
COMMONWEALTH OF AUSTRALIA

# Official Committee Hansard

## JOINT COMMITTEE ON CORPORATIONS AND FINANCIAL SERVICES

**Reference: Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Bill 2003**

WEDNESDAY, 14 APRIL 2004

MELBOURNE

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**JOINT COMMITTEE ON CORPORATIONS AND FINANCIAL SERVICES**

**Wednesday, 14 April 2004**

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

**Senators and members in attendance:** Senators Conroy and Murray and Mr McArthur

**Terms of reference for the inquiry:**

To inquire into and report on:

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

**WITNESSES**

**Committee met at 9.14 a.m.**

**RAVLIC, Mr Tom, (Private capacity)**

**ACTING CHAIR (Mr McArthur)**—Today the committee resumes its public hearings regarding the Corporate Law Reform Program (Audit Reform and Corporate Disclosure) Bill 2003 and relevant matters. The committee expresses its gratitude to contributors to this inquiry, including those who will be appearing before us as witnesses today.

Before we start taking evidence, I wish to reinforce for the record that all witnesses appearing before the committee are protected by parliamentary privilege with respect to the evidence provided. Parliamentary privilege refers to special rights and immunities attached to the parliament or its members and others necessary for the discharge of parliamentary functions without obstruction and fear of prosecution. Any act by any person that operates to the disadvantage of a witness on account of evidence given by him or her before the parliament or any of its committees is treated as a breach of privilege. I also wish to 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.

This is the committee's sixth public hearing for this inquiry, and another one is scheduled for 29 April. I have been asked to act as chairman. I welcome my two colleagues and I thank them for their knowledge of the issues. I welcome the first witness, Mr Tom Ravlic, to the hearing. The committee prefers all evidence to be given in public; but should you at any stage wish to give any part of your evidence in private you may ask to do so, and the committee will consider your question. Do you understand that?

**Mr Ravlic**—Yes, I do, but it will not be necessary.

**ACTING CHAIR**—The committee has before it your written submissions: submissions Nos 1 and 1A. Are there any alterations or additions you would like to make to your submissions at this stage?

**Mr Ravlic**—Although I sent the committee a supplementary submission yesterday, I would not mind making an opening statement.

**ACTING CHAIR**—Do you want to change your submissions?

**Mr Ravlic**—No.

**ACTING CHAIR**—I invite you to make a brief opening statement of not more than five to 10 minutes and then we will proceed with questions.

**Mr Ravlic**—Committee members will know that underpinning my submissions are several key propositions; in my opening remarks this morning I will address two of the main ones. Any oversight structure set up to create community confidence in the capital markets has to have two principles at its core: it must be fundamentally independent and it must also be transparent. I will raise issues of concern that I have about the existing structure and put forward things that I believe should be done in order to achieve those two principles through the CLERP 9 process.

To start with, I remain concerned that the FRC is a group of people that represent certain constituent groups in the community; this should not be the case. People on the FRC should be selected on merit and should be independent; they should not have established ties with bodies outside of that particular forum. They need to be seen to be independent and they need to be seen to be making decisions independently of various lobby groups. This is critical in considering the way the secretariat of the FRC operates, for example. The secretariat is sourced from Treasury. That has to be intolerable in an environment where we have people from Treasury on the Financial Reporting Council.

I am in agreement with Charles Macek, the current chair of the Financial Reporting Council, who argues that the secretariat must be independent in order to ensure that the FRC gets independent advice, well considered advice and appropriately informed advice and not advice that is tainted by the sort of government policy that we have seen develop over a period of time with respect to accounting standards setting and, indeed, audit standards setting. In order to achieve that particular goal, you have to detach the FRC secretariat from the federal Treasury and staff it with individuals who understand the issues rather than with career bureaucrats, who will probably be focused on their next career objective or their next move up the scale within the Public Service as opposed to serving the core task of the FRC—and that is ensuring there is community confidence in the accounts prepared by companies and the audits signed off by registered company auditors.

Let me move to the AASB and the FRC interplay and focus on independence there. I have had concerns since 1997 about the coalition government's insistence that the Financial Reporting Council have the power to set the strategic direction of the Australian Accounting Standards Board; that is fundamentally inappropriate. If you are an oversight body, your job is to oversee and observe; it is not to dabble in standards setting. Setting strategic direction has the ultimate consequence of not allowing a board to make the technical decisions it believes appropriate. The legislation currently before parliament should be amended to ensure that the AASB and, indeed, the Auditing and Assurance Standards Board set their own strategic direction and are held accountable by the council and other parties, including the parliament, for ensuring that they maintain the focus they have set themselves.

Let me move to transparency. The FRC should be required to hold public meetings. It is intolerable that the Financial Reporting Council sets key strategic directions for a standards setter without being held accountable by the general community and without being visible. That has been a concern of mine for a very long time. The Financial Reporting Council should also have a transparent due process where it is required to draft a proposal, issue it for public comment and then make a decision. It is unacceptable to have a situation where the Financial Reporting Council can both meet in private and also not put proposals forward to the community in a formal manner so that the community can respond and the FRC can take account of the views of all constituents and not just those that sit around the FRC table.

The AASB does not escape my criticism in terms of transparency. There have been some, albeit minor, issues with regard to transparency in submissions sent to the AASB. Prior to the CLERP 1 amendments being implemented in 2000, the accounting profession's Urgent Issues Group provided those attending Urgent Issues Group meetings with all of the submissions that that group received. Post CLERP 1, we now have a regime where those in the public gallery do not have access to that information; should you want access to it, you have to inquire through the

means of freedom of information, which takes some time. We have seen in some areas a lessening of transparency with this so-called regime that is supposed to be more transparent in holding these characters more accountable. To me, that is a great concern.

We also have the issue of the posting of working papers and agenda papers of standards setters on the web site so that people can clearly see what is being discussed. Not all agenda papers are made available to the public, as not all submissions to the standards setters are made available to the public. We can learn from the excellent example of the International Auditing and Assurance Standards Board, which puts all its agenda papers and various bits of correspondence, as occur from time to time, on its web site. On its web site are listed every one of its meetings as well as all the agenda papers it discusses. It is behaving in the public interest. Anybody in Australia, New Zealand, France or Germany can see that material. We do not have the equivalent degree of transparency in this country in our standards setting regime. I fear that, if we move further with CLERP 9, we will lose some of the elements of transparency that we still have—and that is something I believe we need to avoid.

I will raise a couple of other minor issues before closing off my preliminary comments. I believe that it is probably time for us to consider revisiting how legislation of this kind—that is, auditing standards—is delegated. I have provided the committee's secretariat with the wording of the Canadian law, which incorporates the accounting standards by reference as opposed to by direct delegation, which is the way it is here in Australia. That may be a model we need to consider from the point of cost-benefit, if we are going to further converge with international standards. I appreciate appearing before the committee and at this point I am happy to take questions.

**ACTING CHAIR**—Thank you for both your evidence and your submission.

**Senator CONROY**—The ASX has submitted to us that the primary function of the FRC should be the oversight of audit quality, of which auditor independence is an aspect. Your submission says also that the focus should be on audit quality rather than on whether the independence rules have been adhered to. Why should the FRC oversee audit quality?

**Mr Ravlic**—If I may put this a little crudely, you can be an independent person but you may know nothing about auditing. By that I mean that you can go to the most ridiculous lengths of implementing a policy of having independence by placing in charge of an audit people who know nothing about a specific industry and little about the complexities of audit and you would have an independent outcome. If you focus on audit quality and then look at the subset of audit quality which is independence of mind and independence of decision making, you are tackling there the quality of audit—the way the work is done as well as how people view the work. Independence in itself is not going to cure anything; monitoring independence is not going to cure the problem. If you have unskilled people doing the work, they can be independent but they might not even understand what it is they are looking at. So you have to have a balance between the two; both have to move together.

**Senator CONROY**—We are not talking about the NAB committee at the moment. Really, you are arguing that the FRC should oversee audit quality. On your own argument, is the FRC sufficiently skilled to oversee audit quality?

**Mr Ravlic**—It needs to have its membership reconstituted.

**Senator CONROY**—So it could not do it with the people it has now.

**Mr Ravlic**—I very much doubt that the FRC has the full suite of skills required to be able to deal with it.

**Senator CONROY**—Your submission also refers to oversight more generally. I think you made the point in your opening address that an anomaly of the FRC is that it does not also oversee the ASX Corporate Governance Council and the ASX listing rules committee. In your view, should the FRC oversee both of these bodies?

**Mr Ravlic**—I cannot see why the FRC should not oversee both those bodies. If you look very carefully at what we are doing here, we are placing bodies that set accounting and auditing rules under oversight but we are leaving a not quite private but publicly listed body to oversee a function that sets the rules by which it has to abide. Even though we are not allowing auditors the opportunity to do that anymore without outside interference, we are allowing the ASX to continue to do so. As far as I am concerned, that is impossible to sustain in the current environment.

**Senator CONROY**—Sure. Given the constraints for the skills you are arguing for, how large do you think the FRC will have to be if it is covering accounting standards, audit standards, the ASX Corporate Governance Council, the ASX listing rules committee? Would that comprise a body of about 400?

**Mr Ravlic**—If I wanted to be facetious, I would say you would probably want the numbers that are in the Mormon Tabernacle Choir. It would be appropriate to step back for a moment and think about how you can fulfil this task. You can have a very narrow group of people who are well qualified, well intentioned and public-interest minded on the Financial Reporting Council. But below them you can set up a structure with a secretariat—which, in my view, should be independent—staffed by people who are subject matter experts and who are not employed by any entity other than the FRC. That is, they are not employed by a big-four accounting firm, the corporate regulator ASIC or a company that is listed on the Stock Exchange. They are employed by the FRC itself to monitor independence, assess audit quality and develop what is left of the framework of accounting standards that we have under our control and in our domain. We are faced with the same proposition with auditing standards. So you need to have a well qualified secretariat to support these guys.

I do not believe that you need a huge FRC in order to do the job. To prudently consider the issues, you need people who might have some subject matter expertise but who are not there on behalf of any lobby group. The composition of the FRC at the moment is a laughable one. I cannot see how you can sustain a Financial Reporting Council that has on it a couple of members who are from the government's Business Regulatory Advisory Group, which has helped the government draft CLERP 9, who then get onto the FRC, which is implementing CLERP 9. What sort of message does that send out to the community? Are the business community and the general community so small that we have to take these people from BRAG and put them onto the Financial Reporting Council? What message does that send out about the structure's commitment to independence? I am not sure I am comfortable with that.

**Senator CONROY**—In your view is there a risk that the FRC, having the AASB and the AuASB under its direct control, will again attempt to set the strategic direction of the standard setters?

**Mr Ravlic**—When children have matches within their reach they are liable to reach for them and do some damage unless they are carefully supervised.

**Senator CONROY**—How would you amend the new provision to ensure that the FRC does not direct the strategic direction of the standard setters?

**Mr Ravlic**—I would remove that from the FRC's powers and make it the responsibility of both the Auditing Standards Board and the Australian Accounting Standards Board. So I would delete it from the FRC's responsibilities and then make it the responsibility of the AASB and put within possibly section 225 of the ASIC Act that the FRC has the responsibility to review the progress of the standard setters in following through their commitment to the council: the commitment that they have obviously then made in the strategic direction they have set.

The council should be there to hold the boards accountable; it should not be there to force them to do certain things. We have already seen various examples of where the public sector, for instance, has had its way on GFS-GAAP convergence or harmonisation. The public sector is a very powerful authority when it comes to dealing with these matters of legislation. They have the secretariat, they have a group of people on the FRC and they are fairly influential in getting their own way, except when exposed publicly.

**Senator CONROY**—You have made a couple of recommendations in terms of a secretariat that meets in public. Keith Alfredson, who I am sure is known to you, recommends in his submission that, before the FRC is given any additional responsibilities, a number of steps need to be taken including a review of the FRC by the Australian National Audit Office. In your view, should the ANAO review the FRC?

**Mr Ravlic**—Any review of the Financial Reporting Council would be healthy from the point of view of probity and accountability. At the current time I am unaware of any formal process of the FRC to have external reviews of its performance. We continually hear talk about corporate boards—that is, boards of companies—that have reviews of board performance, in the great trend towards greater reviews of governance of listed corporations and others. I think it is only appropriate that the FRC have the same standards and rigour applied to it that other organisations have.

**Senator CONROY**—I know you have followed the FRC's decision-making process very closely; and obviously we will get a chance to ask these questions of Mr Alfredson, who has been a member of the FRC. What is your experience from watching their processes, particularly around accounting standards setting? Following on from your close observations, what questions would you perhaps want us to ask Mr Alfredson about the way the standards setting processes worked?

**Mr Ravlic**—Several issues would need to be taken into account in any consideration of the standards setting process as it currently operates. The first issue is whether or not the Financial Reporting Council should have a similar consultation process to the one its board is required to

undergo. That was not the course of action that was followed by the former Chairman of the Financial Reporting Council, Jeff Lucy, in June 2002, when that body made the directive to adopt international accounting standards by January 2005. I find it intolerable that that took place in the way it did; in fact, it put a lot of people offside. I know that the attitude that people had within the standards setting structure was one of alienation because they were not formally a part of that decision-making process. If you are going to make a decision like that, you have to bring the community with you.

We are now seeing the Group of 100, for example, rabbit on in the press about the fact that they have no time to implement the standards that are coming through the process of adoption. But was the Group of 100 asked back in 2002 whether or not the adoption by 2005 was a good idea? Answer: not in a formal sense; not via the provision of documents to the community to assess dispassionately whether the proposal was a good idea. That is something you may wish to consider later on today.

The other issue is the very late provision of papers to the Financial Reporting Council. From time to time in my conversations with people who were on the FRC in its previous permutations I have heard that the agenda papers were provided at a time that made it too difficult for people to understand very complicated issues, such as the public sector accounting recommendation that the Financial Reporting Council made in December 2002. If I recall correctly, Senator Conroy, at one point that was the subject of some animated discussion between you and Mr Lucy during a Senate estimates committee. These are all, in part or in whole, symptomatic of having a structure that right from the outset does not prize the independence of decision making of the Financial Reporting Council and the Australian Accounting Standards Board combined. How can you have a secretariat from Treasury doing many other things and then getting papers to these decision makers too late so that they cannot make their decisions—

**Senator CONROY**—What is your definition of ‘too late’? Are you talking about the morning of the meeting, the night before, two days before or a month before?

**Mr Ravlic**—We are probably talking of the day before or two days before. According to people I have spoken to, that is what happened.

**Senator CONROY**—Without wanting you to reveal your sources, were these members who were talking informally?

**Mr Ravlic**—These were members or advisers to members of the Financial Reporting Council.

**Senator CONROY**—They were getting the paperwork for making very important decisions—

**Mr Ravlic**—They were getting it far too late. It was not practical for them to get on top of everything that had been put before the FRC. That is classic control of a boardroom situation—you give people documents too late, you do not give them time to understand what is going on and the outcome becomes a fait accompli. That cannot be acceptable governance in the current environment, nor should it have ever been.

**Senator CONROY**—The FRC will be appearing before us so I am sure we will get a chance to have them respond to your concerns, and perhaps we can take up some issues with Mr Alfredson later today. Moving on to auditing standards, your most recent submission—I know you have made a number; you are probably our most prolific submitter, Mr Ravlic—raises concerns about the reappointment of the existing International Auditing and Assurance Standards Board for a further 12 months. Your submission notes that, while the IAASB has an independent chair, Mr Boymal, the audit board does not. Could you advise the committee of your concerns in relation to the independence of the audit board in that circumstance?

**Mr Ravlic**—Given that the new structure is all about achieving some degree of parity and confidence in the way standards are set, I cannot see how you can justify not having an independent chairperson at the Auditing and Assurance Standards Board under the new structure. David Boymal does one thing and one thing only—that is, he is the chairman of the Australian Accounting Standards Board. His entire time is devoted to chairing that body; that is his sole responsibility. Outsiders looking at that cannot draw any other perception of that man's activity, other than that he is operating in the interests of the Australian Accounting Standards Board and within the mandate set down for him by the ASIC Act.

It would be unfortunate if people were to perceive that the audit board was being dominated for example by people who were working in specific organisations or groups of organisations. I mention this in the submission. If you have a proliferation of people by the auditing standards set out by example by the big four accounting firms, and from audit practice generally, an observer from the outside might question whether that was appropriate. I happen to know most of the people on the auditing standards board, and generally speaking they behave with integrity when they set auditing standards. The community does not have that degree of personal contact. To give the community some degree of comfort, it needs to be somebody who is not currently in a role with a major accounting firm or another institution that has anything to do with auditing per se.

**Senator CONROY**—Is an independent chair sufficient to overcome this perception problem that you are describing and the domination of the big four? Take Mr Boymal—he is well known to the committee and he appears before us regularly. He has virtually come straight from retiring from one of the big four to be the chair. Is an independent chair sufficient? I am in no way casting aspersions on Mr Boymal; I think he is a man of excellent integrity and he does a fine job. Is an independent chair sufficient to address the problem that you are defining of the big four dominating it?

**Mr Ravlic**—I will come back to the example of the International Auditing and Assurance Standards Board to answer that question. They have three public members, who were appointed when that board was restructured. Those members have an obligation to ensure that the public interest is focused upon at all material times when the board is considering technical matters. I think it would be appropriate for that model to be considered here in Australia. It does not mean that you do not involve people from the big four accounting firms—they are the subject matter experts.

I think it is entirely legitimate to bring other people forward as members of an auditing and assurance standards board for another reason and not just to bring some degree of balance in the environment. It is also a useful education forum for people outside who do not understand what

this body does and the subject matter this body deals with. There is another payback in bringing other people onto an accounting standard setter and an auditing standard setter: members of the community become aware of how complicated some of the issues are and what auditing standards contain. At some stage you may find that people might not be as critical or concerned about the performance of some auditors as they otherwise would be because they do so perhaps in ignorance.

**Senator CONROY**—On the structure of the auditing standards board, Keith Alfredson's submission says that there is a need to differentiate between the technical board of the AuASB and the statutory body. He proposes that the auditing standards board be the employing body but that the staff of the auditing standards board and the AASB be merged into a new entity called the Australian financial reporting and assurance institute. He says that this body could provide technical and administrative support to both of those standard setting bodies. Do you agree with his recommendation?

**Mr Ravlic**—I would find it difficult to disagree with his recommendations. His picture of the way the secretariat functions should operate is similar to that which operated before the government decided to engage in statutory desecration of accounting standard setting back in 1998 and 1999. The Australian Accounting Research Foundation, which is a joint venture of the two main accounting bodies, CPA Australia and the Institute of Chartered Accountants in Australia, did at one stage house both secretariats—that is, the secretariat for the audit board and the secretariat for the accounting standards board. There were some benefits in that.

Anecdotally, when I have spoken to people who worked in that structure, they appreciated being able to talk to people who worked on the auditing side, who were only up the hallway from them, to check the consequences of an accounting change and whether or not it would have any audit implications. Conversely, the auditing people would talk to people on the accounting side of the operation to work out what was going on and whether there were any audit implications involved there. So I think his concept is fairly sound. Whether you give it the name that Mr Alfredson suggests is a matter for argument, I think, later on. I think that a combined secretariat is a fair call. To be able to have people that the two bodies can draw on with various skills within the discipline would be useful.

**Senator CONROY**—I just wanted to look at the US experience. Your submission says:

> We should be aiming to win the confidence of the US regulators by emulating where possible their take on independent standard setting.

What part of the US approach should we be emulating?

**Mr Ravlic**—For starters, the FRC should not have the right to set strategic direction. As I understand it, the Financial Accounting Foundation in the United States does not interfere in the sort of strategic direction setting that the financial accounting standards board does. We could learn a lot from the United States. In fact, a member of the financial accounting standards board did write to Senator Ian Campbell back in 1997 or early 1998. The exact date of the correspondence is not in my mind at the moment—

**Senator CONROY**—I think I may have read that letter into *Hansard* at one stage.

**Mr Ravlic**—Yes, it was mentioned in *Hansard* at one point. That was correspondence that strictly opposed the FRC's ability to interfere. Sir David Tweedie, who was at the time the Chairman of the International Auditing and Assurance Standards Board in the United Kingdom, also wrote a piece of correspondence that opposed the FRC's capacity to set the strategic direction of the Australian Accounting Standards Board. So we can take it from those two organisations, and from Sir David Tweedie in particular, that it is something uncommon that we have entered into.

The International Accounting Standards Board also has a firm segregation between what is technical—that is, what is an agenda to be set by the technical board, headed now by Sir David Tweedie—and what is an oversight matter that is dealt with by the board of trustees, headed by the former head of the US Federal Reserve, Paul Volcker. There is no demarcation dispute between Volcker and Tweedie. At any point in time Volcker knows what his job is, Tweedie knows what his job is, and they both liaise with each other but do not step on each other's toes. That is what we need to have here. If we are on about international convergence, we might as well look at the way the international bodies behave. We might learn a few lessons from them.

**Senator CONROY**—I wanted to discuss the financial reporting panel. Should the FRC also have oversight of the financial reporting panel and does that mean we have to expand the size of the Mormon Tabernacle Choir?

**Mr Ravlic**—I think you might want to add the Harlem Gospel Choir along with the Mormon Tabernacle Choir, Senator. I do not have a firm view on whether the FRC should be the body to oversee the financial reporting panel. In fact, I struggle with that concept because the financial reporting panel is actually, in its own way, an enforcement mechanism. It is not a mechanism that is going to be set up to develop accounting standards or auditing standards or ethical guidance. I think it would actually live quite comfortably next to the Takeovers Panel as a dispute resolution body. So you might in fact decide to have a separate body overseeing the Takeovers Panel and the financial reporting panel because they both do the same thing: they settle disputes. They are an alternative enforcement mechanism. That is what they are. There is a distinct difference between their responsibilities. So I am not sure how the FRC would cope with being a little schizophrenic.

**Senator CONROY**—The joint submissions from the major accounting firms say that the role of the FRP should be expanded to include a role for adjudication of issues prior to publication of the financial statements. In contrast your submission rejects this proposal. Why is that?

**Mr Ravlic**—It is a curious position that is put by people when they say that there should be a pre-vetting of audit opinions or accounting treatments. That is best done, in my view, by mediation set up by bodies such as the professional accounting bodies. The FRP should only deal with disputes that are brought to it post publication. The Financial Reporting Council should not be treated as a nanny to which auditors and their company clients go when they want some advice. The auditors are there to make a call on an issue. That is what they are paid to do—they are paid to do so in the public interest and they are paid to do so in a manner that does befit their knowledge and expertise. There is no point in the financial reporting panel hearing a matter before an annual report is issued. Then, if ASIC—the corporate regulator—decides there is a problem with that set of accounts, to whom will the corporate regulator take its dispute? Would it take it to the financial reporting panel—a body that has already pre-vetted that accounting

treatment? I do not think so. Where would it go? Would it go to the courts, which ASIC itself has had reservations about given the outcome that we saw in a case concerning MYOB Ltd? The FRP should only deal with matters that have been identified in the published accounts of companies that lodged them with the ASX and ASIC.

**Senator CONROY**—Justice Owen, in his report on HIH, noted the deficiencies of the urgent issues group and stated:

I recommend that the Australian Accounting Standards Board alter the Urgent Issues Group or create a separate group that is able promptly to issue binding rulings on important and urgent matters concerning the interpretation and application of the accounting standards.

What is your view on Justice Owen's recommendations?

**Mr Ravlic**—I think that I could dispense with Justice Owen's recommendation very swiftly, Senator. Under the current proposals that we are facing with the adoption of international accounting standards, the urgent issues group abstracts will become a part of the standards that are set—that is, the abstracts, the consensus views, will effectively become the same as accounting standards. Therefore, I do not believe that Justice Owen's call for a binding ruling on the UIG on technical matters is necessarily one that should concern you at this point.

**Senator CONROY**—Given that Australian accounting standards pass through the parliament, would these rulings need to go through the parliament for them to have the same force?

**Mr Ravlic**—It is presently intended by the Australian Accounting Standards Board that the UIG abstracts sit in a separate accounting standard that has been called AASB 1048. Those abstracts would sit in that accounting standard, which would be forwarded to the parliament so that the parliament can read it when it has a spare moment or two and decide whether the typeface is appropriate.

**Senator CONROY**—We take accounting standards very seriously, as you know, Mr Ravlic. Would an Australian urgent issues group eventually be subsumed by an international body? How is that going to work, in your view?

**Mr Ravlic**—That is an interesting question. The Australian standards setter is going to need to change quite dramatically the way it operates in the current environment. We have seen over a period of time an emphasis shifting to the adoption of international standards or an accepted number of international standards. This then requires the domestic board to start recalibrating its processes, if you like, and thinking through how it will have an impact on the international stage. In my view, there are only a handful of things that it needs to focus on. One is leadership in this region. The Australian standards setter should be the core member of a group that communicates with the ISB from this region. For example, we may team up with New Zealand, Malaysia and other countries in the region to talk directly to the IASB about regional concerns because our environment is different to that of Europe and the United States. There is no effective manner in which countries in this region can engage in this way. Secondly, research and development is a core piece of work that the IASB is continually looking to conduct with other people. That responsibility can be led by the Australian Accounting Standards Board and it has to take up those challenges.

We have had a project on intangible assets, Senator Conroy, which you may have heard of, given to us by the International Accounting Standards Board. That, according to my most recent conversations with David Boymal, is something that they have started work on. That project is very important to the future of financial reporting globally; that becomes the template, if you like, on which the IASB—that is, the International Accounting Standards Board—bases future standards. So the research work we do will be critical in facilitating that.

Our role will be to consider forward-looking developments, to take a leadership role in the region and, where necessary, to deal with issues that are unique to Australia—for example, where remuneration disclosure required by the Corporations Act requires some additional work by the Australian Accounting Standards Board. I think we may see a day when the Australian Accounting Standards Board become responsible for setting the standards for the quality of management discussion and analysis in company reports. That may even be something they undertake over time.

**Senator CONROY**—Thanks very much, Mr Ravlic.

**Senator MURRAY**—Mr Ravlic, how would you describe yourself professionally—what is your profession?

**Senator CONROY**—Troublemaker!

**Mr Ravlic**—Leaving aside Senator Conroy's compliment to me a moment ago, professionally, for the past eight years, I have been a writer and commentator on developments in the accounting profession, corporate regulation and corporate governance generally.

**Senator MURRAY**—You are a specialist journalist, in other words?

**Mr Ravlic**—Yes.

**Senator MURRAY**—I must say it is refreshing to find a journalist with your depth of knowledge in the field in which you write. You are very insightful. You write that the Financial Reporting Council should have oversight of the Australian Stock Exchange's Corporate Governance Council and listing rules committee. Why do you say that—why do you exclude the market regulator, ASIC? Why shouldn't ASIC have that oversight? Doesn't the equivalent body in America have those responsibilities?

**Mr Ravlic**—That is an interesting question.

**Senator MURRAY**—You said earlier that we should learn from what is going on internationally, and my understanding of the American system is that they have a market regulatory function.

**Mr Ravlic**—The Securities and Exchange Commission is indeed a powerful body. There is also a body in the United Kingdom called the Financial Reporting Council that has an ethics body responsible for accounting and auditing standards. We can focus on many international examples, but let us talk a bit more about the United States. The US does have a powerful regulator. Thinking through the issue, if we have a model at the moment where standards for

disclosure are being set by bodies that operate under the Financial Reporting Council, there is consistency in that approach. So if the auditing standards that auditors have to follow are overseen by the Financial Reporting Council and accounting standards that set the disclosure and measurement requirements for accountants are overseen by the Financial Reporting Council, the natural conclusion to that pattern is that disclosure requirements set by the Corporate Governance Council that affect company directors and others with respect to listing should also be overseen by the Financial Reporting Council.

I could make the valid argument that you could even have ASIC oversee the auditing standards function as well, given that the SEC has had a huge role in dealing with the restructuring of the way oversight of the accounting profession is done in the United States. But I think, from the point of view of consistency, you would need to seriously consider whether or not the ASX should have those bodies sitting within its structure when these other organisations that have in the past been under the care and maintenance of the accounting profession have been taken over by the Financial Reporting Council.

Put crudely, I would not want to see the accounting profession victimised simply because it is convenient. I would want to see a model that is conceptually sound. While I do colour my submission a bit in the way I write it, I think my concern largely is consistency, and being able to say to people that we have a structure that oversees every single part of the reporting framework in an appropriate fashion.

**Senator MURRAY**—But you have made the clear point that much of what you say is trying to assure the public at large, as distinct from those with specialist knowledge, that the process is not only adequate but you can take assurance from it. You follow that through with strong criticisms of the Financial Reporting Council's closeness to Treasury—it does not have an independent secretariat and its appointments are very much tied to executive views. In contrast, ASIC has a very strong public reputation as an independent regulatory body with its own mind, its own resources and a tradition of even-handed market regulatory activity. I would have thought that, from a practical point of view as well as from an assurance point of view—and I use that word deliberately; you would recognise it—ASIC would be far better having oversight of the governance council and the listing rules committee of the ASX. I just think that your remarks and the framework in which you put them should automatically push you to putting the CGC and the listing rules committee under ASIC, and I cannot see why there are any strong arguments against that being so.

**Mr Ravlic**—I am happy to contest that proposition.

**Senator MURRAY**—Do you want to do it in writing or now?

**Mr Ravlic**—I am happy to contest that proposition. If you make the structural amendments to the Financial Reporting Council that I have suggested—that is, you create a structure that has an independent secretariat, appropriately skilled individuals and an FRC that is chosen on merit; that is, FRC members are not tied to individual nominating bodies—I think you can achieve the same outcome. The problem at the moment is that there are too many extrinsic influences on the FRC's decision-making.

**Senator MURRAY**—But you know how it works—and I am talking to you as a politician—if the government do not agree with you—

**Mr Ravlic**—Which is regularly the case, as I understand it.

**Senator MURRAY**—Yes. If Senator Conroy and I do not agree with you, or alternatively if we do agree with you and are unable to make sure that the government change their mind, then the next option is to refer these matters to ASIC, surely. If the framework stays as it is at present, isn't ASIC then the better body to do these two things?

**Mr Ravlic**—I would agree to putting some of those functions with the securities commission only if it became apparent that the government would maintain its recalcitrance and refuse to take the route of developing a more independent secretariat and council to ensure that the community can have full confidence in the process. I would see that as a matter of last resort.

**Senator MURRAY**—Let me move on to some earlier remarks of yours. Your later remarks, I think, adjusted the framework, but you said there needs to be a balance between the abilities and skills of those on these bodies and their independence. I would tell you that I disagree—I think that the two are distinct. You must have both independence and the skills. I do not think there is a balance—you do not trade one off against the other. I think that, having listened to your later comments, you probably agree with that proposition. You cannot nod your head—*Hansard* does not record nodding of heads. You have to say, 'Yes, sir, I fully agree with you and you have been very wise in making that remark!'

Dealing with independence, there is the issue of personal qualities and the need for somebody to be free of patronage, but there are four essential elements of independence which I think you always have to look at. The first is the method of appointment; the second is the period for which you are appointed; the third is the remuneration—it must be adequate to do the job; and the fourth is the method of separation—that process has to be a good one. I think a lot of your criticisms and my own, I might say, are to do with the method of appointment. The method of appointment throughout government, under any government, smacks of patronage at times, although, at its best, it can produce superb appointments who are truly independent. Would you agree with the proposition that legislation should at least require the minister to determine the criteria being used for appointments and that those criteria should include merit?

**Mr Ravlic**—In my earlier comments at the start of today's hearing I referred to independence and transparency. I think those issues need to be raised in the context of appointment to various bodies. It needs to be a process that is transparent—it has to be. If the guidelines for appointment were made available, people would understand what the ground rules are—that is, people who are appointed would understand what the ground rules are and people out there would understand what they are. If we are in a position where we understand what is going on, it is much better than if things are done in seclusion and secrecy. I would agree with your proposition.

**Senator MURRAY**—Thank you. Would you—

**Mr Ravlic**—I have to agree with something today, Senator Murray; otherwise—

**Senator MURRAY**—I have taken all of your head-nodding for agreement, so, until you counter it, I do not see it as otherwise. I want to talk to you about revenue. I do not recall you having said this in either your submissions or your evidence, but it seems to me that, if there are no truly arm's length and independent bodies with a range of skills that are necessary in this area, you have great dangers. I see those dangers from two aspects, and both relate to reportable profit. Accounting standards affect reportable profit and they can therefore materially affect the pocketbooks, if you like, of those who constitute the Group of 100 or the BCA. They happen to be the chief financial officers and the chief executives, so they have a material self-interest in the matter.

The reportable profit also materially affects the government, because it affects the revenue stream—that which is taxable. To my mind, in a Treasury secretariat, which has one eye on revenue, or a body of people who might be overly connected to the Group of 100 or the BCA there may be influences you would seek to avoid. I am not casting any inference on existing members; I am using the precautionary principle. Do you think the case I have just put to you reinforces the need for the resources of these bodies to be well established, which they are not—that is, money; the secretariat to be truly independent, which they are not; and for appointments to those bodies to be particularly carefully structured?

**Mr Ravlic**—Anything that makes those organisations function more independently would be better than the situation we have now. I do not have a problem with the proposition you have put, which is essentially that Treasury does have its own interests at heart, particularly when it comes to debates about government finance statistics and generally accepted accounting principles where the public sector has greater interest in them than the private sector. So, of course, you will get a heavy push from the public sector for those issues to be dealt with. If individuals within the secretariat are part of the public sector body that is making that push, I have great doubts about their ability to think through those issues as independently as they would like to, because the entire hierarchy would support an approach of reporting the public sector in a particular way. As you correctly point out, this is not just about protecting the community from the influences of private sector lobby groups; it is also about protecting the community from some of the vested interests within government.

**Senator MURRAY**—I have put a deliberate focus on the reportable and indeed the taxable profit issues because I link them directly to a wobbliness starting to emerge about the 2005 deadline and indeed about applying the accounting standards decision, in terms of its international convergence, to the Australian situation. I see a danger that both the government and the BCA ,Group of 100 self-interest groups may have common cause if taxable profit or reportable profit is to be, in their terms, detrimentally affected. What do you think of that linkage?

**Mr Ravlic**—I was wondering when we would get to the issue of thin capitalisation, and I think it is appropriate that we get into it now. When the decision to adopt international financial reporting standards was made in June 2002, there was no analysis of the impact on relevant sections of other parts of our regulation—that is, as far as I am aware, there has been no inventory done of the tax effects of adopting international financial reporting standards. Companies with whom I talk from time to time have indicated to me that they have had to discover the tax impacts as they go through their analysis of adopting international accounting standards. So, as part of the decision to adopt, we did not analyse the full-blown impact of

moving to international financial reporting standards on other parts of our regulation. You rightly point out that tax is one of them. Prudential regulation is another one.

APRA is only now beginning to deal with the issues of the prudential regulations and how they will be affected by the new financial instruments accounting standards that do things to the debt-equity ratios of companies, for example. It is an important issue and one that can be used to muddy the argument about whether the adoption of international standards is a good idea or not. If it is a good idea, then the federal government ought to jump on its bike pretty quick smart and make amendments to the tax law where there are conflicts, and APRA ought to make amendments to its prudential regulations fairly quickly in order to ensure that the transition can smoothly occur.

**Senator MURRAY**—Would it surprise you to know that Sir David Tweedie asked to see me when he came to Australia recently?

**Mr Ravlic**—No, it would not surprise me at all.

**Senator MURRAY**—He understood, from an international perspective, that there are just three parties in the Australian parliament which will determine the outcomes that are at stake: the coalition, the Labor Party and the Democrats. I told him that I, for the Democrats, would deliver the numbers to ensure that the 2005 international accounting standards deadline was met and that we would not go wobbly on it and succumb to the pressure to withdraw from it. What is your attitude to a hardline commitment to a 2005 deadline? You have indicated you need supportive legislative change, which I agree with. But what is your attitude to holding to a deadline and ensuring that the international standards are applied in the way in which they were intended?

**Mr Ravlic**—When you think carefully about the way the decision was publicised in July 2002, we were praised by Europeans, we were praised by Sir David Tweedie, for taking the decision to adopt international financial reporting standards at that time. At that time it was clear to corporate Australia that they would need to understand what the requirements were and how to communicate the change in financial performance and financial position that would occur as a result of adopting international financial reporting standards. The Group of 100 and other bodies seeking to oppose the deadline, which has been reaffirmed at the most recent meeting of the Financial Reporting Council on the basis that Europe is not going to approve the financial instruments standard, is a bit poor, in my view. The Group of 100, particularly, ought to hang its head in shame because last October it had indicated that its members were getting ready to adopt international financial reporting standards and that there was not a problem in corporate Australia—at least at the top end. What has changed from October 2003 to March 2004? I do not think that terribly much has changed; I think that self-interested banks and insurers have sought to find a way of slowing the process down. That is all that has occurred; nothing more, nothing less. I do not have a problem with the deadline. I have also noticed that the parliamentarians across the board have been subject to lobbying from Hills Industries because they do not want to expand their employee share ownership plans, as they would be required to do under the new framework that we are adopting.

**Senator MURRAY**—You know exactly what I have just done: I have just put on the record that if the government wants the numbers for enforcing that deadline they have got them. That is all I have.

**ACTING CHAIR**—Thank you, Mr Ravlic, for your lengthy and thoughtful submission. We appreciate your contribution and thank you for your comments this morning.

**Mr Ravlic**—Thank you very much.

[10.25 a.m.]

**PAATSCH, Mr Dean, Manager, Governance Information Products, Institutional Analysis Research**

**ACTING CHAIR**—Welcome. The committee prefers all evidence to be given in public, but should you at any stage wish to give any part of your evidence in private you may ask to do so and the committee will consider your request. The committee has before it a written submission from IA Research—submission 32. Are there any alterations or additions you would like to make to this submission at this stage?

**Mr Paatsch**—I would like to expand on two minor points.

**ACTING CHAIR**—You can do that in your opening statement, which I now invite you to make before we proceed to questions.

**Mr Paatsch**—Thank you very much for the opportunity to appear here today. I will make a very brief opening statement and mention a couple of other matters which are in the public domain which also have relevance. The submission which the committee is in receipt of makes a very focused suggestion, and that is very simply that tracing information or the beneficial ownership information which is in existence for many corporations be maintained on a register. We believe that CLERP 9 provisions should be amended to require all listed entities to make that beneficial ownership information, where they have it, available for inspection. We have this view because we believe that all shareholders in the market as a whole ought to be able to obtain the information; it is market relevant information. The simplicity of our suggestion is that it is simply a matter of reinstating an earlier provision which was deleted by the first corporate law simplification act in 1995.

There are a few reasons why we believe that the suggestion ought to be taken up by the committee. Firstly, it is market relevant information, and that has been supported both by several court decisions and recently by a decision of the Takeovers Panel. Secondly, we believe that it is in the interests of good corporate governance generally that the true owners of Australian corporations be known to other shareholders. Thirdly, it brings the Australian jurisdiction in line with other jurisdictions where this information is available. In the UK and the US beneficial ownership information, where it is in existence, is in the public domain, and we believe that Australia ought to be brought into line with those other jurisdictions. The final point that I would make in relation to the suggestion is that it is a very simple suggestion to put into action. The information would only need to be put in the public domain where it was in existence. It would not require a listing rule to support it. It would be kept in parallel with other record-keeping requirements for the register. The general shareholder register is available for inspection as well.

Two other small matters that I would like to mention relate to our firm's position in relation to the non-binding votes on remuneration issues. Our firm supports that, and I will cite a small anecdote in support of it. Having looked at the remuneration reports of the three dual listed Australian corporations, we have seen a marked increase in disclosure relating to executive remuneration, and that ought to be supported by the committee. We do not see any downside to

adopting something very akin to the UK requirement that there be a non-binding vote on the remuneration report.

Our final issue is to make a comment in relation to an emerging debate about the potential conflict of interest in relation to the casting of proxy votes. It is best illustrated by the current example in relation to the forthcoming NAB EGM. There is a suggestion running in the press, and in fact just aired in today's *Financial Review*, that there is an inherent conflict of interest between the fund managers, who frequently cast votes, and the listed corporations that they are casting votes on. In the bank's situation, virtually 30 per cent of every retail funds management dollar ends up in the hands of a 'bank' controlled wealth management organisation, and there is a perception that the fund managers are reluctant to cast their votes in a way that would not carry favour with their clients. This could very easily be remedied in the consumer's mind, to relieve this perception of conflict of interest, by having greater disclosure over the way that institutions and fund managers cast their proxy votes. There is legislation in the US which goes to that effect, so all mutual funds there that cast their proxy votes make it available to their members. It is frequently on a web site or the public record, and that is something that I would commend to the committee's attention.

**Senator CONROY**—Your submission deals with the issue of beneficial ownership of shares and recommends reinstating, as you have described, the pre-1996 tracing provisions. These provisions required listed companies to keep a publicly accessible register of beneficial owners. Could you expand on why it is important for companies to publicly disclose their beneficial owners? What is the public benefit?

**Mr Paatsch**—The public benefit is that you know the positions of other holders of parcels of shares below the substantial shareholder threshold. It is relevant to know movement data—you can see institutions building positions in a company. In our view, it is as relevant where it is known to the company that information should be shared with the public. It ought not be something that needs to be maintained on a daily basis and made available to the public, but the practical aspects of it are that most Australian listed corporations do issue tracing notices across, say, their top 100 holders. That information is normally used solely for the benefit of investor relations exercises. So it is in existence. It has been paid for by all shareholders, and it will be shared with other shareholders. It may be price relevant.

**Senator CONROY**—How do the pre-1996 tracing provisions differ from the current requirements in the UK and the US?

**Mr Paatsch**—My general understanding is that they are very similar, but I cannot comment in detail.

**Senator CONROY**—Your submission refers to the OECD Steering Group on Corporate Governance's report on disclosure of beneficial interests where it refers to the importance of disclosure from the corporate governance perspective and the prevention of terrorist financing perspective. Could you advise the committee of the OECD's recommendations in relation to this issue?

**Mr Paatsch**—I think they just made a general recommendation in relation to increased transparency in relation to beneficial owners. Practically I think what they were driving at here

was that known organisations that have their charities or something like that appear on registers would perhaps provide greater intelligence to the intelligence community. For example, it would be an absurd proposition where an Australian company or an investor relations person was aware that a banned organisation was, through a nominee, a significant holder of their shares and kept that information to themselves and did not put it in the public domain. I think that is really what the OECD was driving at there. It may be a long shot, but it is worthy of consideration.

**Senator CONROY**—Do you think that Australia is lagging behind international best practice in this area at the moment?

**Mr Paatsch**—Absolutely, and certainly in relation to the fundamental point that it is market relevant information, it is price relevant and it is in the interests of the transparency of the market as a whole. Other jurisdictions have it, why ought not Australia?

**Senator CONROY**—Given that superannuation funds are now major investors in listed companies, are they entitled to know who the other shareholders are?

**Mr Paatsch**—Yes. They stand in exactly the same position as any other shareholder. For example, there are contentious issues at AGMs and contentious corporate actions. Take the MIM-Xstrata situation. It ought to have been in the public domain for both sides in the interests of good regulation and transparency so that both sides could contact the ultimate beneficial owner, who frequently has the authority to cast proxy votes. In that situation my understanding is that both sides did issue tracing notices. But it is a very complex, costly and time-consuming exercise, and not everyone would be in a position to do that. Where it is known to one side, it ought to be known to all sides.

**Senator CONROY**—Can you envisage any reasons why listed entities should not be required to disclose their beneficial owners?

**Mr Paatsch**—One of the arguments that would be frequently made would be privacy. But I think that is a furphy, in the sense that it is—

**Senator CONROY**—It is called a 'publicly' listed company.

**Mr Paatsch**—Correct. I doubt whether there is any interest in the small shareholdings that are held through family trusts et cetera. Our submission says that only where the information has been collected through a company's tracing activities—and my information is that the majority of ASX 200 companies would do this at least quarterly or monthly, paying between $10,000 and $150,000 a year—will it be put on the public register.

**Senator CONROY**—So the company, either itself or through an intermediary contact—say, in the NAB case, JP Morgan Nominees—will say who the beneficial owners actually are?

**Mr Paatsch**—Yes.

**Senator CONROY**—So it is not like there is a problem with JP Morgan Nominees knowing who its beneficial owners are? Presumably there should not be.

**Mr Paatsch**—No, there is not at all. They have very sophisticated databases that can—

**Senator CONROY**—So they would not incur any extra expense at their end by that list?

**Mr Paatsch**—No. They are already doing it. The simplicity of our proposal is that only where information has been delivered and collected would you be required to put it on the public register.

**Senator CONROY**—Are you familiar with the Offset Alpine case?

**Mr Paatsch**—Yes.

**Senator CONROY**—In one of the judgments on this case, Justice Sackville ruled that Swiss banking laws took precedence over Australian laws. In other words, the disclosure of the beneficial owners was contrary to Swiss law and therefore not required. How can Australian legislators overcome this issue with the new legislation?

**Mr Paatsch**—I am confident in saying that our suggestion would not overcome that. My understanding is that the extraterritoriality defect would still remain.

**Senator CONROY**—Is there anything that we can do?

**Mr Paatsch**—I am not the best person to answer that.

**Senator CONROY**—The pre-1996 tracing laws were scrapped on the basis that regulators needed to simplify the requirements for corporate information and record keeping. Is this a valid argument, in your view?

**Mr Paatsch**—I think it is always a question of balance. We have come an awfully long way in information technology such that, whereas in the past there may have been some sympathy to the argument that it was difficult or costly to keep those records, really, the information is in existence. It has already been paid for by shareholders of the company. It is difficult to sustain that argument. It is really a question of disclosure. We are not suggesting that the disclosure be any more onerous than is currently the case with their register, so there would be no requirement for them to publish to the ASX. They would simply maintain a register available for inspection in the same way that they normally would.

**Senator CONROY**—You have already referred to the letter in today's *Financial Review* from Mr Carroll, who raised this issue of beneficial ownership. The letter says that, whilst the NAB directors know who the real owners of the shares listed under the name JP Morgan Nominees Australia Ltd are and they can lobby these invisible shareholders, no-one else knows so no-one else is in a position to be able to lobby. Do you think this creates an unlevel playing field?

**Mr Paatsch**—The point is that if, for example, Catherine Walter wished to find out, it would be available for her to issue tracing notices to find those out. There are provisions in part 6C.2 of the Corporations Law whereby she could do that.

**Senator CONROY**—That is a unique case though, where you have a director versus a director.

**Mr Paatsch**—No. Any member of the public—so any shareholder—can do that currently. However, it is very time consuming and very expensive.

**Senator CONROY**—I am aware of a particular case. I think it was Rio Tinto—

**Mr Paatsch**—Correct.

**Senator CONROY**—where it was very difficult. From recollection, court cases had to be run before people would reveal who the beneficial owners were.

**Mr Paatsch**—That is right. In that case, a group of shareholders who had put a shareholder resolution on the agenda at BHP asked for ASIC to issue tracing notices on their behalf, and there was a Federal Court decision which declared that they had a relevant interest in doing that. The reason they had to go to court to enforce that is that the previous provision of the Corporations Law had been removed. To address your question: yes, a shareholder could, but practically it is very difficult to find that information out.

**Senator CONROY**—So the market is not fully informed in a proxy contest?

**Mr Paatsch**—Yes, that is the fundamental. It can be fully informed. For example, my understanding in the Solomon Lew proxy voting contest was that Georgeson Shareholder issued tracing notices and found out, but not everyone has the deep pockets that Mr Lew has.

**Senator CONROY**—Sure. I wanted to come to some of that issue. How can you keep track quickly? Even what you are talking about is quarterly or six monthly. The vote renting situation—which people can do at very short notice; it could be three or four days before, although I think there is a cut-off—means it is impossible to necessarily know everybody. How would you try and deal with that?

**Mr Paatsch**—How would I try and deal with vote renting specifically?

**Senator CONROY**—What we are trying to do is get disclosure of the beneficial owners, so there may be an issue of: who is the real beneficial owner in a vote rent? I would be interested in your thoughts on that. Equally, how do you keep track at short notice— particularly in those last-minute proxy surges that you saw in Coles Myer—and keep the market informed in vote renting circumstances?

**Mr Paatsch**—Let us not confuse beneficial ownership with voting authority. They are two separate things. In the case of, say, a superannuation fund that has a beneficial holding through a single nominee structure, it is always within their right, where the contractual situation reflects it, to cast the ultimate vote in a Coles Myer situation.

Your question really goes to the activities of the custodians in relation to stock lending. In that situation, the primary responsibility for enforcing that would lie back on the superannuation funds or other institutional investors. There is a general fiduciary duty that they ought to adopt

portfolio management techniques to maximise the financial interests of their members. So that is a very good guard. They would not be interested in their custodian stock lending such that it would vest control to a third party or a minor lobby group that would compromise the interests of the company. They would not be interested in that. If there were regulatory interest, it would have to be in relation to the activities of custodians. The custodial group generally are not extensively regulated. They are certainly not extensively regulated in the area of stock lending at all.

**Senator CONROY**—I am aware in the Coles Myer situation that some funds and managers were approached and they did rent their portfolio out. They were then given a direction by the actual beneficial owners—and they had already actually rented that—so they had to go and rent some from somebody else to comply with their own beneficial owners. So you had quite a perverse situation where they rented out their entire portfolio for an individual and they then had to go and rent someone else's to actually comply with the request of the beneficial owners.

**Mr Paatsch**—I think you might be gilding the lily to say they rented out their entire portfolio.

**Senator CONROY**—I meant for the individual.

**Mr Paatsch**—The situation is quite complex play with options as I understand it, so there would be a set of vote authorities in existence on that day. The way the current environment is, it is entirely legal and entirely able for you to do that. There is no contravention at all.

**Senator CONROY**—Okay.

**Senator MURRAY**—I think we could call that practice 'shareholding derivatives' really. Staying with the beneficial interests situation, I think the public interest in this area has two components. One is the market component, which you have discussed, and I am informed by the discourse you had with Senator Conroy. The other is the lawful side of things, ensuring that the rule of law is abided by.

I have this in mind, and I want to test it with you. It seems to me that there are circumstances where the regulatory authorities or investigatory bodies—the police, in some circumstances—or the courts should be able to go beyond what you are suggesting in law. The way to do that—you could use the Offset Alpine case as an example—would be to apply the reverse onus of proof. The reverse onus of proof is a device in legislation which is used quite heavily in laws which affects entities as opposed to laws which affect individuals, even though it affects the individuals with entities, if you know what I mean. There are almost two streams of law. One applies to the ordinary citizen and one applies to people within entities. The reverse onus of proof would simply say that, if you cannot prove and get a conclusive certificate from, for instance, a Swiss bank that you are not the shareholder, then the prima facie evidence is that you are. But I am not suggesting it would be used other than in defined circumstances. How do you react to that proposition?

**Mr Paatsch**—It is a very interesting proposition in the sense that it would certainly capture the particular situation that you are referring to, but I would be really concerned about it if it were used generally.

**Senator MURRAY**—I am not suggesting it should be.

**Mr Paatsch**—You would need to give a hell of a lot of thought to what the trigger points were before you did that, because it could actually be market distorting in the sense you could have people unwilling to hold shares in companies that are in play. It is quite a legal activity for you to be involved in arbitraging companies that are in play, which is something that most people I think generally would support, or at risk in some way, shape or form. Where regulators could use that power to unmask their interests at will, if you understand where I am heading, it may lead to people not being interested in that type of investment.

**Senator MURRAY**—That is right, which is why I think it would have to be carefully defined to address unlawful circumstances.

**Mr Paatsch**—I think that is correct. It is an interesting proposition. It is something I have not really considered in detail.

**Senator MURRAY**—Would you have the ability to consider it? Do you have the resources and background to be able to consider it?

**Mr Paatsch**—Yes, I certainly would. I guess the fundamental issue in relation to the cash you are talking about is enforcement. I would be interested in your views and your solutions on that issue as well.

**Senator MURRAY**—The reason I phrased my question like that is that I would like to ask you, through the chair and at your discretion—it is not an order—whether you have some further thoughts on that. If you are able to write to us, we would appreciate it.

**Mr Paatsch**—I certainly will. I will take that on board.

**Senator MURRAY**—Thank you very much. The second thing I would like to ask through the chair is that the secretary get the Parliamentary Library to do a bit of research on reverse onus of proof in Commonwealth legislation, so that we can see some examples of how it is applied. I was interested in your remarks on proxy votes. I hold to the view that voting should be compulsory.

**Mr Paatsch**—Should be?

**Senator MURRAY**—Yes, in certain circumstances. I distinguish between circumstances where shares are held in escrow, which has a particular meaning, and where shares are held under a general duty of care—almost in trust. I think that in both those circumstances the committee should be considering that people who hold those shares for others should exercise a vote, even by proxy. The question, though, is whether the vote should be enforced by institution—the nature of the fund manager, superannuation fund, master trust or whatever it is—or whether it should be by subject matter. You can distinguish between matters which are of a high order of significance—I would put the election of directors there—and those that are just technical, administrative matters. Do you have any thoughts on how you feel about compulsory voting being required under the Corporations Law, even in a defined situation?

**Mr Paatsch**—You might run up against constitutional issues—

**Senator MURRAY**—Company constitutional or Australian constitutional?

**Mr Paatsch**—Australian constitutional—if you are trying to compel holders to vote. I think that is the fundamental issue that you—

**Senator MURRAY**—Why would you think that would apply where shares are held in escrow or under a fiduciary duty? Why would you think there is constitutional impediment? I can see it in a general sense. You could not make the mums and dads the shareholders—I agree with that—but I am specifically confining it to shares that are held in escrow or where there is a fiduciary duty.

**Mr Paatsch**—My understanding—and I will not pass myself off as a constitutional law expert—is in relation to trusts specifically, not those which come under the Managed Investments Act or the Superannuation Industry (Supervision) Act. In relation to trusts generally, am not sure whether the federal parliament would have reach to compel them.

**Senator MURRAY**—We certainly have reach under the corporations power.

**Mr Paatsch**—I do not know that I would be the best placed to provide you with a comment on that, but I can comment specifically in relation to the regulation surrounding managed investments. Practically, this is where your argument on compulsion really falls. As I mentioned in my opening statement, nearly 30c in every dollar at the moment flows into wealth management entities controlled by the four major banks. This is mirrored in the superannuation arena. The rise of institutional investment in Australia has been phenomenal since the superannuation guarantee charge, so the requirement to compel the disclosure of proxy votes falls in relation to those areas. You will, I think, clean up the vast majority of the problem, and proxy voting levels will rise, where you compel those entities which are already within your jurisdiction to legislate on.

**Senator MURRAY**—My last question is on remuneration. As you know, the requirement is that there be a vote on those elements of a remuneration package which are equity related.

**Mr Paatsch**—Yes.

**Senator MURRAY**—I think that is an artificial distinction. I do understand the distinction between staff and directors, but my view is that any director's remuneration, whether an executive or non-executive director, should be voted on in toto, and I believe it should be a binding vote above a certain level of remuneration. How do you react to that?

**Mr Paatsch**—I will just make one comment on the equity-cash distinction. Our research shows that it is roughly only 12 per cent of total executive pay, for the top five executives across ASIC's 200, that calls for a vote. So it is only 12 per cent of executive pay that shareholders are invited to vote on anyway.

**Senator MURRAY**—Yes, but you do not distinguish how many of those executives are directors, as distinct from staff—

**Mr Paatsch**—Correct.

**Senator MURRAY**—and it might be much higher. In fact I suspect that the incidence—of someone who falls in the top five also being director—is much higher.

**Mr Paatsch**—That may well be the case.

**Senator MURRAY**—There is no research on that, is there?

**Mr Paatsch**—We can certainly run those numbers.

**Senator MURRAY**—Easily?

**Mr Paatsch**—Easily, yes.

**Senator MURRAY**—I would be delighted if you would let the committee know.

**Mr Paatsch**—Sure; I would be happy to do that.

**Senator MURRAY**—Thank you.

**Mr Paatsch**—However, we would not support a situation with binding votes. I think you would really get into a bizarre situation whereby, throughout the course of the year, if shareholders had the opportunity to overturn salary packages negotiated with the executives, it would be—

**Senator MURRAY**—Distinguish between executives and directors. I cannot see why directors should have sole responsibility, given the conflict of interest, in determining their own remuneration. It is an impossible concept for me. Therefore, to my mind, if you are a director your remuneration should be established by the shareholders—finish, whether you are executive or non-executive. How do you deal with the conflict of interest? The proposition I would intend putting to the committee is that unless the remuneration were independently determined—and I do not mean by a remuneration committee appointed by the directors—then you would be obliged to have that remuneration agreed by the directors. How do you get over that conflict of interest, where the people who benefit from the remuneration are determining their own remuneration?

**Mr Paatsch**—I think what lies behind it is some notion that Australian directors as a group are overpaid—and there may be instances of that; of course there are. But perhaps I can inform the committee by providing them with some statistics about director remuneration.

**Senator MURRAY**—Let me ask you this question: do you think judges should determine their own remuneration? Do you think politicians should determine their own remuneration? Do you think schoolteachers should determine their own remuneration?

**Mr Paatsch**—It is a powerful argument, but I do not—

**Senator MURRAY**—I have not heard one good argument against my proposition. All I have heard is self-interest wrapped up in supposed principles.

**Mr Paatsch**—At the moment shareholders are frequently invited to approve a cap on total non-executive director remuneration.

**Senator MURRAY**—But what about any director, executive or non-executive?

**Mr Paatsch**—Not the cash component of an executive's fee. I do not have a problem with that. I really think that the whole system of making executive appointments would break down where executives were subject to a binding vote by shareholders. It would be a crazy situation where, if you were the incoming CEO, you would have to wait six months to work out whether your salary package had been approved.

**Senator MURRAY**—That is why we would set a threshold below which it would not be necessary, so you could still put bread on the table.

**ACTING CHAIR**—Thank you, Mr Paatsch. Thank you for your contribution this morning.

**Mr Paatsch**—Thank you very much.

[10.59 a.m.]

**MAYNE, Mr Stephen David, Publisher, Crikey.Com.Au**

**ACTING CHAIR**—Welcome. The committee prefers that all evidence be given in public but should you at any stage wish to give any part of your evidence in private you may ask to do so and the committee will consider your request. The committee has before it a written submission from Mr Mayne, submission No. 63. Are there any alterations or additions you would like to make to your submission?

**Mr Mayne**—I was hoping to table an updated submission this morning.

**ACTING CHAIR**—We have that new submission; thank you. Does the committee wish to accept that submission for the record?

**Senator CONROY**—So moved.

**Senator MURRAY**—Seconded.

**ACTING CHAIR**—The motion is carried. I now invite you to make a five- to 10-minute opening statement.

**Mr Mayne**—My updated submission covers quite a wide-ranging territory and I will just focus on a specific area. I have run for 18 boards over the last four or five years, so I have the perspective of an outsider trying to break into the directors club in Australia. I would advise the committee of some of the issues and some of the roadblocks that get placed in front of someone who tries to get elected or present themselves to a board in trying to effect change by improving accountability and transparency in listed corporations which might be going through difficult times.

My key goal is to try and help create a culture of shareholder pressure in Australia, but I find that a number of problems arise with that. The first is extreme concentration in the financial services sector where, compared with most other economies, we have unprecedented concentration with our big banks now also dominating our funds management industry. As someone soliciting votes from fund managers, I constantly come up against their conflicts of interest: you might run for a board and find yourself running against the Chairman of the Commonwealth Bank, who might have long relationships with the board you are running for and is chairman of the fund manager that controls 15 per cent of the stock. It is often quite difficult to break down those conflicts and to approach fund managers who are genuinely independent.

Similarly, the only reason I run for boards is that the directors effectively have a monopoly over the resolutions that get placed before shareholders at annual general meetings. That is because of the practical difficulty a small shareholder faces in getting 100 signatures to sponsor a resolution to be put up at an annual meeting; the odd union group and the odd green group have been able to do it, but for genuine small independent shareholders logistically it is very difficult. So I would love to see some sort of change to the 100-shareholder rule which would make it

easier for shareholders to put up resolutions. I cite the situation in the US; there you only have to own $US2,000 worth of shares to be able to place a resolution on the notice paper. Last year at the Exxon Mobil AGM in Dallas there were 12 shareholder resolutions. If you exclude Boral, we have not had 12 shareholder resolutions in Australia since the Vietnam War.

**Senator MURRAY**—But that is at an AGM, isn't it?

**Mr Mayne**—That is at an AGM, yes.

**Senator MURRAY**—Not an EGM.

**Mr Mayne**—Yes, that is right. I am more than happy for it to be made more difficult to call an EGM because of the cost involved. But a counterbalancing reform would be to adopt the US system, where shareholders can easily put up resolutions on a notice paper. If you are having an annual meeting anyway, there is no additional cost for the company. The only reason I run for boards is that it is easy; you only need one signature from a shareholder and you are on the notice paper. I run on a platform that I would prefer to put as a resolution at the meeting, but logistically I cannot manage that. So I run as a director not wanting to get elected but just to draw the board's and the shareholders' attention to a particular governance issue. For instance, I ran against every company doing 'cash for comment' with John Laws or Alan Jones as a particular governance issue. I would have rather put that on the notice paper as a resolution.

I would like to deal with a couple of other points. The directors club, I have found, is very tight-knit, and in trying to break into it you come across directors who are overcommitted and who have relationships with each other. I notice that the ASX corporate governance guidelines suggest that individuals only chair one top 100 company each. There are currently seven chairmen who are chairing two, and that is a fairly good example of how tight the system is. If you look at the boards of the big four banks, those directors are on a majority of the top 50 companies. I would say that the apex of the directors club is the big four banks, who dominate now the majority of the funds management industry. Those same directors cover the majority of the top 50, and that is where I think it is too tight. As someone trying to break in, you really cannot do it.

When you are running for a board there are a number of roadblocks that get placed up against you, and I dealt with that in items 17, 18, 19 and 20 of my submission. Firstly, there is the question of open proxy votes. The system that the boards use is that they send out the documentation with reply paid envelopes, and if you merely sign the form and send it back the default mechanism is that that goes to the chairman as an open proxy. Typically they gather about 10 per cent of all votes as open proxies, so that is 10 per cent in their back pocket, which in the vast majority of the boards I have run for they have used against me, sometimes having not stated that they would be doing that. So that is quite a difficult issue.

I want to draw your attention specifically to the NRMA, which I think it is the most egregious example of open proxies being used. There is another system that the directors use: they say that there is no vacancy available. So, when an outsider nominates for a board, they say, 'Sorry, there is no vacancy.' But often the constitution of the company will say they can have between three and 15 directors and there will only be, say, nine or 10. So rather than saying, 'Yes, our constitution allows for another director to come on board,' they say, 'No, there is another

provision in our constitution that says we can say the maximum is whatever it is today.' Then they say to shareholders, 'I'm sorry but there is no vacancy for this candidate so please only tick the box for three out of the four candidates because there is no vacancy.' That is an abuse of the board's powers. That is a decision for the shareholders. It should be included in the Corporations Law that it is the shareholders who decide the size of a board, not the board, provided it is within the bounds of the constitution of the company with the maximum and the minimum set out. When I ran for the NRMA board in 2000 they did the usual: 'I'm sorry, there's no vacancy, sir.' This is what they wrote to the shareholders:

...four candidates are standing for three Board positions. Only three candidates may be elected. In order to be elected a candidate must receive more votes ... in favour ... than against.

That is, from those presenting votes. They went on to state:

If more than four candidates receive such a majority, the three candidates receiving the most votes in favour of their election will be elected as Directors. If you vote in favour of more than three candidates your vote will be invalid.

So they told shareholders, 'Only tick three of the four boxes.' So most shareholders ticked the three incumbents and left my box vacant, as you would because it said, 'Your vote will be invalid if you tick in favour.' But the then Chairman of the NRMA, Nicholas Whitlam, deemed that it was not invalid to have voted against me. He assumed all those people who left my box vacant, as instructed here, as open proxies and voted them all against me. I had 45 per cent of the primary vote, if you like—the proxy vote: I had 60 million in favour and 72 million against. So it was a reasonable performance: 45 per cent of the vote. He then used 163 million open proxies and got my vote down to 17 per cent when he had put out information to the shareholders saying, 'Don't tick the four boxes.'

I think the system needs some sort of Corporations Law guidance as to how elections are conducted on proxies and even on things like proxy information flow. I have never been given a full list of shareholders. I am thinking of running in the federal election as an Independent later this year. As a matter of course, I will get the full voting list. I have never been given that. In 18 board tilts, only two companies, the ASX and AMP, have given me a list of the top 100 beneficial owners. So I would certainly support what Dean Paatsch was saying about the importance of beneficial ownership being released publicly, because someone running for a board should be given that. The last example I would like to give you is News Corporation. I wrote to News Corporation three years ago and said: 'I'm considering running for your board. Can you please provide me with a copy of your constitution so I know the rules.' They refused. A year later I actually ran.

**Senator CONROY**—You have chased them offshore.

**Mr Mayne**—I put a nomination form in, and they wrote back after the deadline, saying, 'We're sorry; you haven't qualified in accordance with our constitution.' I needed five shareholders, I think, and they did not tell me the rules. The next year I did run. I put my platform in, and they completely removed the platform. They did not even tell the shareholders how old I was. So another issue to consider is: who controls the information going to the shareholders in a contested election? In the case of News Corp, they completely censored the platform. Other companies—Westfield, Spotless, the NRMA and the Commonwealth Bank—

have all done likewise when I have put a platform up. I would love to see the AEC running contested elections, controlling the information flows that are going out and ensuring that NRMA style rorts do not happen.

With News Corp, I am thinking of running a 'no' campaign later this year on their proposal to move to the US. If I look at the News Corp annual report because I want to find out who the beneficial owners are and I want to contact them, Rupert is there with 29 per cent—626 million shares. Shareholders 2, 3, 4, 5, 6 and 7 are all nominee companies, and they speak for 52 per cent of the stock. The list of the top 20 is mandated by the Corporations Law, but it is completely irrelevant, it is completely inaccurate and it is of no public use whatsoever.

**Senator MURRAY**—It is worthless.

**Mr Mayne**—It is completely worthless. So why not change the Corporations Law and say, 'Don't disclose it,' or make the disclosure meaningful? In the case of News Corp, I will not be provided with the full list of shareholders by News Corp—you can be sure of that—and they will put every possible roadblock in my way. I will probably have to run for the board again just to get the authority and the ability to deal with the company, because they will not deal in a reasonable way with me as a shareholder trying to run a 'no' campaign. I will have to put myself forward as a director and run the whole campaign through being a director, when I do not want to be a director. I would rather put up my own resolutions, for instance, but I will not be able to get the 100 shareholders together and I will not get any cooperation. I probably still will not get it as a board candidate, but I have more chance of cooperation if I run as a director. Those are a few introductory remarks, and I will be happy to take questions.

**Senator CONROY**—Let me go to your NRMA example and a couple of the others and your concern around the moving goalposts on the number of directors. When they sent out their original piece of paper, which I think you were reading from, they had made a decision that there would only be three elected at that point. They had not made a decision that there should be four to be elected—the three who were existing and somebody else whom they were running. So, when they issued the papers, they had set the goalposts. They did not move them on you mid-electoral process, did they?

**Mr Mayne**—No.

**Senator CONROY**—I just wanted to clarify that in my mind.

**Mr Mayne**—But there is no consultation. You only find out on the day the thing turns up in the mail. It is statistically impossible to get elected, when you combine the three effects of your typical incumbent director getting 99 per cent of the vote, no matter how bad they are; your typical AGM having 10 per cent of the proxies as open proxies, because of the way the reply paid envelopes go out and the default mechanism being that they go to the chairman; and the company saying there is no vacancy. In a typical election, I will get 30 per cent and the incumbents will get 99 per cent. To knock off an incumbent, I have to get, effectively, 109 per cent, because I am guaranteed that the chairman is going to use the 10 per cent that he has in his back pocket against me. I could actually get 100 per cent of the votes of those choosing to vote and still not be elected. In the vast majority of board tilts I have done, that would have been the case: with 100 per cent of those choosing to cast a proxy vote voting in my favour, I still would

not have been elected, because the chairman would have used his 10 per cent. He then would have said: 'I'm sorry, but we said that only the three highest-scoring directors would get elected, and we have 99 per cent, 98 per cent and 99½ per cent here. After the allocation of open proxies, I'm sorry, sir, but you only got 90 per cent of the vote, so you have been rejected.' I think that situation is quite scandalous.

**Senator CONROY**—Your submission says that, prior to the Boral AGM, Australian companies had collectively received fewer than 12 shareholder resolutions during the past 15 years. Why so few, in your view? In the US, for example, almost 40 per cent of resolutions at AGMs each year are sponsored by labour unions. Why is Australia so shy?

**Mr Mayne**—I think it is a cultural issue. There is a go-to-the-beach culture among shareholders. We do not have a culture of shareholder pressure. That is the most important thing. Secondly, it is the 100-shareholder rule. It is the logistics. I would have fired off dozens of resolutions if we had the $US2,000 rule. I will never call an EGM, as I regard it as disruptive, but the only people who do it in Australia are those that have access to the numbers, that can marshal the numbers—unions, green groups and the Shareholders Association. They are the three groups that have done it.

**Senator CONROY**—So you even feel that the 100-shareholder rule for the proposing of a resolution is too stringent?

**Mr Mayne**—Far too stringent, logistically. Think about it from your own lives: to run for state parliament in Victoria you need six signatures; to run for a federal seat, 50 signatures. I would argue that that is probably too draconian. How can you have a system where it is one signature to run for a board and 100 signatures to get a resolution up? Running for a board is a far more substantial issue. Merely getting a resolution up is a fairly run-of-the-mill thing. Why have this roadblock in front of it, when you are having the AGM anyway?

**Senator CONROY**—What sorts of resolutions have you wanted to put up that you have been denied?

**Mr Mayne**—Resolutions on all of the platforms. I would love to put a resolution up condemning any company that is doing cash for comment; that would have been part of it. There would be resolutions to reduce the pay of non-executive directors and resolutions to eliminate retirement schemes for directors. All these governance issues which companies are dragged, kicking and screaming, into doing, I would have been putting resolutions up proposing them; sack the auditor of AMP. The auditor of AMP, Brian Long from Ernst and Young, signed the accounts last year, saying that the company had net assets of $18 billion. They were actually close to $5 billion, although some people argued that they were technically broke at the time. So he missed the mark by about $13 billion or $14 billion. Ernst and Young got paid $42 million by AMP last year to advise on the demerger process, which is, I think, a record fee. I would have been putting a resolution up at this coming AGM to sack Ernst and Young, on the basis that they signed the accounts, saying that they were free of any material misstatement and that the company had net assets of $18 billion. It is a complete joke, yet shareholders cannot put these resolutions up. All you can do is stand up and utter meaningless words which the chairman says they will give due consideration to and thank you for your time—but it has no force. That is why I run for boards. At least when you run for a board you can get a vote and you can get some sort

of a protest message. But it is completely misdirected. People look at me and they do not look of the platform; they just say, 'Troublemaker, publicity seeker; I'm going to vote against him.' I ran for the AMP board—this is another amazing situation—

**Senator CONROY**—You are being very modest; they call you many things other than that, Mr Mayne!

**Mr Mayne**—last year and I got 13 per cent of the vote. The directors—the chairman of the audit committee and the chairman of the finance committee—had just blown $10 billion in the UK, a record Australian corporate loss, and they got re-elected with 81 per cent of the vote each. I ran on a platform of sack these duds, get rid of the auditor, where is the accountability, and got 13 per cent of the vote. No-one looks at the platform; they all just say, 'There's a chance he could get elected; we'd better vote against him. We don't want a troublemaker on the board: we'll reduce board functionality.'

**Senator MURRAY**—Now you know how a Democrat feels!

**Senator CONROY**—I hope not, for your sake. Mr Mayne, in your view, was Boral's decision to nullify the 100-shareholder rule in relation to proposing resolutions under the company's constitution a step back in time for shareholder activism in Australia?

**Mr Mayne**—Definitely. Ken Moss of Boral seems to have a problem with shareholder democracy. I sympathise with him from the point of view that his AGM does get hijacked by green groups most years; Christine Milne, the Greens Senate candidate in Tasmania, runs for the board. But that is a legitimate issue. I do not see why Boral are kicking up such a huge stink about it, because they could just vote against the resolutions. They will knock them down—95 per cent, without blinking—every time. Silly old Ken Moss chooses to draw attention to the whole issue and is seen to be attacking democracy, when institutions will just line up and vote in support of the board, and they will knock back the resolutions every time.

**Senator MURRAY**—Senator Conroy and I are going to try to burn him, so we will see!

**Senator CONROY**—Ken Moss's promotion to the shareholders' friend on the NAB board—it is good to see that the NAB is still keeping its sense of humour.

**Mr Mayne**—There is an important issue about dud directors getting promoted, and there are some celebrated examples. You are right about Ken Moss, who was audit committee promoted, and Graham Kraehe, who was chairman of risk committee promoted, but at least through this NAB process we are seeing an elevation of the importance of the audit committee. I will give you a very important precedent where there has not been the focus on audit committees that there should have been. Margaret Jackson is now the Chairman of Qantas. She was chairman of the Pacific Dunlop audit committee for five years, and chairman of the BHP audit committee for three years. Both companies went through calamitous, disastrous periods over that phase, yet she managed to slink off as chairman of both of those audit committees because she had been promoted to Qantas. Rather than 'I am being held accountable; my fellow directors or the shareholders have booted me off,' it was 'I have just been promoted to Chairman of Qantas, therefore I am leaving these boards to free up my time commitments.'

Australia has a terrible culture in this regard. We sack our bad chairmen and CEOs, and they often go together within a six month period. If you look back at Aristocrat, Southcorp, ANZ, BHP and NAB, whenever there is a crisis, we have a good record of sacking the chairmen and the CEOs, but we do not have a good record of dealing with the non-executive directors. The best example I have of this is a fellow called Tony Daniels, who had a trifecta of duds: Pasminco, Pacific Dunlop and Orica. At that time Orica's share price had more than halved. He was re-elected to the AGL and Commonwealth Bank boards subsequent to those disasters, with 98 per of the vote. Where is the culture of accountability if a director who has a trifecta of duds and overseen the destruction of vast amounts of money is putting himself up to be re-elected and getting resounding Saddam Hussein-like victories in his re-election quest? It sends a terrible message about the accountability of directors.

If I had a better ability to put up resolutions, I would be putting up resolutions seeking his removal as a director at every AGM where he was running. That often has a powerful effect. If you threaten to run for a board, you can often have the effect of getting the director removed. I announced that I was running for the Telstra board specifically to focus on Steve Vizard's conflicts of interest, and he resigned from the board two weeks later rather than have a public debate about his conflicts. Public exposure, sunlight into the dark corners of boardrooms, is a very powerful thing, but we need the legislative tools to do that and the roadblocks to be removed—the 100 signatures being the largest roadblock—to increase shareholder resolutions, to weed out bad directors and to remove poor corporate practices.

**ACTING CHAIR**—Could you clarify the responsibilities of a chairman of an audit committee relative to a director of a public company? You are drawing a comparison and saying that those chairmen of audit committees had responsibilities, yet they remained as directors. Could you give us your view of those two responsibilities?

**Mr Mayne**—Audit committee chairmen, certainly with things such as Sarbanes-Oxley, have been elevated and are clearly now second in line in terms of responsibility, given the heightened powers given to audit committee chairs. The audit committee specifically takes on a lot of the financial responsibilities, so in the case of—

**ACTING CHAIR**—Surely the audit committee chairman reports to the board and the board make the final recommendation. It is not an independent—

**Mr Mayne**—That is correct. They are certainly secondary to the chairman. In the NAB case, Catherine Walter, as chairman of the audit committee, was third in line—the chairman was No. 1, the CEO was No. 2 and she was No. 3. There are some specific issues where the role of audit committee chairman is very important. For example, take apparent breaches of Sarbanes-Oxley. Catherine Walter, as audit committee chair, has to deal with those audit governance issues. That is an example of where she is more important than the chairman.

**ACTING CHAIR**—But she was reporting to the board, though, surely?

**Mr Mayne**—Yes, but, for instance, she used her casting vote as the audit committee chair to reappoint KPMG as NAB's auditor.

**Senator CONROY**—She should go for that, if for nothing else.

**Mr Mayne**—Yes, she should go for that, because NAB's auditor had completely missed the $4 billion HomeSide disaster. We should hold her particularly responsible, as audit committee chair, for the hiring of Christopher Lewis as NAB's executive general manager of risk management, because as audit committee chair she was dealing with him when he was the audit signing partner who signed the accounts, saying they were free of material misstatements when they had missed the $4 billion HomeSide disaster.

**Senator CONROY**—Did not KPMG actually do the due diligence on HomeSide?

**Mr Mayne**—He led the due diligence team recommending the purchase of HomeSide, then became the audit partner who missed the coming $4 billion HomeSide write-down.

**Senator CONROY**—He was auditing his own work, essentially.

**Mr Mayne**—Yes, exactly. He then became the guy covering up the audit failures at NAB, effectively, as the head of risk management. It was the worst example in recent Australian corporate history—I would say even worse than HIH—to have those three roles. The consultant recommending acquisitions becomes the auditor missing a $4 billion loss and then becomes the in-house executive in charge of risk—the very area the auditor missed. That all comes back to the audit committee chair. That is a really good example of why the audit committee chair is second in line of the non-executive directors when it comes to accountability on boards.

**Senator CONROY**—Just on that, I have been surprised by some of the media commentary on the PWC report. The media commentary claims it cleared the audit committee. I have a slightly different view; I think it actually demonstrated the complete incompetence of the audit committee because it clearly pointed to the fact that they were being snowed by management and knew so little about their role that they did not ask any questions. They actually did not know the questions to ask. It was not that they were not given the information but that they knew so little about their role that they did not ask the questions when the information was being presented to them. I think it is described as 'bland' information. Why were they not asking the questions?

**Mr Mayne**—I think that is probably a fair point. Again, it is that issue of whether PWC, as a wannabe auditor of the NAB, is going to tear strips off the audit committee that they are hoping will subsequently hire them. That is a good example of big four conflicts of interest. When you are dealing with a financial conglomerate like the NAB there are conflicts everywhere. So I agree that there was massive audit committee failure at NAB and they probably got off lightly from the PWC report. But I still felt the PWC report was good in the information that it provided as to who said what to whom, the APRA letters and how the losses were accumulated. It was a far better result to have that in the public domain than what happened with HomeSide, where we did not really get the independent report released.

**Senator CONROY**—Your submission refers to the overlapping requirements between getting elected to the board and proposing resolution for election—the 100 signatures. I think you say it takes one signature to nominate.

**Senator MURRAY**—But the elections are rigged, so it does not matter.

**Senator CONROY**—It needs 100 signatures for a resolution, unless you are a Shell or a Boral. You argue in your submission that you support a five per cent rule for the calling of an EGM. Could I put it to you that you are in danger of being a chardonnay activist by being so willing to jump on the corporate bandwagon that virtually says, 'We've got to just make sure nobody can call an EGM at any stage'?

**Mr Mayne**—No. I think that five per cent is not that difficult. If a major shareholder has a concern—

**Senator CONROY**—If you are a Telstra shareholder, what chance have you got of ramming up five per cent?

**Mr Mayne**—You have got no chance. Two or three institutions could get together on Telstra with no problems. You have to have it so that a genuine minority shareholder can call a meeting and a director can call a meeting.

**Senator CONROY**—What is your definition of a genuine minority shareholder?

**Mr Mayne**—I think five per cent covers it. That is pretty small. Five per cent is just one or two institutions. I guess the problem is that institutions never do it. That comes back to that concentrated financial sector issue. You have an AGM every year. That is a very good opportunity. It comes around pretty often. You can do everything you need to do at an AGM. You do not need to call a special meeting. I think that it does become a bit—

**Senator CONROY**—So why is NAB calling a special meeting?

**Mr Mayne**—Because the board functionality has broken down and you have to deal with that sort of issue quite quickly. I think it is obviously a shame that it has happened. They are seeing all of that negative publicity and additional cost that flows from it. But, when you have a recalcitrant director and board functionality and trust breaks down, I think you have to deal with it.

**Senator CONROY**—I think you are aware that all parties have argued for an increase in the number that can call an EGM—the 100-shareholder vote is too low. I think Senator Murray and I continue to solicit the government shamelessly to try to get them to compromise on their five per cent proposal. But certainly this committee has always expressed a view that it is keen to raise that limit because it is artificially low and it happened by accident. Your submission notes that the US is moving to full public disclosure of institutional voting from 1 January next year. You recommend that Australia also requires such disclosure because, you say:

... invisible institutions keep returning dud directors with 99% yes votes and we need to know who is doing this for better institutional accountability.

In your view, should the CLERP 9 bill require the disclosure of the voting record of all institutional investors, including trustees of super funds?

**Mr Mayne**—Yes, in a public web site similar to the mutual fund model in the US.

**Senator CONROY**—Recently Max Walsh made a comment in the *Bulletin* in relation to proxy voting. He said:

Of course, the instos are not going to exercise their voting power—especially against incumbent boards—unless they are obliged to do so.

First, there is the Mary Magdalene factor. Could you imagine AMP or NAB being among the first stone-throwers against an incumbent board on a governance issue?

He goes on to say:

The only solution is to make it compulsory for instos to exercise their voting rights and to make known their record to their clients. Even then, do not expect too much courage.

Do you agree with Max that legislation is required to force instos to vote?

**Mr Mayne**—I think if we have it in politics I cannot see why we would not have it in corporate elections. You are still getting some very poor low votes, like only 30 per cent, at the last AMP AGM.

**Senator CONROY**—AMP was a record low.

**Mr Mayne**—That was a very fluid share register with placements and large turnovers, so there is a big paper trail and some people just could not get their acts together to vote. The only thing that I have seen which would argue against it is JP Morgan's new technology platform, which is allowing the clients who they are the nominee for to dramatically increase their voting levels. At last year's AGM season, they were typically up around the 70 per cent mark—their clients were voting on 70 per cent of their shares. That had almost doubled from the previous year, totally thanks to this technology platform. You have this shocking paper trail where you have 1,200 AGMs happening in six weeks—you have resolutions flying everywhere, you have to be faxing authorities and it is a logistical nightmare. That is probably the biggest factor. If you were going to mandate compulsory voting, it would be quite a burden on the institutions to actually do it. But technology could be the saviour. If you have those platforms then I think it would be—

**Senator CONROY**—Japan has all its AGMs on the same day—

**Mr Mayne**—Yes, to stop the yakuza.

**Senator CONROY**—because of the yakuza. Are you Australia's equivalent of the yakuza?

**Mr Mayne**—I am very polite.

**Senator CONROY**—Your submission says that the company should disclose the votes for and against resolutions as well as the total amount of shares that voted. Should the requirement for companies to disclose these aggregate figures be in addition to the requirement for individual institutions and trustees to disclose?

**Mr Mayne**—Where I am hoping for that to be disclosed is when the ASX announcement goes out saying 'for', 'against', 'open' and 'abstain'—it should list shares and then shareholders. I have had a former BHP director confide in me that there was easily a majority of BHP shareholders who voted against the Billiton merger. But we do not know. It is about faceless institutions and the classic conflict of interest—we have John Ralph, chairman of the Commonwealth Bank; the Commonwealth Bank, the largest Australian shareholder in BHP; BHP putting full page ads in the *Financial Review* from the directors saying, 'We recommend this deal and we urge shareholders to vote for this deal'; and John Ralph on the board of BHP. Colonial are not going to embarrass its own chairman and vote against the BHP-Billiton merger. We do not know how they voted, but I have been told. Obviously they voted in favour, but there is no public disclosure of it. We have had no disclosure of the fact that an easy majority of shareholders voted against that deal. It would just give the small shareholders more authority if you could say, in the press report or the stock exchange announcements, 'The controversial options resolution was passed with 60 per cent of shares in favour, but 80 per cent of shareholders opposed it.' That would give a lot of moral authority and power.

I would not necessarily advocate that it has to be passed by a majority; I am simply saying it should be disclosed because we shareholders all feel completely powerless when we turn up at AGMs and vote. We all just say, 'Faceless institutions, it will pass at 99 per cent of the vote; what is the point?' If it were disclosed, we would at least feel there was a point.

**Senator CONROY**—I think you were in the room when we were having a discussion with Mr Paatsch about beneficial ownership. The Offset Alpine case has put the issue of beneficial ownership of shares into the spotlight. In your view, should listed companies be required to keep a publicly accessible register of beneficial owners?

**Mr Mayne**—Undoubtedly, yes. I think there is a clear benefit to that; these top 20s are completely meaningless. They are public companies and you should not be able to hide the fact that you are a shareholder in a public company. If you do not want to be publicly known, do not buy shares. It is called 'being public'! So I would strongly support—especially as they are mainly paying for the information themselves—the idea that, if the companies have that information, it should be in the possession of the shareholders, who actually own the company.

**Senator CONROY**—Given your activism, given that the CLERP 9 bill is a response to the corporate governance debate world wide as well as here in Australia, and given your support and encouragement of shareholder activism, are you disappointed that the bill only goes so far? How would you rate it?

**Mr Mayne**—I think it is an important step forward, but it is quite clear that we have lagged behind the US and to a lesser extent the UK in our legislative response to corporate governance failures. I think that the audit reforms are welcome—things like a four-year cooling-off period are appropriate; I do not think you should ban an auditor for life—but not the reforms in other areas, like the fines for poor disclosure. I thought they were too small and we could have beefed them up dramatically. Obviously, the non-binding vote on executive pay is a good step. That is working well in the UK: Brambles, BHP and Rio Tinto have had no problems due to having greater disclosure of their remuneration. So I would say that it is an important step forward, but there are a lot of issues which I would love to see incorporated into it, particularly those I have addressed today on board voting and the way those elections are conducted. I think they are very

important things that could really drive governance and accountability, and there are some real cowboy acts in the governance of major companies.

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

**Mr Mayne**—I think that it should definitely apply to directors—for example, if a finance director is on the board and signs a new contract. I do not necessarily think it should extend below that to the chief operating officer or divisional heads, but I do think that the day that a CEO signs a new contract the contract should be released in full. In the US, you can inspect Jack Welsh's one-page contract at GE; you can see it—and you can see it with other companies. You can see the 27 pages spelling out the model of the Merc and the private school fees; it is all on the public record in the US. I think full disclosure of the CEO's contract would be an important thing.

There are a couple of other important things on director pay. When a director leaves a board, there should be disclosure of the payments made on the day. You get a lot of directors leaving on 1 July and you do not get to see it. It is a bit like political donations that come in on 1 July, which you do not get to see until 20 months later, in February. In the case of directors, they can delay it: if there is a 1 July disclosure you do not see it until September the following year—15 months later. I would say: disclose the payments, particularly the director retirement payouts, which are often quite controversial.

The other thing which is disappointing about director pay and things is that there is no requirement that derivative plays by directors and CEOs on their shareholdings are disclosed—and that has been rife. It has been absolutely rife in Australia. You get voluntary disclosure—someone like Roger Corbett or David Clarke at Macquarie Bank have told the Stock Exchange that they have done a put option, a cap-and-collar deal on the options play—but there is nothing in the law. Your typical big bank CEO in Australia has options of over $100 million worth of shares. This is a massive commercial exposure—that is the size of a small listed company that these guys have riding on their options. Of course you have got a massive incentive to manage the exposures there with put and calls and derivatives and this sort of staff—but you do not have to tell the market. I think it is a no-brainer, that one.

**Senator CONROY**—The existing Corporations Act states that the shareholder approval for retirement benefits is only required where the payment exceeds the amount prescribed by the formula. But, in spite of these provisions, retirement payments can still be made without shareholder approval. This amounts to—I think the formula works out to—3.5 times their average annual income if they have been with the company for 3.5 years; five times their average income if they have been with the company for five years; and seven times for seven years. In your view, should these termination payments be approved by shareholders?

**Mr Mayne**—Undoubtedly so. I think the situation with John Ducker at Aristocrat is quite outrageous. Why have a resolution if it can be contracted away? That is what has happened at Aristocrat. The shareholders passed a particular retirement scheme for the directors and then a new director joined the board with a contract—a service agreement—that specifically bypassed the shareholder approval which had been given. If you are going to have shareholder approval for something, make it binding; do not let the directors contract their way around it. Why do we have it so that there are two different types of non-executive director pay—cash up-front and retirement benefits—and different resolutions? It should be the one resolution, which is: director pay—maximum for the year $1.5 million spread amongst the directors—and retirement formula—this. It is all the one resolution so you can deal with it. Because often you do not know—it is like a defined benefit super scheme—how the liabilities are spiralling out. When a board member gets an increase in their annual fee from $100,000 to $150,000, if they are getting a five times multiple of their final fee—which is often the formula—you do not realise that the resolution passed back in 1987 on directors' retirement payments, which has not been mentioned in an annual report for 15 years, means that this director is going to retire with an extra $250,000 lump sum in his packet just because he has been able to ratchet up the final fee.

**Senator MURRAY**—It is a form of indexing.

**Mr Mayne**—Yes. But you know: 'If I can just become chairman of this committee in the last year, I will get the extra 50 grand and then I will get the extra $250,000 lump at the end of it.'

**Senator CONROY**—The regulations which apply to the remuneration have not yet been released, so we do not know exactly what needs to be disclosed in the directors reports. Could you advise the committee whether, in your view, the remuneration section of the directors report should require disclosure of the following—and this is in addition to the disclosure of executives' remuneration: 'golden hellos'—you know, the sign-on bonus which you get paid before you've signed it; equity value protection schemes, which you have already mentioned—that is, the hedging instruments; and the duration of the contract? Should they all be on the list for disclosure?

**Mr Mayne**—I do not think there is anything that should not be disclosed. Everything you cite should be on that list. Relocation packages often run to hundreds of thousands of dollars, but there is no disclosure of that. A company like David Jones has a provision whereby directors get shopping discounts of up to 35 per cent. That is of value—some of them spend many tens of thousands—and the value of the goods they get is not disclosed in the annual report. So I would say every benefit they get, where it extends into large costs for the company, should be disclosed. Often it is a case of a company meeting costs which are providing a benefit for the company—if you agree to relocate six children and put them all in private schools, the shareholders are often spending hundreds of thousands of dollars providing a benefit to the executives—but it is not disclosed.

**Senator CONROY**—What about a spouse getting free access to a limo?

**Mr Mayne**—All of that should be included. There is nothing that should not be in there. A classic example is News Corporation and the two corporate jets. The Murdochs use the jets for their personal use—for example, Lachlan wants to go to the Melbourne Cup and jumps in the company jet, flies down for the day and then flies back for a party that night. That happened last

racing season. There is no mention anywhere in the annual report about the value of the corporate jet for private use by directors of News Corp. There are a lot of ways that benefits can be given to directors without disclosure. Therefore, you should try to have a catch-all provision in the legislation.

**Senator CONROY**—I have one or two more questions. Should non-recourse loans to directors and senior executives be prohibited?

**Mr Mayne**—No, not necessarily. A loan from the company for housing or to buy shares can be a regular part of any package. As long as it is disclosed, I have no problem with that.

**Senator CONROY**—But aren't shares supposed to align the interests of shareholders and management? If they are not using their own money—more importantly, if they are using shareholders' money—how are they aligning their own wealth with shareholders?

**Mr Mayne**—If they do not perform well, they will not get the upside on the shares.

**Senator CONROY**—A non-recourse loan means that, if the shares tank, the shareholders still pick up the tab.

**Mr Mayne**—That is right. But take, for example, someone like Ross Wilson at Tabcorp. When he joined the company, he got a $6.25 million loan for three million shares.

**Senator CONROY**—And how could a monopoly tank?

**Mr Mayne**—He walked out with $58 million—thanks very much. He performed very well with a big loan from shareholders.

**Senator CONROY**—He ran a monopoly.

**Mr Mayne**—My grandmother could have run that one.

**Senator CONROY**—That is right.

**Mr Mayne**—Loans are not inherently bad. Yes, shareholders take a risk if the shares flop, but as long as the loan is disclosed—

**Senator CONROY**—But isn't the point to align the interests? Is this a mechanism which clouds the alignment?

**Mr Mayne**—You do not want your CEO going bankrupt because the share price falls. You actually want to protect your CEO from that sort of hardship, I would say. You want your CEO to be well 'incentivated' to drive the share price higher. You do not want them worrying about losing millions of dollars and worrying about whether they can pay the loan back if they are struck by some extraneous factor which destroys the whole industry. You can never be sure with these things.

**Senator CONROY**—So shareholders can lose all their money, but the CEO should not have to worry about losing theirs?

**Mr Mayne**—I do not think you should have a contract where a CEO can personally go broke if the company does not perform well. So, if you are worried about that, do not go into a loan agreement; just have options. Options are all about avoiding these large financial exposures through loans and things.

**Senator CONROY**—I will defer to Senator Murray, because I am sure he has some questions. He has indulged me greatly so far today.

**Senator MURRAY**—I have been entertained. I sometimes think we should refer to many of the CEOs as corporate bureaucrats—then we might get them into more perspective. In my view, not many of them are entrepreneurs. Mr Mayne, you described your attempts to get onto the boards of companies. I think it was very instructive because what you described was corporate oligarchy, not corporate democracy. I want to see if you recognise this string of concepts: best practice regular elections, compulsory voting, representative bodies, independent institutions and people, appointments on merit, the separation of powers, transparency, accountability and full disclosure. That is the language of politics and democracy.

My view is that it does not apply in public corporations—and it should. I think what you have outlined about directors' elections is illustrative of that difficulty and that weakness. I have suggested throughout this inquiry that if people start to think in terms of corporate democracies then the concepts you have been outlining fall into place, because that is what it is about.

I want to specifically focus on the election of directors. If you search through the *Hansard* of this committee and other committees over nearly eight years, you will find that I have constantly asked ASIC questions and debated the issue of best practice election of directors. In this inquiry I have asked witnesses—particularly academic researchers, but also the professions—whether they have ever bothered to assess the constitutions of companies and to look at the mechanics and the methodology by which elections are conducted. The answer universally is no. Politicians understand the mechanics of elections very well. That is why the Electoral Act is so precise. I would suggest to you that one of the first steps we should take to open up access to our boards is to insist that ASIC produce a constitutional pro forma and a paper example of how elections should be constituted in company constitutions and how they should be conducted. How do you react to a standard, known method across all companies?

**Mr Mayne**—I think that it would be highly desirable. Various constitutions have different little things in them that protect boards. With Qantas you have to have 100 signatures to run for the board; Optus used to require 50. With AMP you have to own 2,000 shares and get 25 signatures. With AGL you have to own 2,000 shares. So they often have little things in there that are barriers. Overall, I would say that that would be highly desirable, specifically if it knocked out the concept of there being no vacancy, which is the key thing that they use to keep outsiders out. It could be an ASIC pro forma, or part of the listing rules could be included in the Corporations Law, so that if you want to become a listed company in Australia there are guiding principles which you must abide by. It would not worry me where it was, but it does need to be laid out because there is no system at the moment.

I will be very interested to see what Rupert Murdoch proposes for the new News Corp constitution on directors running for positions on boards, because I know that he has hated the fact that it was easy for me to run for their board. I will give you one other example while I think of it. I ran for Woolworths in 2000, and their constitution was not clear about whether you could say there was no vacancy, so they did not say there was no vacancy; they did not even say, 'We don't like this guy. Vote against him.' I got quite a large donkey vote from institutions, particularly foreign institutions, and almost got elected. I actually got 58 per cent of the primary vote and needed only 50 per cent. This put the frighteners through all the companies. They were saying, 'My God, this lunatic almost got on the Woolworths board.' The very next year, Woolworths changed their constitution so they could declare that there was no vacancy. The very next year, when two other people ran for the Woolworths' board, they had very large black marks on the proxy form, saying: 'We don't recommend these two outsiders. We recommend you vote against them.'

So there need to be guidelines not just on company constitutions but on how contested elections are conducted, what material should be sent out to shareholders in someone's platform, who controls that material and whether directors can effectively have information on the ballot paper which reflects poorly on some directors and positively on other directors—that they disclose what they are going to do with their open proxies. I had a dialogue before running for the AMP board where—and they were the first company to do it—they sent me through the draft of the notice of meeting and said, 'Is this to your satisfaction?' I said, 'You haven't said what you're doing with your open proxies.' The chairman, Peter Willcox, actually changed the notice of meeting and put in there that they would be voting all the open proxies against me.

These company chairmen have never been down this path before—it is all new territory—and there does need to be something that spells it all out, including the conduct of the meeting: how long you let the director candidates speak for and whether directors can answer questions directly. At the AMP meeting last year Peter Willcox completely shielded the two directors up for election. So, Richard Grellman, chairman of the audit committee, and Lord Killearn, chairman of the finance committee—$10 billion lost, up for election—did not say boo for six hours. People were firing questions at them. How can you vote on someone if they sit there at the public company meeting, are completely protected by the chairman and refuse to answer questions? You cannot make an informed vote. So all of this should be brought under some sort of regulatory guidance—it does not matter if it is under ASX, ASIC or the law—that spells out how these things should be run fairly.

**Senator MURRAY**—I have asked ASX to do it. They have not, and I think it is because everyone in the system understands that what they have got here are barriers to entry which help prop up a corporate oligarchy, and they are not prepared to overturn it—and here is our opportunity. I focus on directors deliberately because I think this legislation does not go far enough with respect to directors. There is a second key to the election of directors, apart from the mechanics of the constitutional provisions and the process by which information reaches people, and that is the compulsory vote.

The debate should be about whether the compulsory vote should attach to bodies—entities or institutions—or to subject matter, and I am exploring this with witnesses. The Labor position is that it should attach to institutions, and only super funds should be obliged to vote. I have not yet made up my mind on that matter, but I do think there are classes of vote where compulsory

voting should occur. That could only occur, of course, where shares are being held in escrow or under a duty of care. You cannot make mum and dad do that; you would be unable to do so. I think the election of directors might be a subject matter on which they would be obliged to vote. How do you react to that proposition?

**Mr Mayne**—I would support compulsory voting; and I think, most importantly, it should be accompanied by disclosure of that voting. I think that the most important area where this should be introduced is in director elections. The reason I say that is that we do not have a problem with executive pay in terms of institutions voting. You are getting 'no' votes regularly on options packages of 30 and 40 per cent. News Corp got rolled last year. So now, institutions in Australia, culturally, are voting down and voting against options packages and director benefits. Southern Cross Broadcasting—

**Senator CONROY**—I think that is a little bit of an overstatement. Only two resolutions were withdrawn; one was the News Ltd one—

**Mr Mayne**—And Southern Cross Broadcasting.

**Senator CONROY**—yes—but 100 per cent of other resolutions were passed; every other resolution has been passed.

**Mr Mayne**—They have been passed, but what I am talking about here is the size of the 'no' vote. You are getting regular 'no' votes of 30 or 40 per cent. Rupert Murdoch should have seen it coming, because for the previous four years he was averaging 'no' votes around the 35 per cent mark for his executive options. But when it comes to director elections there is no culture of 'no' voting; it is 99 per cent for the worst directors. So, that is the area where there is a severe problem—where 'the club', the oligarchy, is self-supporting, and no matter how poorly a director performs they get re-elected.

After HomeSide, Catherine Walter was up for re-election at NAB. She was chairman of the audit committee. I spoke against her election and she got two million votes against and more than 400 million in favour. If there had been a proposal for the directors to get a pay rise after HomeSide, I fairly confidently predict there would have been a no vote of around 30 to 40 per cent. So institutions are onto the issue of executive pay. It has been done to the death in the media. There is movement. On director elections, there is nothing.

**Senator MURRAY**—Let me summarise. You are saying that you do support on the subject matter basis the election of directors to be compulsory where shares are held in escrow or there is a fiduciary duty to—

**Mr Mayne**—There would almost be an argument that it be the only area where it be compulsory, because it is the area where the voting patterns show a terrible problem.

**Senator MURRAY**—Let me turn to another area that has been discussed—that is, the non-binding vote on remuneration. I want to refer you to my questioning to Mr Paatsch, which I hope you heard. Essentially, I take the view that a non-binding vote is, to use popular parlance, just a crock. It seems to me that directors' remuneration as a whole, which they themselves determine, has to be put to the shareholders and that there should be a binding vote. It would need to be

subject to a kind of threshold, because obviously people have to know that they can put bread on their table. The threshold I have recommended, incidentally, is 20 times what is known as MTAWE, which works out at about a million dollars. That is the total package—cash and non-cash. Why would somebody like you support a non-binding vote, when it is non-binding; it is worthless?

**Mr Mayne**—But it is a step forward. There is no vote at the moment. Anything which advances the—

**Senator MURRAY**—But here you have the opportunity for the parliament to tell the government—and they could if Senator Conroy agrees with me on this, which he does not yet—that a binding vote should apply.

**Mr Mayne**—I have no problems with a binding vote, but I take the view that Corporations Law reform is a bit like pulling teeth and progress is slow and any step forward is to be welcomed. Of course you would like to see more. I do not think there would be a problem in having a binding vote, because we already do have binding votes on anything to do with the issuing of shares to executives. Mr Paatsch made the comment that you cannot have a CEO signing up and not knowing for six months if he is going to get paid. CEOs today are signing up and not knowing whether they have got an options package or not, because it has not been approved by shareholders. So we already have binding votes on issuing of shares and on cash payments to non-executive directors.

I would have no problem with it, but I am simply taking the view that any step forward is positive. In the experience of the UK where you have had remuneration policies rejected, the media which flows from that and the whole public focus on it is a very powerful tool. That is why I suggest that legislating about how the shareholders voted, not just the shares, would also be a powerful public force if it were said, 'A majority of the shareholders rejected this particular remuneration package.'

**Senator MURRAY**—I will wrap up with this set of questions, because I am conscious of time. I thought Senator Conroy's questions were very good, so that does not bother me. He covered many of the areas I would cover.

I want to talk to you about the independence of directors. I think the independence area has been poorly defined by the Corporate Governance Council, by ASIC, in this legislation and everywhere else. I was interested to hear you laud an audit committee, yet the directors who get on to an audit committee are appointed by the board and the directors who get on to the board are appointed as a result of somebody's patronage—generally speaking, the dominant management or the dominant financial interests. It is their patronage, so the whole system is a web of patronage and all I can see is an audit committee is patronage at arm's length.

I have the view that perhaps the legislation should include a principles based admonition that no-one can be appointed to certain committees—such as remuneration, audit or risk—unless they are independent and that independence should be defined on a principles based view as not being subject to the patronage of dominant financial or dominant management interests in appointment, tenure or remuneration. That would cut the link, I think, with the oligarchic control which is present in all our main boards.

**Mr Mayne**—I think what you are saying is, in principle, a very important thing: all board committees should be entirely independent. In Australia, we have a system where you have large conflicts. A good example is the way the brokerage firms and the big four accounting firms provide office space to professional directors. Graeme Kraehe and Catherine Walter are both part of the JB Were club. Geoff Tomlinson, one of the NAB directors, had his office and consultancy at PWC. He quickly closed the office and moved out when PWC were tendering for a bit of work. I do agree with you that, in principle, you need that. I think the practicality of it involves finding enough directors with the requisite skills, particularly when you get below, say, the top 100 companies. I think there is an argument about that: that it can be difficult to insist on the presence of an audit committee and insist on the audit committee being entirely independent. It can get a bit bureaucratic.

There is one key point. There is going to be a most important test this year on independent directors—that is, the largest related party transaction we have seen in Australia in recent years, which is the proposal for News Corporation to buy the Murdoch family interests in Queensland Press for what is mooted to be about $2 billion. News Corp have said that all non-executive directors who are independent are on the committee overseeing the sales process, appointing the independent expert. They have only ruled out one independent director—the former chairman of the audit committee—because he is a long-serving investment banking adviser to News Corp; he advised them on a series of deals. But included on that committee are three former executives. The definition is that if you have left a company for five years or thereabouts you are deemed to be independent. I do not buy that for a minute. Ken Cowley is Rupert's longest-serving executive in Australia. How can he be deemed independent and be sitting on a board committee, supposedly at arm's length of Rupert Murdoch, when he has worked for him for 40 years?

**Senator MURRAY**—That would breach my patronage rule.

**Mr Mayne**—Completely, and there are two others there. How do you deal with friends? Geoffrey Bible is one of Rupert Murdoch's closest friends, but he is deemed to be an independent director and he will sit on this board.

**Senator CONROY**—How long have they been on the board?

**Mr Mayne**—Ken Cowley was the managing director in Australia for 20 years or so. I think Geoffrey Bible has been on the board for six or seven years.

**Senator CONROY**—I am not trying to catch you up about it.

**Senator MURRAY**—A principles based rule which said that if you were subject to patronage then you were not independent would automatically rule those people out.

**Mr Mayne**—I would absolutely welcome it.

**Senator MURRAY**—ASIC could easily adjudicate that. It is not a difficult concept.

**Mr Mayne**—There would be a sudden dearth of independent directors in Australia.

**Senator MURRAY**—It would prevent the parliament having to set down a whole set of lists of what is and what is not independent. There is one assumption you have made that I need to test in this last wrapping-up set of questions. The assumption you seem to have made is that we have to be wary of the amount of talent out there. I can see that with respect to specific corporations where you need a very precise skill set on the board that might be so. But one of the advantages, the great privileges, of being a parliamentarian—and I sit on nine committees and currently have 17 inquiries—is that you get access to a huge array of talent that comes along in circumstances like this. In my view, there is acres of talent out there which could fill our boards. You could wipe out every board director right now and probably replace them with people almost as good. I am very wary of the assumption that opening up the process and removing the barriers to entry would endanger the skills ability; I do not buy that. Perhaps I have misread an assumption that I thought I heard in some of your remarks?

**Mr Mayne**—I have a view that the corporate directors club in Australia has performed appallingly, if you look at the sheer performance of our companies. The best measurement of that is the fact that there are more than 200 foreign companies in Australia turning over more than $200 million a year—

**Senator MURRAY**—Billion.

**Mr Mayne**—yet there are only about 40 Australian companies who are generating more than $200 million a year offshore. In this globalised world our companies have simply failed to cut the mustard. That is an indictment on the people in charge of our corporations, and that goes back to the fact that the duds are not weeded out. I would simply say that I am wary of foisting average people onto boards. I am not convinced that there are hundreds of people out there capable of sitting on a board. I think I would be a poor director if I got onto a board—yet I keep putting myself forward.

**Senator CONROY**—But you are prepared to foist yourself on 18 of them!

**Mr Mayne**—Yes.

**Senator MURRAY**—Parliamentary privilege only allows you to go so far!

**Senator CONROY**—Defaming yourself is an unusual way to proceed.

**Mr Mayne**—Australia has been badly let down by the fact that too few people have taken on too many jobs. The system has been skewed towards retired CEOs, and NAB has been punished for the fact that their board appointment system was rewarding the CEOs of big clients. It is an appalling system. Our boards lack IT people and advertising people, and we probably need more retired accountants and lawyers. We have a system that says you can only be on a board if you have run a company, if you have been a CEO. That needs to be broken open. I do not think there are hundreds of people out there who could suddenly join the BHP board, but I look at situations like John Fairfax, where there is no-one on the board with any newspaper experience, and say: how can this be? How can it be that this company cannot find anyone to sit on their board who has newspaper experience? That situation is clearly unforgivable.

**Senator CONROY**—But they are clearly all independent!

**Mr Mayne**—That is one of the problems that you get. If you run the line that you cannot ever have been a competitor or have worked for the company, you might get eight genuinely independent directors who do not know anything about the industry. That is where Rio Tinto will come up with the argument: 'We have eight directors on the board who have mining experience. Most of them are former managers, but at least we have a vast array of extractive industries experience. Yes, we fail some of the corporate governance tests; yes, the unions are going to put resolutions up. But we've performed and we have experts.' That is where I would worry about a system that threw off a bunch of former Rio Tinto executives because they were deemed to have had patronage or to have compromised this sort of stuff.

**Senator MURRAY**—But neither you nor I are suggesting that.

**Mr Mayne**—No. But, when I look at the News Corp situation, I say that it is in moments of big governance situations where you need the independence. If it is just running News Corp, it runs well with all Rupert's mates and all the gurus in the media industry. But, when it comes to doing a $2 billion related party transaction, that is where you need independence. It is when a company is about to collapse that you need your independence. That is when you need the HIH audit committee to not be full of Arthur Andersen people.

**Senator MURRAY**—I am testing with you the proposition that a non-executive director is an independent director. A non-executive director is not an independent director if they are subject to patronage.

**Mr Mayne**—No, not at all.

**Senator MURRAY**—I do not object to all directors being under patronage. But let it at least be acknowledged and known. I do not object to all the directors being not subject to patronage. But at least let it be known and established. The only way to do that is if the criteria for independence are established through a principles based situation.

**Mr Mayne**—I completely agree with that. I grapple every day with the question of my own independence in presenting myself as a shareholder activist. For instance, I have just been invited to speak at the Australian Institute of Company Directors conference in Port Douglas. I was sitting there thinking: 'Hang on, they are conferring a benefit on me. They are putting me up at a nice resort. They are offering me the golf day. That is going to be a benefit. I am actually reluctant about that. I don't want to owe them for anything.' So I said, 'Obviously there is no fee and I am not staying for the golf day; I don't want you to be in a situation where you can be seen to have one over me.'

Rupert Murdoch flies his directors to New York business class six times a year. It is a trophy board. You are honoured to be on that board and you are in his debt for the fact that he has invited you onto that board. Graham Kraehe's status in Australia leapt when Rupert invited him onto the board, but Graham Kraehe has not been the pioneer for independence and removing related-party transactions that we had all hoped for in the News Corp board. I have the feeling that he just does not have the stomach to take on Rupert, because he feels honoured to be on that board and he loves the six business class flights to New York each year.

The whole question of patronage is very important. As a journalist, I listed $40,000 worth of freebies that I received from corporates over a 10-year period working in newspapers, because I felt that these people all owed me. Once you go to the footy or to the opera with them—you go on a trip to Europe with Mayne Nickless, go to South Africa with someone else or Lion Nathan flies you to New Zealand—you are in their pocket. As a journalist, as a director or as a politician it applies right across the board. Senator Conroy and I have had debates before about AMP and the Olympics. I have a very strong view that to maintain your independence—

**Senator CONROY**—Do you think AMP thought it was value for money?

**Mr Mayne**—I do not think so, no.

**ACTING CHAIR**—Perhaps we should conclude our discussions. We thank you, Mr Mayne, for your contribution. We have gone considerably over time.

**Mr Mayne**—Yes, I am sorry about that.

**ACTING CHAIR**—The conversation has been interesting both for the committee and for the record.

**Mr Mayne**—I thank the committee.

[12.17 p.m.]

**ALFREDSON, Mr Francis Keith, (Private capacity)**

**ACTING CHAIR**—I welcome the former Chairman of the Australian Accounting Standards Board to the hearing. The committee prefers all evidence to be given in public but should you at any stage wish to give any part of your evidence in private you may ask to do so and the committee will consider your request. The committee has before it your written submission numbered 52. Are there any alterations or additions you would like to make to your submission at this stage?

**Mr Alfredson**—No.

**ACTING CHAIR**—I invite you to make an opening statement of five to 10 minutes duration, as you see fit.

**Mr Alfredson**—I will make a very brief opening statement. I think the FRC has a very important role, and once that role is expanded or before the role is expanded there should be an appropriate review of its past efficiency and effectiveness. I make this submission because I believe the FRC and the whole standard setting process is in many ways modelled on an international process—in particular the Financial Accounting Standards Board in the US but these days more particularly the International Accounting Standards Board. I think it is of significance—it is not noted in my submission—that the trustees of the International Accounting Standards Board are presently going through a review of their operations. They are doing that by calling for public submissions, and those public submissions are available on the web site. They are also reviewing the operations of the IASB. I think that is the sort of review that ought to be made of the FRC.

I make these comments because I believe a review of the FRC will disclose a few matters, and I give these views in an extremely constructive sense. I believe the FRC has been resource starved. In particular I am not talking about money; I am talking about dedicated qualified staff—staff that understand the operations of the AASB, are dedicated and do not, like the secretary during my time, have other responsibilities, apparently including the writing of the CLERP 9 paper. It is hard to give the right priority to the FRC if that is the way the FRC secretariat is staffed.

There have been a lot of arguments about whether the FRC ought to have an independent secretariat and all of that. More significantly, though, I believe the characteristic of the FRC should be one of transparency and openness. There are two things I would like the FRC to do. The first is that it should open its meetings to the public so that there is complete transparency about how it makes what are indeed fundamental decisions, such as the adoption of international accounting standards in 2005 and the decision that government accounting should be harmonised between international standards and the GFS. There ought to be absolute openness about how those decisions were made.

The other thing is that there ought to be a vast improvement in the way the FRC consults. I compare the way the FRC consults with the way the other bodies consult. The FRC makes important decisions—setting the strategy for the AASB. The two important decisions it has made were made without any call for submissions from those who might have a public interest. I do not think that is good enough for the key body that has an important impact on standard setting. I am not debating the ultimate decisions; I am debating the process.

Finally, I would like to highlight one other point in my submission, and that is that I do not believe that the FRC is an appropriate body for overseeing anything that involves compliance. The overseeing of auditor independence—if I interpret it appropriately—involves compliance with the rules or whatever standards of auditor independence. I firmly believe that the body that is best placed to oversee compliance relating to independence is ASIC. I am not talking about setting the rules; I am talking about compliance relating to independence. That role fits very neatly with the role that is in today's *Financial Review* on account surveillance. I believe an important way of testing auditor independence is to do it hand in hand with the accounts surveillance program—in other words, the issues that are given some publicity in today's paper.

I have no idea how ASIC does its work, so it is inappropriate for me to comment on it. But I would hope that, in the process, it has had regard to the way the audit committees operated in those situations—that is, whether they got independent advice, whether they got advice from the auditors, how the auditors operated, whether the auditors got advice from their own technical staff et cetera. I see that compliance with auditor independence goes hand in hand with the role of ASIC. It is not an appropriate role for the FRC. I have no problem with the FRC playing some role in the setting of standards or being one body that has input into trying to sort out auditor independence, but I do not see that its role is one of monitoring or overseeing actual independence on specific audits. My submission covers other matters, but those are the main features that I wanted to raise.

**Senator CONROY**—Were you a member of the FRC?

**Mr Alfredson**—No, I was not a member of the FRC. The FRC membership is appointed by the Treasurer. I attended all FRC meetings, but that was as an executive, not as a member of the FRC. I did not vote but I certainly attended all meetings and I was allowed to speak whenever I wished.

**Senator CONROY**—So you were a participant and an observer of the processes of the FRC?

**Mr Alfredson**—Yes.

**Senator CONROY**—Earlier today, Mr Ravlic made some criticisms about the process by which decisions were made. He alluded to the fact that information was regularly circulated very late, he believed, to the FRC members, which did not allow them to take full account of the issues that they subsequently considered. Is that one of the issues that led you to make the recommendation for the review of the FRC by the ANAO? Are there other issues on top of that, or is that not an issue? What are the sorts of issues in the process that you believe warrant an investigation?

**Mr Alfredson**—I think there are a lot of issues that, frankly, all come down to the lack of resourcing of the FRC. The FRC had a part-time chairman. During my time there, there were three; there was one acting and two actually appointed chairs. All of them were part-time. They depended very heavily on the secretariat producing papers and getting papers out et cetera. Many things did not happen the way you would expect them to happen. They did not have a schedule of all their meetings for a year; therefore, attendance at meetings was often difficult. I constantly heard some members of the FRC complaining, 'When are the future meetings?' I think these are past issues. I believe the current chairman has fixed all those sorts of issues. They have their meeting dates on the web site, so they are clearly fixed. But papers frequently got out late, and on some important issues. I might say that the 2005 decision was made without any FRC paper that firmly debated the issues or all of the arguments in favour and against. I had a paper on a late edition—

**Senator CONROY**—Can I just clarify that? The single most important decision in Australian accounting standards setting was taken where there was no paperwork provided to the committee at all?

**Mr Alfredson**—I do not recall a comprehensive paper that set out the arguments for and against, and the issues and implications. There was certainly robust discussion at the board meeting and a vote was taken. People will say: 'Of course CLERP 1 covered many of these issues. What do you want to go through the process for? Boy, that was history.' I can remember saying at that meeting, 'You're making very significant technical decisions.' This is another problem that the FRC has, of course. The FRC can set strategy but it cannot intervene in the technical content of standards. It is a bit of a strange one. You set up a strategy that says to adopt the international standards and in one fell swoop you have adopted the technical content of international standards. That is always going to be an issue. I can remember saying at that meeting: 'There are lots of technical issues involved. One of the things that is going to happen is that major public companies in Australia are going to have to de-recognise intangibles. Perhaps people ought to understand these things.' I can tell you that no-one around the table batted an eyelid. They just went on discussing it, and they voted in favour.

All I am saying here is that I think the whole process lacked robust and formal consultation. Yet, prior to that, the AASB had gone through an exposure draft process on a policy statement which I think was called international convergence and harmonisation of accounting standards—something like that. That was subject to an exposure draft, to input and to debate at the AASB. It was sent to the FRC to see whether they had any comment. At a meeting about two months before the FRC made their decision, the final statement involving international convergence and harmonisation was adopted by the AASB. All the discussion at the FRC was as if that document did not even exist. It was as if the process we had gone through had not taken place. We had reached the decision never to set a timetable. I think history will probably show that the FRC made a good decision in saying, 'Let's set a timetable,' although I certainly did not think so at the time. At least it got their minds focused on a definite output.

I think those sorts of issues have been tarnished and not handled appropriately, and it is hard to say what the reasons for that are. But if you had had a stronger secretariat capable of implementing governance it would have said: 'Hey, shouldn't these sorts of things have a robust paper? Perhaps there ought to be public consultation beyond that which is merely the members of the FRC, as representatives of various bodies, giving their views on these issues.' Public

interest is important and these things should have been subject to much wider debate without it going on endlessly. But if you compare our process with what happened in New Zealand and the UK you would have to say it was not as robust. That is not to criticise the end decision; the end decision might be a good decision. I am being critical of the process.

**Senator CONROY**—Unfortunately I have to go to another commitment. I was very keen to ask you a string of other questions and have a discussion with you. Senator Murray has kindly agreed to ask my questions, so I want to put a disclaimer up front that the views he expresses in the questions may or may not be his; quite possibly they are mine. I just apologise that I have a previous commitment and we are running late. I do not want you to feel that I do not value your contribution by my having to race off to another commitment. So I offer my apologies and pass over to Senator Murray.

**Senator MURRAY**—I do not mind asking these questions at all. As you would be aware, Senator Conroy, Senator Campbell and I—and now Mr Cameron—have been in this dance for eight years, so we are used to these issues. Your submission says that the FRC members who were appointed originally were not aware of their role as, effectively, directors of the AASB—and I must thank you for that insight because it is the first time I have thought of them in that way. Why were the members not aware of their role? Also, what changes do you think are necessary to ensure that in the future they are aware of their duties? Should they be constituted effectively as a board and put in an institutional framework of that sort?

**Mr Alfredson**—When I went to the AASB I had not heard of the famous CAC Act—and I am sure that you have heard of it. People call it the CAC Act; it is the equivalent of the Corporations Act and it covers government agencies. The FRC is very strange because it is constituted under the ASIC Act and its responsibilities are spelled out in the ASIC Act. That act says the FRC is responsible for fundraising and for oversight of the AASB et cetera—I cannot remember all of its responsibilities. The act then goes on and says that the Treasurer appoints the FRC's members. I think it is fair to say that the members of the FRC were probably aware of what was in that act when they were duly appointed. That would be a reasonable approach. But it turns out that the AASB is a statutory authority and, under the CAC Act, it has to have a board of directors.

I do not think any member who was appointed to the FRC was ever told, 'You are a director under the CAC Act.' In fact, I can tell you that Treasury took legal advice on whether the FRC members were the board of directors of the AASB. At that time I said, 'I don't know why you're taking this legal advice as it's abundantly clear: anyone who is setting the strategy responsible for all of these things would have to be the board of directors.' An argument was put to me that the members of the AASB—that is, the technical board—are the directors and I said, 'I just don't believe it; you get your legal advice.' The legal advice said the painfully obvious: the FRC members are the directors of the AASB. Then some FRC members said, 'This is a bit strange; we can't actually control the thing that gives the greatest risk to the AASB, and that is the setting of accounting standards.' The success or failure of the AASB depends on how good the accounting standards are, and here you have the FRC not being able to have any impact on the technical content of specific standards. That is a very strange role. I do not know the answer to this situation. I am not a legal man, and I have no idea how other agencies act in these situations—and I do not believe it is an ongoing issue. But I am sure that anyone who is

appointed to the FRC these days is told, 'Yes, you're actually a director of the AASB.' So it is a strange role.

**Senator MURRAY**—Your submission says that you do not support the proposal for the FRC to oversee auditor independence requirements although, provided that certain transparency issues are remedied, you support the FRC overseeing audit standard setting arrangements. Why do you support expanding the role of the FRC in relation to audit standards but not auditor independence?

**Mr Alfredson**—If overseeing auditing independence means going to accounting firms and seeing how they actually operate their independence, I consider that to be compliance and ASIC should do that. I am not opposed to a similar model to that of the FRC overseeing the AASB and overseeing the auditing standards board.

**Senator MURRAY**—I must say for the record that I agree with you; I do think ASIC are better suited. An analogy with which you would be familiar is that ASIC is the one that ensures compliance with accounting standards, and it has just been carrying out that very exercise.

**Mr Alfredson**—Sure.

**Senator MURRAY**—The ASX has submitted that the primary function of the FRC should be oversight of audit quality, of which auditor independence is an aspect. In your view, if the FRC is going to oversee auditor independence should it then also oversee audit quality, or is the FRC not equipped to oversee those issues?

**Mr Alfredson**—Certainly the FRC I knew would be totally unequipped to oversee audit quality. Audit quality involves a surveillance staff, technical staff. I do not know why you would have an FRC building up that sort of staff, when the equivalent staff either exists or could exist in ASIC. To me, ASIC's surveillance of auditor independence and audit quality—the whole surveillance program of ASIC—go hand in hand and the one body ought to be responsible for compliance.

**Senator MURRAY**—Professor Ramsay has advised this committee that the FRC has no representation from groups representing the public interest. He said:

I do see an important role for the public interest and I am not quite sure where that is when I see the current FRC membership. In my report I also made an observation that, in terms of representatives of the public interest, one should give thought even to public advertisement. The relevant minister might want to think about advertising, and choose the best qualified people on the basis of public advertising.

In your view, should the current membership of the FRC be widened to include representatives of the public interest, and should such positions be advertised publicly?

**Mr Alfredson**—I would say that there is some lack on the part of the FRC. I guess the closest thing to the public interest is the representative from the Shareholders Association. You might say, 'Well, that's the public interest.' If you just said, 'Well, what are the characteristics of someone who represents the public interest?' I am not sure whom we are actually thinking about and I am not sure what those characteristics are.

It is very important that at present members of the FRC are sort of representatives of other bodies. I think it is fair to say that the Stock Exchange has a representative there as do the Shareholders Association, the Business Council and the accounting bodies. As for nomination to FRC membership, I guess the Treasurer makes appointments based on advice from these bodies—what their actual role is and whether they are representatives—but in the end they have to speak for themselves and make their own judgments at meetings.

In the end, though, you want a group of people who are competent for the job. Whether advertising actually brings in new names, I do not know. But it is interesting to note that when appointments were made to the AASB the FRC advertised, and I have to say that some names came out of the woodwork that I think would not have been identified if the FRC had not advertised. You do see government bodies from time to time advertising that they are going to appoint boards of directors et cetera and that people who are interested can make submissions. I do not see that as a big issue. I do not see why the FRC would necessarily be any different, but I do not have a strong view on it.

**Senator MURRAY**—Moving to funding, can you advise the committee of your preferred model for funding the FRC in light of the failure to obtain corporate donations?

**Mr Alfredson**—I do not have strong views on this but, given the way governance has gone and given the way independence is, I think it is totally wrong for the FRC to be given a job to go cap in hand to corporates and ask for donations. In my view, they ought to be funded out of money that is already gathered by ASIC through its various processes or there ought to be a levy on publicly listed companies so that they have the strongest public interest in this. But the model at present is such that most of the money comes from government, three accounting bodies and some corporates. I think it is a terrible misuse of FRC time to have to go cap in hand. They do not have the resources to do it. Why should companies do it anyway? I think companies could be interpreted as trying to gain influence through the making of donations. I just think it is inappropriate, and it has not been successful. We are just talking about petty cash. The budget of the Accounting Standards Board is only a few million bucks. Another million is only a drop in the ocean.

**Senator MURRAY**—As you know, ASIC raises more money than it spends. It would be quite easy to hypothecate that across.

**Mr Alfredson**—The members of the FRC constantly said that at the FRC meeting.

**Senator MURRAY**—How does the role of the FRC in overseeing auditor independence differ from the role of the Public Company Accounting Oversight Board in the United States?

**Mr Alfredson**—I am not an expert. I could not comment with certainty now on the US situation. I have not attempted to keep up to date.

**Senator MURRAY**—Should the FRC also have oversight of the financial reporting panel?

**Mr Alfredson**—I believe so. I think it fits there. It fits the UK model. Its role would be pretty limited though. I am not sure who would appoint the members of the panel. I guess the chairman would be appointed by the government. The FRC might play some role in the other membership.

I think it could have an oversight role. That does fit in with standard setting, but I do not see it as a huge role for the FRC. As a package, it fits there.

**Senator MURRAY**—The joint submission from the major accounting firms says that the role of the FRP should be expanded to include a role for adjudication of issues prior to publication of the financial statements. In contrast, your submission says:

Such a process would ... undermine the independence and professionalism of auditors and could become a process for allowing auditors not to have to make the "tough" decisions.

In your view, is it the auditor's role to make the tough decisions?

**Mr Alfredson**—Absolutely. I think it is. I was an auditor for a long time. There are tough decisions to be made at times. There are questions of interpretation. We are going from an era where there was a culture that standards could be walked around. In the past, every now and then a company would say, 'This company or that company is allowed to do this. Why can't I?' I am not necessarily talking about my experience. Of course, you never knew all the facts. In the end, you have to make a decision and you say to a company, 'I'm not willing to accept this.' The audit committee debated it. If you then rush off to the reporting panel, all that is going to do is say to the auditors, 'We don't have to make the tough decisions. We'll go to the reporting panel and get them to make the tough decision. Then we can tell our client that the reporting panel told us to do this.' I think auditors are meant to make strong professional decisions.

I was at a session recently, run by CPA Australia, where the person giving the session said, 'If you've got a financial structurer telling you to take some things quickly off your balance sheet because of the new international accounting standards, don't believe them, because the thrust of the new international standards is to get things onto the balance sheet not off the balance sheet.' I view that as a change in culture. I think people are saying: 'Let's look at the principles behind the standard. What is the intention of the standard? Let's think in terms of the principles and intention, then we might not have all of this debate.'

**Senator MURRAY**—I agree with you and I agree with you for another reason: I think the motive behind this is to avoid responsibility and, because people avoid responsibility, they can avoid liability, and that keeps them out of the firing line in the courts when things go wrong. I think the motive for this is not one we should follow, so I am glad of your answer.

**Mr Alfredson**—Often these issues are extremely complicated. People have very complex financial structuring transactions and heaps of agreements this high, and auditors form views on this because they see a whole range of transactions. When it comes to a reporting panel, they are going to get a summarised version of what this is. They are not going to have the history of all of the other ones. They are going to see a picture and they will be asked to make a decision.

**Senator MURRAY**—That is right. It is a poor proposal.

**Mr Alfredson**—The UK experience is that very few things go to the reporting panel.

**Senator MURRAY**—Justice Owen, in his report on HIH, noted the deficiencies of the urgent issues group. Justice Owen recommended:

… that the Australian Accounting Standards Board alter the Urgent Issues Group or create a separate group that is able promptly to issue binding rulings on important and urgent matters concerning the interpretation and application of the accounting standards.

What is your view of Justice Owen's recommendation, and would an Australian urgent issues group eventually be subsumed by an international body?

**Mr Alfredson**—This is probably the toughest question, and I think the future of the UIG is quite limited. With the standard setters internationally, remember that Australia is one of eight liaison standard setters. When I was there we were having meetings with the IASB about these interpretation groups. You can set standards, but if every country has its own interpretations you are not going to have comparability. David Tweedie's view is that you should not have to keep having these interpretations groups. In fact on the web site now is a list of interpretations the IASB expect to have when the standards go live in 2005. I cannot remember the number, but it would be lucky to be 15. David's view is that we should not have a lot of interpretations—we want the standards with the principles enunciated so that people can make the interpretations. If you cannot make the interpretations, we had better change the standard. For that reason, I think it is not matter of strengthening the UIG. I think it is a matter of how we are going to actually get these international interpretations when it is discovered that the standard does not lead to an easy interpretation. But I think there is a new feeling there.

If people think about the intention of the standard, a lot of the need for the interpretations becomes much clearer. If the push to think in terms of principles works, then hopefully all of these interpretations will not be necessary. But I think the proof will be in the pudding and it will be a bit tougher than that. The strange thing about all of this is that, if we are not careful, the IASB or the AASB and the equivalent of the interpretations groups might avoid making interpretations under the sort of reasoning I have been making, and the courts or ASIC might make them. If you get courts in 10 different countries making different decisions, then we will go down a crazy path away from comparability. So interpretations need a bit of work, and I think it is good that in Europe the regulators et cetera are all saying that we have to get together on these issues. I think Australia has to work internationally on sorting out how to get timely interpretations if standards are found not to work appropriately.

**Senator MURRAY**—Should auditing standards be given the force of law? I am asking this question to recognise that auditing standards would be disallowable instruments. Also there is a proposal to adopt international auditing and assurance standards across Europe, so there is a reluctance to make existing Australian standards part of the Australian law with that prospect in mind.

**Mr Alfredson**—I have heard a lot of debate about this issue. It is a bit ironic, isn't it? Originally accounting bodies asked for accounting standards to have the force of law, which forced them down the regulation path and all the other things that come with it. I am not sure that making auditing standards government regulations will actually improve the quality of audits one iota. I have heard ASIC argue, 'We have trouble implementing cases against qualities of audits,' for reasons I find completely inexplicable. From a legal viewpoint I do not know what the advantages or disadvantages are. I know from an administrative viewpoint that it will be a pain in the neck. We were always criticised for the way we drafted standards. We used to have meetings with people from Treasury and others, and they used to say, 'If you draft it that way it

won't be legally enforceable,' et cetera. I understand that a lot of the auditing standards are not written in language that has passed muster with the legal situation, but these things will be sorted out. On balance, I do not have a strong feeling.

The ultimate test is: will this whole process make any difference to the quality of audits? I have a bit of a jaundiced view. I do not think the quality of audits has got much to do with the auditing standards. When I was doing an audit, whether I did a good audit or a bad audit was a matter of (1) whether I could discover what I should discover—and probably no auditing standard would help me do that, other than in a very generic sense—and (2) if I did discover it, whether I was willing to have a strong enough backbone and make the right decision. That is what quality of auditing is all about. The argument seems to be that, if you make auditing standards regulations, it will give ASIC more teeth and auditors will do a better job. I actually do not think auditors would do a better job because ASIC might do something; they do a good job because they are dead scared of being sued these days. The stronger reason is that they are auditors because they believe in integrity and professionalism, and I think most auditors try to do the right thing.

**Senator MURRAY**—And you cannot legislate for backbone?

**Mr Alfredson**—No.

**Senator MURRAY**—Turning to the structure of the AASB: your submission says that there is a need to differentiate between the technical board of the Australian ASB and the statutory body. You propose that the AASB is the employing body but that the staffing of the AASB and the AASB itself are merged into a new entity called the Australian financial reporting and assurance institute. You say that this body could provide the technical and administrative support to both the AASB and the AuASB. You are concerned that the current structure of the AuASB will not attract high-quality professionals:

... as technical experts tend to wish to work in a collegiate style as part of a larger group, so ideas can be shared etc.

So the question is: what will happen if we do not make the distinction between the technical board and the statutory board?

**Mr Alfredson**—I think that all you would do is add administrative costs. I became chairman of the AASB in complete ignorance of all government matters. I did not know how a statutory agency worked. In fact, I was always amazed that no-one told me how they worked; I just discovered it. The AASB was a statutory authority. It was subject to all the good governance—all the requirements—that parliament, and whoever it is, put over agencies. They had to have risk management things and policies—all the good governance. We were only a 20-staff place. I used to get letters all the time saying: 'Have you submitted this? Have you submitted that?' The lesson I learnt very early in the piece was to respond to all of these letters or you got a black mark on some report that probably got tabled in parliament. It was all with the bureaucracy over a very small organisation.

I learnt that a lot of it was for a very good purpose. I imagine that, if the auditing standards board is going to be a mirror image of the AASB, it is going to have a staff of five people. It is going to need all the same things that the AASB needs, such as personnel policies and all of the

things that go with it. I think it could be a lot easier. When I first went there I used to say, 'Why is it that I have got to cope with all this and the old AASB did not?' The AASB before was apparently a statutory authority, but it did not have a bank account and therefore did not have to do certain things under some rules.

It would seem to me that you could have the auditing standards board there, the Accounting Standards Board there and the financial reporting panel there. You could have the FRC on top, and underneath it you could have one body that was the employing body that did all the accounting and policies, employed all the staff and had a simple process to do all those sorts of things. The AASB and the auditing standards board would not have bank accounts themselves and would not have to produce accounts and go through that exercise. This other body would do a set of accounts that would be clearly broken down into segments: the cost of financial reporting panel, the cost of the auditing standards board and so on. I am just being pragmatic about this. I do not have a strong view, but it would seem to make much more sense to have one employing body and one set of bureaucracy overseen by the FRC.

There might be a bit of a problem: at the AASB my role was chief executive as well as chairman, so I controlled all the staff with my technical director and my administration director. If you had one person—I am not too sure who is in it, but the Accounting Standards Board is going to be the dominant one, so the chairman is still going to be full time. I suspect the auditing one will not be full time, but I may be wrong. I suspect that the financial reporting panel will not be full time either. They will just have some technical staff and a part-time chairman. That is what I was all about—simplifying the bureaucracy that will result out of duplicating a system that currently exists and could be easily duplicated. But, as I say, is that the most cost-efficient?

**Senator MURRAY**—I just hope Treasury are following the transcript, because it makes sense to me. Moving to aggressive accounting techniques: one of Justice Owen's recommendations relates to alternative accounting treatments. In the HIH final report, in section 7.2.6 under the chapter 'Financial reporting and assurance', he said:

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

Do you agree with Justice Owen's recommendation? Should auditors be specifically required to report on alternative treatments of financial information that have been discussed with management—the ramifications of the use of such alternative treatments and the treatment preferred by the auditor? Further to that, should that discussion of the alternative treatments form part of the audit report? Should auditors be specifically required to report to shareholders and the audit committee on such alternative treatments?

**Mr Alfredson**—That is a complicated question, but my basic answer is no, I do not believe that that is the way that it should happen. The thrust of the Accounting Standards Board now is to get rid of options. Regrettably, by 2005 the IASB has not got rid of all its options—David Tweedie will openly admit that. In all the new standards, there are not options; in the old standards, there are still some options. You have to disclose which option you are under. I do not think it is up to the auditors to disclose what the impact is of one against the other. The accounts should stand by themselves.

One of the important things that the IASB have done is to amend one of their accounting standards: IAS 1. I do not have a copy with me, but it is going to require the preparers of accounts—and I emphasise 'the preparers'—to make disclosure on key decisions that are fundamental to the accounts. This has been a much-criticised improvement to the standard, but it is going to put the heat on some boards. For example, I can imagine if someone is debating, 'Is this financial structure on balance sheet or off balance sheet?' and if it has a significant effect on the financial position and the balance sheet of the company et cetera, then that decision will fall within this accounting standards requirement. The preparers—the board of directors—will have to make a decision: 'Will we have to make a disclosure?' Management and the board will have to decide whether the decision they have made is so significant that it falls within the requirements of this standard and will have to be disclosed under that requirement.

I believe that is a much better approach because the board and management will focus on these things. They will be discussed at audit committees, and in the end the auditor has to make a decision: 'Do these accounts give a true and fair view? Have they complied with the standard? Have they complied with this particular requirement?' It is yet to be tested. People have said, 'This is just one of these open sorts of standards: hard to interpret,' et cetera. It has been deliberately written in terms of the principle in direct response to Enron and all the other ones in the US, to flush out key decisions that boards make in the interpretation of standards if they have had a significant impact on the report of financial position and results of operations. I believe that sort of approach is much better than the one you mentioned. And this amendment to the accounting standard postdates Justice Owen's report. I believe it does, anyway.

**Senator MURRAY**—The CLERP 9 bill requires auditors to attend the AGM and to answer questions on the audit. The Australian Council of Super Investors have advised the committee that they are concerned about situations where the chairman of a public company has refused to allow questions to be put to the auditor about the appropriateness of the accounting policies adopted by the company. They say that the chairman's standard response is:

... the choice of accounting policies is the responsibility of directors and management.

In your view, will company chairmen likely use the same excuse in spite of the new provisions in the CLERP 9 bill? Also, the Australian Council of Super Investors have advised the committee that they recommend, to overcome the issue, that the bill be amended to require the auditor to answer questions about the basis upon which the financial statements have been prepared. What are your views?

**Mr Alfredson**—I am mostly retired these days. Last year I took the opportunity of attending a reasonable number of AGMs. At some of those AGMs, I thought auditors gave extremely good explanations of some accounting treatment. They were explanations apparently in response to notices of questions the Shareholders Association had given. One was at CSL and there was another one at Fosters et cetera. In both of those cases, I understand the Shareholders Association has said they want assurance from the auditor that the carrying value of intangibles has been appropriately considered and they should not be subject to impairment. I can only say—and I guess I could declare a little bit of interest: one of the explanations was given by a friend or former associate of mine at Arthur Andersen who is now at Ernst and Young—that I thought that with due notice the auditor had been able to put together a credible and good

explanation of the audit work that had been performed to support the decision the auditor had come to.

I think that is important. The questions of auditors of boards at present are about the conduct of the auditor's audit. The conduct of an audit, of course, requires all sorts of things, including judgments about impairment and appropriate accounting standards et cetera, so it is a pretty wide umbrella. I have no doubt that AGMs are conducted in various ways, but in these particular cases the chairman gave notice that these questions had been asked. He had given notice to the auditor and the auditor was called on to answer. I think that was very well done. Instead of just having to jump to his feet and give a quick response off the top of his head, the auditor was able to put together a small presentation, which I think was appropriate.

I think AGMs are just terrible. I swore I would never go to a particular company's AGM again because I could not stand the continual asking of the same questions by various activists. These meetings have got completely out of control. But I do think that one of the things that ought to happen is that, if questions are going to be asked about the accounts and some other issues, they ought to be put in writing before the meeting. This particularly applies to auditors because auditors have to give technical responses et cetera. If a shareholder is so worked up about some question, I see no reason why the shareholder should not be prepared to put that in writing prior to the meeting so that an answer with due consideration can be given. I am not saying that supplementary questions should not be allowed et cetera, so there could still be questions from the floor. But if people want genuine and good answers to technical questions, they ought to give notice of them.

**Senator MURRAY**—These sorts of issues are always directed at circumstances where you do not have best practice. You can imagine the HIH chairman just refusing to let the auditor answer questions. It probably would have been enlightening if they were able to. I did not attend an AGM, so I do not know what happened there. But it would seem to me that, from your remarks, what you are saying is that, given the separation of powers and the checks and balances which this bill is trying to introduce between the board and auditors, if notice is given in writing, for instance, the chair should not have the ability to refuse to give the auditor leave to answer the question. The bill wants auditors there at the AGM. That means they are there for a purpose—to answer questions.

**Mr Alfredson**—I do not disagree.

**ACTING CHAIR**—Thank you, Mr Alfredson, for your very thoughtful contribution. I do again apologise for the late presentation.

**Proceedings suspended from 1.08 p.m. to 2.31 p.m.**

**MASSON, Mr Rodney, National Communications Manager, Finance Sector Union of Australia**

**ACTING CHAIR**—Welcome. The committee prefers all evidence to be given in public, but should you at any stage wish to give any part of your evidence in private you may ask to do so and the committee will consider your request. The committee has before it a written submission from the Finance Sector Union—submission No. 38. Are there any alterations or additions you would like to make to this submission at this stage?

**Mr Masson**—No, there are not.

**ACTING CHAIR**—I invite you to make a brief opening statement.

**Mr Masson**—Thank you for the opportunity to appear today. The Finance Sector Union represents some 65,000 people employed in the finance industry, and we appear before you on their behalf and as a major stakeholder in an industry that is grappling with corporate governance and corporate social responsibility. We also make the point that many of our members are shareholders, either in their own right, as part of an employee share scheme or via their superannuation fund. As such, we generally support the majority of the proposed reforms put forward in CLERP 9, insofar as its intent is to increase the transparency, independence and accountability of company directors and executives in the decision-making, reporting and performance evaluation.

That said, the main focus of our submission is twofold. Firstly, we want to highlight that unfortunately it is the actions of those from our industry that is, in the main, the reason we are here debating this legislative reform. While there is now a global movement on corporate governance and social responsibility, and there have certainly been other notable global corporate shipwrecks, such Enron, WorldCom and, back home, One.Tel and Ansett, much of what has come to light here has come about from the HIH collapse and the subsequent royal commission. There is no need for me to point out that HIH was a disaster of monumental proportions which reads like a textbook on how not to run a listed company, but it is important to understand that it did cost 1,000 people their employment, and many of those people were our members. Secondly, we believe that corporate governance has an intrinsic link with corporate social responsibility, and we want to challenge our industry and law makers to take the lead in the growing global debate around corporate social responsibility by using the opportunity of corporate law reform to go further and move the debate from shareholder interests, as important as that is, to a broader sustainability agenda of stakeholder interests.

We believe the Australian parliament has a role in pushing Australian corporations, especially those in the finance sector, forward on the process and genuineness of developing sustainable practices and measures for all stakeholders as part of this review. As mentioned, our industry tends to exemplify behaviour that commands corporate governance reform, whether it be questions about auditor independence, non-executive director independence, massive executive severance payments even following questionable performance, multi-directorships and multi-chairmanships across ASX listed companies, non-executive retirement benefits or anything else. The list goes on and on.

For the committee's interest, here are some examples from the recent reporting period: Westpac's Dr Morgan's 'Give it to me or find someone else to do it' offer to shareholders to have them endorse the granting of a further 3½ million share options to him; AMP's decision to give a pool of 40 million as a one-off 'stay with us' payment to executives and then announcing a record corporate loss of $5.54 billion and informing the market that they will also be looking for further cost savings, refusing to rule out that they may include job cuts; NAB shareholders endorsing a remuneration package for Frank Cicutto that could have seen him earn up to $10 million per annum over three years—in hindsight, that may not have been great; shareholder concern about individuals holding more than one chairmanship of ASX listed companies, being on more than four boards of ASX listed companies and holding directorships in excess of nine years; concerns about boards being out of touch with business were aired at the ANZ AGM in December; and last but by absolutely no means least, the National Australia Bank and its risk management and audit mechanisms from board level down failing to guard against practices of forex trading that result in a $360 million loss, resignation of their CEO and chairman, dismissal of numerous personnel including executive management, revelation that the board lacks banking experience, boardroom division over the independence of the PricewaterhouseCoopers report, severance of relationships with KPMG, their auditor, an extraordinary general meeting called to sack a director or directors, daily media scrutiny, brand damage and undermining of consumer confidence, and staff morale damage. In our view, sadly, it is all there in our industry and it is done against the backdrop of a decade of profiteering and cost cutting that saw the loss of tens of thousands of jobs from some of those major institutions and certainly the loss of access to essential financial services for thousands of Australian communities.

As our submission states, the key area that we believe requires reform is that of executive remuneration. In our submission, we detail the excessive executive remuneration across our industry. To update that, at least for the big four banks, we can inform the committee that a combined total of $20 million was paid to the four CEOs in the past reporting season. This does not include the retirement benefits paid to Frank Cicutto, rumoured to be a further $14 million. As we point out in our submission, it is possible for CEOs in our industry to make as much as 74 times the average weekly earnings in the sector; and as much as 188 times the weekly earnings of front-line staff, who earn considerably less than the average. Recent analysis in the *Financial Review* shows that over the past 20 years CEO salaries have risen by as much as 1,500 per cent from an already relatively high base in our industry.

These earnings are generally enhanced with major equity holdings or options that provide massive, often short-term incentives for individual executives, generally solely based on share price. Not surprisingly, such arrangements have done little to promote the interests of all the organisation's stakeholders and have undoubtedly contributed to decisions based on short-term goals that have resulted in harsh, short-term, short-sighted cost cutting.

It is here at the executive remuneration level that we begin to make the link between best corporate governance practice and corporate social responsibility. It is our contention that the performance of a corporation—particularly a government licensed financial service provider—and of those directing it should be measured more rigorously and with a view to greater sustainability. We argue that a stakeholder based approach encompassing shareholders, employees, consumers and community groups provides the best framework to defining sustainable practice and therefore corporate key performance indicators. We would suggest that

those KPIs can then be used and endorsed by shareholders and be the measurement for performance set for executives with regard to their remuneration.

Apart from countless examples of executive excess and poor corporate governance as a reason to change current practice, recent experience also tells us that this approach can provide a practical option for better governance. In December last year, we had the experience of running our national president Joy Buckland, who is an ANZ employee, shareholder and branch manager, for a position on the ANZ board, seeking to highlight the plight of employees and customers within the bank. Joy received fantastic support from thousands of mum and dad shareholders who recognise the importance of employees and customers to the bank's sustainability. By the bank's admission, Joy won the support of the meeting of the day and picked up proxies from a range of others to give her 33 million votes for. But this was never going to be enough, and she was comfortably defeated on institutional and other proxies exercised by the board. But the lesson was drawn, and the ANZ CEO, John McFarlane, agreed to listen to concerns being raised and agreed to meet with the FSU. There were others too on the board who sought the FSU out to talk to them about other matters that had been raised through that process.

The AGM challenge had demonstrated what we would term a disconnect between the executive boardroom and the front-line experience. It had demonstrated a divide between what was being said by the bank to shareholders and what was the reality. In many people's minds, it raised the need for a more rigorous process of developing goals and being accountable for them for key stakeholders. We contend it was positive for the organisation, but we understand that unless compelled they will not progress the issue.

I think the NAB debacle has also raised serious concerns about where the rubber hits the road at board and executive levels. The reports into the forex process seem to come back to the theme of a culture of arrogance pervading senior management levels and perhaps obscuring the reality. You start to see a theme developing: the obfuscating of the executive and the board, the executive and the board seemingly beyond approach, saying the right things but not being subjected to the rigour of direct feedback and input by stakeholders. It starts to become a little like Dory in *Finding Nemo*: 'Just keep swimming. Just keep swimming.' We believe that a more rigorous and accountable stakeholder based approach to performance can only be beneficial for the sustainability of the company and can only be beneficial in bridging the divide between the board and executive and the real world experience.

They are just a few of the recent happenings in the finance industry, but we believe they go to the heart of the debate before us—that is, the need for greater transparency, independence and accountability in our corporate governance legislation. To that end, we support the measures that move us in that direction. That is why we have submitted that further steps can and should be taken to enforce greater transparency and accountability amongst our corporations. Our submission details such steps and I am happy to try and expand on those where requested and to expand on our recent experiences.

**ACTING CHAIR**—I call Senator Conroy for questions.

**Senator CONROY**—I defer to Senator Murray. I have taken up too much time this morning, so I will allow my colleague to kick off.

**Senator MURRAY**—I will repeat for the record that I thought your questioning was very much to the point. I am more than happy with it. Mr Masson, thank you for your submission. I assume it is from both a shareholder and a stakeholder perspective, in that many of your members through the various super funds are effectively shareholders in many of the companies that are the subject of this legislation.

**Mr Masson**—Yes, to recognise that they are shareholders and that we are looking to clearly make a beneficial outcome for them as both stakeholders and shareholders.

**Senator MURRAY**—I want to first address your recommendation 2, which states:

That the protections for whistleblowers to be offered in relation to the Corporations Law be extended to other legislation.

Are you aware that the Senate workplace relations legislation committee is looking at the building and construction industry legislation, with part of its reference being to look into the potential for whistleblower protections to be put into workplace relations legislation directly so that it can apply to non-corporate entities, such as registered organisations, contractors and so on?

**Mr Masson**—I was not specifically aware that the Senate was doing that. However, one of those areas of law that we would be suggesting needs to be looked at with regard to protections for whistleblowers would indeed be the Workplace Relations Act. That would be, in our opinion, because those protections would allow employees who are penalised as a result of their whistleblowing activities to pursue appropriate justice and recompense other than in the normal court proceedings. Presumably, they would then be able to have access to the Industrial Relations Commission under the unfair dismissal if it was a dismissal issue, so we would support that move into that legislation.

**Senator MURRAY**—Were there any other areas of legislation that you would seek it to apply to? As you know, it does apply in a limited fashion to the Public Service Act. I think it is section 16.

**Mr Masson**—I would be prepared to take it on notice and come back to you. The Workplace Relations Act is the one piece of legislation that I would be aware of.

**Senator MURRAY**—In recommendation 8, you say:

Proposed sub-section 250R(2) should require the directors to put and allow the shareholders a vote on a binding resolution as to whether to adopt the remuneration report.

In your evidence you have also indicated that some of the multiples of average weekly earnings are stratospheric. I have put a proposition that above 20 times average weekly earnings—which would equate to around $1 million—cash and non-cash, as a threshold should require a binding vote from shareholders. I have the view that a non-binding vote is a ridiculous idea. You have a binding vote at present on equity measures, so it is really a non-binding vote on monetary measures. It does not make sense to me. I believe that the remuneration of directors, as distinct from staff—and I deliberately use the word ‘directors’ rather than management, because

directors include executive directors—should be ticked off by their shareholders. Is that what you mean by a binding resolution, or were you meaning something different?

**Mr Masson**—We have not put the ceiling or floor—whichever way you want to look at it—that you are discussing into that proposal. But, yes, we are talking about a binding resolution where shareholders vote and directors are bound by the outcome of that vote. We too struggle with the concept of non-binding resolutions and precisely what that means. It is our view that equity matters should be subject to binding resolutions, but the remuneration itself of executives by directors, in accordance with the way you have used the term, should therefore come into effect.

**Senator MURRAY**—I have questioned witnesses on this matter at other hearings. In today's hearing, for instance, I questioned Stephen Mayne as to why he supported a non-binding vote, and he said, 'Well, it's a step forward.' To take another step, surely a binding vote is the way to go. I asked an earlier witness, Mr Paatsch: 'If judges, politicians or schoolteachers determined their own salaries, do you think it right that they then vote on it as well?' Obviously the answer is no; yet directors, even through remuneration committees, which they themselves appoint—and even if they are non-executive directors, they are still the same people—are in effect determining their own remuneration, deciding on it and voting on it. It just seems to me to be an impossible concept.

**Mr Masson**—Yes, and we would probably go a step further, particularly in our industry, and say that if by a non-binding resolution it is the view that somehow we will panic or shame those putting forward that resolution into not pursuing it, we would suggest that that could take an awfully long time, in which there could be a huge explosion of wages—given our experiences with, in particular, publicity surrounding the organisations in which our members work and trying to, I guess, publicly have them reconsider their activities. An example would be the five-year period in which we opposed major banks closing branches across this country. We made massive headlines publicly; however, 2,000 branches still disappeared. So I am not sure that a simple process of shaming or voting in the particular rule and it being non-binding will necessarily stop what is a fairly explosive executive remuneration process within our industry.

**Senator MURRAY**—Attached to the issue of votes, whether binding or non-binding, is the question of validity, I suppose. That means that the votes should be validly exercised and should be exercised in sufficient numbers. There have been two criticisms of voting at present. Firstly, proxy votes tend to just end up in the hands of the chair, which to me does not suggest the valid exercise of a responsible vote; it is just an abrogation of responsibility. The second issue is that too few people are voting. Labor and the Democrats but not yet the government believe that there should be an increase in compulsory voting provisions. At present you only have to have votes on a certain number of issues in the Corporations Act. The Labor Party have suggested that be done by institution—namely, super funds—and that they should be required to vote their shares, whereas we are also interested in the question of subject matter. We think there are certain areas of determination which are so critical to the company that there should be a compulsory vote.

When we talk about a compulsory vote we cannot talk about mum and dad. We can only talk about those who hold shares in escrow or who have a fiduciary duty to cover on those shares. We think that the most important subject matter issue is directors. We think the role of the board and

the role of directors is so important not just to the company but to Australia that the election of those directors should be determined on a compulsory voting basis. What do you think of that idea?

**Mr Masson**—Based on our experience through the ANZ campaign of last year, many of the funds managers and trustees of super funds—I place them separately—that we spoke to would assure us that they exercise their vote and are instructed to exercise that vote. Our view would be that, if that is the way things are moving, there should be no concern about them being compelled to exercise that vote and, further, for that vote to be known by shareholders. So I suppose in a sense where funds managers are voting they should make known the way they will vote. Indeed, where super fund trustees are voting, they should make it known how they will be exercising their vote, and perhaps that is a lead-in step that then goes to the next point of super fund members actually being able to engage and direct trustees with respect to how they may exercise that vote. But that would be a further step down the track somewhere.

**Senator MURRAY**—I want to draw your attention to recommendation 14 of your submission. At the fourth dot point of that recommendation you said:

> ASX listed companies boards should be comprised of independent non-executive directors. The definition of independence should be that set out by the Australian Council of Super Investors.

And you give a footnote. I want to deal with those two sentences separately. Do you really mean that there should be no executive directors on ASX Ltd companies' boards or do you mean that, if there are non-executive directors, they should be independent?

**Mr Masson**—No, I would not think we are trying to state that there should not be executive directors.

**Senator MURRAY**—So it is the latter: you want non-executive directors to be independent?

**Mr Masson**—Non-executive directors should meet the criterion of independence.

**Senator MURRAY**—I want to test that proposition with you a little. You have given us the list from the Australian Council of Super Investors corporate governance guidelines. It is a concern of mine—and I have expressed it all the way through this inquiry—that 'independence' is poorly defined; despite this list, I still think that comment applies. By that I mean that it seems to me non-executive directors are frequently, perhaps almost always, elected as a result of patronage and that patronage comes from either dominant management or dominant financial interests—the mates club sort of thing.

I wonder whether a way around definitions of independence, at least in law—because I think guidelines are valuable in other organisations like ASIC, ASX or, indeed, the super investors—would be to have not a principles based definition but one which would simply say that, if a director owes his or her position to an appointment through tenure or remuneration resulting from any dominant financial or management interest, they are not independent. Attached to that, of course, would be the need for a declaration by the board about anyone who in those terms signed themselves up as being not independent. Do you follow what I am saying?

**Mr Masson**—I think I do. To us, anything that strengthens the independence of non-executive directors is favourable. I would need to take away exactly what you are proposing and have a better consideration of it.

**Senator MURRAY**—Perhaps it would help you if I were to phrase it a little differently. Because as legislators we deal with so much black-letter law, we are often concerned that the criteria we introduce can never be exhaustive. Therefore legislation frequently says, 'Well, the criteria will be established by a regulator,' because that means they can adapt and change it over time. My instinct is that the independence issue needs to be dealt with on the same basis—that the law should simply say that, if you declare yourself to be independent, you must meet the criteria, and the criteria will be established by ASIC, for instance. But I also think the law needs to establish at least the outline of a principle on the basis of which you could not be seen to be independent. In my view, if you are subject to the patronage of either dominant management or dominant financial interests you cannot be independent.

**Mr Masson**—Again we probably need to take that on notice. I cannot give you a definitive response on that.

**Senator MURRAY**—I would be interested in your thoughts on that. My next question relates to the number of directors where in that same recommendation you wish to prohibit multiple shareholdings—to not sit on more than four boards; and, if you are a chief executive officer, to not sit on more than one board et cetera. Like all of these things it is arbitrary. Why four and not five; why four and not three? It is that sort of question. Again I wonder whether there is not a better way to approach what you are after, which I see reported very commonly, and that would be by this concept: provided that you are not a related entity—'related entity' in Corporations Law means entities symbiotically attached to each other, and I see no problem in somebody being a multiple director in those relationships—in any company that would have a material relationship or material interest which would affect the company of which you are a director; and you could not be a director of both. So if somebody is a director of NAB, they simply could not be a director of any other company—

**Mr Masson**—Of KPMG, for instance.

**Senator MURRAY**—which had interests in funds or investments in which NAB had a material interest. I think that would avoid the need to say, 'You cannot be chair of more than this and director of more than that.' It would rule out the conflict of interest situation. Do you want to think about that and perhaps come back to us on it, or do you have a view you could put to us straightaway?

**Mr Masson**—I think I understand that point. The only other matter that may not be considered in that is the capacity of an individual to devote enough time, energy and resources into performing the job. As an example—and here I certainly do not cast any aspersions against the individual that I will mention—the chairman of a major bank is also the chairman of a major petroleum company, and both the bank and the company would be on the list of the top 15 ASX companies. I suppose our concern goes to whether, if we go down the track of better corporate governance and better corporate social responsibility, we get to the point where an individual simply cannot perform all of the functions associated with being the chair of both those companies. That would be our concern. I understand your point about the conflict of interest, and

I think it is worth further consideration. But I just wonder whether that also covers off the issue of individual capacity and resources to do the many and varied functions that directors and chairmen do.

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

**Mr Masson**—Yes, we believe it should. We believe that remuneration of the top 10 executives as well as the directors, particularly where an equity payment is involved, should be disclosed up front and in real time.

**Senator CONROY**—The Corporations Act, as it currently stands, states that shareholder approval for retirement benefits is only required where the payment exceeds the amount prescribed by a formula—and there is a formula there. But, in spite of these provisions, retirement payments can still be made without shareholders' approval. I do not want to pick on Mr Frank Cicutto, but he is the most recent example. He was there for 27 years and his remuneration, which did not require shareholder approval, could have been astronomical—way past even the rumours that you have suggested; it could be $20 million or $30 million. Under this formula that sort of figure would not go to the shareholders for a vote. In your view, should these termination payments be approved by shareholders?

**Mr Masson**—We believe that full remuneration issues should be approved by shareholders and their disclosure needs to be far more specific and clear so that those who are not necessarily financially literate have no difficulty in understanding them and then comparing them back over time to see what growth has occurred.

**Senator CONROY**—Your submission argues that the CLERP 9 bill should reflect ASX corporate governance guidelines and require that termination entitlements be disclosed—as you have already said—at the time they are agreed as well as at the time they are paid. In your view, why is it so important for disclosure of termination payments to be made up front and not just at the time of payment?

**Mr Masson**—I think it better allows the nature of the relationship between the individual and the corporation and, therefore, the nature of the liabilities that will exist within that relationship.

**Senator CONROY**—Should non-recourse loans to directors and senior executives be prohibited? A non-recourse loan is the sort where all of the upside is on the employee or CEO and the downside is picked up by the shareholders if the share price tanks and ends up below the gift price, if you like. So you have actually made a loss, but the shareholders pick up the loss.

**Mr Masson**—No, we would think that that type of arrangement would be totally against the provisions where you are setting performance hurdles and asking them to meet them. It is some form of a 'it doesn't matter if you fail, we'll still pay you' type of arrangement—

**Senator CONROY**—Absolutely.

**Mr Masson**—and we would not accept that that is appropriate, nor would those executives accept that it is appropriate for our members.

**Senator CONROY**—The FSU has had a lot of experience in relation to shareholder activism with your recent campaigns, including the campaign to elect a member to the board of the ANZ. What resolutions did the FSU propose at the ANZ AGM other than the election of the director? What other issues were you canvassing?

**Mr Masson**—There was no other resolution except the proposal for Ms Buckland's election. However, we did gather 100 signatures in order to put forward a statement in support of her candidature, which allowed us then to have the ANZ circulate that statement to every shareholder. Again, it allowed us to raise within that context the issues of import to us and to the customers that Joy sought to represent.

**Senator CONROY**—Stephen Mayne has already advised the committee how difficult he finds it to obtain 100 signatures to propose a resolution. How difficult was it for the FSU to obtain the 100 signatures required to put up the resolution for the election of a director?

**Mr Masson**—We found it reasonably difficult. I suppose we have a bit of an in, in the sense that a number of both our members and our retired or associate members, as we call them—those who are no longer working for the organisation—are shareholders. That allows us, I guess, to access at least that range. However, it is not an easy thing. It does take a fair bit of work in terms of being able to publicise the call and to have people accept and understand exactly why you are doing it and then provide their signature. So I would imagine that, for an individual such as Mr Mayne, it would be an almost impossible feat.

**Senator CONROY**—In your view, should companies be able to override the 100-member rule and instead require five per cent of shareholders just to propose a resolution at the AGM? Boral recently have done this—they have actually overturned the situation. What are your thoughts on that?

**Mr Masson**—We would absolutely oppose that. We cannot understand why these organisations would seek to further hide their operations or seek to be not accountable to their shareholders and, indeed, their other stakeholders. We would think that any move such as the Boral move simply seeks to further put up smokescreens which we do not think need to be there. Transparent and accountable corporations will be good corporations.

**Senator CONROY**—Did you try and put up any resolutions for the ANZ AGM that were rejected? Did you enter into any discussions?

**Mr Masson**—No, not last year, but we have previously. From memory it was in 2001. We sought to place a resolution that went to issues around employment and therefore customer service, specifically staffing levels and sales targets that are confronting people in the front-line operations of the organisation. We secured the required 100 signatures for that resolution and we were informed by the organisations—that is, the ANZ, National Australia Bank and Westpac—

that those resolutions were not within the constitutional framework of the organisation and should not be put to shareholders as they were a matter for management only.

**Senator CONROY**—Did you get any legal advice on that at all, or did you just take the knock-back and move on?

**Mr Masson**—No, we certainly did not cop it lying down. We did seek legal advice, and we were informed that legally we were probably in the right and we should proceed to court on the matter. However, when you are lined up against three of the big banking organisations you may want to consider other options. As it turned out, after further discussions with the organisations they allowed us to speak, as a normal shareholder would, from the floor and raise those concerns, which they were prepared to respond to; however, they were not prepared to allow it to be put as a resolution to the meeting.

**Senator CONROY**—Are there any other resolutions that you have tried to move at other AGMs?

**Mr Masson**—Not that I am aware of.

**Senator CONROY**—Were you able to obtain details of how institutional investors voted on your director candidate?

**Mr Masson**—We did not specifically seek details, but we were not given any direction as to how we might do that, other than those super funds that had informed us that they would be supporting us. But no, we did not seek those details.

**Senator CONROY**—Did you try or were you able to obtain details of how institutional investors voted on the resolutions proposed by management—that is, the ones they put up themselves? Were any of them relevant?

**Mr Masson**—Only in the sense that we understood the final voting outcome in figures. But no, we did not know specifically which institutions voted where.

**Senator CONROY**—Sure. Fund managers are opposed to a proposal to disclose their voting records—how they vote. Do you have any thoughts on that?

**Mr Masson**—We think it is a good thing. We would support fund managers—I think it may actually be in the submission—making public their views on particular resolutions and how they have voted at particular AGMs, if for no other reason perhaps than to inform those within their funds, as well as the shareholders of the corporation they are voting on, as to the type of methodology or the policies that they are implementing with regard to shareholder activism.

**Senator CONROY**—In your view, should trustees of super funds be required to disclose their shares and their voting records?

**Mr Masson**—Yes.

**Senator CONROY**—Your submission states that certain non-audit services may compromise an auditor's independence. Could you advise the committee which non-audit services should not be provided to a company by the audit firm?

**Mr Masson**—Probably just about everything. Specifically, there are seven areas, as stated in our submission:

- Preparing accounting records and financial statements;
- Internal audit services;
- IT system services;
- Broker or dealer services
- Investment advice
- Investment banking services; and
- Legal work

But in general we would support the view that perception is reality in this instance, and they do need to maintain the perception of total independence.

**Senator CONROY**—Thanks very much.

**ACTING CHAIR**—That concludes our discussion. I thank you very much for your submission and for answering our questions.

[3.15 p.m.]

**BRAYSHAW, Mr Geoffrey Frank, Managing Partner, BDO Chartered Accountants**

**KNOTT, Mr Jeffrey Francis, Partner, BDO Chartered Accountants**

**REID, Mr Kevin Richard, Partner, BDO Chartered Accountants**

**ACTING CHAIR (Senator Conroy)**—Welcome. The committee prefers all evidence to be given in public, but should you at any stage wish to give any part of your evidence in private you may ask to do so and the committee will consider your request. The committee has before it written submission No. 50 from BDO. Are there any alterations or additions that you would like to make to the submission at this stage?

**Mr Brayshaw**—No.

**ACTING CHAIR**—I invite you to make a brief opening statement of not more than five to 10 minutes and then we will proceed to questions.

**Mr Brayshaw**—I am the managing partner of BDO in Perth and I was President of the Institute of Chartered Accountants in Australia in 2002. I am an audit partner in our firm. My colleagues are also audit partners. Jeff Knott is from our Melbourne office and Kevin Reid is from our Sydney office. On behalf of BDO I would like to thank the committee for the opportunity to discuss the CLERP 9 bill. By way of introduction, BDO in Australia is a federation of independently owned firms which belong to the BDO International network. We employ some 85 partners and over 700 staff nationally, and over 23,000 staff in 100 countries around the world. We audit a wide range of companies, including a number of small to mid-cap ASX listed companies.

We support the principles based approach reflected in the CLERP 9 bill. Together with the Institute of Chartered Accountants' independence requirements, ASX listing rules and principles of corporate governance, CLERP 9 will place Australia at the forefront of global corporate governance practices. The initiatives taken over the past two years should go a long way to restoring the public's faith in the independence of the auditing profession and the quality of financial reporting. BDO participated in the joint ICAA and CPA submission, which suggested some technical improvements to the bill, and we note that a good number of those amendments were adopted. There are a few areas which I would like to touch on where we believe that further improvements can be made to enhance the practical application of the bill.

I will just reiterate a general point we made in our submission. We believe that there is a need for a balance to be struck between regulation and a principles based approach. The regulatory environment should not discourage skilled people from entering or leaving the auditing profession. A more regulated environment may discourage graduates from joining the profession with a view of partnership. Existing partners may see the responsibilities as being out of kilter with the rewards. If this happens, there may well be a detrimental impact on the quality of audit and financial reporting.

The ethical rules of the Institute of Chartered Accountants have well established standards of behaviour for the profession and have been strengthened by the recently introduced code of professional conduct, F1. This expands the principles of independence and sets out rules and guidance. I have no evidence that the current regulatory environment will have the impacts I mention. However, we do believe that a review of the impacts of CLERP 9 should take place in three to four years and that review should consider the impacts on entrances into and departures from our profession.

The second area I would like to touch on is the rotation of auditors. In general terms, rotation of auditors is the right response to the threat of familiarity. However, capable listed company auditors in small firms may be unable to rotate, and for that reason will not only lose audits but also be uncompetitive for potential audit appointments. If this happens, there will be some reduction of competition in the marketplace. Therefore we continue to hold the view that rotation should be restricted to the ASX All Ordinaries Index or the top 500, although I might mention that in the latest Corporate Governance Council comments they had actually restricted it to the first 300—or their amendments had been made to the first 300.

In addition we believe that ASIC should have and use greater flexibility in cases where the strict letter of the law rules out an auditor, but circumstances are such that rotation will be achieved in the short term; for example, an impending merger or appointment of a new partner. We do not agree with the application of rotation of the review partner outside of the large listed companies. Review partners do not play a major role in smaller listed company audits and should be allowed to replace the lead partner. Review partners for smaller listed companies act in a quality control role and have little, if any, face-to-face involvement with management and the board. Therefore the review partner role, by its nature, does not introduce a threat of familiarity.

Audit managers and the audit team should not be forgotten. While most firms endeavour to maintain some team consistency from year to year, there is rotation. This is healthy in terms of bringing new ideas and perspectives to the audit. Additionally there are invariably changes in the compositions of boards and management, which in itself precludes familiarity at a personal level.

CLERP 9 will give auditing standards the force of law. Given that we abide by these standards already, one could argue that the profession should not be afraid of this. However, it is our view that this will result in a more prescribed approach being taken to the audit process and the reduction of the application of professional judgment. This will increase the cost of audits, and a tick-the-box approach may mean that auditors lose sight of the big picture. This, in our view, will not improve the quality of audit opinions but is most likely to increase the cost.

The financial reporting panel will have the power to consider disputes between ASIC and companies, but this process will only occur once a financial report has been lodged. We believe it would be better if the FRP could act in a pre-vetting capacity as well as a post-vetting capacity. This would be to the benefit of an informed market. In terms of practical application, it is unlikely that this mechanism would need to be used on a regular basis.

On the subject of executive remuneration, we have noted that the definition of ‘company executive’ varies from that in the new accounting standard AASB 1046, about director and executive disclosures. It is possible that there will be interpretational difficulties as a result. The

definition of 'executive' in CLERP 9 includes senior managers. A senior manager is defined as 'a person who makes or participates in making decisions that affect the whole or a substantial part of the business'. Under AASB 1046 an executive is described as 'a person who is directly accountable and responsible for the strategic direction and operational management of the entity'. While one deals with the contents of the directors' report and the other with the content of the financial statements, it does not make sense to have different definitions of an executive.

Thank you for the opportunity to expand on our submission. We would be happy to take any questions.

**Senator MURRAY**—I first want to deal with your issue of the definition of 'immediate family member'. Being an accountant, you might not be aware of a health experiment a decade or more back in America, where they decided to do some genetic testing to see how diseases were passed on from family members. They took a large test population and they tested the children and the parents and they discovered that 20 per cent of the children did not have the fathers they thought they had, which caused some problems. You can imagine that the immediate family member might in fact be somebody you were unaware was a family member. That has led me to a saying: maternity is a fact but paternity is an opinion.

**Mr Brayshaw**—Is there a question?

**Senator MURRAY**—That is a longwinded way of saying—

**ACTING CHAIR**—I am glad you are going to get to a question, Senator Murray!

**Senator MURRAY**—It is a longwinded way of saying that it is important to have precise definitions. You have said that the definition should be confined to an auditor's spouse and dependent children. Whether the children are yours or not, 'dependent' cannot be argued, so I have sympathy with your views.

**Mr Brayshaw**—I think that has been amended in the final CLERP and I am not sure that we have too many problems. I am not sure that we want to get into the genetics of the process.

**Mr Knott**—Unless the senator is questioning our paternities!

**Senator MURRAY**—I know that accountants lead sheltered lives so I did want to bring that to your attention. We had an interesting interaction earlier today with Keith Alfredson, who is a man of great ability and integrity in our experience—and I use 'our' deliberately because I include Senator Conroy in those remarks. Mr Alfredson was not at all sure that it is necessary for auditing standards to have the force of law, and in your supplementary remarks I think you were taking the same view. Is that an accurate view?

**Mr Brayshaw**—Yes, that is an accurate view.

**Senator MURRAY**—There seems to be a consensus among witnesses that all that the Corporations Law should do is say that there should be auditing standards, that there should be professional bodies which design those auditing standards and that you should be a member of

the appropriate body, but that you do not need to go further than that. Is that an accurate rendition of your view?

**Mr Brayshaw**—Yes, I would think so, as a summary. Historically, through the auditing standards board, which was funded by professional bodies, auditing standards were developed. There is also the observation that you now have harmonisation. It is not just a matter of the local professional bodies preparing those auditing standards. There is a matter of harmonisation with international auditing standards, so we are not preparing those in isolation from best practice around the world.

**Mr Knott**—I would like to add a supplementary comment there. Whilst recognising the likelihood of legislative backing to the standards, having legislative backing to what is judgment in the formation of an opinion is an interesting concept.

**Senator MURRAY**—Yes; I think the point is taken. Moving to the expansion of auditors' duties, this bill has a lot to say about auditor independence but it has never come to address the nub of the problem, and that is that the separation of powers is not apparent in an actual sense—by which I mean that the appointment of auditors is still left in the hands of the main board. People like Dr Shann Turnbull and I have conceived of an alternative route within a company to resolve that issue through what I refer to as a corporate governance board and what he refers to as a corporate senate with a different approach. You are probably not familiar with it and I will not take you through it now. The other alternative for the appointment of auditors, to prevent the main board from appointing them, is through a body like ASIC having a register from which people could select. In your submission of 28 November 2003, with respect to the expansion of auditors' duties, you remark:

> An effective audit is dependant upon the quality of the relationship between the auditor and the audited body. The expansion of the auditor's duties has the potential to reduce the quality of the relationship if the auditor has a policing role.

That, to me, is a sure sign that you are not independent. I will just qualify that and then I will ask you a question. I am not making a pejorative remark. If ASIC come in and do a job and they are doing a policing job at the same time, so what? They are independent of the ATO or anybody else. By that remark you recognise that the relationship is qualitatively different. Really what I am saying is that it shows that, if you were appointed from outside and paid by someone outside in some way—I cannot imagine how it would work, but if you were—it would not be such a bother to do the policing role as well. I wonder if you might react to whether that does in fact exhibit the judgment I have that, for as long as an auditor is appointed by a main board—particularly where that board are constructed through a system of patronage, which generally speaking they are—it is very different to escape and be completely independent.

**Mr Brayshaw**—In saying that we have a relationship with our client, to do an audit it is necessary that you have a relationship which is reasonably open. If you want to have an understanding of the client, how it operates and what it is up to—and all those things are necessary for your audit judgments of inherent risk and all those aspects—you do need to have a client who is open to that discussion. But if that client was also thinking, 'Why are they asking that question? Is it a policing role or an audit role?' then I think you are going to find that you will get yes/no answers rather than a description of what is going on. I really think that what will impinge on the ability to do an audit is that you are going to have a closed shop approach to

those types of discussions. The relationship is not a personal relationship; it is the open relationship that the auditor needs and, if you do not get that cooperation and information because people think that you are going up blind alleys to find out if there is a Corporations Law breach or something else—the policeman's role—then I think you are going to lose a lot of that information you necessarily need to do the audit.

**Mr Reid**—Can I just say that the relationship we are talking about here is generally one that relates to management. Given the short timetable that we have to complete audits these days under the new regulations, there needs to be good corporation between the audit team and financial management. That is more what we are talking about here in the relationship aspect. If it is not a workable relationship and they believe that we have got that policeman role, then it is going to make things more difficult.

**Senator MURRAY**—Both those answers make a lot of sense to me. I want to ask you about the way in which the legislature have tried to resolve that problem in similar circumstances—I do not think they have succeeded. The ATO, the ACCC and ASIC all have provisions whereby they can go to a company and ask questions, but the answers to those questions may not be admissible in court. In other words, the intention is that you can explore it fully and get the goods without the person fearing that is going to put them in the chook. I do not think it resolves the relationship difficulty you have just outlined, but do you think there should be such a protective device in this legislation, if it goes through, that information freely given in your inquiries is not admissible in certain circumstances in court to keep the relationship open—if the government is going to insist that you have a policing role?

**Mr Brayshaw**—I suppose I have a fundamental problem with believing I have a policing role. To think that I have to have that type of protection in order to carry out an audit I find very difficult to believe. I have a problem with the fact that I am carrying out such a role that requires such protection. It is foreign to my belief in how you go about doing audits and needing that type of protection.

**Senator MURRAY**—I think you are right: there is a real problem. That is why I said to you earlier that I believe, unless you are appointed by somebody other than the main board so that you are actually sent in almost as a regulator, not as an auditor in the traditional sense—

**Mr Knott**—I do not know that they are mutually exclusive. Given the way the Australian market has developed as a free market and given the evolution, in more recent times, of the tender process for the selection of auditors, be they in the public company arena or in other arenas, and audit committees, I do not know that it is absolutely necessary to have the auditor come forward as a regulator or part of the regulatory model—particularly when, at the end of the day, as I said earlier, the process involves the formation of a professional opinion. If there is a certification, tick a box mentality, perhaps a regulator is the appropriate way to go forward. Even in the case of regulators, where we talk of ASIC and APRA, I perceive that in the case of ASIC, for example, there might be circumstances where they would like to walk into a company, whereas APRA might have a view of looking at the public interest—looking through the issues that are there and asking whether there is a broader public interest to be gained by a discernment process before walking in and taking action. Coming back to the point, I do not see that in our particular markets there is necessarily a need to have a regulator's role for the auditor.

**Senator MURRAY**—I have the feeling that there is a shift in mentality by government, by the parliament and by many informed observers concerning auditors. The shift in mentality is more towards a regulatory function than towards the auditing function. In previous hearings there has been discussion about the need for assurance audits, as well as financial audits, because of the sense that the evaluation of risk is important from a general market perspective and is in the general public interest of the community, not just the specific company. HIH are an obvious example, in that their failure affects the whole market. There is the sense that the auditor is most able to ferret out wrongdoing, which is a regulator's kind of job, because of their access to internal auditors and so on. That is why I particularly wanted to ask people like you, who are experienced coalface operators, how you feel about that and whether it makes you very nervous or uncomfortable.

**Mr Brayshaw**—I was advised when we were having our preliminary discussion to be careful of saying what I am about to say, but I do believe that if you become too prescriptive and we are seen to be too much of a policeman we will only be seen as an extension of the Public Service and as an extension of the regulator. I think that while that trend occurs we will not have the best people coming into our profession, because that is not a role they would want to play. I think you will almost destroy the accounting profession if you take that idea too far. I think you are on the road.

**Senator MURRAY**—But I sense—and just remember this legislation is not designed by me—that there is that impetus internationally, as well as nationally.

**Mr Brayshaw**—I sense that there has been some overreaction in the USA, probably because they had a much worse situation than us. I do not necessarily hold the USA up to be the be-all and end-all of how things should be done, and I suspect that over time they will come back from where they are now. I notice that Parmalat has come up a number of times as an example of what can go wrong, but I would not hold up the Italian corporate governance situation as world's best practice either. I think that the examples that are often given are not examples that relate much to Australia and that we should not be seen to hold the responses of them up as what we should be doing.

**Senator MURRAY**—Some of our discussions with witnesses have been directed towards finding more balance in this approach. A view that I hold is that the legislation probably pays too much attention to auditors and too little to directors. If directors and boards are better constructed you do not need quite as much onus on auditors. Through this legislation, auditors have been required to make up for the shortcomings of directors. Directors may disagree, but that is a view I have.

Do you have any view as to the adequacy or otherwise of the legislation in trying to ensure that there are no barriers of entry to becoming a director—that is, that the proper skill sets and independence are established and available through the Corporations Law through the process of election and that the right safeguards are in place for the relationship of director with auditor? All the safeguards appear to be designed around the auditors. Have you given much thought to that side of the coin?

**Mr Brayshaw**—We probably have not thought about it in those terms exactly—in the way that you put the question—but I am sure that the profession would consider the move to an audit

committee as being part and parcel of a response to maybe the issue you are raising or you feel is in the background. Of course, that now applies only to larger corporates and not necessarily to the smaller ones under the recent application.

**Senator MURRAY**—Think, if you can, when you respond, of the evidence we have had. We have had evidence that company constitutions and the mechanics of electing directors are constructed in such a way as to form barriers to entry. In other words, you do not have corporate democracy; you have corporate oligarchy. So now patronage prevails, and dominant financial and management interests ensure that they have the directors they want. They are not therefore independent, because they are subject to patronage.

When you appoint an audit committee, you have a set of directors who are all subject to patronage appointing people who are also subject to patronage—and they are supposedly your safeguard. If you go back down that chain, the answer to giving you greater protection is of course to make sure that the election processes for directors are better and that the requirements as to independence, conflicts of interest or anything like that are better for directors. Without being specific—because I am sure you do not want to be—in your experience of boards, have you been uncomfortable with the nature of directors and the way in which they reach their positions and deal with their responsibilities?

**Mr Reid**—We have to work with the boards of directors that we are given. We work on three levels: we work with the boards of directors, audit committees and a finance team. What happens at the bottom percolates up to the top. The advent of audit committees over the last decade or so has been an enormous step forward. Audit committees have been adopted in a voluntary sense by many listed companies. The existence of those audit committees provides us with an avenue to deal with key issues which come out of the audit process and allow those issues to be dealt with. The changes that the ASX have made are further steps in the right direction. Regardless of whether you contain it to 300 or 500, some of those principles are going to be adopted by listed companies outside of the 300 or 500. There have already been significant improvements in the way that we can deal with boards in recent years—before and ahead of CLERP 9.

**Mr Knott**—In terms of dealing with directors, whether or not it is through a process of patronage, the fundamental issues are integrity and competency. As auditors in any role—whether we are regulators or voted in by the shareholders or by whatever process—as part of the assessment of the business et cetera, the inherent risk that is associated with that integrity or competency is assessed as best as possible so that if there is evidence of pressure from a board that should not stop an auditor from qualifying or doing whatever is necessary, such as being able to provide no opinion or whatever the end result should be. I think that is irrespective of whether the process for the election of those directors is, as I said, through patronage or whatever voting process is in place.

**Senator MURRAY**—Have any of you ever had the experience of being told by the chair or the board not to attend AGMs or have you been to AGMs where a question has been put from the floor to the auditors and the chair of that AGM has refused permission for you to answer it?

**Mr Reid**—Never. In fact, in my experience we have been telephoned to make sure that we are there.

**Mr Knott**—After all, they are their accounts.

**Mr Reid**—Their accounts.

**Senator MURRAY**—You know that in political life we have a device of asking questions on notice and without notice. Today Mr Alfredson felt that it was desirable, if there were to be questions to auditors, for notice to be given in advance because you need to prepare yourself. Do you think that should be a statutory requirement and that there should be no opportunity for questions without notice to auditors, or does it not matter? In your experience is it not necessary to get involved with that?

**Mr Reid**—I think is better that we do have the opportunity to have notice so that we have adequate time to consider responses. I think that CLERP 9 is a step forward in that area. I do not know about other auditors, but I find that I go to AGMs in trepidation of what left-field question might arise and whether in fact it is pertinent to the content of the audit report, which is what the law deals with. I think that the mechanism that has been put in place for questions to be provided to the company—I think five days is the period for them to be provided to the auditor—is a step in the right direction.

**Mr Brayshaw**—I guess the problem you might have is the admissibility of a subsequent question.

**ACTING CHAIR**—A follow-up question.

**Mr Brayshaw**—Yes. I personally am not the type of person who resiles from the possibility of someone asking me a question or from answering it, but I think people have to understand that the auditor is not going to sit there at the AGM and know everything. If they are unable to answer it, it should not be a reflection on the auditor. But I do not think a supplementary question should be excluded.

**Mr Knott**—Perhaps there also should be time available after the meeting within which to give a more thorough response.

**Mr Reid**—There are circumstances with AGMs where the questioning might continue and where the questions that are being put by the shareholders should be responded to by the board and management and not by the auditor in the first instance.

**ACTING CHAIR**—It is one of the grey areas which is going to require a deft chair to not be too heavy-handed and say, 'No, no, that is a policy issue for the board rather than a number-crunching issue for the auditors.' I do not have any great experience of these areas but I regularly receive reports that chairs seek to protect but take much upon themselves. But in your experience that has not been the case?

**Mr Brayshaw**—I have had some fairly robust meetings but I have never had an issue where someone has precluded me from responding to a question or has not apparently passed on to the auditor an appropriate question.

**ACTING CHAIR**—So what happens now? Does someone stand up and ask one of the three of you a question and, providing it is within the bounds of the audit and relevant in a way that you can answer it, you answer it and get follow-up questions at the time?

**Mr Brayshaw**—Yes.

**ACTING CHAIR**—I would be worried that that situation, because you have got to put it in writing, would actually curtail the ability of the shareholder, which I do not think is the intent. I think it is trying to give everybody a chance to be prepared and ready and to know what the issues are.

**Mr Reid**—I think the important thing with the notice is that you have a rough idea of the areas where you need to prepare. Bear in mind that AGMs often happen some weeks after the financial statements have been signed off.

**ACTING CHAIR**—They should still be fresh in your mind.

**Mr Reid**—Not after you have done another 12 audits, no.

**ACTING CHAIR**—Okay, fair enough. On aggressive accounting techniques: I can always find people, whenever I am chatting with them, prepared to say, 'Yeah, they're pushing the envelope on that one.' But whenever I get people sitting in front of me, going on the public *Hansard* record, no-one has ever heard of them. What is an aggressive accounting technique?

**Mr Reid**—Taking an accounting standard to the nth degree.

**Mr Knott**—Deliberately profit-smoothing, or something of that ilk—that is the effect of aggressive accounting, and that might be because there is a recognition or lack of recognition, or a measurement technique that is employed or not employed.

**ACTING CHAIR**—Have you experienced forum shopping, where companies come to you and ask, 'How would you account for this?'

**Mr Brayshaw**—I am not sure that it was actually opinion shopping, but I was asked to assist a company in understanding how they should do things. I was not aware they were opinion shopping, let us put it that way.

**ACTING CHAIR**—Perhaps you are too noble minded, Mr Brayshaw.

**Mr Brayshaw**—I would not suggest that I would involve myself in that.

**ACTING CHAIR**—Have you heard of that practice—where companies shop around, looking for the firm that will give them the interpretation they want?

**Mr Reid**—I have heard of it, but I think it is significantly less prevalent than perhaps it was a few years ago.

**ACTING CHAIR**—One of the issues that I have been scratching my head about—and I do not claim to have found the perfect solution—is trying to find a way to strengthen the arm of the auditor to resist the blandishments of management to perhaps change the manner in which something is being accounted for because it helps profit-smooth, it helps you to achieve a target, or—God forbid—it even helps you trigger an options package.

**Mr Knott**—Or you just make the banking covenant actually work!

**Mr Brayshaw**—The process for changing auditors is such that you are unlikely to change auditor before the incumbent auditor has to give an opinion on that matter anyway, so it is not going to achieve anything.

**ACTING CHAIR**—No-one in politics has a long memory, but I am sure that in the corporate world there are a few who do. If they do not get the treatment they want from you this time around, even though it may have frustrated their initial ambition there is always the prospect of a change next year. As I said, I have been looking for ways to strengthen the arm of an auditor to resist that sort of pressure. I am considering an amendment that asks an auditor's opinion on whether or not a change in treatment has been sought—this is in the audit report, not just in the audit committee—and what the material effect of the auditor's preferred position, as opposed to management's preferred position, would be. So if a CEO said, 'This is how I want it treated,' there would ultimately be a requirement that that be revealed, while the auditor's treatment would be 'other', and that divergence would be shown in the audit report. Is that something that you think would work in practice?

**Mr Knott**—I think it would have to be coupled with a representation by the board saying that they have not gone out to another firm to get the differing opinion or, if they did, that there were genuine circumstances for wanting a second opinion. Perhaps the auditor, who was after all exercising judgment in forming an opinion, came to a view; the board were not comfortable with that and they went to X. I think that to ensure there is a genuine approach the board need to make a representation, and perhaps the auditor discloses in the audit report whether there were any differences.

**Mr Brayshaw**—My observation is that I am not sure the audit report is the right place for that.

**ACTING CHAIR**—Where should it be?

**Mr Brayshaw**—I think in the accounting policies; the accounts are those of the company at the end of the day. If there were two 'correct' ways of doing it—in other words, it is not a qualifiable position but it is an alternative position—I think that should be discussed in the body of the accounts so that the company is also taking some responsibility.

**ACTING CHAIR**—I am not trying to make the auditor take responsibility for it. I am just trying to—

**Mr Brayshaw**—By putting it in the audit report, you are, though, because that is my property and it has nothing to do with the company, so it is not in the audit report. Put it in the company

accounts, and then I also have an opinion on the company's accounts, as the board do. So we are both commenting on the differential position, not just me.

**Mr Reid**—With the development of more and more accounting standards, we come across fewer and fewer of those situations. Where we encounter them, we will always put it back to management to come forward with a formal view on the way they believe something should be treated. We will have our view on it and, hopefully, we will agree. If there is any form of disagreement, it will be dealt with in the audit committee such that, once we get to the financial statements, everybody is in agreement.

On Geoff's comments about introducing that sort of information somewhere into the financial report, if you look at the 10Ks in the US, you will find that there is a much more open discussion about the application of accounting standards. Rather than the perhaps slightly boilerplate approach that is taken in Australia, there is some discussion about the formation and application of accounting policies. That is probably quite a healthy thing.

**ACTING CHAIR**—We have been having a lengthy discussion about what constitutes auditing your own work. Are there any things that you should not audit?

**Mr Brayshaw**—Yes.

**ACTING CHAIR**—Free feel free to expand.

**Mr Brayshaw**—I think the obvious one that is often mentioned is valuations.

**ACTING CHAIR**—You are obviously well briefed.

**Mr Brayshaw**—No, I just think that that is logical. I do not need to be told by others that that is the situation. If you do an evaluation of something, quite obviously you cannot give an audit opinion on it. Without being prescriptive, I think that type of thing extends in a number of areas and situations. Actuarial areas also touch on valuation. Taxation can even come into that regime of putting together a value on a loss situation or a potential restructuring of what the value of losses—

**ACTING CHAIR**—Fourteen states in the US have taken the auditor of WorldCom to court—I think it was KPMG—arguing that they contrived tax avoidance schemes and were then auditing their own work, and they are suing them for a $156 million.

**Mr Brayshaw**—I am uneasy in that area. It is very difficult to prescribe what particular issue you should or should not be auditing. That is why we have F1 in the form that it is in. Although you might argue that it does not have a very large section on taxation, the general concept of not auditing your own work certainly comes up. Even in internal audits, which I would debate is not always the case—

**ACTING CHAIR**—I was going to move on to internal audits. Pretend Keith Riley is not in the room. Define a boundary for internal audit.

**Mr Brayshaw**—Talking from experience, most internal audits are not truly independent of management; therefore, you would not be able to do internal audits in those circumstances. True internal auditing only reports to the audit committee and is not involved as a supplement to internal control processes but is a true comment on internal control. I do not have a problem with external auditors carrying out that form of internal audit work. There is a lot of internal audit work that has nothing to do with financial statements, and I presume that we are not too worried about whether you do an internal audit of the triple bottom line reporting and that sort of thing.

**ACTING CHAIR**—From the sound of it, in reality that internal audit process is an external audit process.

**Mr Brayshaw**—An internal audit which is truly independent is an extension of the external audit process.

**Mr Reid**—It is deeper than the external audits. The external audit requires you to look at the manner in which the systems operate, and you do have to walk through those systems, but I think what Geoff is talking about is where you get into a greater depth. I would agree with his view that, in those circumstances, provided you are reporting to the right level, which is the audit committee, then an auditor is not breaching his or her independence.

**Mr Knott**—As long as there is not a reliance upon the internal audit working as part of the internal control itself. What we are envisaging is an extended audit opinion that has reference to internal control reviews et cetera—something along those lines. It is not necessarily the internal audit work where people are perhaps doing—

**ACTING CHAIR**—What is left for internal audit then? If you are doing a deeper external audit which is, in reality, a significant part of the internal focus, albeit independent as you have described, what is left other than bookwork internally within the firm?

**Mr Knott**—They would be left with perhaps debtors' circularisation—certain steps which are part of the internal control, where management and the board require assurance internally to ensure that internal controls are actually operating, and that is part of the control environment that is in place in that entity. There is probably a lot of work there for internal auditors. I think we are saying that there is limited work for external auditors. There are areas where there is a report on internal control overview, which some might call an internal audit. We are not so sure that is an internal audit. It is either an extended scope of the external auditor's role or where he is providing an opinion in an audit opinion not only on the truth and fairness of financial statements but also on adherence to controls within the organisation.

**ACTING CHAIR**—Thanks for that. It was very useful.

**Proceedings suspended from 4.02 p.m. to 4.26 p.m.**

**GILLAM, Mr Trent, National Corporate Research Officer, Australian Workers Union**

**SHORTEN, Mr Bill, National Secretary and Victorian Secretary, Australian Workers Union**

**ACTING CHAIR**—Welcome. The committee prefers all evidence to be given in public, but should you at any stage wish to give any part of your evidence in private you may ask to do so and the committee will consider your request. The committee has before it a written submission from the AWU—submission No. 47. Are there any alterations or additions you would like to make to that submission at this stage?

**Mr Shorten**—There are some additional issues on three points which I would like to speak to.

**ACTING CHAIR**—I invite you to make a brief opening statement.

**Mr Shorten**—The Australian Workers Union welcomes the opportunity to talk about the bill which we call CLERP 9, looking into positive reforms to corporate law in Australia. We have put in a written submission. We think in essence the bill is a good step forward, but perhaps in some areas it could afford to go further. The Australian Workers Union represents tens of thousands of workers across a range of industries. Many of our members work in the private sector and for publicly listed companies. Our members are the ones who suffer when there are corporate collapses. Unfortunately, we have had members involved at Ansett, Pasminco, Tasmanian salmon and a range of other companies that have been in difficult circumstances and faced insolvency, so we believe that the efficient administration of corporate law is fundamental to employment security for our members.

Specifically, we think that CLERP 9 will have some positive impacts on corporate law in Australia. There are certainly measures designed to improve the reliability and credibility of financial statements through enhanced auditor independence. We believe that there are improved enforcement arrangements, which we also support. There are also some measures to better allocate and manage risk. Our specific submission to this inquiry is around audit reform, executive remuneration and penalties for breaches of the Corporations Act 2001. At the outset I indicated that the Australian Workers Union believes that, whilst CLERP 9 is a positive first step, the audit reforms contained within it are insufficient to protect auditor independence. In particular, we hold the view that there are difficulties maintaining auditor independence when auditors also undertake lucrative non-audit work for audit clients. We believe that auditors should be prevented from undertaking certain non-audit work for audit clients, such as accounting, bookkeeping services, valuation services, actuarial services, the resolution of legal disputes and internal audit services.

The second part of our submission focuses on executive remuneration. The Australian Workers Union favours increased disclosure of executive remuneration. We certainly believe companies should be required to disclose the remuneration of the 10 highest paid company officers. We certainly believe that companies should additionally be required to disclose comprehensive details of employment contracts with senior employment executives, including ‘golden hellos’ and ‘golden goodbyes’. Furthermore, we believe that shareholders should be

allowed to make non-binding resolutions on the levels of executive remuneration in order to provide guidance to the board on the levels of remuneration they consider to be acceptable. We do not accept the argument that increasing transparency in executive remuneration will increase average executive remuneration.

We support the prohibition on the granting of options and the payment of bonuses and retirement benefits, other than statutory superannuation to non-executive directors, and we certainly support the requirement to fully disclose equity value protection schemes. We do not agree with the Business Council of Australia where they oppose the reporting or disclosure of the remuneration of the 10 highest paid executives. The third area that we want to make a submission about is penalties under the Corporations Act. We believe that the penalties under the Corporations Act should be at least double their present levels. On all three propositions, we broadly support the ALP's current position on CLERP 9.

There are three or four additional matters that I wish to briefly draw the committee's attention to. The first matter is the issue of infringement notices by ASIC. The CLERP bill proposes allowing ASIC to issue infringement notices to companies for breaches of the continuous disclosure regime. The bill proposes a number of limitations, however, of ASIC's power to issue infringement notices. Specifically, the bill proposes that, before issuing an infringement notice, ASIC will be required to hold a private hearing at which the entity would be given the opportunity to give evidence and make submissions.

The bill also proposes that compliance with an infringement notice is not to be taken as an admission by the entity of liability, or as a contravention of the Corporations Act. Furthermore, if the entity does not comply with an infringement notice, the bill certainly requires that ASIC should go to court and prove its case. With the protections proposed within CLERP, it is difficult to see how the infringement notices could be abused. We believe there are clear benefits of the infringement notices, in terms of making them simpler to use. They certainly have the potential to reduce costs associated with enforcing the continuous disclosure rules.

One aspect of the infringement notices which has attracted criticism from business is that, if the entity decided to comply with an infringement notice, ASIC could be allowed to publish in the *Gazette* a copy of the notice or an accurate summary of the notice for the purposes of media reporting. We believe that the positive reporting of companies accepting infringement notices will in many ways—even more than monetary penalties—be a way of promoting better corporate behaviour. It is our experience in a range of other legislative regimes that alternative penalties, such as notices, have a way of focusing companies as much as monetary fines. We have certainly seen it with the Esso corporation, which was fined $2¼ million for a number of breaches of the occupational health and safety legislation. For a company of that size it was a speeding ticket, whereas we have found that the publicity that it has attracted from trying to blame its workers has had far greater impact. We believe that the corollary certainly applies in corporate governance and regulation.

If infringement notices are introduced, the BCA is arguing that a third-party panel should be involved in the decision to issue these infringement notices. We think that is a ludicrous watering down of ASIC's role, unless the BCA is proposing that the third party be someone other than a business, which might well be a panel of trade unions—which is unlikely to be BCA's position.

The second issue we want to briefly touch upon is auditors reporting alternative financial treatments discussed with companies. The AWU supports another proposition that has been raised by the ALP which requires auditors to specifically report to shareholders on alternative treatments of financial information that have been discussed with management, the ramifications of the use of these alternative treatments and the treatment preferred by the auditor. We believe that this would make it more difficult for companies to choose more favourable methods of packaging financial information without shareholders being made aware of the alternatives.

The third additional point we wish to make on the CLERP 9 bill is regarding the maximum number of directorships. We believe that directors in public listed companies should not assume too much responsibility by accepting a number of multiple directorships. The Australian Workers Union believes that the maximum number of directorships a person is allowed to hold in public companies should be three. We note that the Australian Shareholders Association said that the chairmanship of a listed company is the equivalent of three directorships and that the maximum number should not exceed five. We think that the stewardship of three publicly listed companies is a very important responsibility and we are seriously sceptical of the ability of the professional director class to focus upon a number of different directorships. We have looked at the directorships of a number of prominent people who have been involved with Ansett, NAB or Pasminco. Margaret Jackson is currently the Chairperson of Qantas and a director of the ANZ Banking Group, Billabong International and John Fairfax Holdings—she is very busy. We regard that as an excessive number of positions.

Graham Kraehe is Chairman of BlueScope Steel, is currently involved with the National Australia Bank, and is a director of Brambles, News Corporation and other organisations. We think it is impossible to be able to pay the necessary attention to all those tasks, especially in the case of these individuals as chairpersons. We know Catherine Walter is a director of the Australian Stock Exchange Ltd, Orica and a range of other non-publicly listed companies. We seriously question whether or not this director is able to focus on all of the directorial responsibilities required across a wide range of companies. Charles Goode is the Chairman of the ANZ Banking Group, Woodside Petroleum, Singapore Airlines and other companies—just a very busy portfolio.

To look at some of the companies that have been at least controversial and, in the opinion of the Australian Workers Union, have underperformed on their shareholders' expectations: Charles Allen, before he resigned, was a director of Amcor, AGL and Air Liquide. Brian Clark was Chairman of Vodafone Holdings in Japan, a non-executive director of China Mobile Ltd, and chairman and board member of a number of Vodafone Group companies. Peter Duncan is a director of Orica, GasNet and CSIRO and chairman of Scania Australia. Kenneth Moss is a director of Adsteam Ltd and GPT Management Ltd and Chairman of Boral Ltd and Centennial Gold. Geoffrey Tomlinson is a director of Reckon Ltd, Funtastic Ltd and Program Maintenance Services, Deputy Chairman of Hansen Technologies Ltd and a director of Amcor. Edward Tweddell is Chairman of Ansell and a director of the Australian Postal Corporation and CSIRO. These are very busy NAB directors before we even get to their NAB responsibilities.

AMP Ltd were of course involved with the not so successful GIO venture. Peter Willcox is the Chairman of AMP and of Mayne Group at the same time. Richard Grellman of Atlas Group Holdings is Chairman of Cryosite Ltd and the New South Wales Motor Accidents Authority. Meredith Hellicar is a director of James Hardie Industries in the Netherlands, the New South

Wales Treasury Corporation—that will be interesting—the Southern Cross Airports group, Amalgamated Holdings and other companies. Peter Mason is Chairman of JP Morgan Chase and a director of the Mayne Group and Pasminco, who employed many of our members, and Chairman of NAB. Mark Rayner was the Chairman of NAB and Mayne Nickless and a director of Boral. The list goes on, and I will table the list of some of the companies that we have noted, but these people clearly are struggling with the number of directorships they have if you judge the performance of some of the companies they have been in. The gene pool from which the directors is drawn is too small and too limited, and with the cynical gender appointment of an even smaller group of women directors who are the names to have on these company boards it is very difficult to argue wage restraint or to argue the benefits of restructuring to the people on the shop floor when there is such a small group of people whose names constantly reappear time and time again in corporations. Certainly when you look at the performance of some of these corporations it is a wonder how they keep getting reappointed.

There is one final issue that we wanted to raise in terms of CLERP 9. We have had a look at some of the examples of company underperformance and we would go to changes to due diligence in hostile takeovers. It is a difficult area. We are concerned about the manner in which companies, when they make hostile takeovers, mergers and acquisitions, conduct appropriate due diligence in regard to these potential acquisitions. We have in mind HIH's acquisition of FAI, AMP's acquisition of GIO, Air New Zealand's acquisition of the remaining 50 per cent of Ansett from Murdoch, Pasminco's acquisition of Savage Resources, and the Commonwealth Bank's acquisition of Colonial.

We do not know how people could miss the $32 million payment to Chris Cuffe of Colonial; how Air New Zealand could miss some of the problems within Ansett that my members who are engineers there could have told them about; and how Pasminco, in the Savage Resources merger, could have missed some of the issues around the hedging which sank Pasminco. The list goes on. We recognise that it is difficult to conduct due diligence in the climate of a hostile takeover. We are severely sceptical as to whether any of the due diligence undertaken took more than a visit to Dunn and Bradstreet or the use of publicly available information that a first year economics student could have discovered. In our opinion, the due diligence of some of these organisations and these failed mergers or failed acquisitions was based on a combination of insufficient attention to that due diligence combined with an attitude of: 'We have a very large balance sheet, therefore we cannot make a mistake—size will triumph over everything.'

We acknowledge that the Corporations Act does require directors to carry out their duties to the standard of a reasonable director and that it is difficult for the target of a merger to willingly hand over all of its financial details and business strategies to the potential predator business. We do believe, however, that there needs to be some standard which requires more than just arrogance about the size of the balance sheet of the purchasing company or the target company. One option could be an independent auditor who is required to report the results of the due diligence without revealing the necessary commercial and business strategies of the target company. Another alternative would be to provide some legislative direction to the reasonable director tests that have been laid down in the court system. They are the points we wanted to address.

**Senator MURRAY**—Dealing with chairs of publicly listed companies first, how do you react to the proposition that, firstly, they cannot be executives and, secondly, they should not have

more than one chair? It would not prevent them from being directors elsewhere, and I would exclude related entities from that prescription.

**Mr Shorten**—Certainly, if the chair is involved with a related entity, that may be consistent with the overall holding company's business case and proposition. Dealing with the second part of your question first, we believe that seriously chairing a major Australian listed company which employs our members and also may have the superannuation investments of our members in it is a serious responsibility.

Just as we believe that politicians should not have second jobs while they are politicians and just as there is a prohibition on full-time union officials carrying out another full-time job, we think that being a chairperson of a major company, such as Qantas, Blue Scope Steel, Pasminco or a bank requires all of your attention. We are seriously sceptical that they could do much more than one other directorship with that function. We certainly do not support people being chair of two publicly listed companies at the same time. We think that the attention to detail and the leadership required from that position precludes the effective execution of those tasks, acknowledging your caveat about related entities.

In terms of the role of a chair being non-executive, I think that leads to two issues. The first issue is that I think it is difficult for a chairperson not to take some fairly time-consuming role in the organisation. I think it is appropriate to have a CEO and senior management team who are tasked with the operational conduct of the business. In my experience, a wise CEO would involve the chairperson to a large extent. So where one draws the line between being an executive chairperson and an independent chairperson can become blurred, depending on the amount of time that someone spends. We do not have a final and fixed position on that distinction.

What we would say, however, is that one benefit may be director rotation. After a certain number of years, an independent director becomes sufficiently involved with the organisation, so we do support director rotation after a 10-year period. We think it would be difficult ultimately not to have seen all the challenges that a company will raise over a 10-year period. Obviously, you cannot change a whole board in one hit, as one director at NAB is proposing at NAB; that would certainly damage the share value. We think the constant bringing in of new blood to organisations at the board level, at the senior level, makes sense. One way we get around some of the issues of the chair is that you put a 10-year rotation rule onto these positions.

**Senator MURRAY**—I am going to have to go soon to catch an aeroplane so I want to switch to another topic—the remuneration issue. I think there are two distinct issues, although they sometimes coalesce. One is remuneration of executives and the other is remuneration of directors. The evidence from this committee from what I will loosely term the director class is that directors properly should have their remuneration assessed by shareholders, but the remuneration of executives is the responsibility of the board.

Dealing with directors first: at present, a binding vote is required on any part of the remuneration package which relates to equity, but the cash component does not require a binding vote and the proposal is that there should be a non-binding vote with respect to this area. Personally, I think that is nonsense, because I think the entire package for directors—both the

cash component and the non-cash component—should be a binding vote. How do you react to that?

**Mr Shorten**—Let me just make sure I have understood your question: is it about distinguishing executive remuneration from independent directorial remuneration?

**Senator MURRAY**—No. Do not concern yourself with whether someone is an executive at the moment; just deal with someone who is a director. The question is whether the shareholders should approve the remuneration, both cash and non-cash, which would require a binding vote. The important thing to recognise is that a binding vote is already required for the equity side of things.

**Mr Gillam**—Our view would certainly be that the most important thing about directors' remuneration is the total remuneration they receive. In that respect, having an additional non-binding shareholder vote specifically on cash remuneration seems to be an unnecessary extra step.

**Senator MURRAY**—The second aspect relating to directors' remuneration is whether there should be a compulsory vote. There is no compulsory vote at present; a binding vote is required. One of the issues being considered is whether compulsory votes should apply generally for resolutions. The view of the Labor Party is that it should apply for super funds. I do not disagree with that; I just believe it should also encompass other funds and I believe it should encompass subject matter as well. The subject matter I am particularly interested in is directors. Do you agree with the concept of a compulsory vote where you can apply it? We all recognise that you cannot apply it to mums and dads; we are talking institutions here. Do you think it should cover subject matters as well as institutions?

**Mr Shorten**—Whilst I do not appear in this capacity, I am a director of the Superannuation Trust of Australia, which is quite a large industry fund. It has about $4.6 billion. We have discussed that matter, and we have certainly been very active in people exercising their vote on a range of issues, not just remuneration issues. We think that is important. Speaking for the Australian Workers Union, whilst we have not canvassed that matter at our national executive, I believe that the default position of our union would be that we do support compulsory voting. The range of the subject matter to which we extend that beyond remuneration is something we have not turned our minds to. Having said that, I believe once again that the attitude of our senior officials would be that it is appropriate to try to exercise compulsory voting. We think that a corporation will function more efficiently if there is a forced, active interest from all of the shareholders, rather than simply leaving it to a few institutions and the board of the company to make all the decisions without the scrutiny of voting.

**Senator MURRAY**—We have discussed the process by which shareholders should approve directors' remuneration, and I think that therefore covers executive directors. But we need to pay attention to executives who are not directors. I am of the view that shareholders should have the opportunity to approve what I would regard as unusually high, excessive, extravagant—use whatever adjective you like to cover it—remuneration. I have been thinking of something like 20 times MTAWE, or average weekly earnings, which would be about $1 million.

**Mr Shorten**—Twenty times what base?

**ACTING CHAIR**—MTAWE.

**Senator MURRAY**—Or average weekly earnings; we could use that measure if you like. It would be about $1 million a year. I think the executive class have been taking shareholders for a ride and we need some mechanism whereby shareholders are given back power. How would you view a situation which broke the current convention, which is that the directors determine all executive salaries, and which said that in certain instances the shareholders should have a say, particularly where the packages are particularly large? I should indicate that that already is the case for equity related plans.

**Mr Shorten**—The Australian Workers Union, through our experience of having members in a range of large companies and also through the investments of superannuation funds in the Australian equities market, have the very clear view, consistent with a volume of research that has been produced, that there is no correlation between superior performance and superior executive salaries. We are very supportive of shareholders being involved in the processes for the very top percentiles of the company so that they have a say in what the executive packages are. We think that will not lead to a race to inflated executive returns. All of the enterprise agreements that our members are party to are on the public register, and that has not led to a giant wages outbreak.

**Senator MURRAY**—Good point.

**Mr Shorten**—In addition, we agree with much of the question that you put. The performance of executives has been a sort of vaguely masonic ritual. I mean no disrespect to the masons, but it has been a vaguely secretive ritual, which is not at all clear to the employees of companies or shareholders.

**ACTING CHAIR**—I want to talk briefly about the 'ratcheting up' argument of the Business Council. I am sure you have seen their comments and their submissions. They believe that further disclosure of salaries of the top 10 executives—up from the top five currently—would ratchet up executive salaries. I think you have been a bit harsh. This argument of comparative wage justice is something that it is unusual for the Business Council of Australia to advance. It is going back to the good old days. I thought we were more interested in productivity, enterprise bargaining and that sort of stuff, but if they want to advocate a return to comparative wage justice why would we object?

**Mr Shorten**—A bit like the previous question, the most suitable answer would be yes. The argument of the Business Council—that they will not get superior directors because if you reveal the wages and conditions of senior executives and directors in some fashion this will lead to an inflationary wages spiral in the Australian senior executive market—does not work, because we are already told that it is difficult to find good directors and good senior executives. That is where there is no transparency in wages and conditions. We think that companies having more information about what is happening will not lead to a ratcheting up; what it will lead to is a linking of performance to executive remuneration, which is appropriate. The Australian Workers Union are not against successful companies paying senior executives lots of money, but we do believe that, unlike the workers, who tend to get paid much less and have to bear the risk of job losses when companies underperform, there is very little upwards accountability of directors. We think transparency will in fact add to accountability.

**ACTING CHAIR**—The previous Parliamentary Secretary to the Treasurer, Senator Ian Campbell, said that the government would require up-front and real-time disclosure of executive contracts. The CLERP 9 bill fails to implement this requirement. I know you have been involved—unfortunately for you and for the members of your union—when some companies have collapsed. Have you experienced a situation where executives received large payouts, then ultimately the company folded and your members lost their jobs and entitlements?

**Mr Shorten**—The Australian Workers Union represented several hundred maintenance engineers at Ansett, and the waste of money which went on in the senior reaches of the company was staggering. We understand that, when the administrators went through the company and the levels of people, they found that something like 50 senior executives were earning more than $200,000 a year—or it might have been 20 executives earning more than $500,000 a year. Either way, you had $10 million being paid to a class of managers who presided over a collapse.

At Pasminco we were the largest union representing people at the smelters and at some of the mines in Tasmania and Queensland. The board of Pasminco, in our opinion, has been remarkable unaccountable. The company collapsed because it got into hedging, which it did not understand; it overcapitalised Century Zinc mine at a time when zinc prices were decreasing globally. Yet these directors pop up in new companies as if nothing has ever happened. Unfortunately, now we have seen the Newcastle smelter closed, we have seen job cuts at Rosebery in Northern Tasmania, Risdon and Hobart, Broken Hill and the Elura mines in western New South Wales—yet these Pasminco directors operate in a state of a blithe, naive nature, where they move on to the next directorship.

So we absolutely reject the notion that transparency will allow some sort of ratcheting up of wages. We absolutely reject the notion that transparency will lead to some failure of management. There is no doubt that the Australian stock market—not so much this year, thank goodness, but over the last two years—has significantly underperformed, and it has underperformed with the superannuation money of our members who have accounts of $30,000 and $40,000. But you have got a very small number of directors who are of professional director class running around. Any director can make money in a bull market; it takes genius to make it in a bear market. Unfortunately, most of the directors and supporters of the Business Council proposition have proved they only have the Midas touch when they are working in a goldmine—and they have even managed to trash that in a number of very significant Australian companies.

**ACTING CHAIR**—I wanted to talk about the members of your superannuation fund and shareholder activism. You had a brief discussion with Senator Murray on the issue of voting, mandatory or otherwise. A number of unions have already moved to voting 100 per cent of the time and there are some proposals to mandate super funds to vote. I think you mentioned that you have not had a chance to consider this yet; is it something that is on your agenda?

**Mr Shorten**—The submission into corporate governance has not been a traditional area for our union, but we will ignore the performance of companies at our peril in the future. I have no doubt, using my crystal ball, that our union will support, when it is discussed at our national executive, the issue of compulsory voting on a range of issues within company performance. Unions face elections every four years and politicians face elections every four years. We are supporters of compulsory voting. What is interesting, however, is that in corporations, if votes

have to be exercised, people do look at some of the issues more carefully than if there is no requirement to look at the issues.

**ACTING CHAIR**—You mentioned the ASIC infringement powers. I think you said you support the infringement powers for continuous disclosure. Have you had any experience with companies that have not disclosed to the market and therefore, ultimately, they have failed or had significant troubles which have led to your members losing their jobs and/or their retirement benefits?

**Mr Shorten**—There is no question that, in our experience, the mere requirement to have an annual balance sheet and look at what is on it is in no way a guarantee of what is actually happening. We certainly believe that if ASIC had a wider range of administrative powers it could focus on the performance of companies, including continuous disclosure issues. Most external auditors ultimately rely on the honesty of the information they are being given. It is very difficult to legislate against dishonest behaviour or prevent dishonest behaviour. However, you can only wonder what the auditor of Harris Scarfe was doing when there was no inventory to back up what was said to be in the books. You can only wonder.

There is an apocryphal story which could apply to audit, where fund managers come to the board of a superannuation company and say: 'Invest with us because we're real tyre kickers. We go out and investigate companies. We really know what's going on.' You find out they have lent $100 million to a Chinese-Malaysian businesswoman who had hired actors the day before the fund managers came out. The actors worked in the factory during the day. The fund managers—19-year-olds in pinstripe shirts—came out, had a nice lunch, saw the workers on the floor and left, and then the actors were laid off and the $100 million that was lent was gone.

We believe that most of the audit firms work very hard, but it is very hard for them. They rely on the quality of the information they are given. It is the same with independent directors. The first question we ask when we meet the directors of companies that we organise into the union is, 'How do you know what the balance sheet says is correct?' They will generally say to us, 'Someone's told us.' Then we ask the senior accountant, 'How do you know?' and they say, 'Because we have it on an SAP computer accounting program.' Then we ask, 'Who inputs the data?' and it will generally be a 19-year-old putting in the data. That is not a failsafe mechanism, so we are keen to see ASIC enjoy greater powers to seek administrative solutions to improve continuous disclosure.

**ACTING CHAIR**—That concludes all the questions I have. Thank you very much.

**Committee adjourned at 5.03 p.m.**