senator MURRAY—That is what you are asking for, isn't it?

Mr Munchenberg—We are asking all three parties to consider their position. The government may wish to change its mind, but we would certainly—

Senator MURRAY—But one party cannot deliver it. There has to be two.

Mr Munchenberg—As I say, we ask all three parties to reconsider their positions. Whether that means the government and one of the non-government parties or the two non-government parties, we do not mind.

Senator MURRAY—What would you think if government would not change its mind and the Democrats and Labor combined to do what you wanted? Would you think that is a good outcome?

Mr Munchenberg—If the Democrats and Labor were to pick up the proposed changes we have put forward, of course we would think that was a good outcome.

Senator MURRAY—But that is not what you said in your submission to the Department of Prime Minister and Cabinet on constitutional change concerning the Senate. The BCA has a strong view that governments have a mandate and should be entitled to put the reforms they do before the people.

Mr Munchenberg—I think in general terms that is what the BCA is saying. I do not think the BCA in that submission—I am not familiar with the detail, I have to confess—is saying that the upper house has to accept every piece of legislation and every word and letter and dotted i and dotted t that the government puts before them; I think it is suggesting that the upper house considers the role of the government party as the government of the country and, within its role as a house of review, ensures that the government is in fact able to govern.

Senator MURRAY—As you know, our Constitution, laid out over 100 years ago, requires a half Senate election. The consequence is that half the senators operate over two terms. But, from this slightly biased wording in your submission, effectively these features of the Constitution mean that a handful of senators, albeit not half the Senate, that may not have faced re-election for many years—who have not had their performance and positions reviewed during a particular political cycle—can hold an effective veto over reforms that are fundamental to Australia's future economic performance and prosperity. The government believes that this bill is fundamental to Australia's future reform and security. A senator like me who is not up for re-election this time, unless there is a double dissolution, is one of those at whom the finger is pointed. I ask you these questions deliberately—

Mr Munchenberg—I understand that, Senator.

Senator MURRAY—because I think what you are asking us to do—and we will decide whether to do it—is perfectly legitimate as part of the review process. But I think this kind of document is utterly inconsistent with the professional and persistent lobbying behaviour, which I have a high regard for, that I have witnessed from the BCA over the eight years I have been in this parliament.

Mr Munchenberg—I understand your point, and I will feed that back into the organisation very firmly.

Senator MURRAY—And if you would let them know that one of the handful of senators who holds the balance of power is not really very pleased.

Mr Munchenberg—I understand the point very clearly.

Senator MURRAY—Returning from the question of government mandate to the Senate as a review situation, the next issue, of course, is whom you represent. I was asked today by a journalist who specialises in this area what I thought of the range of submissions. I said, 'Of course, they represent vested interest,' and she took that negatively. I said, 'No—I think vested interest or self-interest is very legitimate. I do not object to it at all.' But I ask you, with respect to your interest, whom you represent. Do you represent the managerial class, the corporate bureaucrats or the shareholders? Whom do you represent when you speak to us on these issues?

Mr Munchenberg—As I made clear in my opening statement, I hope, we are an organisation which represents the chief executives of large corporations—approximately the top 100 companies. So our vested interest, if you like, is very much that of chief executives of large corporations. I take your point about vested interests. I will disqualify that by saying that, provided people who are advocating a point of view are transparent about where they are coming

from and what their vested interest is, I would agree with you, and we are always very transparent about that.

Senator MURRAY—I suggest to you it is impossible for us and it is impossible for you—it is probably impossible for anyone—to measure the views of shareholders. I think one company on the Stock Exchange has over 600 million shares, perhaps more.

Mr Munchenberg—The term 'shareholders' also covers a very wide range of entities and individuals.

Senator MURRAY—My question arising from that observation, because I accept it is just about impossible, is: do you think there are going to be times in this debate when the views of the BCA, representing chief executives, might be contrary—because I cannot measure it—to the views of shareholders?

Mr Munchenberg—The views may well be different. There are points where I am sure we would have a different view from various shareholder representatives.

Senator MURRAY—I wish to pick out an item which struck me as correct in both your executive summary and the text of your submission. You said that the Business Council believes that parliament's response should be based on a balanced, principle based approach. I agree with that. I want to know what the principles are, because you do not tell me in your submission. What are the principles and objectives from which all this flows?

Mr Munchenberg—It is a little hard to answer that entirely in the abstract. The principles we are looking for are a certain regulatory regime that allows companies to get on and do their business in a way that is broadly acceptable across the community. So what we are not looking for, by way of contrast—and this sounds blunter than it is perhaps intended—is to have parliament telling us how companies should be run in detail. We see a number of aspects of the current bill and some of the amendments put forward as going beyond what is necessary in terms of saying what is acceptable behaviour or not and actually prescribing the way in which boards or companies go about certain tasks. We believe that is, as a matter of principle, inappropriate.

Another layer of principle is the role of regulators versus some fairly fundamental legal rights. For example, in the current bill, there is a proposal that ASIC will have what is colloquially known as a fining power. We would say in effect that it pretty much amounts to that. We are seeing a trend in a number of different areas of the law for arguments to be mounted that it is too time-consuming and too costly to go to court to prove that someone has breached the law. We need something faster. We are seeing this tendency towards giving regulators interventionist instruments to be able to do that. There may be justification in the argument that it does take a long time to go to courts, but we would argue that the solution to those things is not to give regulators effectively executive discretion to determine that there have been breaches of the law.

Senator MURRAY—I think you clearly gave a specific and practical example of how a principle that you hold to would be breached. However, we are in a situation now where the government has arrived at a view and essentially, out of this process—in which this committee's deliberations are critical—three political parties will determine the outcome. Primarily it is the coalition, then the Labor Party and us, the Democrats. That is the reality of it. Therefore, I want

to test you as to how you respond to principles with which we approach it, because that will enable me to see whether my principles should be revisited, reviewed or revised.

I start with the principle of corporate democracy—namely, that the shareholders have the right to determine the structure and nature of their company, who represents them on their boards and all those sorts of things. The second principle I have is that there should be a separation of powers between the board, management, auditors and those sorts of things. The third principle I have is that there should be appropriate checks and balances to restrain undue power or undue influence so that all the interests of shareholders are properly protected and preserved. It is not a trick question, but these matter to me in the sense that I take a political template arising from our constitutional democratic structure and, in a broad sense, apply similar principles to the corporations. It is not a trick question, because I can see that there would be many qualifications in the answers. But, in the broad aspect of corporate democracy—the separation of powers, proper accountability, checks and balances, best practice election of directors, proper independence where that is required and so on and responsibility to the community—I would assume from long experience with you personally, Mr Munchenberg, as opposed to long experience with BCA personnel, that you accord with those principles.

Mr Munchenberg—At the broadest level, we would have no problems with those principles but, invariably, I have to qualify that. If we take something like shareholder democracy, the issue is not so much whether or not we should have shareholder democracy. At one level, I do not think there is any dispute about that. Shareholders own the entity in which their capital is invested, and that gives them certain rights and expectations about the use of that. But if, under a banner of shareholder democracy, we talk about justifying shareholder votes on what the remuneration to executives is, I have a problem. It would be the equivalent of going to the next general election being presented not only with alternative candidates but with what their salaries are, I would hazard. The ordinary electorate would be saying, 'We want these people to govern the country, and we want them to be paid this amount of money.'

Senator MURRAY—But what you are exhibiting there is what both you and I, as people of experience, know, which is that life is very complex. For instance, in your paper, you say the basic principle is shareholders approve the directors' remuneration package and directors approve the management—the word you use is 'executive'—the executive's remuneration package. However, I know that the greatest problems have been with executive directors. What are you saying to me—that the shareholders can approve those directors who are also executives?

Mr Munchenberg—No. We have no trouble with shareholders approving the remuneration of non-executive and executive directors.

Senator MURRAY—That is important.

Mr Munchenberg—The directors on the board are there as the elected representatives of shareholders. Therefore, shareholders should have a direct say in the remuneration of those directors and whether they continue on the board or not.

Senator MURRAY—So the chief executive officers, who are, generally speaking, directors—

Mr Munchenberg—If they are directors, we have no problem with that.

Senator MURRAY—That is very useful. I am grateful for that.

Mr Munchenberg—Before we move off that, that is also where, if you like, shareholder democracy and the separation of powers come in. It is our view that shareholders delegate to their elected board the decisions on the next layer of executives who are not on the board, if you like.

Senator MURRAY—I am sorry, Mr Munchenberg. I cannot give you all the respect and time I need to because the chair is going to pull me up sooner or later and say that time is up for me. I need to move on relatively quickly. I am in agreement with the BCA that the board is critical in these matters and that its powers need to be very carefully protected in terms of the efficient and effective operation of both markets and companies. I do not have a quarrel with that broad proposition. But access to the boards worries me. I am aware that in the constitutions of the top 200 companies the procedures by which directors are elected—the machinery, if you like, of election and the access people may have to contesting positions on the boards—vary widely. In other words, I do not believe—and this is based on evidence I have had in other committees and the reading I have done—there is best practice going on in general across the board on all companies in terms of the election of directors. Has the BCA paid any attention to that area in trying to produce best practice procedures for both constitutional provisions and the methods by which the election of directors occurs to prevent barriers to entry existing?

Mr Munchenberg—I have to be honest: it is not an issue that we have looked at closely. At the end of the day, we are the representative body of chief executives rather than boards as such. In areas such as corporate governance, we need to get beyond just a chief executive perspective, if you like, if we are to be relevant in the discussions. But I understand the point you are making and, to be honest, I do not feel qualified to give any particular answer at this point in time. I am conscious of the point you are raising.

Senator MURRAY—For somebody like me, I regard it as a seminal issue because I am told with respect to a number of companies—I want to stress I am not generalising for all companies—the lack of best practice, if I can call it that, results in a club atmosphere, the retention of deadwood and the recycling of people who are best connected but who may not be best suited for particular companies. I stress I am not generalising across the entire spectrum. Therefore, that affects our ability to assess corporate governance in that environment.

Mr Munchenberg—I do understand the point. Having said that we tend to keep ourselves to executive issues, we are also looking at the operation of annual general meetings as a general issue. That is something we can certainly look at in the context of that. We have done some work already on trying to improve annual general meetings as a communication vehicle between management boards and their shareholders—particularly the retail shareholders, for whom the AGMs are very important. That is certainly something we can put on that agenda.

Senator MURRAY—Mr Chairman, I am nervous about you coming down on me, so I will just ask one more question, if I may. Mr Munchenberg, I picked up throughout your submission the use of words like ‘isolated’—I think you might have used the word ‘occasional’—in describing instances of community and media concern that flow through to politicians and policy

makers and eventually result in legislation like this. I got the sense that you feel it is not really fair relative to the overall performance of the market, the companies and the BCA members. My question is this: if the reports available to us indicate very large numbers of executives have profited from remuneration packages which are not identifiably performance related and are not linked to the preservation and growth of long-term shareholder value—you know there is a lot of professional literature in that area now—aren't we entitled to assume that there has been not quite an epidemic but perhaps a very serious disease running through boards whereby, effectively, corporate bureaucrats have profited at the expense of shareholders and have done so unjustly and that that therefore warrants the government taking the action they are taking?

Mr Munchenberg—What I suggest you or the committee need to do is look at current practice rather than the legacy of former practice. It may well be the case that, if one is to look at even currently existing contracts but ones entered into three, four or five years ago, one may be disappointed at the level of explicit linkage between performance and remuneration. If you look at today's practice for new contracts, you will find that the majority, certainly in the larger corporations, have very, very clearly articulated the short-term and long-term performance hurdles that CEOs have to achieve. We are starting to see already in some of the remuneration disclosure that the companies are explaining quite clearly that, if this is achieved, the executive will achieve this remuneration and, if something beyond that is achieved, they will receive that sort of remuneration.

It comes back to the point I raised at the beginning. We need to be very careful that we are not looking today at legislating in response to things that happened two or three years ago or longer. We need to look at today what is needed, taking into account how companies themselves have already responded to the issues and to the public pressure. So, in very brief terms, I think you will find that what may perhaps once have been a problem is substantially less of a problem now. If that argument is to be used, it needs to be based on today's practice—it will not always be easy to quantify and identify, but it does need to be done—rather than the practice at the end of a long bull run three, four or five years ago.

Senator MURRAY—I have more questions but I will leave it there.

Senator CONROY—I want to go back to the one of the points you were discussing with Senator Murray. You mentioned that you are here representing the 100 top CEOs.

Mr Munchenberg—Approximately the top 100, yes.

Senator CONROY—How is the BCA funded?

Mr Munchenberg—By contributions from those companies.

Senator CONROY—From the companies?

Mr Munchenberg—From the companies.

Senator CONROY—It is not from the actual individuals?

Mr Munchenberg—That is down to the individual companies, but my understanding would be that in most cases the company itself pays the membership fee. While we are precise about who is the member, we obviously do a lot of work with and on behalf of the company management more generally.

Senator CONROY—Sure. Have any of the members of the BCA asked their shareholders what they think of, for instance, the non-binding vote, or sought the views of any of the shareholders of their own company?

Mr Munchenberg—I am not aware that they have, Senator.

Senator CONROY—I am just a bit surprised. It is actually shareholders' money being spent by you being here today to represent what I put to you are the exact opposite views of the people whose money it is.

Mr Munchenberg—That argument can be carried to extreme lengths. On that basis, I would be here only ever as a shareholder representative.

Senator CONROY—If your organisation was paid for by the personal contributions of the CEOs, you could be here representing the CEOs' personal views. That would be perfectly fair and reasonable. But where shareholders are crying out for this vote all around the world, not just here in Australia, I find it perverse that CEOs feel the need to spend their shareholders' money writing submissions that are completely the opposite of the views of the very shareholders who provide the money.

Mr Munchenberg—Let us look at that in the context of the vote. One of our concerns with the vote is that a board has before it a large amount of information upon which it can make a judgment about what is in the best interests of the company in terms of selecting and remunerating its executives. The shareholders do not have that information. We have publicly put forward arguments as to why we, representing the executive, if you like, believe that this—

Senator CONROY—It just does not seem to convince the shareholders.

CHAIRMAN—Let him finish, Senator Conroy.

Mr Munchenberg—vote is not appropriate. I am happy to go through those arguments with you, Senator. The fact that—

Senator CONROY—I am just trying to get to the basis on which you are here and who you are representing—

Mr Munchenberg—I am being quite candid about who we are here and whom we represent.

Senator CONROY—and whose money it is that is being spent to pay for you to write this submission and turn up today.

Mr Munchenberg—The money comes from the companies. Companies spend money on a range of things which they believe are in the long-term interests of the corporation. Our

members do not believe it is in the long-term interests of the corporations, which are owned by the shareholders, for the shareholders to have what appears to amount to a tokenistic vote about a decision that we believe they have already delegated to their board. That is our perspective.

Senator CONROY—Do you think the shareholders in GlaxoSmithKline thought it was a tokenistic vote when they overturned the remuneration report of the board? Do you think those shareholders thought it was a tokenistic vote?

Mr Munchenberg—Presumably not, but any group of shareholders that felt that way in Australia have the mechanism available to them to have a similar resolution already passed. There are rights, which you are very aware of, Senator, for a group of shareholders to have resolutions put on the agenda of AGMs. If there are sufficient—

Senator CONROY—Let us not go there yet.

Mr Munchenberg—We could have a debate and discussion about what that threshold may or may not be and how some companies have responded. The reason I say tokenistic is that we are slightly perplexed by this 'half pregnant' idea. We would never support the idea that shareholders should have a binding vote on executive remuneration for similar reasons to those that I understand, at least from media reports, were put by the Shareholders Association. But we have a half pregnant situation where, instead, shareholders are being told they will have this vote but it will not mean anything. Our concern is not so much with that, though, as with the underlying principle: why is executive remuneration a decision, admittedly worth millions of dollars, any different from so many other decisions?

Senator CONROY—Because investors are asking that it be different and because shareholders are asking for it to be different.

Mr Munchenberg—They may come back next year and say they want a non-binding vote on the disposal of company assets. They may come back the year after and ask for further things. Our concern is that all of this is chipping away—

Senator CONROY—So it is a thin end of the wedge argument rather than any particular objection to—

Mr Munchenberg—No, it is a matter of principle. If the principle is valid for this circumstance, why isn't it equally valid for a whole range of others? If you want to dismiss that as a thin end of the wedge argument, you can.

Senator CONROY—I proposed a non-binding vote where a company appoints somebody who is chair of another company in the top 100 or 200. I do not think—

Mr Munchenberg—We are opposed to that as well, and I am happy to explain why.

Senator CONROY—it is tokenistic or the thin end of the wedge.

Mr Munchenberg—The reason I say it is tokenistic is that, on the one hand, we are being told this is going to happen and, on the other hand, we are being told it does not matter because it

is non-binding. To me, it does matter because, if sufficient shareholders vote against remuneration for such a resolution to get up, the company would be rash not to respond to that. The companies are telling us that they see it as a vote of confidence in the board. If shareholders vote down the remuneration, it is a vote of no confidence in the board, and the board has to respond to that.

Senator CONROY—Yes. And what is the problem with that?

Mr Munchenberg—Why should shareholders have a vote on that particular aspect of the management of the company? I go back to Senator Murray's point. He is not objecting to executive or non-executive directors, because they are the representatives of the shareholders and shareholders should have a say in how they are remunerated. What differentiates the payment of up to five or 10 executives from a whole host of other company decisions? If we are to give shareholders votes on these things, we end up with companies being run by a series of decisions of shareholders who meet occasionally. It is just not realistic in a commercial world.

Senator CONROY—I can only point you to two well-known shareholder activists, who represent more than me or I will ever do. One is them is called Warren Buffett. He has described internationally the level of corporate remuneration as piracy and says that executives have been treating corporations as their own private piggy banks. My favourite of all, which you may have heard me say before, is from the chair of CalPERS when they were dealing with Mr Grasso. They said, 'Okay, we've got the snouts out of the trough. Now we want to find out who filled the trough.'

Mr Munchenberg—If these are sufficiently important issues for a company, there are mechanisms for them to be dealt with now. There is no need to establish a non-binding shareholder vote. At the risk of repeating myself, I just come back to—maybe it is an intellectual problem I have—asking what the principle is that underlies this policy which is going to be legislated. Why is this area different from a whole host of other areas? In the past, we have had other aspects of corporate collapses. In the future, we will see certain practices that we probably are not even aware of yet or do not exist yet which will be seen as inappropriate and will result in corporate collapses. I just do not understand why, if we accept the principle in this instance, we are not expected to accept the principle more generally. If we accept the principle—that major decisions of companies have to be ratified by shareholders—more generally, we just cannot see the corporate model working efficiently and effectively. It would be akin to parliament having to put legislation back to the people to be ratified.

CHAIRMAN—Essentially a referendum on every bill.

Mr Munchenberg—As electors, we vote for parliamentarians. We delegate decision making to those parliamentarians. The same principle—

Senator CONROY—Have you noticed the argument about politicians' super recently? Electors still get pretty upset about some aspects, even—

Mr Munchenberg—I have not mentioned parliamentary super.

Senator CONROY—even though they could just vote out whoever did it. They are entitled to express a view on an issue. On this one, as with politicians' salaries and superannuation—and we have been under attack probably longer and more ferociously than your—

Mr Munchenberg—And you have responded for those who will come after you.

Senator CONROY—poor besieged corporate 100 CEOs. I want to move more directly to some of the issues that you have raised in your submission. This proposal was put into the Corporations Act—the original notion of listing individuals rather than bands—back in 1998. It was the famous 24 to 28 June. I think Senator Murray always corrects me there.

Senator MURRAY—I am not going to do it again.

Senator CONROY—Have there been any kidnappings that you are aware of since that proposal was put into the Corporations Law six years ago?

Mr Munchenberg—I am not aware of any kidnappings. I also do not see the relevance of the question.

Senator CONROY—That was just one of the things that was proposed—privacy and extra security in case of kidnappings.

Mr Munchenberg—Not by us.

Senator CONROY—It was one of the issues kicked around at the time. I do not think you were with the Business Council in 1998. I may be wrong, but I do not think you were.

Mr Munchenberg—No, I was not.

Senator CONROY—So you are a brave man to say what was and was not said when we were the ones sitting in front of the committee.

Mr Munchenberg—I am not disputing what was or was not said. I understood you to be referring to our current submission and this current inquiry.

Senator CONROY—I am just making the point that certain claims were made six years ago by various groups representing the business community about the impact of where we are currently. I raise that because you have actually proposed that we go back to the 1998 position. In fact, you have gone worse than the 1998 position, so it is relevant. That is the relevance.

Mr Munchenberg—We have raised the apparent dichotomy with the push for privacy and the rights of individuals to privacy, particularly, from our perspective, in the case of information collected and retained by corporations with the idea that corporations also have to publish the remuneration details of a select number of their employees. There appears to be an inconsistency there, but we have not made a major point of it.

Senator CONROY—But you can confirm on behalf of the Business Council and the top 100 CEOs that none of them or their families have been kidnapped.

Mr Munchenberg—If they have, they have not mentioned it to us.

Senator CONROY—There was just a spare seat at the table. Everyone just thought he was on holiday, but he was actually kidnapped.

Mr Munchenberg—They do so travel so much that it would be hard for us to keep constant tabs on them. However, we are not aware of any kidnapping instances.

Senator CONROY—Look, I am very relieved!

Mr Munchenberg—More seriously, there is—

Senator CONROY—That was a serious proposition put to us in 1998. You should not knock it.

Mr Munchenberg—More seriously, in the current context—maybe I missed out in the debate in 1998; I was not at the Business Council, and it sounds like it would have been a fascinating debate—I have to ask: if what we are trying to achieve by the disclosure of remuneration, which we accept, is to allow shareholders and potential investors to look at the remuneration policies of particular companies and how they are given effect to, why do we actually need to know that Joe or Josephine Bloggs earned a certain amount? Isn't it more important for us to know that the top executive earned these sorts of figures compared with what they earned in the past and compared with how the company is performing generally? I do not understand the policy rationale for naming names.

Senator CONROY—Perhaps I can give you a rationale with the possibility of drawing the ire of the chair for giving a speech rather than asking a question. When shareholders are asked to approve various forms of compensation, which they are required to by the Corporations Law—and you have never objected to the equity components being—

Mr Munchenberg—Not that I am aware of, but you seem to be across our previous positions better than me.

Senator CONROY—I am not suggesting that. It seems only fair when you are asked for increased remuneration but only part of the level of remuneration is directly in your knowledge—when you have been given one million shares in X company and you are asked to vote on it—that you can make an informed decision. How do you make an informed decision as to whether that is a fair level of remuneration if you do not know the total package?

Mr Munchenberg—But that is not the issue we are talking about.

Senator CONROY—Yes, it is. If you come to me and say, 'Here is the CEO of this company. We believe that, under current community standards, to hold the best people in the company we need to give this person a million shares and we want you to vote on it. That's a requirement of the Corporations Law,' doesn't it seem reasonable for a shareholder to actually be able to say, 'Okay, this individual is getting a million shares off the back of X dollars'? If you do not know what X dollars is, how do you know whether that is a fair valuation? It may be that, once you

know what X dollars is, you say, 'They actually need two million shares to make sure we hold them, because X dollars is too low.'

Mr Munchenberg—That is a good point.

Senator CONROY—It is a very good point. I was going to come to that right now. I have never met an organisation so determined to keep their salaries down as yours. I have never understood why the Business Council has not invited me along to one of their dinners to thank me for the 1998 amendments, and Senator Murray—we should go together—given that we have led to a ratcheting up of CEOs salaries. I am just amazed at why you are so determined to keep them down.

Mr Munchenberg—We are interested in good policy, Senator, not in being self-serving.

Senator CONROY—You are suggesting that our current proposal will ratchet up salaries. Are you suggesting that some people in the Business Council are currently underpaid?

Mr Munchenberg—No. We are suggesting that when you have a market that is—

Senator CONROY—Surely they are getting the best they can. They have negotiated the toughest deal. Are you suggesting that they could negotiate a tougher deal?

Mr Munchenberg—What we are suggesting is that the more there is perfect information out there, the more you are arming people to negotiate even higher salaries.

Senator CONROY—Are you suggesting there is not perfect information out there and that the CEO does not know what they are worth?

Mr Munchenberg—No, they know what they are worth, but it does not need to be quite as precisely articulated and quantified.

Senator CONROY—The last person I heard advocating the 'I've got to have what he's got over there' argument was Norm Gallagher. It is the comparative wage justice argument. I loved it! Norm appeared before the commission many times advocating comparative wage justice. I know that is a bit out of fashion nowadays and that the Business Council have opposed comparative wage justice—except for themselves, it seems.

Mr Munchenberg—All we can do is report to this committee what we have seen and what we are told has taken place since those amendments came in. What we have seen and what we have been told is that, because you can now construct league charts with named individuals, that puts pressure on the companies to say, 'Why are our executives being paid in the bottom quartile?'

Senator CONROY—So you are actually arguing on behalf of the companies rather than the CEOs now?

Mr Munchenberg—Again, we are pursuing good policy.

Senator CONROY—I am still waiting for that dinner invitation. Andrew, have you got it yet?

Mr Munchenberg—While we are always keen to see you, it is sometimes a little difficult.

Senator CONROY—It is eight years and I have not got an invitation yet.

Senator MURRAY—This directly relates to what Senator Conroy has been saying. At present there is a binding vote for part of a package.

Mr Munchenberg—Yes, I understand that.

Senator MURRAY—Most chief executives are paid in part with options, shares and so on and in part with salary and so on. At present there is a binding vote, which it seems to me that you accept, for one portion of the—

Mr Munchenberg—The equity portion.

Senator MURRAY—remuneration but not for the other. I have always struggled with that, because I do see it as a package.

Mr Munchenberg—I understand the point that is being made. As Senator Conroy said, if you are being asked to vote on a portion of the package, you can only make a judgment about that if you are aware of the broader context. I am still not convinced that you necessarily need to name and precisely detail what the remuneration is. It is possible to give a broad indication of what component of the remuneration is being dealt with as options. I understand the point.

Senator WONG—What is the principle you have set in relation to the disclosure of equity, shares options et cetera as opposed to other forms of executive remuneration? I am not clear as to why you say one is okay and one is not.

Mr Munchenberg—The provision of equity to the management is something that goes directly to shareholders, because they are equity holders in the company, and that affects the relative equity of shareholders as well.

Senator WONG—Yes, I understand that.

Mr Munchenberg—If you then want to argue that cash payments or other forms of remuneration also affect shareholders because they could have been paid out in dividends, it gets back to my argument before that you can say that on any issue.

Senator WONG—Yes, you set up a very good straw man there, where you say, 'Well, if you approve this, therefore you'd have to require that shareholders approve a whole range of decisions which are properly within the province of management.' I do not think anyone is actually arguing for that, so I have to say I do not think that has—

Mr Munchenberg—I am just looking for consistency.

Senator WONG—If I can finish, I do not think that seems to be a particularly cogent argument. Policy lines are drawn all the time about how far parliament chooses to go in respect of an area. I find it hard to understand why your organisation has such a difficulty with a non-binding vote which appears to be, at its heart, about transparency. Why do you have such a difficulty with transparency?

Mr Munchenberg—We have no problem with transparency. The committee has been given a copy of the guidelines that we ourselves have issued which encourage transparency in remuneration policies and practices. I do not believe that I have put up a straw man, because what I am looking for and what we are trying to understand is consistency of policy and principle. We do not understand why, apart from the fact that it is currently politically topical, executive remuneration is fundamentally different from a whole range of other issues that shareholders have delegated to the boards in the management of their investments.

Senator WONG—Why do your members have such a difficulty with the concept of explaining to shareholders and justifying particular remuneration packages?

Mr Munchenberg—We do not. We encourage it. We have no troubles at all. We have put out documents that encourage it, and we talk to boards and encourage them. We are starting to see—and we think it is a positive thing—the heads of remuneration committees explaining at AGMs the basis for remuneration decisions. We have no problems with that.

Senator WONG—Perhaps I misheard your evidence. I thought you said the board has before it a range of information that is not necessarily before shareholders and that is why the board is in a better position to approve particular remuneration packages and make a decision on them. Surely the answer to that is that, if the board has made a reasonable decision, it can argue that position.

Mr Munchenberg—It is exactly the same as any part of the company's strategy. If the company is engaged in an expansion into South-East Asia, it needs to be able to explain that to the shareholders. But does it need a non-binding vote on that with shareholders?

Senator WONG—You are the only person who is suggesting this, Mr Munchenberg.

Mr Munchenberg—No, I am suggesting that, if we are looking for any consistency in the policy and the principle underlying this non-binding shareholder vote—

Senator CONROY—Why not have a non-binding vote on equity?

Mr Munchenberg—Because equity is a direct dilution of the shareholders'—

Senator CONROY—Isn't that the thin end of the wedge?

Mr Munchenberg—It is a direct dilution of the shareholders' interests in the company. Every time you issue further equity, it dilutes the shareholders' interests. If we want to take that argument to the ridiculous extreme, you would not have shareholder votes on anything, including who the directors were.

Senator CONROY—I am sure the Business Council would probably support that decision.

Mr Munchenberg—What we are saying is that, as a matter of principle, the shareholders should have a vote on those things where there is a direct interest that directly affects the structure of the corporate entity where shareholders delegate the authority to run their investments to a board and management of the company.

Senator WONG—Sorry, what is the proposition?

Mr Munchenberg—The proposition—

Senator WONG—In what circumstances do you say, therefore, that shareholders should have a vote?

Mr Munchenberg—We say the shareholders should have a vote on who their elected representatives are—who sits on the board of the company. We can see the arguments for why, if the company is to issue equity and if they can lose the shareholders' holdings, they should have a say on that. Where we draw the line is in saying that shareholders have delegated the authority to run their investments to those companies. When those companies exercise that delegated authority appropriately, it should not have to go back to shareholders to be ratified. I keep coming back to this point: what is different about the management decisions of executive remuneration that separates it philosophically and as a matter of principle and policy from a whole host of other decisions that companies make?

Senator WONG—Maybe because there has been a bit of a problem.

Mr Munchenberg—That is exactly right, so what we are actually talking about is a quick fix to a current political situation.

Senator WONG—A policy response to something that has been a problem.

Mr Munchenberg—What is the next problem going to be, and are we going to have the same response?

Senator WONG—Perhaps that is in the hands of your members.

Senator CONROY—Should shareholders have a right to vote on termination payments?

Mr Munchenberg—Why?

Senator CONROY—They do in the Corporations Law at the moment—

Mr Munchenberg—Above a certain threshold they do.

Senator CONROY—but, on your argument, they should not. It is an ongoing business issue.

Mr Munchenberg—As a matter of principle, if I am going to be consistent, we would not support that. But we have made a decision not to—

Senator CONROY—Address that?

Mr Munchenberg—invest the money that we are getting from the shareholders in pursuing that one.

Senator CONROY—I am conscious of the need to move on. I will ask a couple of quick questions. How does the BCA assess its members' views and draw together a submission based on its members' views? Is it consensus?

Mr Munchenberg—I understand. The structure of the Business Council is that our policy priorities and our broad policy direction are set by the membership collectively, by all the members. In fact, as a matter of interest, we have our annual strategy forum next week in which we do that. Beneath that there are what we call task forces, which are groups of usually half a dozen or more chief executives who act as a steering committee, making sure that the broad policy positions are being given effect to. When new issues come up, we poll our members on what issues, if any, they see on some of these things and whether they are a priority or not.

Senator CONROY—So if a member objects to your submission or disagrees with your submission, what happens then? Are they just ignored?

Mr Munchenberg—No. Their views are taken on board, but our final position cannot be dictated by the views of one member. Otherwise we would end up—

Senator CONROY—Or two members?

Mr Munchenberg—Or two or three.

Senator CONROY—What is the threshold?

Mr Munchenberg—If we reach a point—and it does happen—where we have significant groups of members on either side, we tend to buy out of the issue and say quite explicitly, as we have done on some issues, that business is divided on this point of view and, therefore, we will not be having a position on it.

Senator CONROY—But you dismiss the position of one or two members?

Mr Munchenberg—We do not dismiss at all. There will always be cases where one or two members take a different view for whatever reason. We represent a broad business view. The fact that one or two members disagree with that does not give them the right of veto over our policy. If they do not like that, at the end of the day, they have the option of no longer reallocating some of their shareholders' funds to pay for their membership.

Senator CONROY—I am not sure whether you have had a chance to look through all of the 50-odd submissions that I think Senator Chapman referred to. But ANZ, who I believe are a member of yours, have put in a submission—

Mr Munchenberg—They are, yes.

Senator CONROY—and they do not support your position on a raft of issues. I want to congratulate ANZ on breaking ranks and John McFarlane in particular, who has had the courage to stand up and say he does not agree with your submission. He disagrees quite strongly with your position. He supports the increase of disclosure obligations to the top 10 executives in the corporate group.

Mr Munchenberg—That may suit his company's position and point of view. That is fine. We have no problem with that. We certainly do not attempt to stop our members forming their own views. The chief executive of an individual company has to make a decision on what is in the interests of that particular company.

Senator CONROY—This is my very last question, I promise. Could you advise the committee of the BCA's position on non-recourse loans?

Mr Munchenberg—We have not taken a strong view on that. As a matter of principle, there have been a number of things slated in amendments to be prohibited. We would prefer to see things being disclosed rather than just being prohibited. The reason is that we can see circumstances where, to take that example and a number of others, such as the payment of options to directors, there may be justification for doing it. But, if you are going to do it, it must be disclosed. Non-recourse loans may be a very effective instrument for a company in trouble that wants to bring in a successful executive to try to trade that company out of its troubles. A non-recourse loan would be offered as part of the incentive for that chief executive.

Senator CONROY—Why shouldn't that executive use their own money to purchase equity?

Mr Munchenberg—We are saying that, as part of an incentive to get an executive into that company that is struggling, you may say to the executive, 'If you are able to get us out of this, you get the options, and the non-recourse element does not come into play. But if, despite your best efforts, your expertise and skills and everything that you do, the company still fails—which they do sometimes—you should not be penalised for that.' So it is a way of managing the risk in those circumstances. The payment of options to directors is another one. The vast majority of major corporations do not pay options to their directors. Many, many small companies, especially start-up ones, would not be able to survive unless they could pay options to their directors because they cannot pay cash to them at the start-up stage. So we are just saying that an absolute prohibition on these things has adverse implications. We would rather see full and frank disclosure of these things and then people can make their individual judgments.

Senator CONROY—I have a million other questions, but I am conscious of the time.

Senator WONG—I have one on infringement notices. Your submission is quite critical of the proposed powers to ASIC and so forth. Does the involvement in the draft bill of consultation by ASIC with ASX deal with any of your concerns?

Mr Munchenberg—If I understand you correctly, we would certainly hope that ASIC would be consulting with ASX before acting in that area. ASX is the entity which is watching the market most closely, and we would be—

Senator WONG—What I am trying to clarify is whether that deals with the other concerns you have raised, such as the requirement for a third party, or whether you want that as well as these others?

Mr Munchenberg—It falls well short of addressing our concerns.

Senator WONG—I appreciate that. I am just confirming that your position is that you would still want a third party being involved in the issue of the infringement notice.

Mr Munchenberg—We think that, if a regulator is to be given such a powerful instrument, we need to be very careful that things such as due process, natural justice and other fundamental principles like that are protected. What we are concerned about at the moment is that, in the argument that ASIC needs to be able to respond quickly to these things, those things are being sacrificed. While we do not want to see this proposal put in, we believe some of its risk could be moderated if there was third party involvement. Just involving the ASX is not sufficient, but it is better than not.

Senator CONROY—Mr Morgan was not available today to come along and have a chat?

Mr Munchenberg—Mr Morgan is very keen to meet with you, Senator.

Senator CONROY—We could happily meet in public here. I am happy to meet with him any time. But, in terms of putting the case, Mr Morgan could not make it?

Mr Munchenberg—Mr Morgan presumably felt that I was perfectly capable of making our case.

Senator CONROY—I am sure he was not reflecting on you.

CHAIRMAN—This is just wasting time, Senator Conroy.

Senator CONROY—I am finished, as I said.

CHAIRMAN—May I ask one question before you leave? I have not had any questions yet.

Mr Munchenberg—This is probably the tricky one!

CHAIRMAN—What is the Business Council's view on the compulsory voting of institutional shares at AGMs?

Mr Munchenberg—We have not really taken a strong view on that. That is one for the institutional investors to respond to. I suppose, again, we are not quite sure why institutional investors would be singled out. If you are going to make voting compulsory, presumably you would make it compulsory for all shareholders in a company.

CHAIRMAN—Thanks very much for your appearance before the committee, Mr Munchenberg.

[5.08 p.m.]

McHUTCHISON, Mr Harley Beeman, Chairman, Deloitte Touche Tohmatsu

CHAIRMAN—Welcome, Mr McHutchison. The committee prefers that all evidence be given in public. However, 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 the written submission from Deloitte Touche Tohmatsu, which we have numbered 30. Are there any alterations or additions you want to make to the written submission?

Mr McHutchison—No.

CHAIRMAN—Having said that, I invite to you make an opening submission after which we will move to questions.

Mr McHutchison—My opening submission runs for probably about five minutes. I have been an auditor for about 43 years and an audit partner with Deloitte for 28 of those years. I am the chairman of Deloitte in Australia. My fellow partner, Nick Hullah, who was scheduled to appear with me today, was called interstate last night and he apologises for not being here today.

As indicated in our submission to your committee on 17 November last year, Deloitte fully supports the overall thrust of the CLERP 9 initiatives. Confidence in corporate reporting must be restored. The detail in CLERP 9, however, must be workable, must be in the public interest and must take account of conditions in Australia. We support the government's intended principles based approach to achieve the CLERP 9 objectives and to achieve the intent of the HIH royal commission recommendations as opposed to a rules based approach. Unscrupulous people may be able to exploit a rules based approach if the rules do not cover a particular situation. This is much harder to do in a principles based approach. We also support some of the key initiatives in CLERP 9, and I will mention just a few of them. It comes as no surprise that we support proportionate liability for auditors to apply to damages for economic loss. However, the apportionable claims in the present provisions are drafted narrowly and they do not cover all possible claims against auditors. We believe this aspect should be revisited.

We support the introduction of the financial reporting panel. However, we consider it should be modified to allow the panel to hear and rule on disputes before the publication of financial reports. We also do not see any value in requiring ASIC's consent to issues being taken to the FRP. The new proposed definition of 'immediate family member' being spouse and dependents is appropriate. We consider that a cooling-off period of two years before an audit partner can join his or her client is sufficient. Sarbanes-Oxley only requires one year and, to our knowledge, no other major jurisdiction in the world requires more than two years. We support the rotation of the leading engagement partner. However, we believe rotating the concurring review partner should be revisited. This is an unreasonable burden for smaller auditing firms who audit a number of smaller listed companies, such as in Western Australia, and may effectively put those auditors out of business.

We consider that the ASX Corporate Governance Council's principles of good corporate governance and best practice recommendations, which include the CEO and CFO attestation on the integrity of the system of risk management and controls, should be given a chance to work. Going forward following consultation, it may be appropriate to codify these requirements in the Corporations Act. But we believe this is best left to CLERP 10, by which time hopefully I will have retired.

I note discussion about the notion of prohibiting the auditor from providing any services whatsoever other than audit services. One valid interpretation of audit services is the audit of the statutory financial report. This would mean the auditor could not give accounting advice, could not provide reports to regulators, could not perform agreed upon procedures reports on a range of matters, could not provide reports on fraud, could not report on the quality of internal controls, could not conduct financial due diligence on potential acquisitions and could not prepare an investigating accountant's report on historical results and so on. We do not support this notion because in our view it is not in the best interests of the audit client, nor is it in the best interests of its shareholders. That is all I want to say. We strongly support CLERP 9—albeit with some amendments—becoming law, effective on 1 July 2004.

CHAIRMAN—Thanks, Mr McHutchison. At the outset, I will ask your view on the frequency of audits. Do you believe an annual audit is adequate? It has been suggested to me in light of some of the collapses that have occurred that audits should be conducted quarterly.

Mr McHutchison—My view is that having a quarterly audit would be extremely expensive. The problem with having quarterly reporting and a review by the auditors is that it puts a very great focus on short-term results. I think that is one of the problems they found in the United States. I fully support the half-year review and obviously the annual audit, but I would need some convincing to go to quarterly reporting.

Senator CONROY—I noted your plea for principles based legislation and regulation. I note that you wanted a bit more black letter law around proportionate liability. You are worried about it not being quite defined enough—that a few smart lawyers might be able to find their way around the current principle base in proportionate liability.

Mr McHutchison—I think our view is that principle is not clear in there.

Senator CONROY—That is probably my view on a lot of things too, but we will not debate the philosophical position.

Mr McHutchison—One of the problems they have had in the United States with their rules based accounting standards is that people find ways where their particular circumstances are not covered by the preciseness of the laws.

Senator CONROY—I appreciate the way lawyers get around things. The United States is not the only place. Deloitte is one of the big four that has not spun off its consulting section. Is that right? I thought I saw an announcement a while back where Deloitte said they were not going to do that. Is that right?

Mr McHutchison—That is correct. We have not.

Senator CONROY—Which services that everybody else has got rid of are you still providing in-house?

Mr McHutchison—Within the firm?

Senator CONROY—Yes.

Mr McHutchison—Consulting services. We can provide a whole range of consulting services to non-audit clients. In our case in Australia, we audit about 15 per cent of the top 100 or 200, so there is a very large market there.

Senator CONROY—Are any of them registered in the US?

Mr McHutchison—Yes, they are.

Senator CONROY—I am citing the NAB problem, particularly with the SEC. Are you conscious that NAB may decide to visit upon some of the companies within the SEC jurisdiction that you provide all these services to?

Mr McHutchison—I am conscious of the rules—

Senator CONROY—Are you concerned?

Mr McHutchison—Yes, we are concerned. We have very rigorous processes before we accept an audit and before we accept an engagement. In the case of an SEC listed client, clearly we would not put our hand up to do other services.

Senator CONROY—You could not.

Mr McHutchison—We could not. Even if we thought we could, it has to go to the audit committee and be pre-approved. So there is a fairly rigid process there. It is not in an auditor's best interest to violate those rules, you know. The penalties are huge.

Senator CONROY—I was just wondering how you deal with the fact that in Australia, for companies not listed in that jurisdiction, you are keen to provide those services but in another jurisdiction where they say you cannot you do not. It must make you rather schizophrenic.

Mr McHutchison—We are not allowed to and we do not.

Senator CONROY—I was not suggesting you were breaking them.

Mr McHutchison—No. In my experience, a lot of listed companies in Australia who are not registered with the SEC have regard to what can and cannot be done in the US. Many clients are extremely cautious about what they invite their auditors to do.

Senator CONROY—The accounting standard AASB1046, which is related to director and executive disclosures by disclosing entities, sets out the requirements for the disclosure of

remuneration under the accounting standards. In addition, companies are required to disclose the information set out in the regulations. The draft regulations have not been released, but we understand that the disclosure will be based on the accounting standards. It is a bit convoluted. 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 McHutchison—Make them consistent in the one place.

Senator CONROY—If we only require disclosure under the accounting standard, additional disclosures will not be made. An example is the basis upon which remuneration packages are structured and how this relates to performance hurdles. Do you think that is a problem that can be overcome?

Mr McHutchison—I do not think I understand the question. I actually cannot hear you.

Senator CONROY—I am sorry about that.

Mr McHutchison—I am older than you.

Senator CONROY—I will lean closer to the microphone for you.

Senator MURRAY—Everybody is older than him.

Senator CONROY—Disclosures made under the accounting standard are not subject to the non-binding vote. How do we deal with that if everything is put in one place? The way the law is structured, there are two places. You are advocating putting them all in one place. I am trying to understand how it would practically work under your scenario.

Mr McHutchison—All I can say is that I think it would be more efficient if there was only one place to look at to determine what the necessary disclosure is or should be.

Senator CONROY—The CLERP 9 bill inserts cooling-off periods before a member of an audit firm can join a former client. You mentioned that in your opening address. The final version of the CLERP 9 bill states that this cooling-off period only applies where the member or director was a professional member of the audit team for the audit. Could you advise the committee whether other partners of the audit firm who were not directly involved in the audit are subject to the cooling-off period.

Mr McHutchison—We do not think they should be. We think the cooling-off period ought to apply to the audit partners involved in the audit of that client. If an audit partner had nothing whatsoever to do with our client, we can see no reason why they should be caught by the cooling-off period.

Senator CONROY—Could you, for the understanding of the committee, advise us of the different roles played by a lead auditor and a review auditor?

Mr McHutchison—Yes. The lead auditor is primarily responsible for conducting the audit. Naturally, he works through a team of people. He is the person who will sign the audit report. But before he or she signs that report, the work, the financial report and the audit has to be concurred in by another partner, which we call a review partner. So it is a quality assurance mechanism. Quite often the concurring review partner is not client facing. That is the distinction.

Senator CONROY—In your view, should or would a review partner be caught if they had done a review?

Mr McHutchison—The way it is proposed now, yes, the review partner be would caught by that. That is of little concern to us in our environment because we have the number of partners to be able to accommodate that. My concern is for smaller accounting firms or smaller auditing firms who audit quite a lot of the smaller listed companies. If you only have a three- or four-man practice, you may find that rotation for both the lead and concurring partner is difficult to achieve. Potentially, you could put those audit firms out of business.

Senator CONROY—Justice Owen's recommendations from the HIH royal commission relate to alternative accounting treatments. He said that 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 reports. Do you agree with Justice Owen?

Mr McHutchison—No, I do not. I think it would be quite confusing to shareholders to do that. I think it has the likelihood of undermining confidence in financial reporting. I think if there is an alternative accounting treatment, the place to deal with it is at the audit committee and potentially at the board level. If the treatment is not acceptable, the auditor's response, if he cannot talk the client out of it, is to qualify his or her report. You mentioned Warren Buffett. I like the question he puts to auditors: would you auditors, if you prepare these financial statements, prepare them the same way? I think that is a very strong test. But I do not support all that stuff being included in the audit report. We are criticised enough that our audit report is not clear enough as we speak now. It would just make it far more complicated.

Senator CONROY—As you may be aware, I am a bit of a fan of trying to give more strength to the arm of an auditor to resist the entreaties of management to change accounting treatments or follow a slightly different path. That is certainly what drives me in the debate. I am very keen to try to find a way to discourage management from using the ultimate threat of business. If you take the HIH example, Ray Williams had the audit partner that was asking awkward questions removed from the audit. While I accept that that was probably an extreme example—I think that organisation was long in decay before it finally fell over—it is not the first time I have come across muzzling of the audit function. Other than your suggestion of Warren Buffett, is there anything more concrete you can suggest that would give strength to it? Senator Murray in particular is a fan of ASIC, for example, appointing an auditor. He has raised that on a number of occasions in the past and may even do so when I shut up.

Mr McHutchison—I can tell you what happens in our firm, and maybe there is something that comes out of that. If we have a major disagreement with a client, it comes to a panel of four partners. The matter is virtually taken out of the hands of the audit partner. The panel will decide on the treatment. It is our responsibility. It means that what we agree on in the end we think is

pretty solid. It also takes the heat off the lead audit partner. We have been doing that for a number of years. I do not know how you could encapsulate that notion.

Senator CONROY—That is what I am grappling with, and I know Senator Murray is grappling with a similar sort of issue. When the lead partner on the account looks after one of the really big companies that Mr Munchenberg represents—maybe it is a bank—would they have any other major clients? I am trying to understand the workload. If you have a company that big, would you be on more than one account or half a dozen, two or three?

Mr McHutchison—If it was an account the size of one of the big banks, I doubt strongly that you would have any other major clients. I do not know, but I doubt that.

Senator CONROY—I think that sounds fair and reasonable.

Mr McHutchison—In my experience—and I am not looking after anything the size of NAB—I now have two listed companies, one quite large and one quite small, and a few other bits and pieces, like being the chairman. So it would be rare.

Senator CONROY—That sounds like commonsense. How does the remuneration of partners work in most companies? I am not trying to embarrass you by getting you to talk about yours. Is it based on the fees that the individual partner pulls in proportionately? Is it a general pool so that if you lose a client, every partner loses some of their income?

Mr McHutchison—We are probably much the same as the others. Each partner has to prepare a partner plan of various things. One of those things is fees and profitability. Another is engaging staff. Another is getting profile in business. There is a whole range of things in there. At the end of the day, it is decided what units that partner is allocated. It is not linked to one particular thing. It is also on sustained performance, so if you have a crook year one year, they do not beat the hell out of you.

Senator CONROY—But if your entire contribution to the partnership is one account and you are in danger of losing it in an argument with management over an audit treatment, would you say there is a real dilemma there?

Mr McHutchison—No. None whatsoever for me. If there is an argument, it comes to the panel. We might not like the result of our decision, but we will make that decision. We do not want to have our name on the front of the paper. It is a tremendous thing for an auditor to have made a serious mistake. Life is too short for that. Bear in mind also that for these big—

Senator CONROY—So there is no influence whatsoever. Your entire remuneration is based around one account and that—

Mr McHutchison—The individuals would not, though, Senator.

Senator CONROY—Largely influenced by it. They only provide income from one source, as we have discussed earlier.

Mr McHutchison—Let me back that up with a bit of substance. I was one of the audit partners for Westpac. It went to tender and we did not retain it. That was in 1993 and I am still here. My pay did not suffer particularly.

Senator CONROY—The number of units that you were allocated might have suffered.

Mr McHutchison—It would be marginal.

Senator CONROY—So the pool works—

Mr McHutchison—The pool works.

Senator CONROY—to protect integrity?

Mr McHutchison—Yes.

Senator CONROY—There is a perception that it does not. Do you think that is an unfair perception? You are not aware of any examples where treatments have been compromised, possibly?

Mr McHutchison—Not in my experience. I have seen situations where I think the auditors have made the wrong call but not because of fear of losing the client or for financial reasons. I think they have just made the wrong call.

Senator CONROY—Just an unhappy coincidence?

Mr McHutchison—Yes.

Senator WONG—Are there any parameters or principles that partners operate under to initiate having a matter referred to the panel of partners? Is that just the judgment of the individual?

Mr McHutchison—No. On every engagement there is a lead audit partner and a concurring review partner. There is a safeguard there to make sure it gets to the panel. We identify in our place audits we think are particularly risky. In that case, a third partner, called a special review partner, is allocated. So there is another safeguard there.

Senator WONG—If there is a lack of concurrence between the two or three, then that triggers the matter being referred?

Mr McHutchison—Or indeed if there was concurrence on it and it was going to result in a qualification, that would go to the panel. If there was some doubt about whether the financial report should be qualified, that would go to the panel.

Senator WONG—All right. So what you have just laid out there, is that a written part of your firm's procedures or is that just the practice?

Mr McHutchison—No. It is a written part of our procedures. At the beginning of each reporting period, the engagement partner and the review partner have to identify risk clients before we have actually done a tap of work. At that stage, a special review partner is allocated.

Senator CONROY—Deloitte had a hiccup a few years back with a South Australian company. Grant might even be able to help me.

Mr McHutchison—Deloitte had a hiccup? There have been a lot of hiccups in South Australia. I am not quite sure which one you are referring to.

Senator CONROY—It was one that led to a bit of a chat with the regulator and some conditions imposed on internal management. I understand there was a bit of a shake-up afterwards.

Mr McHutchison—You are referring to Adsteam.

Senator CONROY—Adsteam, thank you. As I said, it is a famous South Australian company. What was the basis of the problem there? I understand it forced a rotation process to be commenced at Deloitte.

Mr McHutchison—I think ASIC contended that Adsteam had paid dividends out of capital. You would understand that we did not agree with that. To get the matter resolved, Deloitte and ASIC agreed on some principles, one of which was the rotation of auditors.

Senator CONROY—There was clearly at least an arguable case that someone had been too long on the job, I presume? I am guessing because I do not know the case. If they insisted on the rotation of lead audit partners after that, presumably there was a debate about how long somebody had been looking after Adsteam.

Mr McHutchison—That is a possibility. But rotating auditors in the US had been on for some time before that.

Senator CONROY—Yes, but it had not been on in Deloitte in Australia.

Mr McHutchison—It was a natural thing to do in Australia.

Senator CONROY—It was a natural thing after you agreed with ASIC that that would become the practice of the company. It was not happening at Deloitte prior to that.

Mr McHutchison—No. It was not happening as a part of our policy. It then became policy. As a matter of complete practicalities, it is relatively unusual for an auditor to be the auditor of the same company for longer than five or six years. It is five years now. Of the one you mention, I actually do not know how long that audit partner was on Adsteam.

Senator CONROY—Your submission says that you support the disclosure of the amounts paid to the auditors for both audit and non-audit services. Where is the term ‘non-audit services’ defined? Which non-audit services will be subject to the requirement that dollar amounts are disclosed?

Mr McHutchison—My view is there should be three pieces of disclosure there. The first one is the fees for the audit of the financial report, and the half-year review is in that. I think there ought to be another line for audit related services, which are some of the ones I refer to. I think they are audit related services. I think there should be another line for other services with a description as to what they are, be they consulting services or actuarial services. I think better practice in Australia today is that kind of disclosure.

Senator CONROY—The CLERP 9 bill, as we have already discussed, does not go as far as the US system and the SEC police it now. Do you agree with the Sarbanes-Oxley position that has been adopted in the US, or do you think it goes too far?

Mr McHutchison—With which bits?

Senator CONROY—They blanket banned.

Mr McHutchison—They have banned certain services, if that is what you are referring to.

Senator CONROY—Yes.

Mr McHutchison—I think services of that nature are actually better dealt with in F1. I could visualise where CLERP 9 has a principle based statement that then refers into F1. My understanding now in the US is that there is getting to be a fair bit of push back on some of those prohibited services.

Senator CONROY—It is an election year. Don't hold your breath.

Mr McHutchison—Well, you know more about that than I do.

Senator MURRAY—It is like auditor rotation. Same thing.

Senator CONROY—We are subject to the rotation on a tragically less than orderly rotation period at the moment. What percentage of your clients pay more for non-audit services than audit services?

Mr McHutchison—Not enough. Our experience has been that our audit clients are very sensitive about awarding too much in non-audit services to auditors. I do not have any figures on that but, if we had an audit client that paid five times more than the audit fee for other services, I would be amazed. That kind of thing only really happens in some of the large financial institutions.

Senator WONG—Why?

Mr McHutchison—I am not in favour of putting a limit—say, people have talked about one to one—in a particular financial year. You may find you are getting close to the end of the financial year and there are particular other services, say, on an acquisition, that the company dearly wants the auditor to do because they are the best person to do it—they know the business, they know the issues and they know the industry—but they cannot do it because it has exceeded the limit.

CHAIRMAN—Senator Conroy, how are you doing with questions?

Senator CONROY—As you were asking me, I was culling questions. The CLERP 9 bill requires the preparation of an operating and financial review. The explanatory memorandum says, 'The G100 guidance may be used for the purpose of satisfying the legislative requirements.' Could you advise the committee whether the G100 guidelines are appropriate and what the key disclosures are under the G100 guidelines?

Mr McHutchison—What area are you talking about there? Is that the G100 guidelines on attestations by CEO and CFO?

Senator CONROY—Yes, I think that is the one.

Mr McHutchison—I have to say that we think those guidelines are pretty good because we participated in writing them.

Senator CONROY—I am sure that the G100 contains some of you.

Mr McHutchison—But we think they are valuable because they do provide some valuable guidance as to how corporations should interpret the ASX governance rules.

Senator CONROY—Some commentators believe 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 the company's future financial prospects—for example, climate change and greenhouse emissions et cetera. In your view, does section 299A require the disclosure of environmental and social matters?

Mr McHutchison—I think I would have to take that on notice. I would have to look at the detail on 299A.

Senator CONROY—Should the operating and financial review be audited?

Mr McHutchison—The operating what, sorry?

Senator CONROY—The operating and financial review. That is what we have just been talking about briefly. This section sets up an operating and financial report. There were some complaints at an earlier hearing that, at the moment, they are audited and, therefore, they cannot be crystal ball gazing, because they have to pass these audit standards.

Mr McHutchison—This is on the management discussion and analysis?

Senator CONROY—Yes.

Mr McHutchison—I see that as akin to the director's report, which is not audited. I do not think the management discussion and analysis should be audited either. Auditors commonly read that stuff to make sure it is not inconsistent with the financial report. If it is, the auditor has an obligation to do something about it.

Senator CONROY—I am sure you have met Keith Alfredson. He has made a submission to this inquiry where he rejects the JCPAA—a parliamentary committee—recommendation in relation to the 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 said:

The financial reports ... must stand alone and ... to include the same information in the directors' report—

which is not audited—

will only lead to unnecessary duplication and possible confusion.

Do you agree?

Mr McHutchison—I think he is saying it should be in one place, isn't he, and the best place to put it is in the financial report, where it is audited. It is not something I have considered.

Senator CONROY—His submission was wide ranging. Corporate Governance International, whose representative appeared yesterday or the day before, has suggested reintroducing the requirement for shareholders to approve the reappointment of the auditor at the AGM. What is your view on that proposal?

Mr McHutchison—I read that. I think I am pretty neutral. We used to do that, as you would remember. It did not result in a change in auditors. The changes came about because boards decided they wanted to change, for whatever reason.

Senator CONROY—Shareholders are getting a bit more bolshie nowadays.

Mr McHutchison—Yes, they are a little. I suppose it does let the shareholders have their say. But, as that person said, he thought it was kind of symbolic rather than substantive to do that. You honestly would not want to change auditors every year. The audits are ongoing. They go right through the year; it is not as though they stop and then you wait for another eight months before you start again. They are ongoing. Changing auditors is expensive and you would not want to do it very often or every year.

Senator MURRAY—Mr McHutchison, I do not know if you recall that I sit on the Joint Committee of Public Accounts and Audit and I was part of the inquiry into the independence of auditors. It was report 391, from memory. Anyway, during that inquiry, I made a declaration which I will repeat here. I was once a very junior auditor, and I rather like accountants and auditors. We will have to see that I do not exhibit any bias. My view is that, the closer auditors are to the board and directors, the more regulation is required. The further away they are, the less regulation is required. Within that is this issue of independence. I began as I did by praising auditors and accountants as a class because my experience of them has been that they are professional people, but I am also well aware of the consequence of influence. That is at the

heart of this. I want to ask you this question: do you think that this bill in fact delivers an independence for auditors from board influence?

Mr McHutchison—Yes, I do. In my experience—and I have audited quite a few public companies over the years—I have never felt that I have actually had a particularly close relationship with the board. For me, it has never worked that way. I have always found it a very professional relationship. There is no question you can build a close relationship with the CFO, but that is not the board. So that does not trouble me. We also have the other controls I mentioned with concurring reviews and so on.

Senator MURRAY—If you put to one side one very important component of independence, which is character, professional standards and those sorts of things, and you focus on three things—hiring, firing and tenure—in my view, objective and fair hiring, objective and fair firing or dismissal, and proper, fair remuneration and tenure all create true independence if they are present. One of the reasons I referred to the Joint Committee of Public Accounts and Audit report is that there is a small section in it on just that issue. One of the reasons Senator Conroy alluded to my remarks elsewhere on the ASIC appointment of auditors is that I have scratched my head to find a way in which the board does not control all those elements—hiring, firing, and tenure and remuneration—because the basic consequence of that is a loss of independence. This bill does not attend to that issue.

Mr McHutchison—It may be a loss of independence, but I think you are overstating the case to say that it is a loss of independence. We do have our professional standards; we actually have our own pride. It just would not look good on my CV to have a major problem with a client, such as signing an opinion that was not right. That is tremendously persuasive to me.

Senator MURRAY—There are a number of rebuttals to that remark. One is that worldwide legislatures—and we are doing it now—have come to the conclusion that there is not independence and, therefore, they need to ensure it through various devices. There have been court cases, royal commissions and so on where it was established that the quality of the audit was insufficient, inadequate or whatever phrase you like. The cause could be that they were not paid enough to do a good enough job or all sorts of things. The fact is that your response—which may reflect your personal ethics, integrity and character, in a class sense—is one that worldwide legislatures are no longer accepting. They are building in mechanisms to enhance independence. The consequence of that is great prescription. My answer is that the way out of that is to ensure that the package of things I outlined—hiring, firing, remuneration and tenure—are taken away from those who can determine loss of independence, which is the board.

Mr McHutchison—In other words, take it away from the board.

Senator MURRAY—That is right. There are only two possibilities I can think of; I am happy for anyone else to think of some. One is external appointment through some fair mechanism through someone like ASIC, and the other is the concept that people like Dr Turnbull—he has a different version—and I believe in, which is a corporate governance board. I will not go through that now. I have an open mind about it. I am trying to deal with that essence of ensuring independence. Once you do that, you do not have to have as much prescription.

Mr McHutchison—I am not aware of anywhere in the world where the regulator appoints an auditor, but you may be able to point me to that.

Senator MURRAY—I see the weaknesses with it.

Mr McHutchison—If you want to engage somebody—in this case, we are talking about an auditor—you also like to feel that you are going to have a good professional relationship with the contractor or the auditor, that they are the sort of people you like to do business with. It may be hard for a regulator to determine that on behalf of the directors, as it were.

Senator MURRAY—There is another aspect to the problem. People will answer, 'We've got protective mechanisms within the board—a non-executive chairman, non-executive directors, audit committees and so on.' I say that is a shibboleth, because the dominant financial and management interests determine who is on the board. So they determine the directors. Those directors that they have determined then appoint the audit committee and the remuneration committee. So in the end the whole box and dice is subordinate to the dominant financial and management interests, who have been found on occasion, through royal commissions, court cases and corporate collapses, to have acted contrary to the interests of the shareholders at large and of the community. So I do not see independence in there either. How do you react to that observation?

Mr McHutchison—I can see your point. It has not been put to me like that. I would like to think about that. I have never felt the problem with the public companies or any company that I have audited in my professional experience. It simply would not have occurred to me. Even if we lost our biggest client, the effect on our revenue would be tiny. It would not be worth our while to, if you like, do the wrong thing just to retain that client. It simply would not work.

Senator MURRAY—Again, I say to you that because legislatures worldwide, including this one, do not accept the basic proposition that the relationship is sound and ethical enough in general—and I am not referring to you, so understand that—

Mr McHutchison—Yes, I understand.

Senator MURRAY—they are coming up with a highly prescriptive solution. In my view, the problem is the method of appointment to the board—because dominant financial and management interests can prevail in the way they do—and the method of appointment of auditors. If you fix those two problems, you would not have to have so much else attached in prescription. I put these questions to you because I have not felt that people have thought it through from a problem analysis to a solution, recognising what the source of the problem is—which is a lack of independence and variety on boards and a lack of independence and a separation of powers between auditors and boards. I will leave it there. Hopefully, I have provoked some thoughts.

I have one last question. It is on performance audits. The Joint Committee of Public Accounts and Audit, in report 391, produced its first ever report into the private sector. That committee has a great deal of experience with performance audits, as distinct from financial audits, because of the way in which the Auditor-General operates. That committee felt that the adoption of a performance audits regime within the quoted sector would contribute to market efficiency and

better performance. For performance audits to work, it is a non-audit service, in a sense, because what we are discussing is the narrowness of a financial audit and then the attached audit services. I would see a performance audit as not part of the first but part of the second. I think the very best people equipped to do performance audits are frequently those who do financial audits because the financial audit will throw up where the risk is, to use Senator Conroy's example earlier, in hedging in banks or that sort of thing. I am concerned that what I think is a very important market performance initiative which needs to come into our market—far more performance audits—might be constrained by restrictions on the source of audit services that those who provide the financial audits might be subject to.

Mr McHutchison—I agree with you that they might be not permitted under a model that does not allow the auditors to do other work. I think it would depend on the nature of the performance audits. I have seen them done in occupational health and safety. I have seen performance audits done on call centres and post acquisition audits, where they look at whether it worked out when they spent $1 billion building something. There is a whole range of different types of performance audits—some of which I think the auditor would be qualified to do; others I do not think they would be qualified to do. Those sorts of reports that I mentioned are being done in a lot of listed companies now. The major issues come to the board and they are acted upon. So it is happening, in my experience, in certain areas. In many cases, the statutory auditor may not be the right person to do those audits because they may not have the skills to do them.

Senator MURRAY—If the Sarbanes-Oxley approach gets applied by sheer force of market power into Australian practice—maybe I have not understood it correctly—I have the feeling that in general the auditor doing the financial work would not be able to do the performance audit. That is my assumption.

Mr McHutchison—It would depend on the nature of the audit. Sarbanes-Oxley allows auditors to do a lot more other services work than I think a lot of people recognise. There are some very black letter law prohibitions. Setting those aside, there is still a lot of consulting work that auditors can do for an SEC listed client, such as activity based costing, maybe revenue enhancement assignments or cost reduction assignments. There are quite a lot of services under Sarbanes-Oxley that auditors can do.

Senator MURRAY—Let it be clear why I am asking these questions. What lies behind the question is whether we as a committee should be recommending that performance audits, in terms of their link with financial audits, should not be automatically proscribed as a class in any consideration of non-audit services that the auditor provides.

Mr McHutchison—Yes. I would not like to see them prohibited. I am more focused on the principle that an auditor cannot audit work they have prepared or participated in preparing. If the service does not fail that test, there are grounds for me to believe it is an acceptable piece of work to do.

Senator MURRAY—That is all I have.

CHAIRMAN—Thanks very much, Mr McHutchison.

Mr McHutchison—My pleasure.

[6.00 p.m.]

HARRISON, Mr Stephen, Chief Executive Officer, Institute of Chartered Accountants in Australia

PALMER, Mr William, General Manager, Standards and Public Affairs, Institute of Chartered Accountants in Australia

REILLY, Mr Keith, Technical Adviser, Institute of Chartered Accountants in Australia

CHAIRMAN—I welcome the representatives of the Institute of Chartered Accountants. The committee prefers that all evidence be given in public. However, 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 the written submission of the Institute of Chartered Accountants, which we have numbered 36. Are there any alterations or additions you wish to make to the written submission?

Mr Harrison—No.

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

Mr Harrison—The Institute of Chartered Accountants in Australia welcomes the Parliamentary Joint Committee on Corporations and Financial Services review of the CLERP 9 bill. CLERP 9 is a major initiative enhancing Australia's financial reporting regime and maintains Australia's reputation as an efficient, transparent and accountable capital market. As such, the institute supports the speedy introduction of CLERP 9 by the proposed due date of 1 July 2004.

CLERP 9 continues the Australian principles based co-regulatory approach to corporate regulation that continues to work well in Australia and incorporates lessons learned from the various global corporate collapses of recent times and includes the intent of the HIH royal commissioner's report. The institute particularly welcomes those aspects of CLERP 9 designed to enhance auditor independence. We do, however, suggest that some amendments to CLERP 9 would be beneficial to ensure that it is workable in practice, particularly having regard to the size of the Australian capital market and the geographic spread of Australian business.

The current proposal for both lead engagement and review partners to be rotated five years or seven in very limited circumstances will, we believe, result in most listed company audits only being done by the larger audit firms. Smaller audit firms do not always have sufficient audit partners to rotate and they would instead have to resign from those audits at the conclusion of their current five-year period of appointment. As the review partner role for smaller audits is mainly a checking function and not involved in the day-to-day operation of the audit, we believe that review partners should not be subject to rotation. That way, a two-audit partner firm could continue to audit smaller listed companies. As with the ASX independent audit committee

requirements that only apply to the top 500 listed companies, we recommend that the rotation of review partners only be required for the top 500 companies.

We believe that it is not practical in the Australian environment to limit companies to being able to employ only one former partner of an audit firm in a senior management position or as a director of the company being audited. We support such a restriction on a former partner involved in the audit of the company but not for former partners not associated with the audit of that company. We also believe it is worth considering a post implementation review of CLERP 9 in, say, a couple of years.

The institute, in connection with CPA Australia, has made recommendations for editorial drafting type amendments in a letter to Treasury dated 1 March 2004. The committee's support for such amendments, which we believe are not policy issues, would be appreciated.

The institute appreciates the opportunity of meeting with the joint committee to outline its support for CLERP 9. Institute staff are attending each of the committee's hearings and we would like the opportunity of providing further comments, if needed, as a result of the later hearings held or the issuance of regulations or ASIC policy statements. The institute would be more than happy to take questions now or at a later stage.

CHAIRMAN—Do your colleagues have any comments to add? If not, we will go to questions.

Senator CONROY—I would certainly welcome any further submissions you wanted to make arising out of the evidence that came along. I am sure we would be able to accommodate that, even though it is likely to be a lengthy process. Accounting firms, as you heard me ask earlier, have raised a number of concerns in relation to the cooling-off provisions, some of which have been addressed in the final bill. Do you have concerns in relation to the cooling-off provisions?

Mr Harrison—The cooling-off provision of two years as it stands? Not with that provision.

Senator CONROY—The CLERP 9 bill inserts cooling-off periods before a member of an audit firm can joint a final client. The final version of the CLERP 9 bill states that this cooling-off period only applies where the member or director was a professional member of the audit team for the audit. In your view, are other partners of the audit firm not directly involved in the audit subject to the cooling off? I am trying to make sure I understand who is going to get caught by this and who is not get caught by this.

Mr Harrison—Are we talking here simply of the cooling-off period or the other provision about the number of former partners who can join?

Senator CONROY—I think we are probably talking about the cooling-off period, but I am interested in your view on the latter as well.

Mr Palmer—I can only speak from my personal experience. If you are unconnected with the audit, I do not see any reason why there should be any restriction on the ability of that person to work for a former audit client of that firm. You are not involved in any way in the detail and knowledge of the intimate financial matters.

Senator CONROY—Which others might be caught? There is some confusion, or I am confused anyway. But who is caught? It is not the principle of whether there should or should not be a cooling-off period. Who does it apply to? That is what I am trying to understand.

Mr Harrison—In general terms, we believe it would apply to those who have played a senior role within the function of the audit, not just being a member of the company that might have been engaged to conduct the audit.

Senator CONROY—The CLERP 9 bill requires the CEO and CFO to sign off to the board on the financial accounts. However, the ASX corporate governance guidelines and the approach taken in the US go further. Both require that the sign-off by the CEO and the 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. In your view, should the CEO and CFO sign-off under CLERP 9 extend to a sign-off on the company's risk management procedures?

Mr Harrison—We support the ASX corporate governance guidelines.

Senator CONROY—Justice Owen made recommendations relating to alternative accounting treatments. You heard me ask the previous witness this. I will read you the quote again just in case it has faded by now, as I am sure it will have:

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

Do you agree with Justice Owen?

Mr Harrison—No, not to the extent that it be part of the audit report. Certainly there are issues that need to be clearly dealt with about alternative accounting treatments. We believe that where those exist they should be dealt with by the audit committee. The auditor needs to ensure that those matters are brought before the audit committee. But to have it in the audit report, as I think you have previously heard, we believe would be particularly confusing to those whom the audit report should mean something—the investors, the shareholders. I think those reports—the full annual reports and the financial statements—are complicated enough. It would be confusing to add that extra level of detail. So we believe the place in which those issues are best dealt with is within the audit committee.

Mr Reilly—The move by Australia to adopt international accounting standards is one of the benefits of that move because the pending accounting standard, AASB101, actually picks up the requirements of the international standard. This requires disclosure where a particular accounting treatment has been adopted and where there are particular estimation issues or judgments there. So one would expect that that would be covered initially anyway by the company itself and then work its way through to the audit committee, where it is a major listed company.

Senator CONROY—I really wish you had not mentioned international accounting standards, Mr Reilly, because we could be here all night.

Mr Harrison—You might have to excuse us, Senator Conroy, if that is your intention.

Senator CONROY—You heard me ask about the term 'non-audit services' and the definition. The previous witness mentioned that it was in F1, the professional standard. How would it work when the CLERP 9 bill is seeking to have these issues disclosed and the reference is to a professional standard somewhere else that the parliament has no control over?

Mr Harrison—There are two issues. One is what services should or should not be provided by the auditor and the other is what disclosures take place. In terms of determining what services an audit firm might provide in addition to audit, we believe it is appropriate for that to be dealt with through the principles based approach in F1 where there are clear statements as to the principle. That can then be applied. That will include guidance, which I know gets partly from principles into prescription. However, we believe that basically it should be a principles based approach and that that be applied with some guidance. The disclosure requirements I think are onerous but will be appreciated in the end by the shareholders in that every non-audit service provided by the auditor will need to be cleared for its independence by the audit committee and will need to be disclosed in the financial statements.

Senator CONROY—When CGI was giving evidence yesterday, Mr Reilly was lurking up the back of the room.

Mr Harrison—He has a habit of doing that.

Senator CONROY—CGI suggested that the auditor of the parent company should not audit a subsidiary company of the parent. Do you have any thoughts on that?

Mr Palmer—I think that is where it is a listed subsidiary, not necessarily any subsidiary. I think that is what they meant.

Senator CONROY—Sure. But do you have any thoughts?

Mr Reilly—I listened to that evidence with a degree of interest, particularly when you look at some of the more recent overseas corporate collapses where there have been different firms involved in the audit of a large group. An Italian company would come to mind particularly. The difficulty I would see—and it would be a good question to ask the audit firms as they are giving evidence—is that, if you are the auditor of the holding company, which is the unlisted company, to be satisfied that you could sign that audit report, you would have to engage in a fair amount of work on each of the subsidiaries. That would include the listed subsidiary. As a matter of practice, where you have a group, you usually have one audit firm that is doing the majority of the audit work for that group.

I guess behind the question on Tuesday was a concern that the auditor of the subsidiary listed company would not be independent because that audit firm would be influenced by the audit of the holding company. I did not see any evidence to suggest that would be the case in practice. I think as Mr McHutchison said earlier tonight, the risk of compromising your audit opinion on a particular issue, particularly post some of the examples in the US, is just not worth the effort. We have not seen any evidence in practice. There may be a perception issue there, but I struggle with that as well.

Senator CONROY—You made the point that the auditor of a company should not audit another company if there are major transactions between the two companies. Do you have any thoughts on that, or ditto?

Mr Reilly—I think the answer would be much the same. Again, I was struggling see where the auditor would have an independence issue.

Senator CONROY—The joint submission says that the role of the FRP should be expanded to include a role for the adjudication of issues prior to the publication of the financial statements. Could you advise when this pre-publication role is required? How would it work?

Mr Harrison—We would see it applying in pretty rare circumstances. It would be where you had a standard which was open to genuinely different interpretations and where the client and the auditor had reached quite different conclusions that could not be reconciled. They then want genuinely to have that resolved in a way that was seen to be binding on all parties and applied later so that, for example, ASIC would not turn around after the event and say, 'Look, we didn't agree with the final interpretation. We are now going to challenge that.' As it is now, the FRP could be used after the event to challenge that interpretation. We would like to think the panel in those circumstances could be used beforehand to resolve such differences rather than after the gate has been shut, where it is a punitive issue rather than something to be resolved with an appropriate accounting treatment in the interests of the shareholders.

Senator CONROY—As you are aware, the ASX listing rule requires companies within the ASX All Ordinaries to have an audit committee. In your view, should CLERP 9 mandate the requirements for audit committees that have been set out in the ASX guidelines? Those requirements are these: only non-executive directors, a majority of independent directors, an independent chair who is not chair of the board, at least three members, a formal charter and those sorts of things.

Mr Harrison—I think we are pretty happy with the balance we have at the moment as proposed between CLERP 9 and the principles and recommendations in the corporate governance guidelines. There is that balance. I am not sure that we see the need for there to be some formal reinforcement of them. They have started to work well, even though the guidelines are not yet mandatory, and we expect that will remain the case.

Senator MURRAY—In your submission, you write about the general definition of auditor independence. You say it would be best if such a definition were consistent with international best practice, as is the case with the profession's current standard. I have looked at it once, but I do not recall it all and I would like you to refresh my memory. My understanding is that relates to attitude and attributes far more than to the things I was raising earlier, which is how you are appointed, how you are dismissed, what remuneration you get and your tenure. To me, they are the essential components of true independence. Is that correct? Am I right in that judgment?

Mr Harrison—I think the points you raise are very valid and they are critical and part of the issue of auditor independence. F1 does not go to the heart, I guess, of the issues that you have raised, such as the appropriate appointment process and whether there are alternatives. But I think it deals with it very comprehensively and in a way that is now internationally applicable, or

has the opportunity to be through the leadership of the International Federation of Accountants. Therefore, that is why we are supporting it on a global basis.

With regard to your points about the appointment process and the tenure, I have a couple of comments. First, I think they are worth continuing to review. I do not think any of us have found the solution that we think is the alternative to the current arrangements. I do not think they are therefore part of the CLERP 9 bill, but they are matters worthy of continued investigation. But there are issues, for instance, on tenure. For example, the auditor cannot resign or just be dismissed out of hand. There is a role for ASIC in that. It is not as though all of those decisions are going to be made—I have forgotten the exact words you used—by essentially the corporate power, however that might be defined, be it the board or management.

Senator MURRAY—The phrase I use is 'dominant financial and management interests'. It tries to draw the two together on the board.

Mr Harrison—I understand the point you are making. We think there is a fairly useful set of checks and balances that has been brought in now. The auditor is appointed by the shareholders at the annual general meeting. The nomination of the auditor is through the audit committee. The role of the audit committee has been greatly strengthened through the ASX Corporate Governance Council and the ASX listing rules. We think we have a practical solution for the time being. If we can find something that goes to the heart of some of the issues you have raised, that is probably something for a later time. But it is a point that is worth the further examination you are encouraging.

Senator MURRAY—I am not sure it is for a later time. I will explain to you what I mean. My understanding is that, rather than the legislature attempting to define auditor independence, you would prefer it to continue to be defined by the profession in consultation with ASIC, ASX and other good sources of input and with regard to international commonality, if you like, or harmony. Is that right?

Mr Harrison—That implies it is being left almost entirely to the profession. We have strongly supported the role of the FRC, which now will have a significant role in ensuring auditor independence. Therefore, we will be interested in the definition of independence and how that is applied. We are not suggesting that that be left entirely in the hands of the professional bodies, both locally and through the international federation.

Senator MURRAY—I will return to why I said I do not think it is a topic for another time. My own personal belief is that the legislation should determine that a definition of auditor independence should be developed and would determine by whom—in other words, by ASIC in consultation with the professions or by the professions; I do not much mind. I believe that the statute should be saying, 'If you're working out a definition, we want you to attend to how people are hired, how people are fired, how they are remunerated and what the tenure is as well as the other attributes which are you familiar with from the international standards.' You would have regard to that. So the statute does not get involved with the precise, prescriptive definition, but it tells you the topics you must at least cover. My sense of things is that the package I am concerned about—hiring, firing, tenure and remuneration—is not well covered in the literature which focuses on independence.

Mr Harrison—I think we now have a model in Australia with respect to the setting of standards, at this stage auditing and accounting standards. If that model were, as I think you are implying, extended or augmented, the consistent approach to setting standards makes sense.

Senator MURRAY—But at the heart of my question is this: would you as a professional body object to the statute going in the direction I suggest—in other words, not itself writing a definition but saying a definition must apply and saying who should develop it and what some of the component parts should be? Would you object to that as a profession?

Mr Harrison—In principle, no. The component parts, yes. I am a bit hesitant to say yes and then be tied to specific component parts.

Mr Reilly—One of the areas where the accounting bodies have worked fairly carefully and closely is in independent audit committees. Our submissions over a long period of time have argued for the importance of an independent audit committee so that the auditor has an opportunity, as indeed do the non-executive directors, to look at particular issues, particularly in relation to hiring, firing and remuneration.

Senator MURRAY—And tenure?

Mr Reilly—And tenure, yes.

Mr Harrison—We are concerned that the definition be embodied within CLERP 9. You are not proposing it would, but the manner in which the definition might be determined might be defined there.

Senator MURRAY—I am testing you because you have a different proposition. You have said that, on that basis, the current internationally consistent independent standard F1 should be the definition adopted in CLERP 9. My view is that it could be the definition adopted but it might need to be augmented because of my concerns that some areas of independence are not covered.

Mr Harrison—It is probably a poor choice of words in what we said there. I do not think we intended that to mean in CLERP 9 as in the bill but that it would be adopted through the powers of CLERP 9 rather than be defined within CLERP 9.

Senator MURRAY—Now you understand why I had concerns.

Mr Harrison—Yes.

Senator MURRAY—I want to ask you about remuneration and how we deal with that area. It seems to me that if you look behind the worst examples of audit failure in corporate collapses—and please do not misunderstand me; you have to have market failures because otherwise the market is not working, so I do not seek an auditing nirvana—one of the problems has been insufficiency of audit. It seems to me that that is sometimes provoked by a minimalist audit—in other words, one which complies with the statute and nothing more. There is only a certain amount of money and that amount of work is done. I am not expert enough in the field. These are things that are said to me by very senior, very experienced, very big people in the audit game

as well much smaller people. Because we have a responsibility as representatives of the people, how do we ensure that prudentially there is as much audit going on as is reasonable in cost terms but to avoid the lowest common denominator mentality—in other words, we have to do this by statute, we are going to pay as little as possible for the meanest audit and get by? How can we ensure that what has to be done is done well? How can we address that issue?

Mr Harrison—My colleagues might want to add comments. The discussions I have had with senior auditors have made it very clear to me that, when it comes to determining the resources to be applied to an audit, the thing that focuses them most is ensuring that they get the audit right. The reputation of the company depends on getting the audit right at the time.

Senator MURRAY—That is the auditor; that is not the board.

Mr Harrison—That is the auditor. The auditor will therefore make sure that they apply the necessary resources. To skimp on an audit simply because of any particular circumstances is to put their whole future at risk. They cannot afford to take that risk.

Senator MURRAY—I do not want to use the word 'they' because who are they? I have had the contrary view put to me—namely, that boards say to auditors, 'Here's the budget. You tender for it. This is how much money it is. That's it. When that money is finished it's finished.' In an audit, as you know, you can discover that much more needs to be done and it is just not done. That is what is said to me.

Mr Palmer—But in practice the auditor does not compromise his opinion. As we have in the present process now, an auditor may tender for an audit on an expectation of what number of hours the auditor thinks will be involved in that job. But if it transpires that it takes longer, those hours are put in sufficient for the auditor to arrive at his opinion in accordance with the auditing standards now encapsulated in the CLERP 9 bill. So you have inbuilt into the system a minimum requirement by definition irrespective of the cost.

Senator MURRAY—But then why do you get circumstances where royal commissioners, courts, liquidators and others will assert and sometimes prove that auditors did not do a sufficient job?

Mr Palmer—I think there are queries about whether the auditor arrived at the right opinion, which is a matter of opinion. I am not aware of many instances, if any, where there has actually been evidence to the extent to which the auditor did insufficient work. I think the issue has been whether he arrived at the appropriate opinion.

Mr Reilly—I think that is important because in terms of the litigation—and the institute has a role in disciplining its own members and in the review of all of the overseas literature on the corporate collapses—I am not aware of criticism of an auditor because they just have not done enough work so they have not discovered the problem. It has either been because there has been a judgment call at a particular point in time—Mr McHutchison made some comments on that—or where there has been a systematic fraud of such magnitude where it would not have been reasonable for an auditor to uncover that fraud. They tend to be fairly rare. When they happen, they can sometimes be quite big.

From a professional body's perspective, the institute would be interested in following that through, and we would be happy to do that. I have not seen any evidence that would suggest that the fee has been so low that the audit cannot be conducted effectively and, therefore, an audit has been conducted which has not met our own professional standards. We are required to monitor our members' compliance with our Australian auditing standards, which are in fact the same as the international auditing standards.

Senator MURRAY—Are you telling me that, if you take all the listed companies, there are no instances where the lowest tender is taken just purely based on price and that in every case boards and auditors combine to ensure that the work to be done is done—

Mr Palmer—I do not think one could conclude that the lowest price was never taken. What I believe one can say, though, is that that has not been a factor resulting in work being done that was less than what was in accordance with, or required under, the auditing standards.

Mr Harrison—I can think of a recent example where it was suggested with the benefit of hindsight that more work might have been done on a particular audit. I do not believe that was caused by insufficient resources. With the benefit of hindsight, knowing now what people did know about the problems of that company, more work might have been done. But there was no suggestion that the reason the work was not conducted was any shortage of resources or lack of effort on behalf of the auditor. They read it as they saw it at the time.

Mr Palmer—My own experience in terms of submitting tenders for audits has been that audit committees are very inquiring as to the hours and other things that have been allowed for in an audit when contemplating the tender process.

Senator MURRAY—I must not generalise, but what about those occasional speculative mining resource outfits that have popped up in my home state of Western Australia, which are publicly listed and somewhat cowboyish? Do you have the same view about the probity of their processes?

Mr Reilly—I would argue so. Again, the auditor is required to form an opinion. We have specific standards in place to ensure that opinion is fairly formed. Again, one of the issues that we raised earlier is that one size does not fit all. Therefore, some of those smaller listed companies are using smaller audit firms who are using the same techniques and complying with the same standards that others are. We have not seen any evidence that would suggest that audits are being conducted at a price which is below what the professional standards should be to form an opinion. It is just not worth the audit firm's while to do it.

Senator MURRAY—Thank you for that. An area I would hesitate to get into is prescribing a minimum remuneration for auditors, although they would probably like me to do it.

Mr Harrison—They might.

Senator MURRAY—It helps to have that sort of evidence. The remaining area I want to ask you about is directors. In the relationship with auditors, the directors—both executive and non-executive—loom large. On the executive side it is because of the instructions, access and information which flows through them; in the audit committee it is because of the

responsibilities provided. One of the assertions made is that we do not get in every case the best directors we might get and that the processes by which directors are appointed or elected is not best practice. Senator Conroy and I have been exploring from different directions the question of compulsory voting—namely, that institutions that hold shares in trust or escrow or who have a fiduciary duty with regard to those shares should exercise their vote. The question is: on what? Is it on everything, which is costly? At the barest minimum, if you accept what I accept—which is that the board is the central institution we are discussing—if you held shares in escrow or in trust or you had a fiduciary duty, would you agree that institutions should be obliged to vote for the election of directors to ensure that those directors properly represent the widest number of shares?

Mr Harrison—Unfortunately, I do not think I could give you an answer on behalf of the institute. We have not canvassed that subject at all with the members. Any comments I gave really would not be on behalf of the institute, so I think I have to decline to give you an answer.

Senator MURRAY—If you were able to come back to the committee at your discretion, of course, because it is not an obligation—

Mr Harrison—I will take it on notice.

Senator MURRAY—I would be interested in your answer. I also have in mind the question of legitimacy. On another topic, if you asked somebody, 'Should there be zero foreign ownership in Australia?', they would say, 'How ridiculous.' If you asked, 'Should 100 per cent of property and assets be owned by foreigners?', they would say, 'How ridiculous.' Of course, we are then discussing what should happen in between. What exercises our minds is, with the importance of boards, if you have a low vote it erodes the legitimacy of their representative capacity.

Mr Harrison—I appreciate the significance of the question. I think we would have to take it on notice and seek a response.

Senator MURRAY—If you could come back to me on that, I would be grateful.

CHAIRMAN—There being no further questions, Mr Harrison, Mr Palmer and Mr Reilly, thank you very much for appearing before the committee.

[6.38 p.m.]

ADAMS, Mr Dennis, Deputy Chief Executive Officer, National Institute of Accountants

AGLAND, Mr Reece, Technical Counsel, National Institute of Accountants

CHAIRMAN—Welcome. The committee prefers that all evidence be given in public. However, if at any stage of your evidence or answers to questions you wish to respond in private, you may request that of committee and we would consider such a request to move in camera. We have before us the written submission from the National Institute of Accountants, which we have numbered 25. Are there any alterations or additions you wish to make to the written submission?

Mr Adams—No.

CHAIRMAN—Having said that, I invite you to make a brief opening statement, at the conclusion of which I am sure there will be some questions.

Mr Adams—Thank you, Mr Chairman. It is with a great deal of pleasure that the NIA has been given the opportunity to present some views to the parliamentary joint committee with regard to the Corporations Law and economic reform program. Corporate collapses are neither new nor something unique to Australia, as Enron in the US and Parmalat in Italy testify to. It is normal after such collapses to look at corporate law to try to find ways to prevent such failures happening again. Australia, from our point of view, has been very fortunate that the reform of the Corporations Act has been an ongoing area of development well before the most notable of the recent collapses. This has meant that such reform has not merely been a reaction to current events but an attempt to make the system as a whole more effective.

While the NIA was concerned that some of the provisions of the first draft of the bill might have been a simple reaction to the HIH royal commission findings, the NIA was pleased to see that many of the concerns raised by the profession were addressed in the bill that was tabled in the parliament. The NIA and the profession as a whole were in particular concerned about the proposed limitations to be placed on auditors' future employment. While a perception of independence is important, the profession was in general of the view that the proposed restrictions were excessive, did not improve the outcome to shareholders and failed to understand the benefit that former auditors could bring to a company.

The NIA was pleased to see that the proposals outlined in the Ramsay report and CLERP 9 discussion paper eventually replaced those of the first draft. We believe that these proposals are more measured and provide a better balance between the need to protect independence while not restricting companies' access to qualified personnel. The NIA also sought a change to the proposed 'might' test in relation to the definition of auditor independence with a 'would' test. The reason the NIA sought to have this change was not to dilute the test but to ensure that the test which was adopted would be feasible given the work that auditors actually do. We are pleased that the test has been changed to reflect these suggestions.

The NIA has always supported giving legal effect to the auditing standards in the same manner as the accounting standards as it is important that these standards are accessible by more than just those in the audit profession. However, given that such standards are technical standards developed by the profession, the NIA would not wish to see auditing standards become politicised under the proposed changes.

One of the changes that the NIA have been eagerly awaiting for some time is changes to the assessment of the qualifications for auditors. It is fundamentally important, in our view, that we do not lower the standard for those entering the profession. The NIA are of the opinion that the proposed changes will not produce that outcome. However, it has also been important that the means of assessing the qualifications of company auditors be modernised to reflect current practices. The proposed reform, we believe, will go some way towards doing this. While the NIA do not believe that there will be a flood of new applicants to become registered company auditors, we believe the new system should encourage a number of qualified persons who might not have sought registration to date.

The NIA plan to work closely with others in the profession, as well as the treasurer in ASIC, to make the new process workable and to inform members about the new changes. Audit competency standards are an important step in that direction and will provide the platform for the assessment of auditing skills in other areas. We believe it is often overlooked that there are many types of audits, not just those required under the Corporations Act. One problem that has been brought to the attention of the NIA is that, on many occasions, state law has adopted the company auditor requirements in relation to audits that do not really require the same level or set of skills as required to audit a large public company.

The NIA supports the adoption of the rotational requirements for audits and is pleased that it allows for the extension of the audit rotation period in certain circumstances. However, the NIA also believes it may be advantageous prior to the end of the initial five-year period for a review to be undertaken on the effectiveness of rotation. Of note is that Parmalat in Italy was subject to auditor rotation; however, this did not succeed in preventing the collapse.

I will conclude my opening remarks there. I would like to pass to Mr Agland, my colleague here, who will talk about the Companies Auditors and Liquidators Disciplinary Board.

Mr Agland—In view of the time constraints, I will probably just go to questions, if that is all right.

CHAIRMAN—Fine.

Senator MURRAY—I was not going to ask this question, but it popped into my mind as you mentioned that rather famous Italian company. The auditors were rotated but the directors were not—that is my understanding.

Mr Agland—Yes.

Senator MURRAY—That is a major problem. I have noticed more and more criticism in Australia about multiple directorships, particularly multiple chairmanships—usually men; I suppose there are some women in there. I have not seen it proposed anywhere—it is fairly

radical—but do you think there should be a requirement that directors cannot stay on boards for longer than a certain period and that there should be a limit to the total number of directorships and chairmanships they can hold?

Mr Agland—I guess the problem with setting those kinds of limits is that there may be people who can be on more than a set number of boards and are able to do the work. I do not think it should be put into legislation. It is probably something the ASX and groups like that could look at to say, 'Well, it is not a strict rule, but generally we don't think you should be on more than three major corporations,' or something like that. I do not think it is something that the law should restrict because, in doing that, you may limit people who are quite worthy and do have those capacities. I think it is dangerous to go down that path. However, I think it is important that those issues be discussed so that the community can come to some sort of feeling as to whether it believes people should be able to be on numerous boards.

Senator MURRAY—I will turn to the second part of the question. When people talk about being principles based, you often want them to be consistent. If a principle being developed in this legislation, and elsewhere in the world, is to maximise auditor independence and performance—market effectiveness, if you like—it is desirable that the same auditors, particularly the same people, as opposed to the company, do not stay with a company for more than a certain period, and it varies. Don't you think the same protection might be applied to boards?

Mr Agland—No, I do not think it does, because in certain circumstances it may be good to have someone who has had years of experience in that industry and in that company. Through having that experience, they may have known what the company has gone through before. It is important to have probably a mixture of people who are new to the company and people who have experience. So I do not think it is the same principle when you apply it to boards as to auditors.

Senator MURRAY—I find that difficult to accept because I reverse it with auditors. Particularly in very specialised and complex fields, it seems to me that audit experience is very important and it takes quite a few years to get across a particular industry. The shorter the period of rotation, the more it affects that judgment. I am almost challenging the idea that auditor rotation is everything it is set out to be by showing the weaknesses when you argue it for boards.

Mr Agland—Okay, I understand what you are saying. In relation to the rotation, we understand the reason is to try and separate the perception that, by auditing the same company, there is that bond that can form between the auditor and the CFO. We understand that is the reason for the rotation. However, rotation is not necessarily everything—that is definitely right. That is why we think, before requiring the rotation at the five-year period, we should look at those jurisdictions that have had rotation and see whether it has been effective. If it has not been effective or it has been an impediment, we should consider whether we go ahead with the required rotation in the next period.

Senator MURRAY—Turning to a different topic, there has been some criticism about the new powers of the FRC. Those powers, as are many regulators' powers, are discretionary and require judgment. Therefore, the integrity, expertise and variety of people on the FRC and their

employees are critical. Don't you find it strange that nowhere in the legislation, either CLERP or the primary act, does it require that appointments to the FRC be on merit?

Mr Agland—You assume that whoever makes the decision on who is appointed to the FRC does it on merit.

Senator MURRAY—Are you aware that 22 times so far in different legislation in the parliament the major parties have voted against appointments on merit being entrenched for board appointments, authority appointments or anything of that sort?

Mr Agland—No. I definitely was not aware of that.

Senator MURRAY—Doesn't that surprise you?

Mr Agland—Yes, it does. However, I hope it would be implicit in the process of whoever they choose that part of the decision was the quality of those people and the skills they brought to any board.

Senator MURRAY—The question of civil penalties imposed on individuals for breaches of the continuous disclosure provisions has attracted a lot of attention—probably rightly so. They can be quite fierce. The bill would make a person involved in a contravention of the continuous disclosure provisions liable to a civil penalty. You support the idea of extending this civil liability to other persons involved in the contravention, as long as it is limited to those with 'real involvement'—that is the phrase you use.

Mr Agland—Yes.

Senator MURRAY—I and everybody else who deals with legislation get into trouble when we try to turn that into statute. What do you mean by 'real involvement'? If somebody were to take up your suggestion, how would they translate it into a legislative view?

Mr Agland—I must admit I have not really thought of how you would translate it into legislation. The principal idea, I guess, is that there may be a whole range of people involved. If someone other than those already mentioned in the legislation have had an influence on it, why should it simply be limited to them? I have not really thought through the process of actually achieving that, but I wanted to raise the issue that there are other people who should be brought into it as well.

Senator MURRAY—You must have had something in mind—you are an experienced person. What does 'real involvement' mean to you?

Mr Agland—I guess anyone who has actually had an impact on the decision that was made, but I cannot think of an example at this stage.

Senator MURRAY—Commonly in legislation and in law you use the principle of materiality. Is that what you mean? Should people with a material involvement be affected by this?

Mr Agland—'Materiality' is probably a better term than 'real involvement'.

Senator MURRAY—In your submission, you state that the NIA would like specific remedies in relation to failures to address conflict of interest issues. I think you have your finger on one of the greatest problems of boards anywhere: the manner in which conflict of interest is dealt with. In my own way, I believe that conflict of interest should really be handled separately by a corporate governance board of non-executive directors who are elected by shareholders, not by shareholding. I have spelt that out in full elsewhere. I have seen consistently that that is a major issue. From your perspective, what do you mean when you say you would like specific remedies in relation to failures to address conflict of interest issues? Was this a throwaway line? You are allowed to have throwaway lines.

Mr Agland—I am not sure it was a throwaway line. I cannot remember what the specific issues were when the paper was developed, so I do apologise.

Senator MURRAY—You can come back to us, but I can refresh your memory. I will read it to you:

> The NIA agrees that reforms to conflict of interests are not only impact—

I think you meant 'do not only impact'—

> analysts but also the many other financial services licensees will face the same pressures in relation to conflicts of interests. The NIA would also like specific remedies in relation to failures to address conflict of interest issues. Even in circumstances where a person has not suffered a loss as a result of a failure to disclose a conflict of interest, there should be some form of penalty for not disclosing such.

That was headed 'Chapter 10: Management of conflicts of interests by financial services licensees.' Does that refresh your memory?

Mr Agland—Yes, that refreshes it. I guess the remedies they are talking about are some sort of penalty. I think I was really referring to financial services licensees and the need for anyone who has a conflict of interest to make that clear. If that has not occurred, there should be some sort of remedy or action taken against them.

Senator MURRAY—Who would discover the conflict of interest? Would it be the auditor or the regulator?

Mr Agland—I suppose it would have to be the regulator.

Senator MURRAY—You can see a difficulty, can't you?

Mr Agland—I can definitely see a difficulty.

Senator MURRAY—Most conflicts of interest, especially if not disclosed, are very difficult to discover. If they are discovered within the company, they often will not be discovered by any outside authority. It is just the way things are.

Mr Adams—I would have thought the corporate governance committee would be the ideal vehicle for identifying that.

Senator MURRAY—All right. I will leave it there.

CHAIRMAN—Thank you, Mr Adams and Mr Agland, for your appearance before the committee.

[6.57 p.m.]

CLARKE, Professor Frank Lewis (Private capacity)

DEAN, Professor Graeme William (Private capacity)

CHAIRMAN—Welcome. Do you have any comments on the capacity in which you are appearing?

Prof. Dean—I am from the University of Sydney but appearing in a private capacity.

Prof. Clarke—I am a professor of accounting at the University of Sydney and an emeritus professor at the University of Newcastle, but I am appearing in a private capacity.

CHAIRMAN—The committee prefers that all evidence be given in public. However, if at any stage of your evidence or responses to questions you wish to respond in private, you can request that of the committee and we will consider such a request to move in camera. We have before us your written submission, which we have numbered 59. Are there any alterations or additions you wish to make to the written submission?

Prof. Clarke—No.

Prof. Dean—No.

CHAIRMAN—Having said that, I invite you to make opening statements, at the conclusion of which I am sure we will have some questions.

Prof. Dean—This is a little different in the sense that we did not have a formal submission initially and we would just like to talk very briefly with an opening statement to the submission that has come to you fairly late. Professor Clarke and I thank the committee for inviting us to discuss the matters raised in the CLERP 9 bill, notwithstanding that we did not make a formal submission initially. Because of that, we wish to provide some summary thoughts. We will keep it very brief to enable some questions.

Given that, I would like to raise about five points that go to the heart of our submission. Firstly, we do advocate simplicity in governance reforms. That will become clearer, perhaps, through some of the questions later. Secondly, we concur with the principles based reform process that underpins CLERP 9. We particularly want to emphasise today the significance of the true and fair view criteria and particularly extend that to the discussion of the serviceability of accounting data that is audited.

We would also like to stress that, in some of the submissions and some of the discussions today, there appears to be some lack of evidence about certain aspects that have been discussed today. In particular, there has been discussion in many instances of corporate crashes. We argue it is certainly not corporate crashes per se that should be the focus of this committee; it should be the unexpected nature of those crashes and the quality of the data that appear to the market

participants that lead to the general lack of market confidence. That seems to us to be the major issue.

Further, we do not believe—this will cut across some of the committee members—that the international nature or the national nature of the standards setting is the real issue. Rather, it is the relationship between accounting standards and true and fair view that is at the crux of the debate. We believe that the audit report should be a warrant, an indicator of quality criterion, that is formed by this true and fair view criterion. Finally, we are concerned by the deletion of several sections related to true and fair view that were initially in the October 2003 draft and which do not appear in the CLERP 9 bill. We have not seen any discussion in any of the submissions as to the reasons that those sections have been deleted. We make reference to that in our submission. With that, I will leave it to any questions.

CHAIRMAN—Thank you. Professor Clarke, do you have anything to add?

Prof. Clarke—No.

CHAIRMAN—CLERP 9 and all of the CLERP processes were supposed to be part of simplifying the Corporations Law, and yet it seems to me that it is becoming ever more complex. Do you have a view on that? Is this complexity necessary?

Prof. Clarke—I think the complexity arises primarily because there is no singular quality criterion in particular in respect of the disclosure of financial information. In almost every other aspect of human endeavour, there is a quality criterion. I have heard a number of people here today talk about principles. I heard Senator Murray earlier wondering what that principle was. I think a notable absence in all of the discussion, which Senator Murray seems to have put his finger on, is that everyone talks about principles based accounting information but no-one tells us what that dominant principle is. We believe that the dominant principle ought to be that the data are serviceable for the purposes for which they are ordinarily used. That is the sort of criterion. That is the dominant quality criterion in respect of all other aspects of the primary quality that has to be achieved in respect of goods and services. We cannot see any reason that the same sort of criterion cannot be applied in respect of accounting.

Senator CONROY—Unfortunately, I have to catch a plane so I apologise that I will run out on you in a minute. I am trying to understand how you would write a law that captured that. Mark Liebler—ironically, a lawyer—argued that the notion of true and fair is sort of in the law now and it is just not being enforced. ASIC would disagree and say that it is not really there. Mark's suggestion is to put true and fair back in as an equal partner to meeting the accounting standards. Would that satisfy what you are driving at? I just got a sense that it maybe would not.

Prof. Clarke—I think it is a bit difficult talking about Mark Liebler's submission to the JCPAA, because in that submission he referred to us. In a sense, we are now referring back to him, which is a bit circular. He picked up some of the aspects of our argument and, being a lawyer, he looked at the legal aspects of it. Our understanding is that his argument was really that the true and fair criterion in fact had not been overridden at all and it is a misinterpretation that has given rise to this idea that the true and fair override is gone.

But if you think in terms of the way in which quality criteria are expressed elsewhere and think, for example, in respect of the Sale of Goods Act and those sorts of things, there is a statement which simply says that the goods and services have to be of merchantable quality—have to be serviceable, fit for use and all those sorts of things; there are different phrases, but they all mean the same thing—which is that they have to be fit for the purposes for which they are ordinarily used. So a motor mower has to be able to cut grass and all those sorts of things. It is unreasonable and not proper to complain if in fact it does not do the things for which it is not ordinarily used.

Accounting data in financial statements under the Corporations Act have to, amongst other things, be organised in order to show financial performance and financial position. Of course, financial performance and financial position are not defined, yet everyone in respect of their affairs has a fair understanding of what those things ordinarily mean. We also know that financial data are in fact extracted aggregates, subaggregates and all those sorts of things. Individual data is extracted to derive financial indicators of the wealth and progress of firms. A simple application of the true and fair criterion would be in those terms whether that data could be used for those purposes. If in fact, as in the original bill, it seems the directors were going to have to explain why something showed a true and fair view or did not and, for example, they were asked: 'How do you use this data?' or 'Could you use this data to determine solvency, rate of turn, asset backing, debt to equity and all those sort of things?', in most cases they would be saying, 'No, no, no, no, no.' The ultimate question would be: 'What do you use the data for? What can the data be used for?' So I do not think it is difficult to implement that sort of thing.

Prof. Dean—In 1978, the New South Wales committee on accounting standards actually put forward in a document a legislative draft of how to do that. So the accounting standards committee report 1978 has an answer to your particular question.

Senator CONROY—We can track that down.

Senator MURRAY—I have an idea that the original bill had the JCPAA recommendation—

Prof. Clarke—It did.

Senator MURRAY—on true and fair in there and it has gone out since.

Prof. Dean—That is exactly the case. We refer to that in our submission. We ask this question: if it has gone out, you would expect to have found somewhere in either a second reading speech or somewhere along the lines the reasons for why the JCPAA recommendations were not deemed appropriate. To us, it seemed a totally appropriate way to reinforce the significance of the true and fair view override.

Senator MURRAY—For the record, it is worth remarking that that recommendation was unanimous for all political parties.

Senator CONROY—Would that fall in the definition of a reasonable person test? My concern here is that judges ultimately have to make a judgment. Is that a similar type of legal concept to a reasonable person?

Prof. Dean—Yes. It is a commonsense test.

Senator CONROY—Is that a legal concept?

Prof. Dean—No, that is not a legal concept.

Senator CONROY—I understand the type of concept it is.

Prof. Dean—When you think of the way most of the developments in science have occurred, it has been in the context of a commonsense approach to a problem. All that is being suggested in our simplistic solution to this complex CLERP set of arrangements we now have is perhaps moving back to something more akin to a simplistic commonsense reasonable test approach.

Senator CONROY—One of the arguments I have heard against Mark's proposal coming from some accountants and accounting bodies is that we had the old 'fair' just by itself and that led to the disaster of the 1980s, of which you were an acknowledged expert. Is that a fair criticism, in your view, or a simplistic criticism?

Prof. Clarke—I think the criticism generally runs along the lines that a large number of people were not complying with the prescribed accounting standards, as they were, at the time. Consequently, it was very difficult to regulate. In fact, that, in a sense, is the proof in the pudding. Not everyone who did not comply with the accounting standards and chose alternative interpretations or methods of disclosure and treatments for various transaction data and so on was out to gip the system. Not all of them were out to mislead and befuddle people. We have to accept that some of them were sincerely of the view that complying with the accounting standards did not show a true and fair view. Indeed, we would argue at the moment that that is really the situation. By and large, complying with the accounting standards will not show financial performance or financial position in any sensible, serviceable sort of fashion without any intention to mislead or deceive and with the best of intentions.

Senator CONROY—I give my apologies—I have a plane to catch. But I am sure Senators Murray and Chapman will keep you busy.

Senator MURRAY—I have had the benefit of speaking to these two expert witnesses before. They leave me floundering in a number of areas, I might say. We as a committee will have to deal with all the varying complaints and adjustments people want us to make. At the heart of my concern about this bill is that I am not sure it is going to achieve what it is intended to achieve, because I do not think it addresses the fundamental problem, which for me is how the board is constituted and how the separation of powers is ensured to maximise the independence of those who advise the company and, therefore, ensure market integrity in the manner we would expect. That is at the heart of my problem. That is why I keep going after these lines. I am pleased you have sat through the evening. I would just like your views on that area.

Prof. Dean—Whether or not the board of directors is independent, whether they have integrity, at the end of the day what really matters is: do you have an independent monitoring mechanism that will highlight that their actions have in some way led to the company going in a deleterious fashion or not? If you had a monitoring mechanism, a reporting system, an instrumentation, that actually revealed the financial drift in an entity's affairs, some of the issues

you are raising, although critical, would still come to the surface and there would be a mechanism in place to enable shareholders and others to look at the situation. At the moment, that is not in place.

Prof. Clarke—A number of people here today have said that failure was inevitable. Earlier I think that in discussion with you it came out as a reasonable proposition that, by the inefficient use of resources and so on, companies that are inefficient should fail. It is just a natural sort of process. The biggest problem, it seems to us, at the moment is that, irrespective of what directors do, irrespective of what CEOs do and irrespective of what the executive directors and the non-executive directors do, there is no reliable financial indications of what the outcomes were. Earlier there was some talk about more or less shareholder activism and so on. Shareholders and the whole range of stakeholders in most circumstances are floundering in the dark. They do not know what the circumstances are. They get the annual reports and the financial statements in them and so on, but anyone who would rely on that sort of data, were they to know the funny rules by which 99 per cent of the data has been derived and calculated and so on, would be horrified at the prospect.

So what we are concentrating on is that we could have most of these CLERP prescriptions in the act regarding how directors are appointed and whether there are binding or non-binding votes by shareholders on executive remuneration and all those sorts of things we heard earlier. However, unless we end up with a system that provides, as Graeme says, information which shows what the financial outcomes are and what these people have done, with the best of intentions or with fraudulent intentions, with great skill or ineptitude, the whole game is lost. We are being told we are adopting the international accounting standards, the IFRSs. We do not think it matters where the rules come from if you have to have a whole stack of rules. At the end of the day, the financial statements need to be able to show the financial performance and the financial position. So I do not think any evidence has been put forward to show that changing from what we have is going to be any better. I think what we have at the moment is pretty poor.

Senator MURRAY—The way of a parliament is that, when you have community angst translating into legislation like this, the fact is the legislation will go through. It is the job of the committee to see if they can remedy any obvious deficiencies or make any criticisms which would improve the environment. So I put the question back to the two of you. I do not know if my colleagues share this view, so I will not assume to put it from them. But if you were us and were uncertain that the bill will fulfil its intentions, apart from those things you have already said to us about two components—namely, having the quality principle established right up front and attending to the true and fair view—what other key shifts or adjustments would you suggest we should be looking at with this bill?

Prof. Dean—If you go back to the original CLERP 1 bill, where it suggested having a market value accounting system in place, we have a halfway house in place at present. One suggestion we would make is that, if you are going to have a true and fair view criteria sitting on top of whatever standards we adopt, we should be doing our best in either legislation or through the profession to ensure that we have a systematic approach to deriving and arriving at a market value system. It is only under that sort of system that, for example, the concept of solvency makes any sense. Can any of the committee members think of a context in which you determine solvency without having an understanding of what the market value of the, say, exit price or

selling price of your assets is compared to the settlement prices of your liabilities? Solvency indicators do not make any sense without that data.

Senator MURRAY—It sounds as though we should bring you back for our insolvency inquiry.

Prof. Dean—It is interesting that we appeared before the HIH royal commissioner and we spent two hours talking about solvency and looking at the difference between the regulatory solvency test in the insurance industry and the accounting insolvency indicators that come out of your accounting standards. I believe it may have been a revealing experience to a few people in the room.

CHAIRMAN—There is quite a difference between them, I assume, from what you are saying.

Prof. Dean—A lot of the accounting numbers are backed out for regulatory solvency tests because they are not deemed to be appropriate for determining real solvency indicators. It seems strange in that setting that it is accepted but not in the financial reporting setting where people are trying to get some indicator of solvency as well. Creditors, wage earners and shareholders would like to know whether a company is solvent, insolvent or moving towards an insolvent state.

CHAIRMAN—If you took the third option of a true and fair assessment, would that be different again?

Prof. Dean—The true and fair would provide you with, hopefully, a serviceability criterion that would ensure that solvency meant solvency. It would be hard to see, in order to form an opinion about solvency, if in fact they had to take the true and fair as the overriding criterion and say, 'Yes, that data will provide some indication of solvency.' That is where our other suggestion about having the explanation about what is meant by true and fair becomes critical. That is why we believed that what was in the JCPAA recommendations was useful.

Senator MURRAY—And version one of the bill?

Prof. Dean—Yes.

Senator MURRAY—Help me with the solvency issue. What is the mechanism? How do you deal with it in the legislation?

Prof. Dean—Again, if I could suggest that the committee looks at that 1978 report, it actually has that embedded in it. It starts off with an overarching quality standard. That is the only standard in the legislation. You then have schedules akin to standards that would enable the operationalisation of that standard.

Senator MURRAY—Who develops those standards?

Prof. Dean—The quality standard would come through the legislation and the schedule would be presumably done in conjunction with the profession.

Prof. Clarke—It would really be the way in which, if you like, common standard, in a pejorative sense, of practices emerge in other professional pursuits. As I understand it, there is no standard about how a heart surgeon undertakes a heart bypass but they all do the same sort of thing. I am certain that brain surgeons have not got a batch of standards there, but there are tried and tested professionally competent ways of achieving those ends. So, in a sense, there would emerge best practices—I will avoid the word 'standard'—for how to achieve that end. It happens in every other professional area where you are resting upon experience and accumulated wisdom and so on. That would become the norm. So when someone deviated from the common practice, they would be in exactly the same position as when a professional deviates. They are up before the medical board and they say they performed a particular surgical procedure in a manner which was different from the way in which a whole lot of other surgeons normally perform that procedure. The onus would be upon them, no doubt, to explain why in those particular circumstances what they did was professionally competent, proper and not negligent and all those sorts of things.

Senator MURRAY—What other major things would you suggest in adjusting the principles and objectives and direction of this bill to better achieve its obvious intention?

Prof. Dean—In terms of the principles, which are pretty well set out in the bill, where it talks about transparency, accountability and shareholder activism, we have no problem with them. I do not think many people in the room would have a problem with them. For example, with transparency, it is hard to imagine that something can be transparent if in a solvency setting—I will use that example again—the data you are using does not give you indicators of solvency. That cannot be a transparent outcome. We feel that there needs to be a recognition that there are certain financial characteristics, salient features, that are supposedly derivable from your financial reporting regime, which is what the bill is about. They are things like solvency, rate of return and liquidity. At the present time, those salient characteristics are not determinable under either the existing conventional standard setting or under the proposed CLERP bill as it currently sits.

Prof. Clarke—A large part of CLERP is directed towards governing in some sort of fashion the behaviour of individuals. Earlier—I think it was the first witness this afternoon—the debate centred around what was essentially a principal agent sort of situation. These modifying sort of behavioural things are intended to try and get the agents—the managers, CEOs, directors and so on—to behave in a fashion which is in the interests of the shareholders and perhaps the wider stakeholder sort of community. We see that as being quite proper. You mentioned earlier in respect of directors' behaviour a number of things that have to be in place otherwise shareholders and so on will not get a fair go. I suppose our major concern is that all of those things could be in place. If, in fact, accounting stays as it is or if, in fact, it stays how the IFRSs are—as appears to be the case—in many ways it will still be very difficult to know what the wealth and progress of companies is. So it may be that with the best of intentions it still all goes haywire.

Senator MURRAY—This question derives partly from your expertise and your area of interest. You are saying, 'On the financial side of things, here are the principles and the objectives you have to establish. As a consequence of that, everything else will flow and you will get not just statements of integrity but statements of practicality, of usability.' On the other side, if we talk about behaviour and institutional performance—I do not mean institutions; I mean in the more academic sense of that phrase—I am of the belief that there is not sufficient guidance to

corporations as to the manner in which their constitution should be structured, their institution should be structured and their behaviour should be conducted. I therefore have felt that principles or objectives should state that company constitutions should attend to the separation of powers and corporate democracy—which the bill describes as shareholder activism—minimising barriers of entry to contesting directors positions, proper accountability, conflict of interest procedures and all the little checklist things, without stating in the constitutions exactly how they will be dealt with because you want horses for courses. However, you want for them to understand that they must develop the principles. To my mind, it is almost like the community of democracies. There are many different types of democracies but the basic principles are the same: universal and equal suffrage, the separation of powers, and so on you go. Do you agree with me? Is it possible to do that?

Prof. Dean—I think we do agree; we do not disagree with that sort of proposition. We are saying you need to have something as well as that. That can be, in our view, covered to a large extent by the way in which the true and fair view was addressed in the JCPAA committee report. So we certainly do not disagree with many of the things said here today. It seemed that most of the people were agreeing with this co-regulatory principles based approach to resolving some of those procedural matters.

Senator MURRAY—Let me ask about shareholder participation. Plainly, if people hold shares in their own right, there is no drive from anybody to try and make people vote their shares. It would be impractical to do so, I think. There is a view of different intensity by the Labor Party and the Democrats in this instance—but I do not think it is exclusive to us—and I would encapsulate it by saying that those, as you heard me earlier, who hold shares in trust or in escrow or who have a fiduciary duty should fulfil that duty and vote their shares. I have not made up my mind if that is a universal approach or should be a subject matter approach. As you heard me outline, I thought the election of directors is probably the one in flashing lights which says that they should be involved. How do you feel about making institutions and trusts, who could be described as having shares in escrow or in a fiduciary situation, vote?

Prof. Clarke—As I understand it, there is not any need for compulsion in the United States. They have been pretty active in doing this sort of thing for some time. It is only in recent times it has been suggested that the major funds and so on ought to be speaking out on behalf of the members of the fund superannuants and all those sorts of thing. It seems to me that that would amount to rather a large voting block that may well address some of the issues that were talked about earlier, such as voting in respect of executive remuneration packages and all those sorts of things. I suppose there is a bit of a problem, however, as to who determines how the institutions exercise those votes. There is a problem in the mechanism, isn't there? How do we ensure that the institution votes in such a way that it really is achieving this sort of representation of all the individuals who have their money invested in those funds? Somewhere the institutions would have to be directed how to vote, wouldn't they?

Prof. Dean—I really do not have anything to add. I listened to Stephen Harrison ponder on that one and passed it or deflected it to the winger. I think it went out over the sideline. It is obviously a very contentious issue and I do not have an informed view on it.

Senator MURRAY—It is a live issue for us. The Labor Party have announced that they will require super funds to vote. As I understand it, it is on all resolutions. There are questions of

cost, practicality, ability and so on and people can argue about it. But, even if it is not part of the committee's view, it is going to end up as a view in the Senate chamber.

Prof. Clarke—How are they suggesting that the institutions would determine how they would vote?

Senator MURRAY—I cannot answer for them and I have not looked at it deeply enough to know. What I am saying to you is that I am sympathetic to the concept, but I am questioning whether it needs to be selected as to subject matter or if it should be per institution, which is the view.

Prof. Clarke—As a superannuant, I am sympathetic to it as well, I can assure you.

Senator MURRAY—I do not have any further questions.

CHAIRMAN—Thank you very much, Professor Clarke and Professor Dean, for your appearance before the committee. As you have seen from the exchange, it has been very useful in terms of our deliberations on the bill.

Prof. Dean—Thank you very much.

Committee adjourned at 7.32 p.m.