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JOINT COMMITTEE ON CORPORATIONS AND FINANCIAL SERVICES

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

THURSDAY, 29 APRIL 2004

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JOINT COMMITTEE ON CORPORATIONS AND FINANCIAL SERVICES

Thursday, 29 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 Brandis, Conroy and Wong

Terms of reference for the inquiry:

To inquire into and report on:

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

WITNESSES

Committee met at 9.44 a.m.

LAWSON-KERR, Ms Carolyn, Chairman, Australasian Investor Relations Association Limited

MATHESON, Mr Ian, Director, Australasian Investor Relations Association Limited

ACTING CHAIR (Senator Brandis)—Welcome to this hearing of the Parliamentary Joint Committee on Corporations and Financial Services. Today the committee continues its public hearings in its inquiry into the Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Bill 2003 and related matters. Before we begin taking evidence I wish to remind you for the record that all witnesses appearing before the committee are protected by parliamentary privilege with respect to their evidence. 'Parliamentary privilege' refers to the special rights and immunities attached to the parliament and its members and others necessary for the discharge of parliamentary functions without obstruction and fear of prosecution. Any act by any person which operates to the disadvantage of a witness on account of evidence given by him or her before the parliament or any of its committees may be 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.

I welcome to the table representatives of the Australasian Investor Relations Association. 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 request to do so and the committee will consider that request. The committee has before it a written submission from the Australasian Investor Relations Association, submission No. 17. Are there any alterations or additions you would like to make to the submission at this stage?

Ms Lawson-Kerr—No.

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

Ms Lawson-Kerr—Thank you for the opportunity to appear before the committee. We are here today in our capacities as chairman and director of the Australasian Investor Relations Association, or AIRA for short. Ian Matheson was the founding chairman of AIRA and represented the association on the ASX Corporate Governance Council. AIRA was founded three years ago with the aim of providing investor relations practitioners with a single voice in the public debate on corporate disclosure issues and to improve the skills and professionalism of its members. Membership is currently on an individual basis and members comprise investor relations professionals from over half of the top 200 companies, as well as those who are involved in investor relations as suppliers to the industry.

The investor relations role has rapidly evolved as a discrete corporate function over the last five years, as the number and sophistication of inquiries from the investment community has increased. Global competition for capital has also meant listed companies increasingly have had to communicate with investors at home and abroad. The vast majority of the top 200 companies would now have someone dedicated solely to investor relations. If there is no investor relations officer, or IRO, then the functions are normally combined with one or more other external affairs

functions or the company secretary's role. For smaller listed companies, investor relations is usually carried out by the CEO, the CFO or the company secretary but is usually confined to the statutory requirements, such as making announcements to the stock exchange, preparing and releasing full- and half-year profit results and the production of the annual report.

The investor relations officer tends to report to the CFO, or in some cases the chief executive officer, and is the first point of contact for investors and broking analysts. The IRO tends to be on top of the details of the strategy, financials and operations of the company and has a number of responsibilities, which tend to include the following. I have five listed here. The first is the way in which the company communicates with institutional and individual investors, both existing and potential, on matters including profit announcements, strategy presentations and so on, as well as the management and organisation of AGMs, analysts' meetings, roadshows, the annual report and day-to-day contact with investors. In some cases the IRO is the designated disclosure officer with the stock exchange. The second area is that the IRO feeds back to management and the board what the issues and areas of concern for investors are. Third, the IRO also deals with the financial media. Fourth, along with the company's legal adviser, the IRO advises management on continuous disclosure issues and recommending further disclosures and communication approaches to achieve best practice. In the fifth area, they need to be across issues such as corporate governance, voting issues, reputation, sustainability and related areas.

Interestingly, in all of the *Hansard* transcripts of hearings on CLERP 9 there has been hardly a mention of the investor relations role in the context of continuous disclosure. Yet as a practical matter IROs are usually the company executive most closely in touch with the market on a day-to-day basis. Despite this, there are no Australian educational qualifications for IROs, although most IROs would come from a finance, accounting and, more rarely these days, communications background. We believe that the issues dealt with are important enough that there should be educational qualifications for IROs. We are currently planning an executive development program.

The Australasian Investor Relations Association strongly endorse the CLERP 9 objectives of greater disclosure and accountability and are supportive of the measures contained in the bill. We place great importance on good governance, which includes good disclosure practices and transparency. We consider that most of the proposals strike a good balance in protecting and advancing the interests of all parties. We have identified three areas, and we have focused on these in our submission. The first relates to electronic communication with shareholders. IROs are usually responsible not only for helping to develop the messages and presentations for AGMs and other investor briefings but also for the technology which allows communication with their shareholders. Many of our members already use these methods, including the use of web casting and conference call facilities. We are very supportive of the proposals in relation to electronic communication with shareholders. It will help efficiency and reduce costs. I am happy to talk about CBA's experience with electronic communication with shareholders, during Q&A.

Our other two issues relate to continuous disclosure. In both cases, we agree with the intent of the proposals—in other words, to help ensure good disclosure practices by listed entities. Our issues are with the approach rather than the intent of the proposals. Before raising the issues again, it is worth noting—as a Stock Exchange witness mentioned in evidence before the committee recently—that the number of announcements made by listed companies has increased by 120 per cent. We believe that the continuous disclosure regime in Australia has served

investors extremely well and makes for an extremely efficient market. We believe that the incidences of blatant breaches of the continuous disclosure regime are few and far between but, when inadvertent breaches do occur, they tend to result from differences in interpretation of the so-called grey areas.

The first issue in relation to continuous disclosure is that we are concerned about the possible impact of the proposed provisions which would extend civil liability for contraventions of the continuous disclosure regime by disclosing entities to any other persons involved in a contravention. We believe this should be limited to senior managers as defined in the amendments. This would place the onus and the deterrent or incentive effect at the decision-making level. We acknowledge that the government has tried to address this issue in covering, among others, individuals who can be said to have 'aided, abetted, counselled or procured the contravention'. However, we believe that a person who is not a senior manager as defined may still be subject to civil or criminal liability and even third party action such as compensation, even though they may have advised correctly in relation to a particular disclosure.

ACTING CHAIR—Isn't that the same test as in the Corporations Law, though?

Mr Matheson—We believe that it is going further than the existing provision.

ACTING CHAIR—I don't think that is right.

Ms Lawson-Kerr—The second issue is our concern about the proposals with respect to the infringement notices. Once again, we agree with the intent behind the proposal but have commented on the approach. We would like to add here that, if no change is to be made to the concept of an infringement notice, one way to mitigate some of our concerns would be the approach outlined by Chartered Secretaries Australia of an independent review panel to arbitrate in contested matters. In the absence of this panel, we would welcome the right of appeal to the Administrative Appeals Tribunal and the availability of some due diligence defences. The issues concerning continuous disclosure that companies have to deal with are rarely black and white and can involve much angst within a company. That concludes our opening statement.

ACTING CHAIR—Thank you very much.

Senator CONROY—Your submission—and you have outlined some of your concerns again just now—raises concerns about the provision extending to people such as investor relations officers who do not have the authority to make a decision as to whether or not to disclose the relevant information. You mentioned it again in your opening statement and you suggest limiting the liability to directors and senior managers. I am interested in the point that Senator Brandis has made about whether or not this is, in your view, as you have said, an extension of the existing Corporations Law. I am not sure myself, so I am interested in you teasing that out a bit more.

Mr Matheson—It depends on the process by which different listed entities go about the disclosure process. Some companies have a disclosure committee, which may involve the company secretary, the legal council, the CFO, the CEO, the investor relations person et cetera—and, in some cases, the chairman of the company as well. In other cases where a formal disclosure committee does not exist, there may be an informal process by which information

flows up to senior management and the board. But we believe that line managers and—in respect of our membership—investor relations managers, not all of whom may be considered to be senior managers for the purposes of this definition, may be caught by this civil provision and exposed to civil penalties. We believe that is not appropriate, given the seniority in some cases of the individual involved.

Senator CONROY—One suggestion of an amendment that has been made by the Treasurer, I think, is the due diligence defence, which you referred to very briefly. In your view, without that due diligence defence, would companies which receive an infringement notice be more likely to take the matter to court in order to ensure that individuals are not subject to potential civil liability suits? If there was no due diligence defence, what do you think the real impact would be?

Ms Lawson-Kerr—The infringement notice goes to the entity, but the civil action can go against the individual.

Senator CONROY—Yes. But, say, if someone was going to just cop the fine, but they knew that could open the way for the civil actions to be taken, do you think it is more likely that people would then contest more rigorously than they otherwise would have because of the threat of the civil liability, particularly without due diligence? Assume you were advising the CEO about this and you were faced with having to say to him, 'We can either cop it on the chin—yes, they got us—or we can contest this to the ends of the earth, because, if we don't, you're going to go down on a civil penalty as well and be open to all sorts of other litigation, and you had no serious defence,' because, as I said, there was no due diligence.

Ms Lawson-Kerr—I think that would depend on the circumstances of the case. I think it would be hard to answer that broadly.

Mr Matheson—Neither of us is a lawyer, so it is a bit hard to give you, in a sense, a considered legal opinion. One could say intuitively that a company may decide, for the reasons you have just outlined, to fight the penalty, particularly if there are no due diligence defences.

ACTING CHAIR—Section 79 of the Corporations Act, which is the parties provision, says:

A person is involved in a contravention if, and only if, the person:

(a) has aided, abetted, counselled or procured the contravention; or

(b) has induced, whether by threats or promises or otherwise, the contravention; or

(c) has been in any way, by act or omission, directly or indirectly, knowingly concerned in, or party to, the contravention; or

(d) has conspired with others to effect the contravention.

I think that the expansion of accessorial liability in those terms is not new; I think it has been part of the corporations legislation in its various editions for many years, as it is part of other commercial legislation. The Trade Practices Act uses the same words. 'A party directly or

indirectly knowingly concerned in or a party to' is a standard formula. So I am at a little bit of a loss to see why, in relation to this legislation, the reach of the provisions governing accessorial liability should be any narrower.

Mr Matheson—I suppose there are two issues. One is the absence of any due diligence defences. Secondly, as a practical matter, the way the disclosure process is determined, particularly in many large listed companies these days, there is arguably an accessorial liability—if that is the right expression—

ACTING CHAIR—Accessorial liability is the right expression.

Mr Matheson—which extends to junior managers who might participate on a disclosure committee. By virtue of their membership of the disclosure committee, we would suggest that they may be caught by this provision.

ACTING CHAIR—They might. But you are opening a broader issue—that is, whether the whole basis on which we extend liability to accessories for contraventions of commercial law should be narrowed.

ACTING CHAIR—Sorry, Senator Conroy. I interrupted.

Senator CONROY—No, that was the main thrust of my questions. I did have one other issue that I would like to move on to if you have finished, Senator Brandis.

Mr Matheson—Perhaps I could just make one final comment. I suppose our concerns would certainly be significantly reduced if, as we have suggested, there were due diligence defences, but also if there were some appeal mechanism—either the Administrative Appeals Tribunal or this peer review panel that we and Chartered Secretaries have suggested—and some process for involvement of the ASX in the process as well.

Senator CONROY—Would that peer review involve a review of whether or not you were an accessory or whether or not there was a breach?

Mr Matheson—Whether there was a breach.

Senator CONROY—So what would ASIC be doing?

Ms Lawson-Kerr—We would assume that the peer review would be a review panel which would include someone from the Stock Exchange.

Senator CONROY—Most of the time when these things happen it is the Stock Exchange that has referred it to ASIC, so I am just not sure how the Stock Exchange, given that they have raised the issue, could then be part of a peer review. They would have a conflict. They would be reviewing themselves, in effect.

Mr Matheson—Sure. It is currently the case that ASX do, in the majority of cases, refer matters to ASIC. But our understanding is that under the proposed regime ASIC do not require—

Senator CONROY—They do not necessarily really require it now.

Mr Matheson—That is true, but the infringement notice regime certainly opens the way for ASIC to take a much more proactive approach to breaches of the continuous disclosure regime.

Senator CONROY—I think Mr Lucy has gone public and said, 'Don't worry, I won't ever be bothering to enforce this,' or words very similar to that effect, and tried to calm the concerns. I did read an article where he was promising to be very reasonable in his application of this part of the law.

Mr Matheson—The acting chairman of the commission or someone else, perhaps his predecessor, put it a different way: that ASIC, or one of the commissioners, have said that the infringement notices will be left to 'minor' breaches of the continuous disclosure regime.

Senator CONROY—I do not know what he is planning for major breaches, actually.

Mr Matheson—I suppose that to some extent reinforces our concern—albeit for minor infringements, whatever that means in their view. It potentially makes the process for them, dealing with whatever they might constitute to be a minor breach, all the more subjective.

Senator CONROY—I am just not sure how practical an appeal to either the peer panel or the AAT might be. That is sort of inserting another mechanism and I am not quite sure how it would fit into the Corporations Law. These are matters of questioning whether there is a breach of the Corporations Law and, ultimately, there has to be a decision made. Having a third party making a decision would mean having a major change to the Corporations Law about how it would be actually used. Suppose ASIC disagreed with the AAT. Where would we be there?

Mr Matheson—I suppose it is all about process and appeal, at the end of the day. Under the current proposal, ASIC would sit as judge and jury and everything else. That is really the basis of our concern, I suppose, that with that in mind there should be—as there are in many other areas of the law—due diligence defences and some appeal mechanism.

Senator CONROY—I wanted to move on to one other issue. IA Research have advised the committee that the CLERP 9 bill should require the disclosure of beneficial owners. You may be aware that the issue has been raised in the media in relation to Offset Alpine and in relation to the ownership of NAB shares. Although this issue is not discussed in your submission, I was just wondering whether you could advise the committee of your views or thoughts on the proposal, if you have given it any consideration. I know it is something that you guys do every day, talking to the major shareholders. Do you have any thoughts on that?

Ms Lawson-Kerr—We understand that this came about because, as a result of the corporate law simplification program, a listed entity can only access its own beneficial shareholders. In other words, the top 20 shareholders listed in the annual report are the registered shareholders so, to some extent, it is meaningless because a large number of them are nominees, custodians. So we do not see why beneficial shareholders should not be known. This inadvertent outcome of the corporate law simplification program has meant that in Australia we have less transparency than in other markets such as the UK and the US. It probably also helps retail shareholders to see which large institutions own that stock.

Senator CONROY—Your job is to deal with investors. How frustrating is it for you if you cannot find out who they are, particularly if they are substantial investors?

Ms Lawson-Kerr—We can for our own company, but the issue is transparency for others. It is about one investor knowing which other investors own the company.

Senator CONROY—Are you saying, for example, that Offset Alpine would have known who owned the Swiss shares—that they would have been able to establish that for themselves?

Mr Matheson—As I understand it, Offset Alpine was not a listed company. That said, I am not sure whether the provisions of section 672 of the Corporations Act—that is, the beneficial ownership tracing provisions—extend to unlisted entities. I would imagine they do, but, in answer to your question, on the assumption that those tracing provisions did extend to Offset Alpine, as an unlisted entity, your assumption is correct that they would have been able to lodge tracing notices against their registered shareholders as per their share register. But they would have hit a brick wall at some point because they would have found a Swiss entity behind which they could get no further information.

Senator CONROY—Are you saying that you would be able to find it—that there is no shareholder in your company you would not know about?

Ms Lawson-Kerr—Yes, it is a matter of practicality. A lot of listed entities will go behind, say, the top 100 registered shareholders and find out who is behind them. Usually they go one step behind and find out who they are. As a result, a listed entity can work out who is actually making the investment decisions in relation to the shares and therefore can engage with those investors.

Mr Matheson—Senator Conroy, if I understand where you are heading, I think it is fair to say that, in my colleague's case, the Commonwealth Bank would have hit the same brick wall as Offset Alpine hit. If the Commonwealth Bank were searching for that same Swiss entity, they would not be able to get any more information than any other company.

Senator CONROY—Thank you for clarifying that. I know that the Takeovers Panel has had two recent cases where it has sought to establish who the beneficial owners are. In one case they decided not to bother: Belgian dentists were apparently involved again. I want to become a Belgian dentist! They get to own most of the shares in the world. It is quite extraordinary. In one case they demanded to know, for the purposes of a takeover, who was one of the entities involved. I am interested in whether or not you have the same problems. I imagine that substantial holders are not trying to hide anything and are happy to tell you who they are.

Mr Matheson—You are right. At the threshold of 5 per cent, the substantial shareholder notice disclosure provisions kick in, regardless of whether they are a Swiss based investor or a domestic investor. I suppose IA Research's proposal that there be greater disclosure of beneficial ownership would still not address the issue of who is behind a Swiss bank—

Senator CONROY—I want to move on to that. In one of the judgments on Offset Alpine, Justice Sackville ruled that the Swiss banking laws took precedence over Australian laws—in other words, that disclosure of the beneficial owners was contrary to Swiss law and therefore not

required. In your view, is there a way that Australia can overcome this issue with new legislation?

Mr Matheson—You are right that the tracing provisions do not have any extraterritoriality. There are, in some countries, not legislative provisions but company constitutional provisions. I am aware that in the UK some companies have in their constitutions provisions which enable them to withhold dividends, for example, unless beneficial holders make themselves—

Senator CONROY—Identify themselves.

Mr Matheson—yes—and that often has the desired effect of—

Senator CONROY—Flushing them out.

Mr Matheson—flushing out the Belgian dentists that you referred to, who are particularly common in European jurisdictions.

Senator CONROY—It is a bloody lucrative business, that Belgian dentistry.

ACTING CHAIR—It is all the 'frites' they eat in Belgium!

Senator CONROY—That must be what it is!

Mr Matheson—If I could make one other comment, there is a class of underlying holder that has grown in significance for many top 100 type companies in particular or Australian companies that are currently subject to takeover bids: hedge funds. Hedge funds are probably the fund managers that have grown the most over the last five years, investing globally. The way they tend to hold and register their shares is in many cases through tax haven jurisdictions, and it is those tax haven jurisdictions, including Switzerland, that do not recognise Australia's—or any other country's—beneficial ownership tracing requirements.

Senator CONROY—Do you think the withholding of dividends would flush them out or not? I suspect not.

Mr Matheson—In the case of hedge funds, probably not.

Senator CONROY—They are not buying it for the dividend stream.

Mr Matheson—Correct.

Senator CONROY—Any thoughts on how to flush them out? As you say, they are growing at a significant rate.

Mr Matheson—Given that most countries' laws do not apply in other jurisdictions, it is almost an impossible task. It may be intergovernmental regulatory agency cooperation more than anything else that addresses the issue. Alternatively, as is the case in the US, every country could have a similar disclosure regime, where you get particular classes of investors—including hedge funds—to disclose their holdings to the regulator. In the US, hedge funds have traditionally been

exempt from what are called the US 13F disclosure requirements, where any fund manager managing more than $100 million is required to disclose their portfolio holdings to the SEC. Most hedge funds have actually been exempt from that disclosure regime, but I think there are moves afoot by the SEC to catch hedge funds in that regime. That could be another way; but, again, it would require overseas based investors or particular classes of funds to disclose their holdings to their local regulator.

Could I bring one other matter on beneficial ownership disclosure to the committee's attention, relating to ASIC's involvement in the process. Section 6.7.2 currently, as you are aware and as my colleague has indicated, gives the issuer the power to lodge tracing notices against its own registered holders. There is another mechanism under section 672 whereby ASIC can lodge notices, as it does at its own discretion, but it can be requested to do so by a shareholder of a company who is interested. But it is of concern to us that ASIC charge $500 for every notice that they lodge on behalf of a shareholder in a company. For the purposes of transparency, it is a very expensive exercise for any shareholder, if you like, to request ASIC to obtain that information on their behalf; and, even then, that information is not required to be disclosed publicly. In a sense, ASIC are a guilty party in this process as well.

ACTING CHAIR—We should ask ASIC about that. They will be here soon.

Senator CONROY—I am sure we could chat with ASIC about this.

ACTING CHAIR—Thank you very much indeed. Ms Lawson-Kerr and Mr Matheson, you are excused.

[10.25 a.m.]

MACEK, Mr Charles, Chairman, Financial Reporting Council

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. I invite you to make a brief opening statement before we proceed to questions.

Mr Macek—I will confine my comments to those matters pertaining to CLERP 9, although during the discussion the range of questions might be broader than that. Last year, after the CLERP 9 draft legislation was put out, the Financial Reporting Council established what we called a CLERP 9 task force—a subcommittee of the council—to review our position. The members of that task force are me, Elizabeth Alexander, who is deputy chair of the Financial Reporting Council, Karen Hamilton, Graeme McGregor, Gregory Pound and Lewis Ting. To date, that subcommittee has met on three occasions—in September and October last year and in February this year. The overriding objective we have taken with regard to CLERP 9 is that the FRC ought to carry out its expanded functions in a way that ensures Australia employs world's best practice whilst avoiding any duplication of effort and minimising compliance costs.

Our initial focus back in September and October was to provide feedback to the government on the draft legislation. We identified a number of issues which were then matters contained in our submission, which I will come back to. We believe that the FRC would best achieve the desired outcomes of the bill if our role included oversight of audit quality in general rather than being limited to auditor independence, as was contained in the bill. This was based on our understanding that auditor independence is only one of the many aspects that determine audit quality, with competence probably being by far the most important. We also took the view that the FRC should only have a role in monitoring, not in enforcement. Therefore, we considered that the co-regulatory framework that was the implication of the CLERP 9 bill was actually an advantageous outcome and one that we would support. With that in mind, we initially undertook a preliminary review of the quality assurance processes employed by the professional accounting bodies.

We were also concerned—and this probably underlay part of our thinking as to why our remit should be broader than just auditor independence—that in the minds of the public the FRC would be held responsible for any failures in the area of audit, which may not necessarily be duly a function of independence. We also acknowledge that the level of funding that is likely to be made available to the FRC would not enable the FRC to undertake any significant inspection function, as for example the PCAOB in the US does. But we considered that this was appropriate, given that it was clearly not the government's intention to give the FRC significant inspection or enforcement powers. Those responsibilities lie, and will continue to lie, with ASIC. We are also of the view that the funding arrangements of the FRC that have been discussed with government would be sufficient to carry out the expanded functions as we understand them. We concluded that we would need to engage an external consultant to help us with our deliberations. We also believed that oversight of the Auditing Standards Board—in other words, the audit

standards setting function—would be undertaken in pretty much the same way as we presently oversee the Accounting Standards Board.

On other operational issues that flow from our increased responsibilities, the task force was unanimously of the view that the FRC would be better able to carry out its functions if the council itself was a smaller, more focused body than the large representative body that it presently is. Our thoughts were that a board somewhere between the size of seven and 10, consistent with best practice in the corporate sector, would be appropriate.

Again in line with good governance principles and particularly taking into account independence, we are of the view that the FRC would be best served by having an independent secretariat—that is, separate from the provision of support staff within the Treasury department in Canberra—and ideally, given the location of the two standards boards, that that independent secretariat should be co-located in Melbourne. We have some sympathy for the UK model, which has a Financial Reporting Council with an independent staff of only four, including an executive director, and the sorts of responsibilities that we have in Australia with some additional responsibilities, including governance.

The submission we made to Treasury in November is on the public record. The main points contained in that submission—some of which I have already touched on—are that our role should be expanded to include oversight of audit quality and not just independence; that the provisions in the bill should be framed to facilitate a co-regulatory model; that the roles and responsibilities of all regulatory and oversight bodies in the area of audit quality should be made quite clear; and that our information gathering powers should allow measures to obtain information and provide to consultants who may be undertaking that task on our behalf adequate levels of protection.

In December last year we had a presentation from the Treasury indicating the outcome of the review of the draft bill and making it quite clear that our remit would be confined to auditor independence. We then had a meeting earlier this year to review the implications of the legislation. At our council meeting at the end of February we engaged a consultant, Mr Robert Lynn—whose background is as a previous audit partner at Coopers and Lybrand and a former member of the Auditing Standards Board—to undertake an exercise for us. At that meeting we also decided to enter into a series of memoranda of understanding with a number of other parties with a vested interest in this area, including the three professional accounting bodies—ASIC, the ASX and APRA—and the Companies Auditors and Liquidators Disciplinary Board. We are working constructively with those bodies to try and conclude those memoranda of understanding by the time of the FRC meeting that is scheduled to be held on 18 June.

We have since received Mr Robert Lynn's report. That was tabled at the council meeting we had last Friday, 23 April. A CLERP 9—as we call it—task force meeting has been convened for next Thursday, 6 May, to review that report and then discuss it with the full council at its meeting on 19 May.

Senator CONROY—As you are aware, the CLERP 9 bill expands the responsibilities of the FRC, which currently oversees the accounting standard setting process, to also oversee auditor independence requirements of the auditing standards setting arrangements. Under the structure you have just outlined, where does the expertise come from for this oversight? One witness

suggested that something of the size of the Mormon Tabernacle Choir would be needed for you to be able to fulfil all of your new roles. You obviously looked at that and said, 'No, in actual fact we don't need the whole choir; we can just have the sopranos.' How will you manage to do all these things? How will your seven- to 10-person best practice body actually do it?

Mr Macek—I guess we take the view—and this is the correct legal view—that the Financial Reporting Council effectively is a board and, therefore, we have the same responsibilities as any board. I suggest that typically boards have three functions: to provide the strategic context or strategic direction for management to go away and develop strategy; to appoint management; and to approve and monitor the annual plans of management. Clearly for a board to be effective in undertaking those responsibilities it needs to be comprised of not the Mormon Tabernacle Choir but a small group of experienced people with sound judgment and the appropriate mix of skills. However, at the moment we essentially have a democratic board, if you like, that is there at the nomination of various stakeholders. One could argue that some stakeholders have as much right to nominate someone to the council as those who presently do, and so that would suggest that we may end up with something closer to the size of the Mormon Tabernacle Choir. But that would not necessarily ensure that we have the appropriate skills and it would not necessarily ensure that the board, given its size, would be absolutely efficient and effective.

Senator CONROY—That is one issue that the committee has been pondering: how do you get the skills base to understand all of these issues? Some would argue that you need people almost exclusively with the technical experience; others thought that perhaps there should be a structure of subcommittees set up, by which you could contract the technical skills in. Do you have a view on that?

Mr Macek—My view really reflects my observation that the FRC should be thought of as a board. It does not do the technical work; it does not have to have the same technical skills as do the two standard boards. But clearly there needs to be enough knowledge and expertise around the council that they understand the issues sufficiently. Clearly, the increase in our responsibilities, of itself, suggests some additional skills may need to be brought to the council table.

Senator CONROY—The explanatory memorandum at page 86 says that the FRC's role is:

> ... purely one of monitoring activities and/or developments and providing appropriate advice to Ministers or the accounting bodies.

Under the structure you are talking about, how will the FRC monitor activities in relation to audit independence? What practical steps will you take?

Mr Macek—The two steps that we have taken to date are, firstly, to begin to understand what measures the accounting profession itself adopts in monitoring the professional performance of its membership and, secondly, to engage the services of a consultant to provide us with his perceptions and perspectives on how we might go about our task. I am not yet in a position to be able to discuss that report, because we have not yet had the opportunity to consider it. Clearly the point I think you are heading towards is: how do we acquire the necessary skills and expertise? In that regard we have already telegraphed that, in all probability, we would need to engage some consultants in general. But bear in mind that we do not see ourselves and nor does

the government see us as having inspection powers; and nor does the bill convey on us inspection powers. We are not a regulator and we are not the enforcement agency—that responsibility lies with ASIC—and therefore our role is principally one of oversight and, on the basis of that oversight, forming views that may provide input to government.

Senator CONROY—In your view, is monitoring the same as oversight? Are they the same concepts?

Mr Macek—I think monitoring is a little—

Senator CONROY—I have just quoted from the explanatory memorandum. To me, oversight implies a little more than monitoring.

Mr Macek—I would suggest the reverse. In my dictionary, monitoring involves a bit more than oversight. But either way, if one has oversight and monitoring, which we clearly do, it means not only that we need to have a view on the overall systemic framework, the systems and the processes by which the auditing profession undertakes its responsibilities—and we need to do that obviously in consultation with the profession, because they are the principal source of expertise—but also that we need to satisfy ourselves at the same time that those systems and processes are not only appropriate but also being adopted.

Senator CONROY—You have outlined a lot of discussion, monitoring and interaction with the accounting bodies, who are ultimately service providers. Is there any thought of any discussions with the recipients of the services—the shareholders—that are being provided, or don't they rate on the horizon?

Mr Macek—Yes.

Senator CONROY—They are the ultimate users of the process you are now in charge of monitoring. You have outlined a process but you do not seem to have mentioned content at any stage. Will you be engaging in any discussions with the ultimate users of the material that is spilling out of your process?

Mr Macek—Absolutely. With respect to accounting standards, we have already; not only through the composition of the council but through extensive consultation outside the council. On occasions we have even invited outsiders—APRA, for example—who are not represented at the council to attend council meetings. That has been our philosophy and our approach, and we will certainly adopt exactly the same philosophy and approach with regard to auditing. The starting point, obviously, is to understand what the current practices are and then to review whether or not they are appropriate. In determining whether or not they are appropriate, clearly, a users or investors/shareholders perspective needs to be reflected in that judgment.

Senator CONROY—So your first recommendation for consulting shareholders is to have them kicked off your board.

Mr Macek—Not necessarily.

Senator CONROY—So you would argue strongly to retain some shareholder perspective on your seven- to 10-member, best practice, board? They are currently on your board, and you are reducing it from the size of the Mormon Tabernacle Choir, as it is now, as we have said. I am trying to gauge how that consultation process will work when your first act is to throw them off your board.

Mr Macek—I have not indicated who should be thrown off the board. All I am suggesting is that the current model is effectively a very broad representational model as opposed to a meritocracy.

Senator CONROY—That would be your opinion. In my opinion, it is fundamentally unrepresentative, undemocratic and has nothing to do with the sorts of things you have described. But you are entitled to your opinion.

Mr Macek—Of the 16 members of the council, three are from the investment, or user, perspective. Three out of 16 is not bad. You might argue that it should be more than that. In terms of the composition of the board, I am really arguing that the board needs to have the requisite skills and perspectives. Clearly, with regard to our expanded responsibilities, part of that would be understanding audit, both from a preparer's, from a professional, point of view and from a user's perspective. So one could see that even if various organisations were no longer used to nominate people for membership to the council there would still need to be people on the council that reflect some of those perspectives, and a users' perspective would be one of them.

Senator CONROY—Given that the FRC's role is one of monitoring, will they rely on ASIC to investigate whether the new requirements in the Corporations Act are being followed? Do you plan to refer matters to ASIC to investigate? How would you see that interaction working?

Mr Macek—That will clearly be one of the issues that would need to come through in the memorandum of understanding. But our starting point—and, equally, ASIC's starting point—in these discussions has been that they are the regulator and they have the enforcement and inspection powers. We have neither the power nor the desire to duplicate what they will be doing.

Senator CONROY—So you would refer it to ASIC?

Mr Macek—Obviously there will be a sharing of information. If we discover anything that should be referred to ASIC, we would do so.

Senator CONROY—You mentioned MOUs: have you signed any yet?

Mr Macek—There are no MOUs signed. The request went out to each of those organisations following the February meeting of the council. There have been follow-up discussions with each of those bodies. Each of them have indicated their willingness and their enthusiasm for entering into an appropriate memorandum of understanding. In a couple of cases, drafts are now well advanced. As I indicated in my opening remarks, it is our hope and desire that we can conclude that process by the end of June.

Senator CONROY—If the 1 July commencement date is in place then hopefully you would have finished that. The committee is trying to get an understanding of how you are going to operate under this new entity. Is it possible for the committee to get a copy of the documents that you have sent out? I appreciate your saying that you are at a draft stage and you have not finalised anything, but what you have put forward to those organisations would give the committee a picture of how you see it operating. Is it possible to get a copy of that documentation?

Mr Macek—Yes. There would be no difficulty in providing you with that. I could give you an outline of the content.

Senator CONROY—Please do. I was just trying to save you having to read out 10 pages of things, but an outline would be useful.

Mr Macek—I could give you an outline of the desired content of the MOUs. That includes: the scope, which in our view needs to be confined to the auditor independence issue; the extent of proposed cooperation between the FRC and the other entity; the powers and responsibilities of each entity; information sharing; confidentiality; contentious issues; and the timing, which I have already indicated. That is just an outline of the subject headings. The devil will be in the detail.

Senator CONROY—It always is. If we were able to get those other documents which the organisation has sent out, that would be helpful to the committee's understanding. Thank you. ASIC's submission on the CLERP 9 policy paper says:

... to ensure that the FRC can effectively oversee the audit profession and the financial reporting framework, its role should be further expanded so that:

(a) the FRC has a fully functional research capacity;

(b) the FRC is required to ... report on the ethical codes developed by the professional bodies ...

In your view, does the FRC need a fully functional research capacity? I think you have talked a little bit about that. I am not sure that the research capacity is quite the same as a secretariat. You may envisage that they are one and the same; I am not quite sure they are. I was wondering what your thoughts were.

Mr Macek—It may be a question of semantics. Clearly, in order for the council to undertake its responsibility to provide advice to government on these matters—which will deal with the overall system and how effectively it is operating—we would need to stay abreast of best practice globally and we would need to understand whether or not the current system, whatever it was, is working and what improvements could be made. I am not sure whether you would call that research or whether that is just part of ongoing monitoring. I think there is an element of research in that, so we would need to ensure that we have adequate skills in that regard.

Senator CONROY—In your view, should the FRC report on the ethical codes developed by professional bodies?

Mr Macek—It is one of our responsibilities now. We did have some concerns when we were originally reviewing the draft bill as to how extensive our scope would be with regard to the teaching of ethics, because not only is it confined to the profession but it includes all of the tertiary education sector, and that is a very large area. Given that the CLERP 9 bill reform largely focuses on improving audit and audit independence, and the ethical position of auditors is part of that, we clearly do need to form a view on that, in the same way that we need to feel satisfied that the quality assurance programs and the monitoring by the profession itself of its members is adequate. Equally we need to have the same sense of comfort with regard to the teaching of ethics and, clearly, adherence to high ethical standards.

Senator CONROY—Professor Ramsay has also advised the committee that the FRC does not have sufficient resources to do the job given to it under the new CLERP 9. He advised the committee:

> I do, however, see some scope for improvement in the bill. I recommended the introduction of a new body to supervise the new auditor independence requirements. The bill gives this task to the Financial Reporting Council. This could work, but there are two key issues: will the FRC have sufficient resources, and does it have the right membership? I am not yet sure that the FRC has sufficient resources to undertake these new and important tasks.

In the light of the recommendations from ASIC and Professor Ramsay, the FRC needs more resources to do the job it has been given. Has the FRC sought additional resources from the government?

Mr Macek—The resources question has been a perennial thorn in our side since the establishment of the council at the end of 1999. I have been on the council since its inception, and a large amount of council time has been spent on one of our requirements, which is to seek funding, which is not particularly productive.

Senator CONROY—Unfortunately, we have been spectacularly unsuccessful.

Mr Macek—Technically unsuccessful, in terms of getting voluntary donations from the corporate sector. The government has now accepted that that is not a proper role for the council, that the council does need to be properly resourced and financed and therefore that there needs to be a more robust funding mechanism put in place, where the source of the additional funding should ideally be the corporate sector. Without such a robust funding model, we will not have the appropriate resources—the skills that you are referring to—and nor would we stand up to any rigorous scrutiny by overseas regulators such as the PCAOB as to the soundness of our system in Australia.

Senator CONROY—I know. I have had many conversations with your predecessor, Mr Lucy, supporting the desire to get those voluntary contributions in, and I know you have been considering it extensively, as you say. Have you settled on a model? Have you recommended a model to the government?

Mr Macek—It is not up to us to recommend a model but, in terms of what is under consideration, it would be one of two options. One would be to make a provision effectively from the levies that ASIC already collects from the corporate sector but to clearly signify that this is an allocation from that pool of funding to the FRC.

Senator CONROY—Which sorts of levies are they? If it were to be tacked onto that or hypothecated out of that, which are the levies you are talking about?

Mr Macek—I am not sure that ASIC necessarily segregates them, but they do have registration and licence fees, which are their main source of revenue, and they do collect more.

Senator CONROY—Do they go to the Commonwealth, or are they repatriated to the states?

Mr Macek—They just go to Commonwealth consolidated revenue. The allocation for the operations of ASIC is well below the total quantum that they collect, so there could just be an allocation from that, or it could be made just from consolidated revenue. There are advantages and disadvantages with either of those models. Which of those two models prevails is a matter for the government to determine. We, the FRC, are indifferent—

Senator CONROY—As long as you get the dough.

Mr Macek—as long as we get the money and it is a secure, robust model.

Senator CONROY—The bill amends the ASIC Act in relation to the functions and powers of the FRC. One of the amendments relates to the FRC's oversight of the AASB and says that the FRC's function will be to promote the adoption of the international accounting standards. A similar amendment will be made in relation to the AUASB in relation to auditing standards. As the FRC's function is to promote the adoption of international auditing standards, isn't the FRC implicitly adopting the content of the standards and not just setting the strategic direction?

Mr Macek—That is a discussion you and I have had previously.

Senator CONROY—That is right.

Mr Macek—Our view is that there is a distinction between strategic direction and the actual wording and detail of the standards, albeit once the strategic direction has been set—

Senator CONROY—Which part of 'You will adopt that standard there with all the words in it' do you see as setting the strategic direction as opposed to the content?

Mr Macek—Yes.

Senator CONROY—You see them as two different things?

Mr Macek—Clearly the strategic direction significantly constrains the standards board, but we are not saying, 'You will adopt verbatim.'

Senator CONROY—Have you taken legal advice about the FRC's position? Have any of you at any stage contemplated that you are in breach of the Corporations Law with your direction?

Mr Macek—We do not have any advice to indicate that we have acted other than in accordance with our responsibilities, functions and powers.

Senator CONROY—Have any of you even read the legislation establishing the FRC?

Mr Macek—Yes.

Senator CONROY—And you do not think there is a conflict between—to use your word a moment ago—constraining the AASB and the law about the content of accounting standards?

Mr Macek—No, because we are not forcing anyone to adopt a particular standard verbatim. We are signalling a strategic direction. The ASIC act requires both the FRC and the AASB to act in the national interest. Historically accounting standards, and in the future auditing standards, will have the force of law, and therefore ultimately the Australian parliament still has jurisdiction.

Senator CONROY—The parliament makes the decision about what is in the national interest, not you. I will come back to questions about the process, which I do not think we have gone through at length publicly; we went through it privately. In the last budget the FRC was provided with $4 million over four years. The budget papers say that this will cover the FRC's expanded role under CLERP 9, including oversight of the audit standard setting and audit independence issues. In addition, the AASB will be moved under the control of the FRC. In your view, is $1 million per year of federal funding sufficient for the FRC to adequately fulfil the new tasks assigned to it under CLERP 9?

Mr Macek—No, it is not, and that is a position accepted and understood by government.

Senator CONROY—You have raised that with the government and made it clear to them that it is not?

Mr Macek—Yes.

Senator CONROY—Mr Keith Alfredson, who I am sure is known to you, has advised the committee 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. He said that the International Accounting Standards Board is presently going through a review of its own operations and the FRC should do the same. In your view, is a review of the FRC required?

Mr Macek—Given that the FRC was established only at the end of 1999 and we are about to go into a changed role or an increased role for the FRC—and with any new organisation there is bound to be some learning that can be obtained by monitoring one's performance—I think it would be quite appropriate for there to be a comprehensive review of the FRC. It would include matters which I have already touched on, such as the composition of the board, the secretarial support and the location of that, amongst other matters.

Senator CONROY—Is that a yes or a no?

Mr Macek—It is a yes.

Senator CONROY—As I thought. A number of witnesses have said the FRC should hold its meetings in public except, obviously, in relation to a couple of issues, such as the appointment of

board members, although that may or may not any longer be your role—I am not sure. They have said that by opening up meetings to the public there is complete transparency about the decisions that are made by the FRC. In your view, should the FRC hold its meetings in public?

Mr Macek—That is a matter that we have reviewed on more than one occasion—

Senator CONROY—And rejected on each occasion?

Mr Macek—Yes, rejected on each occasion. On the last occasion that it was reviewed, which was in the middle of last year, we took the view that we absolutely accepted the principle that is implicit in the desire for greater public scrutiny, transparency and accountability but that, given that we were uncertain as to how the CLERP 9 provisions might impact on our functions and the way in which we operate, we would revisit that issue once that position is clarified. In the meantime, we would undertake a more comprehensive bulletin, which would be made public—posted on the web site of the FRC—and that we would make the bulletin available as expeditiously as possible. To date, the turnaround for the sign-off on the bulletin has typically been about a week. Following the March meeting of the council—about which there was considerable external interest, given that our principal agenda item was to complete the review of the timing issue in terms of the adoption of international accounting standards—the turnaround was 48 hours. I am pleased to announce that the bulletin dealing with the meeting that was held last Friday was posted to the web site this morning, despite Monday being a holiday.

Senator CONROY—There seemed to be some confusion at the completion of your meeting. The media reported that you would not comment on the decision until the bulletin had been posted. Is that an accurate representation, or did they verbal you—or, in this case, not verbal you?

Mr Macek—That is an accurate interpretation; that is our public position. Given that the content of the bulletin is akin to very comprehensive minutes of the meeting, and that boards do not finalise or release minutes without all the council or board members having had the opportunity to have input to the draft, then that—

Senator CONROY—But you had made a decision.

Mr Macek—That is correct.

Senator CONROY—It is not as though you need the writing to support a decision.

Mr Macek—The words you use to describe a decision can at times have as much impact as the actual decision. Clearly, the words will influence perceptions.

Senator CONROY—You said, 'We will be sticking with the implementation date.' Which of those words would be open to misinterpretation?

Mr Macek—The decision taken in March was an in-principle decision and had some caveats attached to it.

Senator CONROY—Are you not capable of explaining that to the Australian public? I am confident that you would be, but I am surprised to see you being so bashful.

Mr Macek—I am capable of explaining it, but I would feel more confident if I knew that the entire council were in agreement that the words and description that I would be using in that dialogue were consistent with their understanding of the actual discussion and decision.

Senator CONROY—You would be the only board I have ever come across that refuses to speak about its decisions before it has published them. Even judges announce their decisions and then take months to produce their reasonings. You are the only organisation I have ever met that refuses to speak until after it can get the words out. I find that a slightly unusual process. Will it be the ongoing practice that you are gagged until after the minutes have been produced?

Mr Macek—It is not a matter of being gagged.

Senator CONROY—A self-imposed gag.

Mr Macek—It is a self-imposed policy decision. It is one that we can obviously review at any time. If there are reasons to change it, we would certainly do so.

ACTING CHAIR—Do you regard the procedure you have adopted at the moment as prudent?

Mr Macek—In terms of the release of the bulletin?

ACTING CHAIR—Yes.

Mr Macek—We take the view that it is prudent, given the sensitivity and complexity of some of the issues that are being discussed and the need to convey quite accurately, in a way that is consistent with the understanding of the entire council, that that is the basis of our discussion and decision.

Senator CONROY—What I am looking for—this will save a lot of confusion, or at least it will mean that you do not have to be gagged, albeit by yourself—is for the meetings to be held in public. You would not have to worry about being misrepresented, because the people would be able to watch it as it all happens.

Mr Macek—Yes, that is true.

Senator CONROY—You are aware of the CLERP 9 recommendations. I do not think there is a lot of argument, politically or anywhere else, about the role the FRC will have. Are you able to give a commitment that the FRC will in future meet in public?

Mr Macek—The only commitment I can give you is that the FRC will review that policy stance. We will obviously be able to do that in full knowledge of our total responsibilities. Given that our responsibility with regard to the monitoring of auditors will be confined to the independence issue and will not involve inspection or any enforcement provisions, it seems to me that the sensitivity of the likely content of the discussions at FRC meetings will be somewhat

diminished from what it might have been under a different level of responsibility, and therefore the case for making the meetings open to the public is stronger than it otherwise would be.

Senator CONROY—I am glad the FRC believed in the principle of transparency and, for the third time, voted against being transparent. But I do get a sense from you that we may be moving to resolve that positively. Hopefully, the FRC can vote in favour of their principles in the future. A number of witnesses have said the FRC should be required to prepare cost-benefit statements when setting the strategy of the AASB and the proposed AUASB and to openly consult on strategy papers. Do you support those ideas?

Mr Macek—Obviously, when one is considering the national interest, that does require some sort of view or judgment about cost-benefit. Coming from the investment community and the corporate sector as I do, I can say that this is a very sensitive issue. We are not a regulator, but we do have an impact on policies that the corporate sector has to adopt.

Senator CONROY—You are a public body, though.

Mr Macek—Yes. I am expressing a view that I am very sensitive to the concept of a cost-benefit analysis, for all sorts of valid reasons. The problem with any such exercise is the difficulty of getting precise measurement. Therefore, it invariably does come back a matter of judgment, but national interest does require some sort of evaluation of cost-benefit.

Senator CONROY—Do you think that is a process that you should go through when you are making these big decisions?

Mr Macek—In terms of the judgment that is required, absolutely. But, as I have indicated, the difficulty is getting precise measures, so it is a highly subjective process.

Senator CONROY—I accept that, but you believe that you should go through some process. It may not include a definitive dollar cost-benefit, but there should be a process.

Mr Macek—Yes. As an illustration, the strategic decision to adopt international accounting decisions is based on such a judgment—the judgment being that, by being a fully-fledged signed-up member of global capital markets by facilitating cross-border comparison of financial reporting in Australia, for the benefit of overseas investors, the cost of capital for Australia at the margin will be lower, and that is therefore a benefit.

Senator CONROY—As you well know, I would disagree strongly with you on that assessment and, more importantly, on that outcome. I want to go to that process issue you have described. Keith Alfredson, who was an attendee but not a formal member of the FRC—though I think he did receive the papers and participate in the discussions—advised the committee that, when the decision to adopt international accounting standards was taken:

> ... the whole process lacked robust and formal consultation.

He also said that the decision to adopt IAS 39 by 2005 was:

> ... made without any FRC paper that firmly debated the issues or all of the arguments in favour and against.

Is he correct?

Mr Macek—In broad terms, he is correct.

Senator CONROY—So there was not even a paper summarising the benefits put to the FRC before you made that decision?

Mr Macek—Not a detailed paper. We have learned from that process.

Senator CONROY—Can we have a copy of the non-detailed paper—or whatever you want to refer to that document as—on which you based your decision?

Mr Macek—I do not see why you should not have access to that.

Senator CONROY—Neither do I, but I ask: can we have it?

Mr Macek—Yes.

Senator CONROY—I want to go to that process. As I am sure you know that at Senate estimates we get to ask lots of boring and annoying questions of many people. At one round of estimates, Ian Campbell, who was then parliamentary secretary in charge of this area, stated that funding for the FRC was provided—I will try not to verbal him and I am happy to get the *Hansard* for you to check this—out of a grant from a government pool. He approached the Stock Exchange and asked them to provide that funding and they agreed to provide it. But the funding was tied to the introduction of international accounting standards and you only received your funding on the basis that you agreed to the introduction of those standards. That is Senator Campbell and he is quite unabashed and unashamed, whereas you seem to be trying to pretend that some sort of discussion by the FRC about the national interested was involved.

Mr Macek—Certainly the FRC had a discussion about the merits of that strategic direction.

Senator CONROY—There is no supporting paperwork of substance whatsoever.

Mr Macek—Not of the same quality that we have been basing our current review on, no.

Senator CONROY—Comparatively this was a process into the future; at that time this process did not exist. Fundamentally you had been told, 'If you want the money, here's what you have to do to get it,' and there was no national interest argument. That was the condition on which you received funding; is that not correct?

Mr Macek—Not to my knowledge, no. Certainly we were not aware of the funding being tied in that way. I think the source of funding that you are referring to is contained in a body called the Financial Industry Development Account.

Senator CONROY—Yes.

Mr Macek—That account effectively is the surplus of the old Stock Exchange fidelity account from when the Stock Exchange was member based, and the ASX administers it.

Proposals to access that account are approved by the government. The major criterion for accessing funding from that feeder account is 'for the promotion and benefit of the securities industry'. Clearly, as I indicated earlier, the judgment we made regarding international accounting standards was that it would contribute to lowering the cost of capital at the margin and, therefore, it is compatible with—

Senator CONROY—Can I come back to the facts?

ACTING CHAIR—Senator Conroy, Mr Macek was in the course of a long answer and I think he should be given the opportunity to finish what he was saying.

Senator CONROY—He was not actually answering my question. He is talking without answering my question.

ACTING CHAIR—Mr Macek, please finish what you were in the course of saying and then Senator Conroy can ask his next question.

Mr Macek—The basis of the application by which the FRC sought to access that $1 million per annum for only two years from the feeder account was specifically consistent with part of our functions and responsibilities, which is to promote the development of high-quality international standards. The intent of the council in accessing those funds was to make those funds available to the International Accounting Standards Board in London to facilitate the work that they do. I cannot recall and certainly am not aware of any suggestion to tie that fund to council making that strategic decision. That strategic decision was made by the council. I have admitted, as Keith Alfredson has already observed, that the way in which that was discussed and reviewed was less than ideal. We have learned from that and the process that we have followed in the last four or five months, as we have been undertaking a review of whether or not that original timing decision is still appropriate, is far more robust and we feel it would certainly stand up to scrutiny. That is the practice that the council adopts today.

Senator CONROY—But it is not the practice by which it went down the path of ramming down the throats of the AASB the fact that they would be adopting international accounting standards by 2005.

Mr Macek—I have already admitted that the process that was adopted back then could be improved.

Senator CONROY—But it was not a process.

Mr Macek—It was a process where there was quite a lengthy discussion.

Senator CONROY—I understand that it was a lengthy and robust discussion.

Mr Macek—It was lengthy and robust. But whether it was on the basis of the sort of documentation that you would have liked to have seen is questionable.

Senator CONROY—It was not on the basis of any documentation. That is the truth, isn't it? No prepared paper was put forward to argue the case; a motion was moved.

Mr Macek—I certainly recall the discussion.

Senator CONROY—Just for clarification, can I ask whether the item was even listed for discussion on the agenda?

Mr Macek—My recollection is that it was, but I stand to be corrected.

Senator CONROY—I do not know the answer either. When would most council members have received the papers advising them that this item was listed on the agenda?

Mr Macek—Again, I think as Keith Alfredson observed when he met with you a few weeks ago, on many occasions council members were provided with papers, in my view, far too late. That practice no longer applies. The secretariat, to give them their credit, now prepare and make the papers available generally one week before a council meeting.

ACTING CHAIR—When were the papers provided in this case?

Mr Macek—I cannot recall but, going back a few years, as a general practice, typically they were made available only a matter of a day or two before the council meeting.

Senator CONROY—So the papers for a debate that was in 'the national interest', to use your words, and which went to the single most important decision that you had ever made were provided with most members getting them only the night before—and the content of those papers, even you admit, was less than satisfactory. So the single biggest decision that you had made was rammed through on one discussion, with no paperwork of note or substance—and that was the national interest at work. I raise these questions because when I asked—

ACTING CHAIR—Before you explain why you raise them, let us hear the answer to that question. Is that the case?

Mr Macek—It is not true to say that it was rammed through on one discussion. If one reads the bill under which the FRC was established, clearly a prime function and responsibility of the council is to promote and contribute to the development of high-quality international standards. The discussion that took place at the meeting in June 2002 was the final such discussion that we had. It was a lengthy, robust discussion and, in my judgment, notwithstanding any deficiencies in the process back then, it was the correct judgment. That position has been reviewed very rigorously over the period since December last year, culminating in our meeting last Friday, at which we ratified and confirmed the in-principle decision that it would be in Australia's best interests to adopt international accounting standards from January 2005.

ACTING CHAIR—At the time this discussion took place—of which you have told Senator Conroy that there was, it seems, very brief notice in the agenda—would it be right to say that those who participated in that discussion already had a well developed or sophisticated awareness and understanding of the issues going back over time, or is that not the case?

Mr Macek—In terms of the big picture, I think it is fair to say that the members of the council or certainly the council in aggregate would have had such a view and knowledge and

understanding. If you drill down too deeply in terms of technical issues, then I am not sure the same observation could be made.

ACTING CHAIR—Did the discussion at the level at which it was conducted require an appreciation of those technical issues?

Mr Macek—I think in an ideal world that would be desirable. Certainly in the process of the review we have undertaken we have engaged very comprehensively particularly with the AASB, who do have that technical knowledge.

Senator CONROY—Would it be fair to say that the AASB had reviewed that topic already and had specifically not committed to both the timetable—importantly—and the actual issue around the content; and that they had done a very thorough review and a comprehensive paper had been presented to the FRC previously outlining the AASB's view on this? Is that a reasonable interpretation of the report that they prepared a few months prior to your making your decision?

Mr Macek—I think it is—and their position was one of harmonisation, whereas our judgement was that we should go the next step. The trigger for that, obviously, was the fact that Europe were signing up to go to that next step from 2005.

Senator CONROY—Yes, we are up there with Botswana. We are well aware that we are now going to align our standards with Botswana—and that is something I would proudly champion, too, Charles.

Mr Macek—The ASB, the Accounting Standards Board for the UK, have already come out in the last week and indicated that they will be adopting the full body of international standards for all of their listed entities.

Senator CONROY—Do they have any idea of what they are adopting? Does the full body exist yet?

Mr Macek—Whether Botswana also signs up is immaterial. The UK has a very good reputation.

Senator CONROY—Does this full body of standards exist yet?

Mr Macek—Effectively, yes.

Senator CONROY—That is not true, Mr Macek. IAS 39 is not agreed.

Mr Macek—There is one standard—IAS 39—that is subject to further reviews.

Senator CONROY—Do you understand anything about that standard?

ACTING CHAIR—Just a moment, Senator Conroy. You finish what you were in the course of saying, Mr Macek, and, then, Senator Conroy, if you have another question, please ask it.

Mr Macek—The point I was finishing up on was that the UK—which, I think, together with the rest of the Anglo world, has traditionally enjoyed a very high reputation for accounting standards and certainly would not regard itself in the same league as Botswana—has signed up to the full body of international accounting standards for the listed entities.

Senator CONROY—The standards that do not exist.

Mr Macek—Those standards are complete.

Senator CONROY—No, they are not.

Mr Macek—The final batch was released on 31 March. One of those standards that was released on 31 March, IAS 39, is still subject to some further minor modifications.

Senator CONROY—That is not true—and you have had the same briefing I have had. That is not true. The French government are continuing to reject it.

Mr Macek—The French government may continue to reject it. The French banks may continue to reject it. But, at the end of the day, it is up to Europe to make a decision on how they will deal with that.

Senator CONROY—They have already vetoed the first standard. Is that not true? The French government vetoed the first standard on IAS 39. They refused to support its implementation at the European Union and blocked it at the commission level. Is that not a fact?

Mr Macek—The French are well known for rejecting that standard. The reality for Europe is that they need to harmonise standards over Europe. At the moment they are a mishmash of separate national standards. They have made a policy commitment to adopt international accounting standards. The process that they follow is that they endorse each standard individually. It is very clear that they will be adopting all international accounting standards with the possible—that is, possible—exception of IAS 39.

Senator CONROY—Given that they have rejected it once and there is continued, ongoing debate from them about whether they will accept this, they are, in actual fact, currently pressuring the IASB to further water down this standard, are they not?

Mr Macek—They are. That is a process that has been going on for a long time.

Senator CONROY—That is the French government interfering in accounting standard setting—is that what you are you describing?

Mr Macek—There is European—and, particularly, French—opposition to greater transparency and disclosure of the economic performance of some of their reporting entities. They would prefer to hide the reality in terms of what is really happening to those companies, for obvious reasons. In our judgement, the position for Europe is that they will adopt all standards, with the possible exception of 39. In the event that they do not adopt 39, the most likely scenario is that the adoption of 39 would be optional and what we would find is that those global institutions that want to adopt high standards would do so, and those that have got

something to hide—such as, presumably, the French banks—would not wish to do so. The question for Australia, if that were a plausible scenario—which it is not—is: to which benchmark do we wish to align ourselves? Would it be global best practice or a cover-up similar to that which the French are still pursuing?

Senator CONROY—I agree with a large part of what you are saying and I am disappointed that the French are pursuing the line that they are pursuing and the cover up and not wanting to report accurately. Would you put Australian insurance companies who are opposed to the same standard in the same boat?

Mr Macek—No; I think we can take pride in our insurance industry, notwithstanding HIH. But there are a whole lot of other issues not to do with—

Senator CONROY—They are publicly lobbying for a change in IAS 39, though.

Mr Macek—Their problem is broader than just IAS 39. Their problem primarily revolves around the fact that the insurance standard itself, which is still a work in progress, is not everything that they would wish it to be—and that it does interact with IAS 39. The version of IAS 39 that existed back in December would have created quite substantial difficulties for our insurance sector in terms of the veracity of their disclosure. The version that was released on 31 March goes a long way to reducing most, but not all, of those concerns. We do not believe that the IASB, given its track record to date, will bow before the French government and the French banks.

Senator CONROY—Could you explain to me the difference between the December standard and the March standard?

Mr Macek—That is an area outside my competence.

Senator CONROY—Could anyone that is a member of the FRC explain it to me?

Mr Macek—The AASB would be able to.

Senator CONROY—I said 'that is a member of the FRC'. I just wondered if any of the voting membership that voted to adopt this standard could explain to me the difference between the December standard and the March standard.

Mr Macek—Not to your satisfaction. If you wanted such a explanation, the AASB—

Senator CONROY—The AASB would not be technically competent to give me that explanation, would it?

Mr Macek—No, but the AASB was a participant at the council meeting that made that decision.

Senator CONROY—And opposed it.

Mr Macek—No.

Senator CONROY—So a robust discussion was had, and everyone that had a vote agreed with the decision in the end—because the AASB representative did not have a vote.

Mr Macek—That is correct. But at the end, the AASB was totally supportive of the decision to proceed with 2005.

Senator CONROY—Given that you control their funding as much as the government controls yours, I am sure they went along with it. Independence is not an issue in this—this is sheer, raw political dollars. It is: 'We've got the dollars. You'll do what you're told.'

Mr Macek—That is a very cynical view.

Senator CONROY—That is an accurate view.

ACTING CHAIR—Is it common practice at meetings for the Financial Reporting Council to be guided on technical issues by the AASB or, indeed, other bodies that may be represented before it?

Mr Macek—We are specifically precluded from making technical standards. That is the point that Senator Conroy was, I think, alluding to earlier.

Senator CONROY—What sort of standards are they if they are not technical?

ACTING CHAIR—Before you interrupt, Senator Conroy, can Mr Macek finish answering my question?

Senator CONROY—Help me out: what is the difference between a standard that you can make and a technical standard?

ACTING CHAIR—Order, Senator Conroy! Could you answer my question, Mr Macek? I am interested in knowing the extent to which the FRC is guided on technical issues by the AASB or, indeed, by other advisory bodies. Please explain that to me, because I do not understand it.

Mr Macek—Clearly, on technical matters, the AASB has enormous clout. In fact, a large part of every agenda of the council is devoted to—

Senator CONROY—It is not enormous clout; legally, it is under the parliament in charge of it.

ACTING CHAIR—Order, Senator Conroy!

Mr Macek—A large part of each council meeting is devoted to a very detailed report by the chairman of the AASB on their program, their process, problems and issues. A significant number of council members do have an accounting background that is much stronger than mine. I come from a user's perspective as a reader of accounts rather than from a background of preparing accounts and ensuring that they comply with corporate law, which is the level of detail that one needs to have in terms of drilling down to make technical standards. In answer to your question, we rely very heavily on the AASB in the event that we need further advice. For

example, we are very aware of the concerns that the insurance industry has had about these international standards, which have implications for prudential supervision. At both our March and April meetings, we invited representatives of APRA to be present and to make presentations to the council.

Senator CONROY—I just want to quote from *Hansard* Mr Alfredson's evidence when he appeared before us recently. He said:

All I am saying here is that I think the whole process lacked robust and formal consultation.

I think you conceded that. He continued:

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.

So Mr Alfredson says that the discussion took place as if that document, which was from a robust consultation process, did not even exist. Is Mr Alfredson gilding the lily there in any way? Is that an unfair representation of your less-than-robust policy making process?

Mr Macek—I think it is the sort of perception that one would expect of any group of management that has a proposal that it brings to the board rejected by the board. It is not necessarily an accurate representation, but it reflects disappointment that a particular position put up by management—or, in this case, a view adopted by the AASB—is not supported by its board, the Financial Reporting Council. That does not mean that that position is not being taken into account; it merely means that the council forms a different view.

ACTING CHAIR—You said it is not necessarily an accurate representation. In what respects do you demur on the account of the meeting that Senator Conroy has read to you from the evidence of Mr Alfredson?

Mr Macek—What is factually correct is that the AASB, in undertaking their own activities, had detailed review of the appropriate stance they would take, as they need to. They clearly arrived at that position in a very thorough manner. That paper was made available to the council. That is all factually correct. To then interpret and infer that the council acted as if that paper did not exist I think is inaccurate.

Senator CONROY—So we have agreed that members were notified that a motion was going to be moved and it was on the agenda for final decision. Can I get a copy of all of the FRC's agenda papers?

Mr Macek—Pertaining to that particular meeting?

Senator CONROY—No, all of them. I will happily look at those as well, but what I want to do is look at this robust process where everyone had an overview of the general macro national interest argument that you were describing before. So I would like to go through the minutes, the agenda papers and the supporting documentation to see how often you discussed it, at what level you discussed it, what the minutes say and those sorts of things. I would actually like to satisfy myself on that.

Mr Macek—I see no reason why they cannot be made available, but I would caution you against inferring that only the written word is the totality of discussion. For example, if one looks at the bulletin relating to the last two meetings, they are relatively brief, yet those meetings ran for four or five hours each. A lot of discussion is not captured in minutes.

ACTING CHAIR—Are your minutes written in the style of a record of decisions as opposed to minutes that are written in the style of a summary of what is said?

Mr Macek—They are more comprehensive than just recording decisions. Minutes of large corporates tend to be very brief for fairly obvious reasons. Our minutes are far more comprehensive. Therefore there is more content in terms of the flavour of the discussion and obviously any decisions that were made.

Senator CONROY—Going back to my discussion with Senator Ian Campbell, the reason this arose was largely that I asked him whether he had been approached by the Stock Exchange as part of that arrangement you described to release funds to the FRC, and he said, 'No, in actual fact I approached the Stock Exchange,' which caught me by surprise because I thought this whole mess was created by the Stock Exchange. But Senator Campbell was proud enough to put up his hand—which is why I remember it so clearly—and set this debacle in train. He proudly said, 'No, I went to them and sought the release of these funds,' and by 2005 was the condition under which those funds were released to the FRC. Are you unaware of that?

Mr Macek—I am certainly unaware of any conversation that Senator Campbell had with the Stock Exchange.

Senator CONROY—I think Mr Lucy was sitting next to him at the time of this particular discussion, so certainly Mr Lucy would have been aware of it.

Mr Macek—He is aware of the comments—are you implying he was present at that meeting?

Senator CONROY—No, I was not suggesting that—just that he was certainly aware of the comments. So, when the money arrived, it just arrived in a brown paper envelope with no documentation?

Mr Macek—No, there was a very detailed submission to the Stock Exchange that the FRC or the AASB had to make to access those funds. Clearly, the purpose to which those funds would be applied was an integral part of that submission, to ensure that it met the broad criteria by which funds could be accessed.

Senator CONROY—That was never spelt out; nowhere did this commitment to 2005 ever turn up in writing.

Mr Macek—Commitment to whom?

Senator CONROY—Senator Campbell indicated these funds were tied, if I can use the word 'tied' symbolically. So at no stage was the FRC advised that these funds were tied?

Mr Macek—Absolutely not; certainly not to my recollection. The funds were applied for specifically on the basis that they would be committed to furthering the development of international accounting standards. We chose to do that by making those funds available directly to the IASB to help their funding.

Senator CONROY—I understand the point you are making about the application process; I am talking about the granting conditions. But, as you are indicating you are unaware of what they were, I will not bore you with it anymore.

Mr Macek—Absolutely.

Senator CONROY—I think you have indicated that you believe the FRC should have a secretariat which is independent of Treasury; is that right?

Mr Macek—Correct.

Senator CONROY—Professor Ramsay has advised the committee that in his view no groups representing the public interest are members of the FRC. 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 … 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? I know you have expressed a view that the council's membership should be substantially reduced; but, even in its reduced form, should it include a representative of the public interest?

Mr Macek—I think it depends on how you define 'public interest'. I would argue that the current composition already reflects the public interest, if you are defining it as people who come to the council—

Senator CONROY—Representatives of vested interests.

Mr Macek—with an investor perspective. There are three members with an investor background. There is only one other organisation that readily comes to mind that could make a legitimate claim that it deserved to be represented, consistent with the user perspective, and that is the Australian Council of Super Investors. With that one exception, I cannot think of anyone else one would invite onto the board to provide that level of public interest knowledge.

Senator CONROY—I disagree with you about the current board, as we have already discussed, but I am talking about the new board that you are recommending. On that new board,

do you believe there should be a representative of the public interest, in whatever broad or narrow sense you want to define that?

Mr Macek—I think in a new board that would be by definition a smaller board, there would need to be a diversity of skills, an appropriate mix of skills. There would need to be a diversity of background, perspective and understanding. When one thinks of the different perspectives that ought to be reflected around such a board table they would include—I prefer to use these words—the user or investor perspective rather than public interest. They would certainly need to include the profession. They would need to include preparers and they would need to include the regulator.

Senator CONROY—In your past life you might have fallen into that category of an investor representative, Mr Macek, but you would not define yourself as that now, would you?

Mr Macek—I still see myself as someone who has an intimate knowledge of and interest in your sort of investor perspective. One of my roles is that I sit on the investment committee of the largest industry fund in Australia, UniSuper.

Senator CONROY—Would you define yourself as independent of the government at the moment?

Mr Macek—I am independent to the extent that the chairman of the FRC is a government appointment—as is the chairman of the AASB.

Senator CONROY—Do you have any other government appointments?

Mr Macek—Arguably, you could say that being a director of Telstra does imply that the government, through its 51 per cent shareholding, endorses and supports my directorship.

Senator CONROY—So under the traditional definition of independence that you and I have championed over many years, could you be considered independent of the government?

Mr Macek—Absolutely and totally, for two reasons. One is that I have never belonged to any political party. I have no political affiliations.

Senator CONROY—Political affiliation is not the issue. We are talking about independence. Independence is far broader.

Mr Macek—I have no conflict of interest and, secondly—

Senator CONROY—Would you say there is a perception of a conflict of interest?

Mr Macek—On what basis?

Senator CONROY—On the basis that you are hand-picked by the government to be on the Telstra board and to be the chair of the FRC.

Mr Macek—There are always going to be perceptions of conflict, given that people will have more than one involvement.

Senator CONROY—Sure.

Mr Macek—That is a fact of life.

ACTING CHAIR—What was the second reason you were going to mention?

Mr Macek—The second reason—and to me this is often overlooked in the discussion about independence, whether it is independence of directors or independence of auditors—is that there is a great deal of focus on potential conflicts of interest and of course there are well-documented processes for dealing with conflicts.

Senator CONROY—Governance is much broader than that, though.

Mr Macek—What is far more important in terms of the principle of independence—and independence is vital to achieve the best outcomes—is an independence of mind.

Senator WONG—But that can be impacted on by other relationships that you have. With respect, it is a bit facile to say, 'What is important is whether I have an independent mind, not whether I have other appointments which potentially might be perceived as a conflict of interest.'

Mr Macek—The two are obviously connected but they are also unrelated. I will give you an illustration. I have been involved with some boards where certain directors would meet absolutely every single test of independence as it is understood out there in the community and yet they are absolutely not independent because they are totally dependent on the income from a particular source and they do not have the financial independence to be able to walk away from that commitment.

Senator CONROY—Is $1 financially independent or does it have to be their entire livelihood? You and I have championed this debate for a long time.

Mr Macek—It is a matter of one's personal aspirations as to one's self-perception of financial independence.

Senator CONROY—Unfortunately we are running out of time, Mr Macek. Thank you very much.

ACTING CHAIR—Thank you very much indeed, Mr Macek.

[11.44 a.m.]

MACAULAY, Ms Louise, Director, Enforcement Policy and Practice, Australian Securities and Investments Commission

PRICE, Mr John, Assistant Director, Regulatory Policy, Australian Securities and Investments Commission

RODGERS, Mr Malcolm, Executive Director, Policy and Markets Regulation, Australian Securities and Investments Commission

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 the request. I invite you now, Mr Rodgers, if you wish, to make a brief opening statement before we proceed to questions.

Mr Rodgers—I thought it might be useful to tell the committee what ASIC are doing at this point about the implementation of the proposed CLERP 9 legislation. We are assuming a 1 July start this year, as the government has announced. We have been working extensively over the period immediately before and after the bill was introduced into the parliament to make sure that, if the bill is in place and commences on 1 July, we have done or are in the process of doing the work necessary to do the things that the bill will immediately require us to do: to operate the new auditor registration regime, to make discretionary decisions as a regulator, to undertake compliance activities in the light of changes to the bill and to be ready to take whatever remedial and enforcement action the new legislation will require us as a regulator to take. We are confident at this stage that we will be in a position credibly to carry out our role under the legislation by 1 July this year, certainly for those parts of it that we understand will be in operation on 1 July.

I will make one other comment. ASIC made a public submission at the stage when the government was calling for submissions generally—effectively at the discussion paper stage of this legislation. We made a public submission in November 2002. We advocated a number of positions in that paper. Not all of those were accepted by the government, but some of them—which we pointed out in our paper that we thought were important for the effective administration and enforcement of the bill—were adopted. It is generally not our policy to speak publicly on the underlying policy of the legislation at this stage. There are clearly areas where we have taken public positions in the past, but the underlying policy of the bill at the moment, as we see it, is a matter for the government. I think the committee is to hear from Treasury a little later in the day. I wanted to emphasise at the beginning that we see our role at this point as making sure that we can put ourselves in a position where we can implement the legislation in the form that it has been tabled in the bill, knowing that the parliamentary process is not complete and that we might have some last-minute adjustments to our own implementation plans between now and 1 July.

Senator CONROY—It sounds like ASIC may soon become one of the government's security services. Schedule 10 of the bill introduces new requirements in relation to the management of

conflicts of interest with the proposed section 912A(1)(aa), introducing a requirement for financial services licensees to be subject to an additional licensing obligation which requires them to have adequate arrangements for managing conflicts of interest. In addition, ASIC has released a consultation document on managing these conflicts. In your view, is this general requirement for licensees to manage their conflicts of interest adequate, or are there certain types of behaviour where disclosure by itself is not sufficient?

Mr Rodgers—As you note, we have released a policy proposal paper on how we would approach the administration of those provisions. We think that the provisions inserted by the CLERP 9 bill will effectively extend our ability to enforce and ensure compliance with the obligations of licensees whose standard of professional provision of services might be affected by conflict. As you will note in that policy proposal paper, we have directed some very specific parts of that policy towards securities analysts. That was an issue we raised with the government in our public submission in November 2002 as requiring some attention in our view. The government took the view that the correct principle was that rules about conflict management should apply generally across all Australian financial services licensees rather than just one particular type of licensee.

Senator CONROY—What I am asking, though, is whether in your view the general requirement for licensees to manage their conflicts of interest is adequate or whether there are some conflicts that are so significant that disclosure is not sufficient.

Mr Rodgers—I think our policy paper envisages circumstances where a conflict may arise that cannot completely and adequately be managed by disclosure. The result of that is that a licensee bound to comply with the obligations to manage conflict should refrain from that conduct.

Senator CONROY—So your view is that it is inherent that there are some things they just should not do?

Mr Rodgers—I am not sure that—

Senator CONROY—Can you think of an example to help the committee? What sort of example would fall into that category? It may be that it is relatively infrequent, but what sort of behaviour or conflict would you see falling into the latter category?

Mr Rodgers—The fundamental proposition in our own published policy proposal is that you cannot identify a particular piece of conduct that you would say in every case cannot be managed adequately by disclosure. It all depends on the particular circumstances of the licensee and the particular interaction that they have with their clients. You cannot say that a particular piece of conduct will always involve you in a conflict that you cannot manage by disclosure and you must refrain from it. I think we have not taken the view that we should go as far as prescribing some conduct as always necessarily involving a conflict that cannot be dealt with by disclosure. It is a slightly academic point. It is not possible—particularly in the context of Australian financial services licensees, with the vast spectrum of activities that they engage in and the vast spectrum of relationships they have with their clients, whose interests might be damaged by a conflict—for you to prescribe a rule saying, 'This conduct will always fit into that category, whereas that kind of conduct will always be able to be managed by disclosure.' Indeed,

we can envisage circumstances where one licensee can effectively manage conduct by disclosure but another licensee in a different set of circumstances might not be able to credibly adopt that approach.

ACTING CHAIR—What is being put to you is not very controversial. There will always be some conflicts of interest which are per se unable to be dealt with merely by disclosure. For example, if one individual were required to act in inconsistent capacities, that could never be dealt with by disclosure. As I said, I do not think that is a particularly controversial or novel proposition.

Mr Rodgers—My colleague draws my attention to an example we give. In the policy we say that a licensee should not permit their staff to offer, publish or give positive advice about a particular financial product solely in return for continuing business from that issuer. In other words, we would say that they have put themselves in a position where the integrity of what they do as a licensed professional would be fatally flawed if the only reason for them recommending the purchase of a particular product is that the issuer is paying them for it.

Senator WONG—What if that is the predominant reason but not the sole reason?

Mr Rodgers—Again, we were asked for a clear example of where we would say there is a conflict. The rest will depend on the circumstances. The closer you get to that being the sole purpose, I guess we would say the more dangerous the territory you are in and that you are not effectively managing the conflict.

ACTING CHAIR—I do not think too many people would disagree with you when you say that you cannot be too prescriptive about this because of the multitude of possible circumstances in which the problem might arise. But wouldn't you agree that one is readily able to envisage circumstances in which the mere fact of this closure could never be sufficient to correct the inconsistency of roles?

Mr Rodgers—Yes.

Senator CONROY—In your submission, you suggest a couple of activities that should be prohibited, including trading by an analyst, or by its individual researchers, in products that are the subject of a current research report, within a set period. Is that right?

Mr Rodgers—That is correct; we did say that.

Senator CONROY—You also mention trading by an analyst, or by its individual researchers, against a recommendation or opinion contained in a current research report. Another example I am thinking about is where they recommend a buy to their clients when they are the seller. That is a conflict. Rene Rivkin ran foul of you on that. Is that something we can clearly identify?

Mr Rodgers—That is correct. And we do say in our own policy on this that we would take the view that some types of conduct are so inconsistent with the proper management of conflicts that they should not arise. We use the example of research providers providing research reports about products that those advisers have a direct interest in. Taking this as an example, in some cases an analyst may have an interest in a superannuation fund which in turn has an interest in

stocks covered by the analyst, but it would be a very hard ask to say that, in every circumstance, that analyst ought to be precluded from providing research reports on those underlying stocks.

ACTING CHAIR—But that would be a case where disclosure would be sufficient. Indeed, I dare say that in most cases disclosure would meet the occasion.

Senator CONROY—Does your consultation document outline the sorts of things we have talked about, Mr Rodgers?

Mr Rodgers—Yes.

Senator CONROY—What about recommending a buy when you are the seller—the Rene Rivkin problem? Is it clear in your consultation document that that would fall into the category of 'not able to be managed'?

Mr Rodgers—At paragraph 38 on page 46 of our policy proposal paper, we say that research report providers should also ensure that they and their staff who are involved in the preparation of the research report do not trade inconsistently with a recommendation in one of their current research reports.

Senator CONROY—As you know, I am not a lawyer. One of the things that worries me about your consultation document is the word 'manage', which seems to imply that it is possible to work your way through anything, so long as you have a process. You can say, 'I put a process into place; I was managing it,' but, as Senator Brandis said, there are clearly going to be some areas where you have to say no—where you have to say that no amount of disclosure or managing will get you through.

Mr Rodgers—'Manage' is the language of the draft bill, of course. The policy proposal says in effect that, in some circumstances, the only appropriate management is to ensure that the conflict does not occur.

ACTING CHAIR—Surely, 'manage' just means 'deal with it in an appropriate fashion'?

Senator CONROY—As I said, I am not a lawyer. The word 'manage' can be twisted at various stages and by some lawyers to mean anything you want it to mean.

ACTING CHAIR—That does not mean it does not have a natural meaning.

Senator CONROY—Oh my God! That is how you make your living. Lawyers make their living by bastardising the English language. Give me a break!

Mr Rodgers—The reason we have put out this policy proposal, in this form, is to give people a very clear understanding and to set their expectations about the way we as regulators are going to approach these provisions.

Senator CONROY—You have been consulting for a number of months. I presume that process is close to completion, if not completed. Could you advise on the progress and whether you are anticipating any major revisions to the original document?

Mr Rodgers—I need to be a little cautious here. I can say that, yes, the consultations have been completed. The policy staff of ASIC are looking in detail at the written comments they have and are drawing together all of the other material that they have collected through that policy process. I am told that a policy statement, which is really the final part of the policy process, is to come to the decision-making forum within ASIC for policies as soon as practicable after the legislation itself is available. We cannot, of course, settle our policy until the text of the legislation is settled. But assuming the bill were enacted during June, we would anticipate publishing a final policy early in July.

Senator CONROY—Unfortunately we are in a bit of a chicken and egg situation here. To some degree, whether we are comfortable with the words in the legislation and whether we therefore will or will not seek a change to the words will depend on how ASIC is going to interpret them. It may be that we need to change the words to give you more or less strength. I am not sure how we are going to be able to progress this.

Mr Rodgers—Let me answer the second part of the question about whether I anticipate a major change in direction as a result of the consultation. We have received quite a large number of submissions on this.

Senator CONROY—Was there anything compelling?

Mr Rodgers—There are concerns in some areas. The example that springs to mind is that the definition of research report that we used in the policy statement was deliberately broad in order to effectively elicit comment on that. The policy proposal is not confined to research analysts' reports. I think we will need to look in detail at the comments that are made about the breadth of that and make sure that we have given it as sharp a focus as we think it needs to have. Nonetheless, at this stage, I do not envisage that we will be revisiting any fundamental conceptual underpinnings of the policy. The policy proposal process that we have is designed to elicit comments, including comments about what will and will not work. I would expect the policy to change in some of its detail but not in any of its fundamental directions.

Senator CONROY—Do you have any views on the natural meaning of the words 'research report', Chair?

ACTING CHAIR—I do not think they have a natural meaning. We would have to see what the statutory definition is—

Senator CONROY—What have been the key concerns raised by the industry in relation to the documents, Mr Rodgers?

Mr Rodgers—I have mentioned one. To flesh that out, part of the policy does deal specifically with securities research reports. There is some concern about the secondary use of that material. An example that springs to my mind at the moment—and I do not pretend to be able to give you a comprehensive review of industry submissions on this—is a concern that an investment firm, part of which involves formal professional securities analysts, also involves people who are basically client advisers and provide, for example, a newsletter to clients that perhaps incorporates some of the material from research reports. In the ordinary course of

business they would not be subject to information barrier limitations or other things—that belongs to the people who are the professional research analysts.

When the research report comes out, they sometimes incorporate it in a newsletter and send that around to clients. They might say, 'Our research people have done this.' They are concerned that some of the more stringent suggestions in our policy proposal paper will apply to that activity as well. In some senses these are technical issues, but I am getting to the point where I am persuaded that we will need to be clear and differentiate a little bit between where we need our own approach to the administration of the legislation to be intensive where there is a higher degree of reliance on the independent professional skills of people providing information and where we need it to be less so in the selling circumstances, but it will not be removed altogether from the selling circumstances.

Senator CONROY—Do you think a sort of FSR style definition so that you are not caught having to define a document—something that induces the purchase of a financial product—would make life easier?

Mr Rodgers—I think the general conflict obligations apply across the board to all aspects of the conduct of a licensee and their staff, whatever they are engaged in. How that plays out will vary according to the nature of the activity.

Senator CONROY—Is that the key test though? According to the chair, there is no natural definition of research report.

ACTING CHAIR—No, I did not say that; I said there is not a natural meaning—not a natural definition.

Senator CONROY—Sorry. What is the difference between a meaning and a definition? Is there a natural view on that?

ACTING CHAIR—A definition is something that is defined. A meaning is a much broader conception.

Senator CONROY—That is why we employ lawyers. The parliaments are greater for them. Mr Rodgers, I am trying to gain an understanding of the overriding obligation that people will have in terms of the policy statement and this concept of inducing. Do you feel it has captured this concept? If you induce someone to purchase a security, no matter whether you called it a research report—a note saying, 'The dog chewed up my homework last night'—do you think that is captured?

Mr Rodgers—The general proposition on which the paper proceeds that covers the part that deals with conflicts generally is that licensees provide professional services of a whole variety to their clients. If a conflict or the potential for a conflict creates a real prospect that the quality and integrity of that professional service will be undermined by the existence of that conflict, that triggers an obligation on the part of the licensee to manage that conflict to ensure that that does not occur. In some cases, disclosure will be sufficient to do that. In other cases, the conflict must be altogether avoided.

Part of the policy proposal is very generic in its terms, because it covers the entire spectrum of AFS licensees. Because of the debate over the position of providers of securities research reports, we have devoted a part of the policy proposal specifically to that activity, partly by way of illustration to those who are in that market and partly also to enable others to see how our thinking works in a particular area of detail. It applies to every licensee, and every licensee has an obligation to put their mind to the question of whether the professional services they provide are undermined by any conflict that may be present in their relationship with any person. We want to signal quite clearly that that is a significant obligation. It is additional to the obligations which already exist for licensees, and we propose to approach our own compliance and enforcement work with what we see as an additional and important tool to make sure that the integrity of the services provided is not undermined by conflict.

Senator CONROY—The CLERP 9 bill also requires disclosure of non-audit services and a statement that they do not compromise audit independence. In contrast, your original submission says:

The provision of some non-audit services will almost always threaten the independence of the appearance of independence of auditors regardless of the safeguards adopted. ASIC considers that the best approach is to prohibit the provision of such non-audit services through the act rather than through the ethical rules of the professional bodies.

We have had a lengthy discussion with a whole string of witnesses about what sorts of services create an absolute conflict and you should not do. Probably the easiest one that almost everybody has come up with is valuation: how do you audit a valuation done by your own company? Would you agree that that is one that falls into that category whereby you just have to manage it in a way that it does not arise?

Mr Rodgers—I would articulate a slightly broader principle. I agree that that is an example of a broader principle. Anything that involves self-review—that is, where an auditor is in a position where, in effect, the audit function is to review the work that that auditor has done—is arguably non-independent and would be caught by the general prohibition that auditors are to maintain their independence as a statutory obligation. Our own propositions in 1992, at that relatively early stage of the legislation, were that there should be some specific prohibitions. As I understand the government's thinking—and I am sure that Treasury can help you with this—they adopted the alternative position of saying that there should be a general prohibition on putting yourself in a position where conflicts arise. You need to maintain your independence. The way that plays out in practice will arguably have the same result—that you will not be able to engage in that kind of conduct as an auditor consistent with your general obligation to maintain the independence required of an auditor.

Senator CONROY—So after this legislation has passed, if you came across somebody that was auditing a valuation, what would you do?

Mr Rodgers—Hypothetically, if we had the evidence, and the evidence was available to us, I imagine we would assert that the auditor had breached their obligations under the act and we would be asking ourselves whether referral to the Companies Auditors and Liquidators Disciplinary Board, civil action or, in an egregious case, criminal action was the appropriate remedy.

Senator CONROY—I have mentioned valuations but which others would you consider, if the evidence was there, referring to any of the remedies you just mentioned?

Mr Rodgers—I think the underlying principle is the self-review principle. My own view, which was a view that we expressed in 2002, is that anything that involves direct self-review by the auditor is fatal to the continuing independence of the auditor. We had a number of examples that we listed in the 2002 submission.

Senator CONROY—I am just looking to know how you are going to interpret the legislation in the light of certain facts. You will be sitting there with the legislation in front of you: what are you going to prosecute and what are you not going to prosecute?

Mr Rodgers—Fundamentally, we will be interested in any circumstance where a person has breached an obligation imposed by the law. That obligation might be imposed directly by the law through independence requirements; it might be imposed indirectly through the law's requirement that auditors comply with audit standards. We will be maintaining compliance programs to ensure that auditors are complying with their obligations under the legislation and, where we detect non-compliance that we think we can maintain a case for in a disciplinary tribunal or in front of a court, we will be taking action.

Senator CONROY—I understand that, but I do not think it is unreasonable for the committee to ask the chief enforcement officer of ASIC how they are going to interpret and deal with the law. I appreciate you can make the point that you are not quite sure these will be the final words and so on.

Mr Rodgers—You flatter and reappoint me, Senator—

Senator CONROY—On the basis that these are the words that you will have to enforce, which things will you prosecute for? Valuation is one, we said—reviewing your own work. Reviewing your own tax work—

Mr Rodgers—Valuation involves a breach of an obligation imposed directly by the statute—that is, the obligation to maintain your independence. In any of these circumstances, we will need to prove a breach of the statute. It is not for us to say, 'Here is a list of things that will inevitably and invariably involve a breach of a statutory provision.' As to the example that you used, if evidence was available to us and it supported an allegation that someone had actually breached a provision of the statute then I am asking you to be confident that we would act on it.

Ms Macaulay—One other situation may be where the auditor or another part of the auditor's business is given advice on the financial reporting systems that the entity is to put in place. That is an example where the auditor would be reviewing his own work.

ACTING CHAIR (Senator Wong)—Do you not think that there is merit in actually prescribing in the legislation certain prohibitions on certain activities rather than simply relying on a general proposition that then relies in turn on ASIC's enforcement process of, firstly, obtaining the evidence and, secondly, proving that particular evidence contravenes a general proposition?

Mr Rodgers—I think these are alternative policy approaches available to the government.

ACTING CHAIR—We understand that this is the government's decision. I suppose what I am interested in is: do you think that the legislation is weakened by the failure to prohibit certain activities?

Mr Rodgers—No. We are confident that we can deliver the results under a general obligation that will play out in the same way.

ACTING CHAIR—But, in its submission to Treasury, did ASIC not indicate that certain prohibitions should be put into the legislation?

Mr Rodgers—We argued a number of positions in that which were not accepted by the government.

ACTING CHAIR—I understand that, but are you saying that you have had a conversion on the road to Damascus in that what you previously thought required amendment no longer does or that you have read the writing on the wall politically and, because it is not going to go, you can live with what there is?

Mr Rodgers—It is neither of those. The view that we took in 2002 at the very early stages of the legislative process was that, in some respects, we saw practical enforcement of it being easier in some respects.

ACTING CHAIR—That is still the case, isn't it? It is easier to regulate where there is a specific prohibition which someone has contravened. This is a simple matter of law. If there is an act that says, 'You can't do this,' that is generally easier to prove than an act that says, 'In general, we have to maintain this standard,' because then various pieces of evidence have to be collated in order to infer that that standard has been breached.

Mr Rodgers—We enforce many obligations in the law that are at quite a high level of generality. The policy argument for having reasonably high levels of generality is that it is very difficult for the regime to anticipate in every case in advance where a particular problem might occur.

ACTING CHAIR—That is a straw man argument, I am sorry. It is not an either/or situation, is it? One could have a general provision which says, 'For the purposes of this, the following acts are prohibited,' while making it clear that that is not an exclusive definition.

Mr Rodgers—All I can do is repeat my confidence that we can administer the provisions in the present bill in a way that will give robust effect to that legislation. The rest, I think, is a matter for government policy.

ACTING CHAIR—So you have changed your mind since 2002?

Mr Rodgers—Again, the position we put at an early stage of the legislative process we do not think is—

Senator CONROY—What the chair is really asking is whether you are standing by your original submission.

Mr Rodgers—To that extent, no. I think we can make the present provisions work in an effective way.

Senator CONROY—So you are not standing by your previous submission? The normal response at this point is: 'Yes, we do, but we haven't got anything further to say.' It is not often that you dump your own submission in front of us. I was trying to offer you a way out, but you have decided to do the full chicken run!

Mr Rodgers—To the extent that I have painted myself into a corner, I must accept the responsibility of staying there.

Senator CONROY—You may be aware that 14 US states have recently filed charges against KPMG on the basis that it audited its own tax advice to what was then called Worldcom—it is now called MCI. What are ASIC's thoughts on whether tax advice falls into that category, or is that the sort of groundbreaking case where you would wait to see what the judgment is? Do you have a view? Would ASIC prosecute on the basis of auditing tax advice?

Mr Rodgers—I could not speculate in advance on that question. I do not think that I could commit to the sort of proposition that, in every case, an auditor that provided tax advice has fatally compromised their independence.

Senator CONROY—Is it their own work? Would you say that they are auditing their own work in that case?

Mr Rodgers—I think that is a moot point. I do not think it is—

Senator CONROY—I am not asking about the US case; I am talking in general now. I do not think it is moot. I am asking you: in general, are they auditing their own work when they audit their tax advice?

Mr Rodgers—It may be, but you can imagine circumstances under which it might not be.

Senator CONROY—Sorry, I did not ask you whether they were or were not in conflict; I asked you whether they are auditing their own work when they audit the tax advice and the tax structures that they advise on. That is not a moot point.

Mr Rodgers—But auditors audit financial reports. It depends—and it would depend—on an analysis of the extent to which that advice shaped the financial report. If it is no part of that, then there may be a case that the independence of the audit process has not been compromised.

Senator CONROY—But I was not asking you whether the independence was compromised; I was just asking you whether it is factually correct that, if you audit your own tax advice, you have audited your own work. I did not ask you whether there was a compromising of independence at this point. I was obviously going to move on to that, and I accept that you have

probably answered my second question, but what I was asking you specifically was: do you consider that by auditing your own tax advice you have audited your own work?

Mr Rodgers—Again, the audit process is directed towards the financial report. If the company has adopted a view about tax treatment in that financial report and the sole source of that adoption is advice provided by the audit firm, then there may be a case that the quality of the audit has been compromised. And the decision of what goes into the financial reports—the starting point for that—is a decision for the company, not the auditors.

Senator CONROY—That is a fair and reasonable answer. I think the case in the US revolves around an argument that they created not just a tax treatment but a tax structure, deliberately designed to avoid state taxes of various sorts, and then they were asked to audit their own created tax structures, which those states are arguing were pure tax evasion. In that case, the question arises of whether or not there is a conflict if the company adopts the structures that you have advised.

Mr Rodgers—And there is clearly a very strong argument in that kind of scenario that that involves the sort of self-review that may be fatal to the independence and integrity of the audit process.

ACTING CHAIR—May be.

Mr Rodgers—Is likely to be.

ACTING CHAIR—In what circumstances would it not? I am sorry; I am confused by that answer.

Senator CONROY—You are taking words out of my mouth.

ACTING CHAIR—In what circumstances would it not, Mr Rodgers?

Mr Rodgers—I cannot presently envisage them—

ACTING CHAIR—No, nor can I.

Mr Rodgers—but, being a cautious lawyer, I am slightly hedging my language.

ACTING CHAIR—So you can envisage circumstances where an auditor has provided tax advice which underlies a financial report, which she or he then audits, where that would not constitute an inappropriate conflict of interest?

Mr Rodgers—One has to be cautious about asserting that in every case. There might be a variety of reasons—which may or may not include advice provided by external third parties—that led to the company adopting that tax treatment. That is why you cannot, in my view, make an absolutely blanket statement that, in every case, that will involve a fatal conflict. That is what explains my use of language such as 'may', 'is likely to' or at least 'prima facie might suggest', but I am not sure that that will help you. As a regulator, where we are talking about the

enforcement end of the business, we have to look at that in all of the circumstances in which it has occurred.

Senator CONROY—As I said, you are going to be interpreting the law, so for the purposes of this discussion let us assume that the words you have in front of you are the law. I want to understand whether or not your interpretation of this law means that you will be looking at cases. In your original submission, you list cases (a) to (m). If you like, I can go through every single one, because they each involve self-review. With this legislation, you are saying to us that you believe cases (a) to (m) at least require your perusal, given that they are not prohibited any more—that you will have to look at each company in this country that engages in any of (a) to (m) to decide whether or not they are breaching the law.

Mr Rodgers—Those circumstances suggest the possibility of a breach of a general obligation—

Senator CONROY—That is all I am talking about.

Mr Rodgers—and therefore, in the work we do, we would take an interest in whether any of those circumstances apply and whether they apply in a way that amounts to a breach of the general obligations.

Senator CONROY—So if Mr Pound is reviewing accounts from what I think is a random selection of companies, and he finds that there are some of these issues—and I presume there will be a footnote that says: 'We provided the following services as per the requirements'—you would say that, if they are making or participating in decisions that affect the whole of or a substantial part of the business of the audit client, other than in the performance of the audit, you would have to look at it, in each individual circumstance. That is really the only way you can do it. That was case (a).

Mr Rodgers—We will be using the financial reporting surveillance work that we do, which looks at the accounts of around 400 listed companies. That is a very useful source of information. The reports that go with that may well send us off to look at particular issues.

Senator CONROY—Hopefully, they will. Under the interpretation of the law, if they are managing, I presume they are going to have to list it somewhere for you to have a look at.

Mr Rodgers—We also intend to be doing direct surveillance work of auditors, other than through that process. So we will be running at least two programs that are designed to put us in a position where we can detect potential non-compliance with auditor obligations.

Senator CONROY—Using (d) as an example: if, in either of those two compliance programs, you come across negotiating, initiating, approving, authorising or executing a transaction on behalf of the audit client, you would need to have a look at it because there may be breach?

Mr Rodgers—That is correct.

Senator CONROY—And that applies for all of (a) to (m)?

Mr Rodgers—This list was in part inspired by professional standard F1, which is a standard adopted by the profession to deal with independence issues. To the extent that any of those circumstances suggest a breach by an auditor of their obligations under the act, you can expect us to take an interest.

Senator CONROY—And that includes this list of cases (a) to (m) that I keep referring to, which includes: (j)—which refers to taxation services—advocating a position with a taxation authority, including assisting the audit client in seeking a ruling from a taxation authority, acting as a tax agent for the client or preparing any information to be lodged with taxation authorities; (l) providing actuarial services; and (m) providing internal audit services. If you come across any of these things, through your compliance programs, for either the financial statements or the auditors, you would say that you would need to have a look at it?

Mr Rodgers—Where we detect them, they will suggest that we should take an interest. To the extent that we have resources to do that, we will.

Senator CONROY—I am not trying to be flippant when I say that that is very big job. I doubt that you would have the resources to do it for all of them. That is not a reflection on you or ASIC at all.

Mr Rodgers—It is unreasonable to expect ASIC to be in a position, for example, where we could say in this forum, 'We are confident that there are no examples of that conduct and no breaches.' That is not a reasonable expectation of the regulatory regime.

Senator CONROY—So, in 12 months time, when this is the law, I will be able to sit here with you and say: 'Have you detected any of these things. Have you come across any of these conflicts? What have you done to ascertain whether they are auditing their own tax advice and the tax structures?'

Mr Rodgers—That is perfectly possible, and it is perfectly possible that I will say, 'Since that is a matter of current investigation, I would rather you did not draw details from me.'

ACTING CHAIR—Is it your intention to issue any general advice indicating that the sorts of circumstances that are listed in (a) to (m) would contravene, in ASIC's view, at least at a prima facie level, the general proposition as to independence?

Mr Rodgers—Not presently.

ACTING CHAIR—So how are companies supposed to know that you would have concerns about those sorts of circumstances? Or is it now ASIC's position that you no longer have concerns about them?

Mr Rodgers—As I said, that list was at least in part inspired by, and runs parallel with, professional statement F1. Those who are concerned about this are, of course, auditors.

ACTING CHAIR—I think that is what we are talking about.

Mr Rodgers—Auditors are well aware of the obligations in F1as a statement of professional practice.

Senator CONROY—Every single auditor who has appeared before this committee has said, 'Trust us with F1'—every single one of them.

Mr Rodgers—My understanding of one of the underpinning assumptions behind the auditor provisions in CLERP 9 is that it is to move the conduct of audits and the conduct of auditors more firmly within a regulated regime. The existence of F1 will always be helpful to us because it will often suggest that, if there has been a significant departure from good practice as evidenced by F1, then there has been conduct that, as a regulator, we should take an interest in.

ACTING CHAIR—Should that principle be specified in the legislation?

Mr Rodgers—That principle already works in practice. We take quite a number of cases, for example, to the companies audit—

ACTING CHAIR—That was not my question.

Mr Rodgers—It is not clear to me how that would actually add to the regime. My point about that situation already existing is that I am not sure what it would add to current practice, or practice that we envisage under the new legislation.

Senator CONROY—As I said, auditors have appeared before us and said: 'Trust us on F1. There is no such thing as discounting on audit work to get other business.' They have denied the existence of any structural impediments whatsoever. I have already ruined Mr Pound's committee sufficiently that I can quote him again without doing him any further damage. Mr Pound made it clear from ASIC's perspective that they do not believe this self-regulatory regime is sustainable in the long term.

Mr Rodgers—The legislation does not ask us or anybody else to take that entirely on trust.

Senator CONROY—Proposed section 307C requires auditors to give the directors of the company a declaration that there have been no contraventions of the auditor independence requirements in the acts or the professional codes of conduct. In contrast, your submission says that it would be more appropriate if the declaration was made to the company in general meeting rather than a board of directors. I have some sympathy with that view, as I am sure you are aware. Why do you believe that it should be made to a general meeting rather than just the board?

Mr Rodgers—The thinking behind that proposition was the relatively straightforward and perhaps oversimplistic proposition—if I might comment on our own comments——

Senator CONROY—Did you just reflect on evidence to the committee from your own organisation?

Mr Rodgers—No, I was involved in the preparation of these comments—

Senator CONROY—So you are reflecting on yourself, then; that is OK.

Mr Rodgers—It is merely a reflection on myself. The thinking was that those who are most dependent on the integrity of the audit process—

Senator CONROY—Shareholders. The owners.

Mr Rodgers—are members of the company other than the board. I am sure Treasury will be able to explain to you that that is not the only public policy in issue. It is not something I think we felt was essential to the integrity of the regime.

Senator CONROY—So you have dumped that proposal as well?

Mr Rodgers—It is not our job to dump proposals.

Senator CONROY—You have dumped your own position.

Mr Rodgers—I am saying that, given the reasons that we expressed that view, a change to that of the kind that is now reflected in the bill is fatal to the integrity of the regime.

Senator CONROY—ASIC's original submission said that the original test proposed in the CLERP 9 policy paper in relation to the standard of independence for auditors was too low. Is ASIC satisfied with the CLERP 9 requirements which say that the general standard of independence is not met by the auditor where a conflict of interest situation exists?

Mr Rodgers—We are comforted that some of the propositions that we made in this submission about how that test ought to be expressed—in fact most of them—are now reflected in the bill.

Senator CONROY—Recently, the implementation review group of the ASX recommended that the listing rules be amended such that only the top 300 companies be required to have audit committees, whereas the original one said, I think, that it should be the top 500. Are you comfortable with the fact that the requirement to have an audit committee has been limited to the top 300 companies?

Mr Rodgers—We have expressed the view that that change is not objectionable.

Senator CONROY—Your submission on the CLERP 9 policy paper says:

... to ensure that the FRC can effectively oversee the audit profession and the financial reporting framework, its role should be further expanded so that:

(a) the FRC has a fully functional research capacity;

(b) the FRC is required to monitor, assess and report on the ethical codes developed by the professional bodies;

You might have missed most of Mr Macek's evidence—I am not sure if you were here for that, Mr Rodgers—but why is that research category so important?

Mr Rodgers—As you will see from the submission, our fundamental proposition here is that the role of the FRC in our view is to monitor the health of the system as a whole as applies to auditors and auditor independence. We were simply making what I think to be the uncontroversial point that in order to do that they will need to have the capacity to gather and analyse information that is relevant to that.

Senator CONROY—Sections 308 and 309 of the Corporations Act require an auditor to report to members on whether the financial report complies with accounting standards and represents a 'true and fair view'. Breach of these provisions will attract a penalty of $5,500 and/or imprisonment for one year. In light of the impact of a breach of these provisions on shareholders and other users, do you think these penalties are sufficient? Is $5,500 much of a deterrent?

Ms Macaulay—It is not the financial amount itself; it is the fact that the prosecution takes place and a fine or a term of imprisonment is imposed. It represents a 100 per cent increase on the previous penalties.

Senator CONROY—In light of the new auditor independence rules, a new liability framework has been adopted in the bill. A breach of the following sections attracts a maximum penalty of $2,750 and/or six months imprisonment: section 324CA, which establishes a general requirement for auditor independence; section 324CI, which requires a two-year cooling-off period before a member of an audit firm who was part of the audit team can join a former client; and section 324DB, which requires auditors to rotate after five years. In your experience, is a fine of $2,750 a significant fine for an audit firm?

Ms Macaulay—No, it is not, although you will be aware that the fine is multiplied by five where a corporation is concerned. Again, it is the fact of the conviction that I think would have—

Senator CONROY—Will that disqualify them from holding that position, do you think, or do they just get a one-off fine and keep doing the job?

Ms Macaulay—I am not qualified to answer the question of whether or not it would disqualify someone from being an auditor.

Senator CONROY—So you cop the $2,750 fine and the conviction for working for somebody and you go on doing your job. Is that the way it is supposed to work?

Mr Rodgers—There is a mechanism open to us which involves the CALDB. A conviction of an offence under the legislation might well persuade the CALDB to consider removing an auditor's right to practise.

Senator CONROY—What I am talking about here is where an individual breaches the two-year cooling-off period. If someone goes to work as a CFO at a company they used to audit, you cannot take that person to the CALDB.

Mr Rodgers—I think we are probably at the limits of our ability to contribute on this. I do not think that we have contributed on the setting of the penalty rates in this case.

Senator CONROY—But it is not disqualification. A person can cop the $2,750 fine—that is, if they do not get the six months' imprisonment—and go on doing their job. Is that a fair interpretation? Is there anything that disqualifies them? The six months in jail may make it harder to do the job unless they have a day pass—

Ms Macaulay—I am not aware of what provisions audit firms would have in place for vetting employees.

Senator CONROY—The CLERP 9 bill gives ASIC the power to issue infringement notices to companies that fail to disclose price-sensitive information in a timely manner, but the bill does not give ASIC the power to publish the fact that they have issued an infringement notice when that notice is issued. I think we have had some of this discussion previously, Mr Rodgers. Does that ring a bell?

Mr Rodgers—It does.

Senator CONROY—We were trying to discuss the continuous disclosure obligations of the company where they have had an infringement notice against them and whether or not that should be required. You may remember some of that discussion last time. Would they be in breach of the continuous disclosure regime if they do not advise the market that they have been issued with an infringement notice? Is it material if they—

Mr Rodgers—I hesitate to give you a lawyer's answer—

Senator CONROY—You know that only upsets me.

Mr Rodgers—but what I would say is that it will not necessarily be material in every case.

Senator CONROY—But there could be cases where it is material?

Mr Rodgers—There could be.

Senator CONROY—The bill extends the civil liability for contraventions of the continuous disclosure regime to individuals. Could you advise us of the rationale behind extending the liability to individuals?

Ms Macaulay—Treasury may also want to say something on this, but my understanding is that it is simply that a corporation acts through its officers and it was thought that an additional way of ensuring that disclosing entities put the requisite amount of importance on these provisions is to make it clear that people who are involved in any breach will also be personally liable.

Senator CONROY—The explanatory memorandum states that civil liability will apply only to those individuals with real involvement in a contravention—that is, where there is intentional participation and actual knowledge of the elements of the contravention. If a person does have

the requisite intention and knowledge to warrant a breach of the provision, why should they be entitled to a defence of due diligence?

Ms Macaulay—That defence is something that sits alongside the elements that you need to prove. It is just the reverse side of the coin. It is similar to the 1317S provisions that currently exist, which provide for where a person acts honestly and in the circumstances ought fairly to be excused from a contravention. It simply means that, as I understand it—and I have not seen a draft provision—where someone makes all due inquiries, acts to the best of their capacity and, for example, gets all the necessary advice in the circumstance then they should not be exposed to a civil penalty contravention. That is reflected in the definition of the term 'involved in' in a sense. That is defined in section 79 of the Corporations Act. As you said, it requires some kind of intent and actual knowledge.

Senator CONROY—Without a due diligence defence for individuals, would companies that receive an infringement notice be more likely to take the matter to court, in your view, in order to ensure that individuals are not subject to potential civil liability suits? Do you think that could be the effect? They would say, 'Oh my God, we can't possibly say, "Just take the fine." We're going to have to fight this because we'll then have these civil liabilities sicked on us'—a shareholder class action type thing.

Ms Macaulay—That may be possible, but it is very hard for me in my current position to speculate on that.

Senator CONROY—I just thought that human nature would possibly have leapt to that view. If it were just the company copping the slack and the fine, they would say, 'Okay, we'll cop it and we'll move on with life,' but if it were something where I could be sued personally then I would be more likely to want to spend the company's money to defend the case and just have the argument. It is human nature rather than—

Ms Macaulay—That is one way of looking at it. There are a number of other ways. Obviously directors and officers have duties to the company. Why would they defend a case which is indefensible, if they have advice?

Senator CONROY—Who would be potentially subject to the civil liability for a breach of the continuous disclosure regime—lawyers, I hope; merchant bankers; other advisers? Who is going to get caught? We have received a couple of submissions from some professional associations that put forward the argument about sheer panic.

Ms Macaulay—Those people may well be caught. It just says 'a person', so it does not have to be an officer of the company. They would simply need to be involved. Again, if I can refer you to section 79, it talks about people who aid, abet, procure or counsel.

Senator CONROY—That has me smiling. Much of the CLERP 9 bill is directed towards enhancing the disclosure obligations of listed companies, especially in relation to remuneration. Has ASIC considered whether such disclosure obligations should be extended to companies which are not listed?

Mr Rodgers—We do not have a view on that.

Senator CONROY—For example, a large number of investment banks in Australia are not listed on the ASX, although they may be listed in their home jurisdictions. One argument is that such companies are not listed and are not relying on shareholders funds, at least in this jurisdiction, and therefore should not be under the same disclosure obligations as their listed counterparts. Would you say, 'That's the way it is. That's just tough'?

Mr Rodgers—This is really a policy issue, I would suggest. We have not formed a view on that. As I think I said at the beginning, we have been concentrating on implementing the law as we understand it is going to be.

Senator CONROY—The Business Council have been very strongly making the argument that this is unfair because it is only targeting listed companies—all the disclosure obligations and all that sort of stuff—and their argument to me is, 'This is going to start driving people away from listing ultimately.' I think that is a little overstated, but it is an argument where they are saying, 'These unlisted companies should be covered by some of these disclosure regimes.'

Mr Rodgers—My only comment about that is that the law in a number of areas distinguishes the obligations that apply to listed companies, just as it distinguishes between the obligations that apply to public and private companies. There are special rules of the law that only apply to listed companies. The disclosure obligations that you are talking about only apply to listed companies presently.

Senator CONROY—I will take that. Accounting standard AASB 1046 removes the requirements for banded disclosure and instead requires specified directors and specified executives to be individually named and each component of their remuneration disclosed. This is welcome, but a tabular form of presentation is recommended but not mandatory. For consistency of disclosure and ease of comparison, it would seem appropriate that the table should be mandatory. In your view, should there be a specified format?

Mr Rodgers—I have no doubt that you will take this question up with Professor Boymal later this afternoon. My only comment is that, because we spend a lot of time thinking about the quality of disclosure generally and particularly at the consumer and retail level, I think the better view is that disclosure is very often enhanced by easy to understand tables. I think that we have supported some of that work in other contexts and I can certainly see the merit in doing that and that it is supported by generally good thinking about effective consumer communication.

Senator CONROY—Numerous studies, including research by the PSS/CSS, one of the country's largest super funds, has found that companies are not disclosing their remuneration in accordance with the requirements under the Corporations Act—that is not a surprise to me, and I am sure it is not to you. What measures does ASIC plan to take to ensure that companies are complying with the new disclosure obligations in section 300A and under the regulations?

Mr Rodgers—This year, we have used the examination of financial reports as a mechanism to look at compliance with the present 300A. I think we have publicly announced that one of the results of our examination of that was that a number of companies we looked at made some supplementary disclosures to the market to bring themselves more clearly within our expectations of what 300A required. I would expect that we will continue that process, certainly on the sample basis where we have the material in front of us. We look at, in effect, all of the

strictly speaking financial reporting and other material, including compliance with 300A. I would expect us to continue to do that and I would expect us to intervene in the way that we have this year—and in enforcement mode if we found real departure from the obligations in the legislation.

Senator CONROY—CLERP 9 requires disclosures in relation to remuneration in a dedicated section of the directors' report. That report will not be audited. Should the remuneration report be audited?

Mr Rodgers—Again, I hesitate to articulate an ASIC view on that.

Senator CONROY—Some would say it is a semantic difference.

Mr Rodgers—I note that some consequences of the remuneration report are reflected in the audited accounts in the financial reports themselves. There is an audit process to the extent that the remuneration reflected in the remuneration report forms part of the financial report. It is subject to the audit process. I have not put my mind to this question, including whether that creates additional difficulties for the auditor and the audit process in asking them to review effectively a part of the directors' report which is not—

Senator CONROY—Just trying to make sure that they do not fudge in the one that most people would immediately turn to. Rather than having to sift their way through the financial reports, they can just go, 'Let's go and look there,' and there is not a requirement that they actually be identical.

Mr Rodgers—I understand the point you are making.

Senator CONROY—Creative is my concern. That is all the questions I have.

ACTING CHAIR—There are two questions you might want to take on notice. One was whether there has actually been another change of position by ASIC since your submission to the ALRC in relation to civil and administrative penalties. This is on the issue of infringement notices. The briefing notes we have indicate that your submission was to deal with infringements which were not of a less serious nature.

Mr Rodgers—I think I will have to take that on notice.

ACTING CHAIR—And why you now apparently have a different position on infringement notices, if that is okay.

Mr Rodgers—Without conceding that we do have a different position, I am happy to take that one on notice.

ACTING CHAIR—The second question is: does ASIC have any response to the Business Council's submission that it is opposed—again for obvious reasons—to infringement notices and to their criticism that your organisation has not made effective use of existing provisions, which therefore undermines the case for seeking infringement notices? If you have not done so already, I would ask you to have a look at the Business Council's submissions.

Mr Rodgers—Particularly at Professor Baxt's comments.

ACTING CHAIR—And Professor Baxt's comments, which are on the *Hansard*, which he made at our committee meeting in Melbourne. It would be useful for us to have your response to those comments.

Mr Rodgers—Yes.

ACTING CHAIR—Thank you very much, Mr Rodgers, Ms Macaulay and Mr Price.

Proceedings suspended from 12.55 p.m. to 1.44 p.m.

DYLEWSKI, Mr Michael, Policy Analyst, Department of the Treasury

HEALY, Ms Kate, Governance and Insolvency Unit, Department of the Treasury

HOLMBERG, Ms Kyla, Financial Reporting Unit, Department of the Treasury

LEVY, Mr Peter, Policy Analyst, Department of the Treasury

NIGRO, Mr Lenny, Policy Analyst, Department of the Treasury

PASCOE, Mr Les, Financial Reporting Unit, Department of the Treasury

RAWSTRON, Mr Mike, General Manager, Corporations and Financial Services Division, Department of the Treasury

ROSSER, Mr Mike, Manager, Investor Protection Unit, Department of the Treasury

SMITH, Ms Ruth, Manager, Market Integrity Unit, Department of the Treasury

TAFT, Mr Peter, Policy Analyst, Department of the Treasury

WIJEYEWARDENE, Ms Kerstin, Manager, Financial Reporting Unit, Department of the Treasury

WINCKLER, Mr Simon, Policy Analyst, Department of the Treasury

YOUNGBERG, Ms Naomi, Policy Analyst, Department of the Treasury

ACTING CHAIR (Senator Brandis)—Welcome. We also have some Treasury witnesses in Canberra who will be participating by teleconference. The committee prefers that all evidence be given in public, but if at any stage you wish any part of your evidence to be given in private, you may ask to do so and the committee will consider that request. It has not been the custom to have Public Service witnesses make an opening statement, but, Mr Rawstron, if you would like to say anything by way of clarification or expansion upon evidence that has been given earlier in the day, you are welcome to do that now.

Mr Rawstron—I thank the committee for the opportunity to appear before it today. As the acting chair indicated, we have staff in Canberra who can also assist in answering questions. The reason that there are so many people is that the bill has involved quite a few different parts of my division and lots of people have been involved in different elements of that. Hence, the expertise is spread across quite a few people.

The legislation is the ninth phase of the government's CLERP initiative. It builds on reforms that have occurred in other areas, including directors' duties, takeovers, accounting standards and financial services reform. We see the CLERP program as part of a microeconomic reform agenda which the government has pursued to build a competitive and robust financial services sector.

The bill improves the accountability of managers to stakeholders by measures that are designed to improve the reliability and credibility of financial statements; to ensure better disclosure to shareholders and to facilitate shareholder activism; to improve enforcement arrangements, including continuous disclosure; and to better allocate and manage risk. The bill incorporates measures that have been raised by the audit review working party, the Ramsay report entitled the *Independence of Australian company auditors*, the Joint Committee of Public Accounts and Audit, and the Cole and HIH royal commissions.

Over the past few months, and certainly when the exposure draft of the bill was released in October last year, considerable attention has been drawn to the infringement notice provisions for breaches of the continuous disclosure requirements and of the disclosure requirements for executive and director remuneration. Whilst these are important initiatives, I would also like to point out that the bill is much wider than these provisions and that there a lot of other measures relating to financial reporting, protection of whistleblowers, disqualification of directors and the remuneration and management of conflicts of interest by financial service licensees. A major component of the bill is the package of reforms that relate to audit regulation. These reforms are far-reaching and provide an effective legislative regime for governing audit independence and oversight. Indeed, when Professor Ian Ramsay did the review for the government some years ago, in his report he commented that audit independence had not been upgraded in the Corporations Law for over 40 years.

The bill is directed at publicly listed companies. It recognises the growth in direct and indirect involvement of Australians in the share market and the importance of financial information to that market. It recognises that the audit function is the principal external check on the veracity of financial statements. In developing the bill, we consulted widely with stakeholders. We have been monitoring developments overseas. Most of you would be familiar with the Sarbanes-Oxley legislation in the United States. There have been developments in the United Kingdom and in the European Union on auditing and accounting regulation which we have also taken into account. Having said that, we are well aware that laws in other countries are made in response to particular circumstances, and that our response in Australia needs to be proportionate to the risks we face and needs to recognise the characteristics of the markets in which we operate. In that context, we have to bear in mind that the Australian capital market is only two per cent of the world capital market. There are clearly benefits in modelling some aspects of our approach on overseas examples so that we better integrate and facilitate cross-border market operations by companies and institutions. However, the bill must be relevant to Australia's needs.

The final form of the bill very much seeks to achieve a balance between providing certainty to companies and investors, on the one hand, and the flexibility to respond quickly to changing circumstances on the other. For this reason, the bill adopts a principles based approach in which industry initiatives play an important part in shaping market conduct.

We are working in an environment where there has been extensive media focus on corporate collapses such as Enron, Parmalat and HIH, just to name a few. It is also important that, whenever we design a measure, it has to be flexible enough to adapt to our market. Our experience has been that a one size fits all regulatory scheme will simply not work effectively in Australia. We have built on the existing premise of a mixture of regulation and co-regulation to encourage industry best practice. In our view, this approach is the best means of aligning the regulatory requirements with market conditions and investor expectations.

The CLERP 9 bill is about improving the extent and timeliness of the information that investors need to make choices on investment decisions, and it sets out some core standards with which company management and auditors should comply. It enhances the disclosure regime and is aimed at fostering a culture of compliance. As indicated, the government has consulted widely on both the policy development and the legislative processes stages of this bill. It contains significant and wide-ranging measures. We also look forward to the committee's input.

ACTING CHAIR—Thank you, Mr Rawstron.

Senator CONROY—In relation to the remuneration of directors and executives, the explanatory memorandum states that, to assist in meeting the disclosure obligations under sections 300A(1A), 300A(1B) and 300A (1C), the regulations will require disclosure of certain information. Those regulations have not yet been released. When will they be released for consultation?

Ms Wijeyewardene—The regulations are currently being drafted. We have seen some parts of the regulations already. We anticipate that we will have a full batch of regulations by the end of next week. We will review those regulations at that time, and we intend to consult publicly on them. We have obligations under the corporations agreement to consult Minco, the ministerial council for corporations. We intend consulting the AASB as well in relation to remuneration regulations.

Senator CONROY—So when do you hope that they will be publicly available?

Ms Wijeyewardene—I would hope within the next seven to 10 days, as a best estimate.

Senator CONROY—How long will that consultation process last?

Ms Wijeyewardene—We would like to give stakeholders between three and four weeks to have a look at those. If we are aiming for a 1 July commencement, the timetable is fairly tight.

Senator CONROY—So you would like to see them finalised before 1 July?

Ms Wijeyewardene—Yes. I should add that the remuneration regulations are probably the most important batch of regulations under this act. I would make the point, though, that the extent of the regulations under this piece of legislation is not comparable in any way to the FSR legislation.

Senator CONROY—I am sure everyone is pleased to hear that. So, do you think we will see the final draft before they are debated in June?

Ms Wijeyewardene—Certainly you will see the first draft, and we will take on board comments. The process after that will depend on where we are in the timetable before 1 July.

Senator CONROY—My anticipation is that, with goodwill from all—particularly Senator Brandis, if he behaves himself—we will have the debate in mid-June in the two-week parliamentary session. Obviously you will need that as we only have budget week, and I do not

anticipate that we will be able to deal with it in that week. Then there are the two weeks of Senate estimates, as you would be aware. So there is only that two weeks of sittings.

Ms Wijeyewardene—That is right. We are aiming for the week of 15 June, which is the first week of sittings.

Senator CONROY—We hope to be able to look at those as a final batch of regulations before we vote on the bill. It would make it very hard to vote on the bill if we had not seen the final regulations.

Ms Wijeyewardene—I understand.

Senator CONROY—The non-binding vote on the remuneration section of the directors' report only applies to the disclosures made under section 300A and does not relate to the disclosures under the accounting standard. As the regulations under section 300A have not been released, we do not know exactly what shareholders will be voting on at the moment. Could you advise whether the following will be required to be disclosed under section 300A and therefore voted on: what we call 'golden hellos', equity value protection schemes or hedging instruments, the duration of the executive's contract and non-recourse loans. They are the ones that I am particularly interested in.

Ms Wijeyewardene—I anticipate that 'golden hellos' will be covered in the regulations. At this stage we are not proposing to require disclosure of equity value protection schemes in the regulations. My colleague might be able to help me with duration of contracts.

Mr Winckler—There is scope to include duration of contracts in the regulations. It has not been proposed at this stage, but it would be possible.

Senator CONROY—What about non-recourse loans?

Ms Wijeyewardene—That is something that we are still considering. We note the position that is taken in AASB 1046 to require disclosure of these loans alongside the remuneration disclosures. At this stage it is not proposed to put non-recourse loans in, but, as I say, this is something that we are still examining. Part of the issue with non-recourse loans is that the full value of the loan may not necessarily be attributable to remuneration, so we could require it to be disclosed as an element of remuneration or we could require it to be disclosed alongside the remuneration disclosures.

Senator CONROY—You said that the full value is not remuneration—take me through the logic of that.

Mr Winckler—Where parts of the loan may be paid back by the director or the executive, it may be difficult at the start of the grant of the loan to know exactly how much that will cost the company by the time the loan period has expired. Therefore, it may be more appropriate to require disclosure of loans alongside remuneration so that shareholders have an idea of the value of those loans without actually including them in attributive remuneration disclosures.

Senator CONROY—I was interested in your comment that the full value may not be part of remuneration. What part would not be?

Ms Wijeyewardene—The element that is repayable—that is, any element of the loan that may be repayable.

Senator CONROY—So how are we going to calculate it? For instance, if I give you $1 million to borrow at interest free—let us put aside the non-recourse argument—and you buy $1 million worth of shares, which part of that would not be disclosed? There is an interest component, but you are saying that, because you are going to pay back the $1 million, that should not be included.

Mr Winckler—If we included disclosure of loans in the regulations, we would require disclosure of the full value of the loan, but it would be alongside remuneration. So you would have disclosures; we would say: 'These are the elements of this individual's remuneration. This is what they are paid. Also, this individual received a loan of $1 million for these purposes on these conditions—

Senator CONROY—On these terms.

Mr Winckler—at this interest rate'—which may not be on commercial terms, obviously—as well as any special clauses to repay or not repay that loan.

Senator CONROY—Are you saying that it would not be included in the remuneration section of the directors' report—

Mr Winckler—No.

Senator CONROY—or that it would be, but as a separate listed item that is broken down?

Mr Winckler—Yes.

Senator CONROY—Are there any other regulations in relation to CLERP 9 still being drafted and not yet released? Is this the last of them?

Ms Wijeyewardene—We have a range of regulations. There are regulations in relation to authorised audit companies—perhaps someone from Canberra can inform you.

Ms Healy—We are working on regulations that are currently being drafted relating to the authorisation of proxy appointment that deal with electronic voting of proxies.

Senator CONROY—Does that include the query of the Shareholders Association that you have to appoint a person rather than an organisation when you are appointing a proxy?

Ms Healy—I think that is separate. There is a separate amendment saying that a body corporate can be appointed as proxy.

Senator CONROY—Are there any other regulations?

Mr Pascoe—We are preparing regulations dealing with practical experience in auditing, the prescribed universities and other institutions for the purpose of the educational requirement and the transitional provisions dealing with the existing professional auditing standards to give them the interim backing for two years.

Senator CONROY—Anyone else?

Ms Holmberg—Yes. I am from the corporations and financial services division, the financial reporting unit. We are preparing regs in relation to the financial reporting panel. Specifically in relation to the corporations fees amendment act we will be prescribing a fee for companies to refer matters to the panel under the regs and also some other miscellaneous regs in relation to the financial reporting panel.

Senator CONROY—Any others?

Mr Rosser—No, Senator.

Senator CONROY—That covers it. Great. My policy adviser just passed out at that list, but never mind. Thanks. Much of the CLERP 9 bill is directed towards enhancing the disclosure obligations of listed companies, especially in relation to remuneration. Has Treasury considered whether such disclosure obligations should be extended to companies which are not listed?

Ms Wijeyewardene—This is something that we have not specifically considered. We have maintained the coverage of the disclosure requirements that currently exist in section 300A.

Senator CONROY—The Business Council, for example, have raised with me their concern about creating a two-tiered situation where non-listed companies are not being required to meet any disclosure obligations—it is all falling on one section. They argue that this will lead to companies not bothering to list. I think that is a little dramatic, but they have a fair point in terms of who is being covered and who is not being covered. If you are not looking at it, that is fine. Thank you very much.

In the last budget, the FRC was provided with $4 million over four years. The budget papers say this will cover FRC's expanded role under CLERP 9, including the oversight of the audit standard setting and audit independence issues. In addition, the AUASB will be moved under the control of the FRC. Most of you were here when Mr Macek gave evidence—obviously the ones in Canberra were not. Mr Macek indicated he did not believe $1 million was enough. Has the FRC made that representation to Treasury?

Mr Rawstron—Yes, Mr Macek has made that representation. The funding of the FRC and the new statutory bodies is being considered in the current budget context.

Senator CONROY—Professor Ramsay has made the same point. He is very concerned. He does not believe they have the resources to undertake these 'new and important tasks'. Currently Treasury provides the secretariat to the FRC. Are the members of the secretariat dedicated to the FRC role or do they perform other functions in Treasury?

Ms Wijeyewardene—Perhaps I can answer that. The secretariat falls within the responsibility of my unit. We have the secretary, who is a dedicated staff member that services the FRC; we have one other dedicated person who works within the secretariat; and we have what we would call a surge capacity, where the secretary can draw on eight other people within the unit and others within the division of about 34 people where necessary.

Senator CONROY—Has that always been the case—two dedicated people with surge capacity?

Ms Wijeyewardene—No.

Senator CONROY—You may have heard earlier discussion that papers were only arriving to FRC members 48 hours or 24 hours before meetings.

Ms Wijeyewardene—Yes.

Mr Rawstron—It is a conscious decision we have made in the last 12 months to give enhanced resources to the FRC in light of the work we were doing in CLERP 9.

Senator CONROY—This may be one on which you need to say, 'It's a policy view.' Do you believe there is a need for an independent secretariat? I appreciate that it may be a policy decision.

Mr Rawstron—It is truly a matter for the government. You can easily argue both sides. There are some benefits being inside and being a Treasury official; there are some advantages that the FRC gets in terms of accessing Treasury's overseas posts. We have very good information about what is happening in Europe and the United States, which is very useful, and we are able to leverage off all of the expertise within Treasury. By the same token, I can understand Mr Macek's view that he would prefer to see an independent secretariat.

Senator CONROY—I would like to discuss the Financial Reporting Panel. The explanatory memorandum states:

Funds will be expended in the establishment of the Financial Reporting Panel (FRP).

What quantum of funds do you anticipate expending in establishing the FRP?

Ms Wijeyewardene—We have done some costings on this. We anticipate that the establishment costs will be in the order of $98,000 or $100,000.

Senator CONROY—Ongoing costs?

Ms Wijeyewardene—No, I think they are one-off establishment costs, but Kyla Holmberg can probably clarify that.

Senator CONROY—I was just asking what the anticipated ongoing costs would be for the FRP.

Ms Holmberg—There is an establishment cost of $98,000, which will be a one-off cost.

Senator CONROY—And the ongoing costs?

Mr Rawstron—In our initial calculations we have allowed for $1 million a year. That is based on advice that ASIC has given us and our assessment of what the costs would be to have the appropriate panel and resources sitting underneath that panel.

Senator CONROY—Have you estimated how many referrals would be made to the FRP? Do you have any thoughts?

Ms Wijeyewardene—We have discussed the issue with ASIC. It is difficult to tell, but we are estimating that potentially in the first year we will see 20 referrals. We are estimating 20 referrals.

Senator CONROY—What would be the composition of the FRP? Will there be, say, five part-timers or one full-timer?

Ms Wijeyewardene—No. I think we have said that there will be between 20 and 30 part-time members. We very much based it on the structure of the Takeovers Panel.

Senator CONROY—Will there be a full-time secretariat for it?

Ms Wijeyewardene—We anticipate there will be a full-time administrator with support staff and a part-time chair with 20 to 30 part-time members to draw on to comprise the actual panels.

Senator CONROY—Will that again be independent of Treasury? Will they be Treasury officials? I think the Takeovers Panel uses Treasury.

Ms Wijeyewardene—We are proposing the same structure as the Takeovers Panel. The secretariat will effectively be employed through Treasury but would be separate.

Senator CONROY—You talked of referral fees. Do you anticipate what those fees will be?

Ms Wijeyewardene—We are looking at this in the context of current fees in the Corporations Act. As a ballpark figure, it will probably be between $500 and $1,500. That is something we are still examining.

Senator CONROY—If there are 20 referrals at $500 or $1,500, that will not cover the costs of running the FRP.

Mr Rawstron—No.

Senator CONROY—So it is not self-funding?

Ms Wijeyewardene—No, it will not cover the cost of the FRP.

Mr Rawstron—There is a slight complication in terms of calculating the fees because there are some cost issue limitations associated with when a fee becomes a tax. So you seem to err on having to fix a lower fee to minimise the risk of over-recovery. That is the difficulty we face.

Senator CONROY—Sections 308 and 309 of the Corporations Act require an auditor to report to members on whether the financial report complies with accounting standards and represents a true and fair value. A breach of these provisions will attract a penalty of $5,500 and/or imprisonment for one year. In light of the impact of a breach of these provisions on shareholders and other users of financial reports, were increases to these penalties considered? They just seem fairly small.

Ms Wijeyewardene—I do not think we did increase those penalties. Was that 307 and 308?

Senator CONROY—No, 308 and 309.

Ms Wijeyewardene—We did make some changes to those penalties. Currently, section 308(1) is an offence of strict liability and attracts a 50-penalty unit fine and imprisonment for one year. There is no penalty specified in schedule 3 for breaches of other requirements of sections 308 and 309. We tried to get some consistency. Contraventions of the requirements of each section will attract a penalty of 50 penalty units. Contraventions of all requirements, except those in 308(2) and 309(2), will be offences of strict liability. So we have made changes to those.

Senator CONROY—But $5,500 for a corporation—even a small listed corporation—is still a relatively insignificant amount. Do you think that is a fair call?

Ms Wijeyewardene—We have assessed the penalties in the overall bill in terms of the broader penalties in the Corporations Act. We have tried to ensure that there is some consistency across the act.

Mr Rawstron—To give you further context, the other thing we have to work within is the legal policy of the Attorney-General's Department. At Treasury we can make recommendations to the Office of Parliamentary Counsel about what the penalties might look like, but they will also be guided by the Commonwealth criminal provisions and by what is in the act. They are not going to be minded to insert penalties that are fundamentally different from ones which are already in the legislation. So we tend to be a bit confined in how we can push the envelope in that context. That is just a contextual explanation of why it looks as it does.

Senator CONROY—In light of the new auditor independence rules, the new liability framework has been adopted in the bill. A breach of the following sections attracts a maximum penalty of $2,750 and/or six months imprisonment: section 324CA, which establishes a general requirement for auditor independence; section 324CI, which requires a two-year cooling-off period before a member of an audit firm who is part of the audit team can join a former client; and section 324DB, which requires auditors to rotate after five years. On what basis were the penalties chosen for those breaches?

Ms Wijeyewardene—Perhaps I could start, and Mr Levy may like to provide some further detail on that. In setting the penalties for the independence offences, we looked at what it is in there now, which is not a lot. The independence penalties have been increased fivefold, but I

think one of the important points about breaches of the independence requirements is that every breach will attract a penalty: for example, in terms of a cooling-off period, for every day you are in breach you will attract the maximum penalty.

Senator CONROY—With every day?

Ms Wijeyewardene—Yes.

Senator CONROY—So signing the contract of employment would be a breach but every day you work there you can be penalised?

Mr Levy—The provision relating to the cooling-off period is worded: 'the person becomes, or continues to be, an officer'. So you can prosecute the person for joining and, if the person does not leave, for every day that he or she continues to be an officer further prosecutions can be instituted.

Senator CONROY—Is it every day up until the two-year period?

Mr Levy—Yes: beyond the two-year period, on my reading, there is no contravention, because the cooling-off period has expired.

ACTING CHAIR—Is it clear in the legislation that each day constitutes a separate breach? The fact that it says 'becomes, or continues to be' does not seem to me at first blush to indicate that every day would constitute a separate breach.

Mr Levy—In my view that is the normal interpretation of the provision.

ACTING CHAIR—Is there legal advice to that effect?

Mr Rawstron—Certainly in respect of some other legislation I am familiar with, in the way that Mr Levy has described it, cumulative offences also apply for offences under the Trade Practices Act.

Mr Levy—We discussed that specifically with the drafter at the Office of Parliamentary Counsel. The words have been very carefully crafted: 'if the person becomes, or continues to be, an officer of the audited body'.

Senator CONROY—Who actually commits the offence if auditors are not rotated after five years? Is it the company, or is it the audit firm?

Ms Wijeyewardene—We might have to take that on notice, if you would not mind.

Senator CONROY—If it is either the audit firm or the company employing them, it is still a relatively modest amount of money for any corporation.

Ms Wijeyewardene—I would just go back to the point I made earlier, which is that we have tried to get some consistency and comparability. I would also reiterate the point that Mr

Rawstron made, which is that we are, to some extent, confined by Commonwealth criminal policy about the magnitude of offence or penalties that we can impose.

Senator CONROY—Who would go to jail if the auditors were not rotated—the auditor, the chief executive of the audit firm or the employing company? Who actually does the six months imprisonment?

Mr Levy—On my reading of the provisions, it depends on whether it is an audit firm, and then it is a member of the firm who could go. Where you have the situation where you have an audit company, a director of the audit company could be prosecuted and go to jail.

Senator CONROY—Any chance of getting the Institute of Chartered Accountants included on that list?

Mr Levy—I cannot comment on that.

Senator CONROY—I live in hope! The bill extends civil liability for contraventions of the continuous disclosure regime to individuals. Could you advise us of the rationale behind extending civil liability to individuals?

Ms Smith—The rationale is to bring it home to those who are responsible for the breach. The shareholders of the disclosing entity may have already suffered through the breach, and the idea is to bring it back to those responsible for the breach and to focus their attention on compliance.

Senator CONROY—The explanatory memorandum states that civil liability will apply only to those individuals with real involvement in a contravention—that is, 'intentional participation and actual knowledge of the essential elements of the contravention'. If a person does have the requisite intention and knowledge to warrant a breach of the provision, why should they be entitled to a defence of due diligence, which is currently being—

Ms Smith—They might not meet the requirements for the defence, but there was disquiet that those who did not have actual knowledge or involvement would be caught.

Senator CONROY—It says 'intentional participation and actual knowledge'. If you did not have them, how could you be caught?

Ms Smith—That is certainly the intention. In section 79, there is a definition of 'involved in' and the case law on a similar provision in the Trade Practices Act.

Senator CONROY—Who could be potentially subject to civil liability for a breach of the continuous disclosure regime? Could lawyers—I live in hope!—merchant banks or other advisers?

Ms Smith—There is no carve-out for a particular professional group.

Senator CONROY—The CLERP 9 bill requires directors to include a management discussion and analysis in the annual report. The ASX has suggestion that the bill prescribes

discussion of certain matters. In your view, is there a risk that failing to specify the required disclosures will result in boilerplate disclosures that are meaningless to investors?

Ms Wijeyewardene—In putting the operating and financial review requirements in the bill we very much implemented the HIH Royal Commission recommendation. I guess we had the choice to provide a general high-level requirement or something that was more detailed. We opted for a requirement which was much broader than specifying actual matters in the legislation, on the basis that we thought that this offers flexibility and can be tailored to the needs of individual companies. That is recognising the spread in terms of characteristics of companies that will be subject to these requirements. We think that it is more flexible. We have indicated that G100 guidelines would be an appropriate document to look at in terms of deciding what should be disclosed. We do not think that it will lead to what you have termed 'boilerplate disclosure'.

Senator CONROY—It is not my term, I assure you. The original CLERP 9 policy paper included a proposal in relation to externally generated speculation. The proposal was that the market operator should require listed entities to respond to externally generated speculation in circumstances where the operator determines that this is having a significant impact on the market for their securities. Has this proposal been rejected? It is not in the bill; it has vanished.

Ms Smith—It has been encompassed by the ASX listing rules.

Senator CONROY—How is that different from the fact that they have always covered that speculation?

Ms Smith—Whether the ASX can do that, if there is speculation?

Senator CONROY—Yes. The ASX did that before this proposal in the original CLERP 9.

Ms Smith—It is now considered appropriate that it be dealt with by the listing rules, which have statutory backing.

Senator CONROY—I thought that they already covered it. What is different from the listing rules prior to this suggestion and the listing rules today?

Ms Smith—Can I take that on notice?

Senator CONROY—Sure.

Ms Smith—I think there were amendments in that area, but I do not know the details.

Senator CONROY—Without a due diligence defence for individuals, would companies who receive an infringement notice be more likely to take the matter to court in order to ensure that individuals are not subject to potential civil liability suits, in your view, or is compliance with an infringement notice not taken as a contravention of law for any other purposes, including action by third parties?

Ms Smith—We have yet to see how it works out in practice, but certainly the infringement notice, and compliance with it, does not constitute admission of a liability.

Senator CONROY—If they paid the fine, would that constitute admission?

Ms Smith—No.

Senator CONROY—So they are just going to pay the money and they are not guilty of anything. Can you talk me through how that works? I did not know they were feeling so generous. Should I try that with them? What are they guilty of, if they have paid money?

Ms Smith—They are not guilty of any contravention of the continuous disclosure requirements.

Senator CONROY—Why have they paid the money?

Ms Smith—To forestall court action.

Mr Rawstron—The measure was introduced to give ASIC additional flexibility. They thought they needed that.

Senator CONROY—I know that they said they needed some teeth. I welcome the proposal, though I am finding it is hard to understand. Is it hush money? Shut up and go away—is that what it is? 'We are not guilty of anything; we are just paying some money.' It sounds good. I like it.

Mr Rawstron—Based on the discussions we have had with Attorney-General's in regard to how Commonwealth legal policy in criminal matters apply, I would imagine we would have to change the architecture of the infringement notice quite substantially to get what you are seeking, mainly because it is not a court based process. The argument would be: if you are going to assign liabilities to people then they should be subject to the same rigors of evidence et cetera that you would deliver in a court.

Senator CONROY—Genuinely, I had no idea that the process would be: 'I'll just pay you some money, but I'm not admitting any guilt of anything.'

ACTING CHAIR—It is like a civil settlement, is it not?

Senator CONROY—But this is the government.

ACTING CHAIR—Are these not civil penalties such as exist under the Trade Practices Act, which can be the subject of a negotiated settlement between the regulator and the offender? Is that, in effect, how it works?

Mr Rawstron—In that case, it is my understanding that they would normally be endorsed by the court and can be. In this case, it would simply be an agreement. ASIC would nominate a penalty based on the guidance in the legislation, and it would be for the company to make a decision whether or not they agree to pay a penalty.

ACTING CHAIR—These civil penalties that exist under this act, the Trade Practices Act and other acts as well are unusual creatures; they are not, conceptually, criminal penalties. To the extent to which they are comparable with any other form of judicial process, they are comparable to a civil damages award and are susceptible to, in effect, a civil settlement. Is that not right?

Mr Rawstron—I would have to take advice on that.

Senator CONROY—We are talking about the Corporations Law, though.

ACTING CHAIR—That is right. In a lot of commercial legislation, there is this unusual animal—this civil penalty—which the courts have said is not in its nature the same as a criminal punishment.

Senator CONROY—I am querying 'not guilty of anything'.

ACTING CHAIR—I think the response is not quite 'not guilty' but 'not liable'.

Senator CONROY—What offence will they have committed if they have paid you money?

Ms Smith—No offence has been proven.

Senator CONROY—They have committed no offence and they have handed over money? I love it!

Ms Smith—But they have forestalled civil penalty action and criminal action.

ACTING CHAIR—It is a bit like a plea bargain.

Senator CONROY—They are not guilty of anything, but they are paying money—that is good! Proposed section 307C requires auditors to give the directors of the company a declaration that there have been no contraventions of the auditor independence requirements in the act or of the professional codes of conduct. In contrast, ASIC says it would be more appropriate if a declaration were made to the company at a general meeting rather than to a board of directors. Does Treasury have a view as to why the declaration should be made to a general meeting rather than to directors?

Mr Levy—Making the declaration to the directors of the company is in accordance with the Ramsay report. But item 88 of the bill also requires the directors to attach a copy of the auditor's declaration under section 307C, in relation to the audit for the financial year, to the annual directors' report. So it does get to the shareholder, but I suppose it is a stepped process.

Senator CONROY—ASIC's submission also suggests various penalties where the auditor makes a false or misleading declaration, such as the creation of a civil action, that the auditor not be entitled to audit fees if the declaration is not made, and a disgorgement of the audit fee if the statement is false or misleading. Can you explain the rationale behind that proposal?

Ms Wijeyewardene—Was that a proposal in ASIC's submission?

Senator CONROY—I think it was an ASIC concept.

Ms Wijeyewardene—I suggest that that question may be best directed to ASIC.

Senator CONROY—Did Treasury consider that?

Ms Wijeyewardene—We consider all submissions, but it is certainly not reflected in the bill.

Senator WONG—Can you cast any light on why the submission to which Senator Conroy is referring was not accepted?

Ms Wijeyewardene—We received a range of submissions from a range of stakeholders suggesting a range of things. I cannot precisely say why we did or did not accept various items in ASIC's submission. I guess we try to take all the views and balance them.

Senator WONG—That is not really an answer to my question. Is anyone able to tell me why that particular suggestion from ASIC was not taken up?

Ms Wijeyewardene—I would have to take that on notice.

Senator WONG—Mr Rawstron, are none of the many officers here able to tell me?

Ms Wijeyewardene—This is a submission from 2½ years ago, so we would have to go back and have a look at exactly why it was not accepted.

Senator CONROY—Can we get a copy of the A-G's policy regarding penalties?

Mr Rawstron—We would have to get it from the Attorney-General's Department.

Senator CONROY—You look scared when you say that.

Mr Rawstron—Maybe I have good reason to be. I do not know whether we have a copy of that.

Senator CONROY—I cannot imagine it would be a top-secret document.

Mr Rawstron—No. It is basically designed around the Commonwealth Criminal Code and model litigant legislation. But they are the arbiters of what the penalties should look like and of consistency between different acts.

Senator WONG—You made some comments earlier that you were constrained by the A-G's code—was that the phrase you used, or was it 'policy'?

Mr Rawstron—It is basically Commonwealth government policy.

Senator WONG—Are you able to tell us in what areas you were constrained? In what areas did Treasury seek a different form of penalty than was permitted after consultation with the A-G's Department?

Ms Wijeyewardene—It is not so much that we put something up to A-G's and were actually told, 'No, you can't do it.' We had a general discussion about the need to lift penalties. For example, the auditor independence area had not been looked at for 40 years and penalties were perhaps reflective of times past. We thought that there was a need to lift the level of penalties in the act. In discussions with them it became evident that a significant increase may be difficult—

Senator WONG—Why?

Ms Wijeyewardene—to justify. We need to have a balanced approach. Basically, the reasoning is that that represents the government's criminal law policy. I would suggest that the rationale behind that and the actual nature of their policy are questions that really should be directed to Attorney-General's.

Senator WONG—What is the relevance of the penalties that, as you say, were outdated or the legislative provisions in relation to auditor independence that were outdated? Did that have a bearing on the extent or severity of the penalties that could be put into this bill?

Ms Wijeyewardene—What we have in the bill are some penalties which we have doubled. As I indicated before, in the independence area the increases have been fivefold. I think that is reflective of the fact that they have not been looked at for quite some time.

Senator WONG—That was not really my question. Do you want me to ask it in a different way, perhaps?

Ms Wijeyewardene—I think you should in that case.

Senator WONG—In answer to a number of questions now you have made reference to the fact that the previous provisions were outdated. I am asking whether that is a relevant factor in determining what range of penalties can be inserted into the bill.

Ms Wijeyewardene—Given that we did get approval for those penalties to increase fivefold, the fact that this area had not been looked at for quite some time was a relevant factor.

Senator WONG—So, Mr Rawstron, as to Senator Conroy's request for the provision of some documentation which clarifies what this policy is that has constrained you—and I think I use your words there—what are you suggesting that the committee does?

Mr Rawstron—I can certainly pass that on to my colleagues in Attorney-General's and ask them to get hold of whatever documentation they have that is publicly available. I suppose that all we are pointing out is that, if you look at the provisions, Treasury does not have a free hand in terms of what it proposes. We would seek the advice of Attorney-General's and the Office of Parliamentary Counsel, because they are the lead policy agencies in respect of the law or the penalties that apply to law generally.

Senator WONG—Did you seek more serious penalties in the area of auditor independence than are in the bill?

Ms Wijeyewardene—My recollection is that we proposed a fivefold increase.

Mr Levy—The existing penalty in the Corporations Act is five penalty units and no imprisonment. I think a unit is about $110 or so, so that is about $550.

ACTING CHAIR—That is a fairly slight penalty.

Senator WONG—I think that is the point.

Mr Levy—Whatever you say. So we have increased—

Senator CONROY—Do you think a 2½ thousand dollar fine to a multimillion dollar corporation is any more than slight?

Mr Levy—We have increased the fine fivefold and also introduced a term of imprisonment—

Senator WONG—Which is an alternative.

Mr Levy—It is an alternative or it could be cumulative.

Senator WONG—Were there any areas in which Treasury's position was for a higher or more serious penalty than is currently in the bill?

Mr Levy—No. I think we negotiated this with the Attorney-General's Department. What they were interested in was whether we had what they call proportionality with other penalty provisions. They felt that what we had struck in the bill was reasonable.

Senator WONG—With which other penalty provisions?

Mr Levy—That is right through the—

Senator WONG—The Corporations Law or—

Mr Levy—The Corporations Act, yes.

ACTING CHAIR—Thank you very much indeed for your assistance. You are excused.

[2.40 p.m.]

BOYMAL, Professor David, Chairman, Australian Accounting Standards Board

STODDART, Ms Ellen Kathrine, Senior Project Manager, Australian Accounting Standards Board

ACTING CHAIR—I welcome Professor David Boymal and Ms Ellen Stoddart from the Australian Accounting Standards Board to the hearing. The committee prefers all evidence be given in public, but should you at any stage wish to give part of your evidence in private you may ask to do so and the committee will consider your request. I now invite you to make a brief opening statement prior to questions.

Prof. Boymal—I do not have an opening statement of any length because the Accounting Standards Board did not make a submission in the first place. Suffice to say I am quite pleased to answer questions relating to the accounting standards and the relationship of my board to the FRC. My previous experience was as the technical standards partner of one of the big four firms, so I have a lot of audit expertise. If you want to ask questions relating to auditing standards, I am familiar with those. I am prepared to answer whatever questions you have.

ACTING CHAIR—We will turn to questions, then.

Senator CONROY—You advised us during Senate estimates, Professor Boymal, that you wrote to the Treasurer suggesting the removal of section 300A disclosure requirements, which as you know are very dear to my heart. Have you received a response to that letter?

Prof. Boymal—There has been no response to that letter.

Senator CONROY—Are you aware of the government's view?

Prof. Boymal—I am not aware of the government's view.

Senator CONROY—Has the AASB been consulted in relation to the regulations which are expected in relation to section 300A?

Prof. Boymal—I may check with Ellen, but to the best of my knowledge there has been no consultation in relation to it.

Senator CONROY—I think Ms Stoddart would tell you that Treasury indicated they are due for release shortly and there will be a consultation process over the next four or five weeks. They were hoping it would be in seven to 10 days. Again, during Senate estimates, we discussed the issue of benefits in the form of equity in an entity other than the disclosing entity or its subsidiaries—an example is an overseas listed parent company. I am not sure if you go over the *Hansard* as much I do, but we had a discussion around that. Under the accounting standard, this form of remuneration is not classified as an entity compensation scheme and therefore does not need to be disclosed. You said that if a company was trying to deliberately circumvent the

disclosure obligations in the accounting standards it could use this loophole—that is my word—to do so. Have you considered ways to close this loophole?

Prof. Boymal—Could I pass the question to Ellen.

Ms Stoddart—It would not be considered equity compensation because if it is an Australian listed company it would not be equity in that Australian listed company. It would, however, be caught under non-equity remuneration. It would certainly be caught under the definition of remuneration in section 5.1 of AASB 1046, which includes things that are made available for the management of the company by the entity and by any related party. An overseas parent would undoubtedly be a related party. So it would be caught but not as equity because it is not equity in that company.

Senator CONROY—During Senate estimates, we also discussed the issue of equity value protection schemes—sometimes called hedging instruments—and the fact that the accounting standard does not explicitly require them to be disclosed to shareholders. A narrow reading of the accounting standard would mean that disclosure is not required. Have you given further thought to this issue?

Prof. Boymal—There has been no further thought given to that particular issue at this time.

Senator CONROY—Is it one that might be further considered as part of this standard?

Prof. Boymal—It is a point that will be given consideration in due course. That standard is subject to amendment because, as we move to international accounting standards, we will be internationalising accounting standard 1046 in the very near future, and that particular point will receive consideration then.

Senator CONROY—Is it included in the internationalised standard?

Prof. Boymal—It is not included in the international standard, no, but it gives us the opportunity to revisit the question.

Senator CONROY—We are not restricted to only what is in the international standard; we can enhance disclosure. Is that a fair statement?

Prof. Boymal—That is a fair statement. It is an issue over which there has been considerable debate. Many people, including the IASB, at the meeting I was at only yesterday or the day before, were saying, 'Don't tamper with our standards in any way.' They were basically arguing, 'Don't even put in a comma.' But that has not been our view. We must stay with the international standards because that is the directive of the FRC, but there are a number of changes which are not regarded as departures: enhanced disclosures, which is the one that you just mentioned, and removal of options. We have had it confirmed to us that those types of amendment to the verbatim language do not represent departures from the international standards.

Senator CONROY—Have we had any progress on the debate around the documents that they want to charge you for? Charging for Australian legislation is something that the parliament is going to find very difficult to swallow.

Prof. Boymal—Let me explain the situation. It actually has not changed, although our agreement is nearly bedded down. Firstly, they are not going to charge for the standards; there is a royalty waiver in relation to the standards. The only remaining royalty question applies to other areas which come out—I should not say 'in the international standards'—in the international set of documents. Those two other publications are the basis for conclusions—which means the reasons that they came up with the standard the way that they did—and additional implementation guidance. So the two areas that we have to pay a royalty—

Senator CONROY—So how is parliament going to attach them to its documents? How is parliament going to put them up on the web site of the explanatory documents to interpret the law?

Prof. Boymal—The intention is that they not be attached to the documents. On the other hand, they will have to be available on the web site but there will be a charge—

Senator CONROY—For downloading them?

Prof. Boymal—for people accessing them, yes. And the reason for that is—

Senator CONROY—They read them if they put them up on the web site but they cannot download them—is that what you are saying?

Prof. Boymal—No. There will need to be a secure section of the web site which people can access only after they have a code, and to get that code they will have to have made payment.

Senator CONROY—So if I want to read how to apply my own law that I will be voting on, I will be charged for it.

Prof. Boymal—Unfortunately that is where we are left, because the IASB is in turn charging us royalties for that material.

Senator CONROY—We will see what we can do to sabotage that.

Prof. Boymal—I might say that we have objected to this all the way along but to no avail.

Senator CONROY—Sure. I think it has long been a principle of the parliament that we do not charge our citizens to read and interpret our laws. That will no doubt be one that we debate at some considerable length. AASB 1046 talks about disclosure and not expensing of options, is that right?

Prof. Boymal—That is correct. At the present time AASB 1046 is a standard of disclosure purely in relation to a limited number of executives and directors. The other issue is altogether different, which is the question: should options that have value be treated as an expense to the company? The international accounting standard which has only now come out basically says: yes, the issue of options with value is an expense to the company. The significant difference is that that international accounting standard relates to options issued as remuneration to any member of staff whereas 1046 is limited to the top executives.

Ms Stoddart—And disclosing entities; AASB2 will apply to all.

Senator CONROY—Are there any other major changes between 1046 and the international equivalent?

Prof. Boymal—There are some changes. Perhaps I could ask Ms Stoddart to explain them.

Ms Stoddart—There are some differences between them because we brought out AASB 1046 before we knew the final contents of IFRS 2. However, 1046 addresses quite a different area. Essentially IFRS 2 only deals with the measurement of one of the elements of the remuneration of specified directors and specified executives, and so we will change references to that and bring it in line. But 1046 will remain a domestic disclosure standard because the IASB have said, 'National jurisdictions will determine what is required in this area; we will not be touching it.' So we do not anticipate there being another IASB standard to cover the full area that 1046 covers.

Senator CONROY—So they have chickened out.

Ms Stoddart—The IASB will not be doing that.

Senator CONROY—Why not?

Ms Stoddart—Because they think every national jurisdiction should determine what it wishes to disclose in respect of governance issues.

Senator CONROY—I thought they wanted a single comprehensive set of standards on all these matters.

Prof. Boymal—The answer is: yes, they do. But they appear to have drawn the line between what we might say are financial disclosures and governance disclosures, and they have put this particular issue into the category of governance disclosures.

Ms Stoddart—They did have difficulties in trying to find an international definition of 'director' and 'executive' and in trying to reconcile all the differences there are at the moment between the UK, the USA and Australia. So in this area they decided to leave it to national jurisdictions.

Senator CONROY—Professor Boymal, in respect of Ms Picker, your temporary predecessor, I am sure you have heard me quote the differences between Australia's standards and the IAS standards. I presume that the board has done some analysis of what the differences are.

Prof. Boymal—Yes, the board has an analysis, but it really depends on what you mean by 'differences'. We are not simply photocopying the standards; a number of changes are being made to, as we might say, Australianise them to get them to fit into our legal structure. They are differences but it might be said that they have no effect.

Senator CONROY—No substantive effect?

Prof. Boymal—Yes.

Senator CONROY—I am looking for—and frankly yours would be the only body able to provide this and I would hope it could provide it fairly quickly—a comparison of Australia's existing standards with the new international accounting standards and what major differences there are between them. I note that Mr Ravlic is in the room; I know that he has written in one of the many publications to which he contributes the differences he perceives between the differing standards. So there is a document out there. While Mr Ravlic is highly regarded by many, I am sure that the AASB's contribution in this area would be very valuable. Can you provide to the committee, in reasonably quick time—I would hope that you have already done it and therefore it would be just a photocopy of a document—the major changes in content between our current standards and those coming in?

Prof. Boymal—We have that information already. However, it is not just a matter of what the differences are. There are four or five what we might call missing standards in the existing Australian suite of standards for which there are international standards.

Senator CONROY—I am sure that if you had a piece of paper with two columns you could write in one what is the international standard and in the other column that Australia has no standard. I am sure that would cover off on my concerns.

Prof. Boymal—Yes. The point is that obviously if we have no standard on these four particular issues the changes are very substantial, as you could well imagine.

Senator CONROY—You might want to do a quick summary of what the new standard covers, but I am sure you could just write, 'Australia currently has no standard'—on financial instruments, for example.

Prof. Boymal—We already have this information, so we will provide it.

Senator CONROY—I hesitate to ask you for a commentary on the quality and robustness of the new standards versus the existing standards. I would think your body really would be the only one eminently qualified to give us that view. Ms Picker has been quite clear: she thinks that probably four or maybe six standards are of a lower quality or a less robust quality—I am trying to avoid pejorative terms. I hope that we can have a discussion about the technical content of this country's standards. I also hope that your body can give us that analysis, without wanting to place you in a position where you are producing a critique—but frankly I regard that as your job.

Prof. Boymal—Indeed, I agree. We have that information. Each time there is an amended or an internationalised Australian standard a document is produced, at the back of which are detailed explanations of the changes that are occurring; these are addressed standard by standard. That is already published material.

Ms Stoddart—Before David joined the board, we did have a publication that went through every single Australian standard. That was about two years ago. That publication is now out of print; it was popular. That went through and divided up every single standard as to where the Australian standard required more to be disclosed or where the international standard required more disclosure and any differences. It was fairly detailed.

Senator CONROY—Would it be possible to get an update of that? Given there have been some changes in international standards but that ours are still the same, the only area of update would be where they have made some changes—and, as we all know, they have made some changes.

Ms Stoddart—It would be an extensive job, and I do not wish to decline to give it to you. As David says, such detail is at the back of every pending standard, every standard we are issuing. But what you are asking would take a lot of time at the moment and we are a little pressed for time.

Senator CONROY—But if that is not your job to be able to tell us—

Ms Stoddart—We can tell you on an individual basis, but compiling it and updating a previous publication—

Senator CONROY—Maybe we can find some middle ground. In terms of almost photocopying, at the back of the documents you are referring to, the new standards—

Prof. Boymal—We can do that.

Senator CONROY—to just compile a summary on top of that would be very helpful. I know that not everybody on the committee will want to read all of it, as I will want to.

Prof. Boymal—I think that is the point. What we have is very detailed and, quite frankly, it needs to be detailed. Companies need that depth of information to be able to apply these new standards. But I would venture to say that you would find it very boring because it is just too voluminous in the form that it is in.

Senator CONROY—People are continually surprised at what I find interesting.

Ms Stoddart—Also some of those standards deal with something that we have dealt with in another one, and so you do not get an exact sort of lock where they have a standard for this and we have one for that. We might spread something over several while they might put it elsewhere.

Senator CONROY—Is it possible to encompass that in that sort of precis on the top?

Prof. Boymal—We will put something together.

Senator CONROY—Meaning no disrespect to Mr Ravlic, I hope to have something more substantive than the couple of pages of summary of this he compiled a few years ago. I hope you will be able to give us—

Prof. Boymal—Every one of the speeches I give contains this sort of information.

Senator CONROY—I do not want you to take this personally, Professor Boymal, but I have been slack in reading all of your speeches.

Prof. Boymal—That is okay.

Senator CONROY—I hear hisses of disbelief next to me, and I plead guilty. It would be great if you could provide that to the committee. Would that cover the ones that you know are coming—or, other than IAS 39, are they all out and agreed?

Prof. Boymal—They are all out and agreed.

Senator CONROY—Are they just in draft stage for comment at the moment? Have any of them bobbed up as Treasury regs yet? Do I need to check Treasury's web site to see if you have slipped any in on me that I have to disallow?

Prof. Boymal—There are no surprises. The reason for that is that we have been advised it is necessary for us to actually make—which means gazette and put on the tables of parliament—those all at one point in time. They make reference to each other, so it must be done at one point in time. In order to keep the marketplace informed as we conclude what the wording should be, we put them on the AASB web site, labelled 'pending standard'. We are about two-thirds of the way through all of the standards at this point in time and we expect to be finished by 30 June.

Senator CONROY—Mr Macek and I had quite a lengthy discussion about IAS 39 earlier. I think Ms Stoddard was here, but you were probably still flying in from London.

Prof. Boymal—I was sleeping it off.

Senator CONROY—I asked Mr Macek if he could give me an explanation of the difference between the December and the March versions of IAS 39. Despite being the chairman of the FRC and championing both standards at different points in time, he was unable to explain to me what the difference is. I am happy for it to not be right now, but are you able to give us a summary of the difference between the December standard and the March standard, even though you have been supporting both of them—and, if there is a further change, you will be supporting it?

Prof. Boymal—That is not quite correct.

Senator CONROY—When I say 'you', I am referring to the AASB. You would have promulgated the December one, if they had not changed it in March.

Ms Stoddart—We put it up as pending in December.

Senator CONROY—You put it up as pending in December and you put up the new one as pending in March. Therefore, you are supporting them. You would not promulgate something you do not support, would you? Would the Australian Accounting Standards Board promulgate a standard that they do not agree with?

Prof. Boymal—No, they would not. The difficulty is that there is still a proposed change to come.

Senator CONROY—I want to come to that. I am going step by step at this stage. I would like an explanation of the difference between the two standards that you have previously supported and the one you are currently supporting. If you are able to at this point, can you suggest the

standard that you will eventually support? I am happy to take the two that you have officially been supporting. If you have any idea about the one you will end up supporting, that will be useful to the committee. Mr Macek indicated that, if IAS 39 was not able to be agreed, it would end up being treated as an optional standard.

Ms Stoddart—By the EU.

Prof. Boymal—I think that is the important thing, because that is certainly not intended to be the case in Australia.

Senator CONROY—So Australia and Botswana would adopt it if the EU do not.

Prof. Boymal—That is not correct either.

Senator CONROY—I am sure Tanzania and Uganda are in there too.

Prof. Boymal—The inference is not correct. That is because Europe has not quite decided what it does with IAS 39. There is a considerable amount of speculation as to how it deals with what one might call its final disagreement.

Senator CONROY—Can we just clarify the word 'Europe'. What we are talking about is the French President.

Prof. Boymal—We are talking about the European Commission, the EU, in terms of the final decision making. Behind the scenes the flack is coming from France.

Senator CONROY—But all other standards have been moved and adopted by at least the commission, if not their parliament. I would happily be corrected on that. All of them were tabled, but IAS 32 and 39 were not proceeded with, on the basis that the French said they would veto them.

Prof. Boymal—That is correct. The term that they use is 'endorse'. So all but those two standards have been endorsed.

Senator CONROY—I just wanted to clarify for the public record and everybody in this room, including some journalists in this room, that it is the French President who has vetoed the adoption of IAS 39. That is a factual statement.

Prof. Boymal—I am not quite sure of that. I am unable to confirm it. What I have read in the media is that the strong disagreement is coming from the French banks and they have appealed to the French President, who—

Senator CONROY—Agrees with them.

Prof. Boymal—has intervened.

Senator CONROY—The French banks do not have a veto on the European Commission, do they?

Prof. Boymal—No.

Senator CONROY—So it is the French President who has issued the veto.

Prof. Boymal—I guess that must be the case.

Senator CONROY—That would be an accurate statement of fact.

ACTING CHAIR—Do you know that, Professor Boymal, or is it simply a matter that you infer might have happened if what Senator Conroy has put to you is correct? Something is being put to you and you are being asked on the public record to verify that assertion. Are you in a position to verify it, or don't you know?

Prof. Boymal—I am not in a position to verify it, but I have heard it through other sources. The French President has not told me, if that is what you are getting at.

Senator CONROY—What has Sir David Tweedie told you on that matter?

Prof. Boymal—Sir David Tweedie has said that the French banks are the stumbling block. There is no doubt he has said that.

Senator CONROY—The way they have effectively stumbled the process is by having the French President—

Prof. Boymal—It is via the President.

Senator CONROY—issue a veto on IAS 32 and 39.

Prof. Boymal—Yes, to the best of my knowledge.

Senator CONROY—I do accept that you have not had a personal conversation with the French President where he has confirmed that to you, but Sir David Tweedie is Chairman of the International Accounting Standards Board.

Prof. Boymal—That is right.

Senator CONROY—Thank you. Does that help you, Senator Brandis?

ACTING CHAIR—I am just trying to clarify for the record what Professor Boymal is in fact saying, rather than adopting your words, Senator Conroy. Professor Boymal, let me ask you the same question in my own way. Are you able to tell us whether or not it is the case that the French President has vetoed the standard?

Prof. Boymal—I do not know enough of the exact process in the EU to know whether it is indeed the French President. He probably does not sit around the table where this process takes place.

ACTING CHAIR—So you are not sure.

Prof. Boymal—I am not sure, but I have heard that the influence has gone as far as the French President.

Senator CONROY—He has personally intervened. You are aware of that.

Prof. Boymal—Yes, I am aware of that.

Senator CONROY—In terms of the formal process of the European Commission, heads of state and/or the ministers of governments are the people who sit around the table of the commission—the 15 current heads of state. You will note that there is an argument about expanding that 15 and there is a new voting process.

Prof. Boymal—Yes, but the part that I am uncertain about is who in fact sits around the table when they discuss things as mundane as accounting standards. I suspect that it would not be the presidents of the various countries.

ACTING CHAIR—What about the relevant French minister? What we are trying to establish is the existence or non-existence of a fact. The question is: has a veto been exercised by the French government through its appropriate minister or official? Do you know whether or not that has happened?

Prof. Boymal—Yes. My understanding is that that has happened.

Senator CONROY—Thanks for your assistance there, Senator Brandis.

ACTING CHAIR—That is all right. It would have been a lot faster if you had asked the right question about 20 minutes ago.

Senator CONROY—I always appreciate your ability to cut through to get the facts, Senator Brandis. It is always of help. Professor Boymal, what is your understanding of what will happen if the EU does not adopt 39? Who will be left to adopt 39? Bear in mind that I am actually a supporter of 39.

Prof. Boymal—The difficulty in answering the question is that we are not aware what this so-called veto is likely to do. We are uncertain whether the EU will endorse those standards minus a few offending paragraphs, or if they will refuse to endorse the entirety of the standards. Clearly, those two different approaches make quite a difference. Truly, we do not know what is likely to happen next in relation to what their reaction will be in connection with the parts that they do not like. We know what it is they do not like but we do not know what the next step in the process will be.

Senator CONROY—Your predecessor, Mr Alfredson, believed it was very important. He said to the committee many times that for financial instruments currently Australia does not have a standard and that internationally there was not much of a standard. The US does have a standard, I believe.

Prof. Boymal—The US has a number of standards that produce the same effect.

Senator CONROY—They generally produce the same effect. He was fond of saying that something like $8 trillion worth of financial instruments were not recorded in any way on balance sheets around the world.

Prof. Boymal—It was David Tweedie who said that.

Senator CONROY—David Tweedie. That is why it is so imperative to get this one right, because this is actually the biggest of the lot. No other standard would impact on $8 trillion worth of financial accounts. Eight trillion dollars is a lot of money compared to the level of accounts.

Prof. Boymal—Yes indeed. Simply, what he was saying was that the total value of derivatives out there in the marketplace is like that amount of dollars. How he arrived at that number I have no idea but the message is that it is huge. The point, though, is that yes, many of them are not on balance sheets but that is not to say that these are unknown, secret numbers. For example, derivatives that Australian companies enter into, whilst they are not on balance sheets, are disclosed in notes to the accounts. So it would be wrong to say that you have these enormous amounts that are a total mystery. The issue, though, is that we have large amounts that are not on balance sheets.

Senator CONROY—What went wrong at Pasminco, then? They seemed to have a bit of trouble with some financial instruments.

Prof. Boymal—Yes, they did. My understanding is that they were hedging.

Senator CONROY—In fact if the market had known that they had given up trading in commodities and were actually a financial instruments trader they might have had a different view on them.

Prof. Boymal—Yes, that could be. But my point though is that the Pasminco hedges were disclosed in the Pasminco accounts. So it was not a secret piece of information; it was just that they were not on the balance sheet. But they were quite well disclosed. If a company—

Senator CONROY—Did people not understand the risks?

Prof. Boymal—I cannot speak for the company, but the point though is that if a company makes unwise decisions to enter into derivative trading or unwise decisions to do anything else the accounting should reflect that. But the accounting comes after the decision. It does not alter the business decisions.

Senator CONROY—I just have two further points. What I am really trying to get to here is how important IAS 39 is to the overall integrity of the international accounting standard setting process.

Prof. Boymal—It is very important.

Senator CONROY—Many others hang off 39, don't they?

Prof. Boymal—Indeed they do. It is very important for Australia. In the anticipation that in going international we will pick up this international standard, we have not produced an equivalent standard. So it is very important.

Senator CONROY—If Europe are allowed to pick and choose or if Europe decide that they are going to veto 39 and go on with business as usual—Europe says, 'No, we are just going to come and go'—even though the UK, as Ms Stoddart said, has opted in, do you think that will impact on the level of credibility of the IASB?

Prof. Boymal—I do not think that it will affect the credibility of the IASB, particularly if the IASB holds out and does not succumb to pressure. Basically, there are already countries that say that they have gone international, but if there is a standard that they do not like then they conveniently leave that one out.

Senator CONROY—I am sure Japan says that it is completely international.

Prof. Boymal—They would not even claim that they were.

Senator CONROY—Fair enough.

Prof. Boymal—But countries do claim that but they are really not. In Australia we have resolved that, if we go international, we will go for the entire package, because the whole process is intended to enhance the credibility of reporting in Australia, and to pick and choose would be contrary to that. My point is that, irrespective of what Europe does, it should not affect the direction that Australia goes in.

Senator CONROY—Sure, but my question was: will it strike a blow to the credibility of the International Accounting Standards Board if almost every member of the team is not going to adopt it?

Prof. Boymal—No, I do not think it will. In my own view, if the IASB succumbs to that sort of pressure and amends standards simply because of pressure from the French President, for example, it is more likely to come into disrepute for giving way than for holding out.

Senator CONROY—You have just returned, as we have joked about, from the IASB meeting in London.

Prof. Boymal—Yes.

Senator CONROY—You indicated earlier in your evidence that there may be a further change to IAS 39. What are you alluding to?

Prof. Boymal—I am alluding to the very same issue that we have been speaking about. The situation is that this accounting standard, IAS 39, deals with the measurement of derivatives, requires them to be put on the balance sheet, requires different financial instruments to be valued in different ways, depending upon what the intention of them is, requires derivative instruments

to be marked to market, and deals with hedging and sets strict rules for hedging—and on and on it goes. It is a very wide, comprehensive standard. There is only one relatively small but clearly important area—if the French President is involved it must be important—that is still subject to debate, and it has to do with an optional choice which sits in those standards that enables all financial instruments to be marked to market. We call it the fair value option. It is already in the standard. It is in the December 2003 version.

Senator CONROY—What is the difference between a fair value option and marked to market? They are not quite the same thing.

Prof. Boymal—They are not absolutely the same, but for the purpose of this presentation it is just the same.

Senator CONROY—Some people whom I have some regard for would argue that is not right.

Prof. Boymal—You are correct. That is not right; it is simply the terminology that we use. Fair value is the rule. It is the fair value option, but we tend to say 'marked to market' because that is a long used term. They are not identical, but they are very similar. The only issue that is left, and the reason that French banks have shown concern, is that, instead of there being different valuation approaches depending upon the objective of entering into these various financial instruments, there is an alternative choice—that is, you can mark everything to market.

The French objected to that particular small piece—it is only a single paragraph in the entire standard—because they argue two things: firstly, some fair valuations are not sufficiently reliable and you need to have both reliability and 'auditability' there before you can simply mark things to fair value; and, secondly, if you can mark all of your financial instruments to fair value, it has a counterintuitive effect for a company that is going bad, because, if a company is going bad and it has, let us say, debentures in the marketplace, nobody will want to buy those debentures at the full amount, so they are worth less. Does that mean that this company that is going bad can record its liabilities at less than their full amount because the marketplace will not buy them? It has this single counterintuitive piece attached to it which probably needs some further attention.

Senator CONROY—But Adam Smith wrote in 1700 that the value of—

ACTING CHAIR—Adam Smith was not born in 1700.

Senator CONROY—Whenever it was. He wrote that the value of a stock is what you can get for it on a given day, Professor Boymal, and I am just confused as to why you describe that as counterintuitive. If they can only get a certain amount for it on a given day, that is what it is worth. Its economic value is what you can get for it on a given day.

Prof. Boymal—I would not want to argue with Adam Smith—

Senator CONROY—That is the fundamental concept of marked to market: what you can get for it on a given day.

Prof. Boymal—Think of the consequences in relation to a company's own indebtedness. The company is going bad and people will not buy those debentures. Does that mean that the very company that is going bad can put its liabilities in at a lesser amount and show a profit because of that and therefore no longer be going bad? There seems to be something counterintuitive about that, and the reason is that this company that is going bad cannot raise the money to buy out its debt. That is the trick to it.

Senator CONROY—That is the point.

Prof. Boymal—The French are saying that there is one small piece of unacceptability in relation to the option to mark all financial assets and liabilities to fair value, and they have a point. That is probably going to be attended to, but that is why the whole thing at the moment is being held up. It is a very small slice of a very large and comprehensive standard. This particular point is going out for re-exposure very soon and comments will come in.

Senator CONROY—Have you received any comments on any of the standards you have put out so far?

Prof. Boymal—Have we received comments? We always receive comments when we put out the exposure drafts.

Senator CONROY—Mr Alfredson indicated that there was almost no interest and that previously they were not getting enough. His complaint was, 'Please, put in standards; put in comments.'

Prof. Boymal—There always have been responses to exposure drafts that we put out.

Senator CONROY—Have any of the big four been putting in comments?

Prof. Boymal—Always—absolutely. In fact, we are surprised if they miss any of them at all. They are very strong contributors.

Senator CONROY—When do you hope that this argument can be resolved and we can get a standard? Did you just resolve it?

Prof. Boymal—Let me explain: we have a standard in that the FRC directed us to draw a line in the sand, and for going international in 2005 the standards used should be those that are in place at 31 March 2004. That standard is in place at 31 March 2004 minus this one piece that is still being debated. So it is the existing standard that we are going to use. We have put it to David Tweedie that, if there are to be amendments to that standard arising out of this particular remaining point at issue, that should be a 2006 amendment with the choice to adopt earlier if Europe wants to. David Tweedie is considering that very suggestion at the present time. But we have drawn a line in the sand of 31 March 2004 standards. So our package of standards for 2005 adoption is now complete. The various professional groups and companies who were complaining about uncertainty because the international standards were not finished have stopped complaining about that, because we drew the line in the sand.

Senator CONROY—My last discussion with Sir David was around this issue. We were discussing the recording of a liability as an asset. Has that issue been resolved? I think you were there for the discussions, and that is why I am shorthanding it. No-one else will understand my reference to the discussion at this point, but hopefully you and I will.

Prof. Boymal—What David Tweedie was saying was that the French were arguing that if there are exchange gains and losses, but in particular exchange losses, then the existing rules in the international standards—and I am using technical terms, unfortunately—require those to be charged to the result for the year and put direct to equity. 'Put direct to equity' means held in equity for the time being until the transaction is completed. This has to do with hedging. If you hedge a transaction but the transaction that you have hedged has not arrived yet—and that happens all the time; you take forward cover for a future purchase and you have your forward cover transaction in place but your future purchase has not arrived yet—the international rules require the gains or losses on that hedged transaction to be taken to the profit and loss account. The other side of the accounting entry is that it sits in equity waiting for the underlying transaction to arrive. Old accounting rules basically said that you can hold that in your balance sheet as a deferred loss. The existing conceptual framework of accounting does not acknowledge deferred losses—it says that the balance sheet is made up of assets, liabilities and equity, and a deferred loss is not an asset. As David Tweedie says, if you have a deferred loss you cannot go to the bank and borrow money on the strength of it—the bank will pretty quickly tell you that a deferred loss is not an asset. I am afraid we are getting into technical issues here, but—

Senator CONROY—Let me speed it up for you. Has Sir David won that argument?

Prof. Boymal—The argument is still going on, but, in my view, he has to win that argument because it is fundamental to accounting concepts.

Senator CONROY—I would have thought so. When will he be able to claim victory?

Prof. Boymal—He has an accounting standard sitting there—it is IAS 39, which includes hedging requirements. He says that he has already won because his standard is complete.

Senator CONROY—But, as you know, he is under enormous pressure to fold on that.

Prof. Boymal—Europe is refusing to endorse, so he will have won when Europe finally endorses this standard. That is my estimation of it. He would say that he has already won because his standard requires it to be accounted for in that particular way. So I think that 'win-lose' is probably not the best way of identifying it—'win-win' is probably what we are after.

Senator CONROY—I did not realise you were into the political spin, Professor Boymal, but that was very good!

Prof. Boymal—Thanks!

Senator CONROY—Just going back to what I have called in my notes a share based payment standard, which I think is now No. 2—did you say that it was now No. 2?

Ms Stoddart—Yes.

Senator CONROY—That has now been released?

Ms Stoddart—The IASB released IFRS 2 on 19 February, and our version, pending AASB 2, went up on our web site in March.

Senator CONROY—And options are required to be expensed in that?

Ms Stoddart—Yes.

Senator CONROY—Will options that are expensed be tax deductible to the company?

Ms Stoddart—That is the taxation department's problem; we do not deal with tax.

Prof. Boymal—I am not a tax expert, but I believe the answer to that is, no, at the present time they would not be.

Senator CONROY—That is my understanding as well, but I just wanted to confirm that. Much of the CLERP 9 bill is directed towards enhancing the disclosure obligations of listed companies, especially in relation to remuneration. Has the AASB considered whether such disclosure obligations should be extended to companies which are not listed?

Ms Stoddart—Yes, it has.

Prof. Boymal—You said 'disclosure obligations'. At the present time, these disclosures apply to disclosing entities.

Ms Stoddart—The very explicit disclosures in regard to the directors and the specified executives apply only to disclosing entities. There are, however, the existing disclosures required from all corporate entities in AASB 1017, related party disclosures, but that is not on an individual basis.

Senator CONROY—What I was asking is: have you considered expanding them? At the moment, the Business Council, for instance, are saying that the disclosure obligations are falling unfairly on publicly listed companies and, in their view, that is causing a distortion in the marketplace.

Prof. Boymal—A slight correction is that disclosing entities actually do extend slightly beyond publicly listed companies. That would cover entities that have issued prospectuses, which may not in fact involve public listing, but that is only a subtle difference. The idea of requiring those disclosures outside of disclosing entities has not been considered at this point in time—other than that to require it for disclosing entities and not others meant that a decision that it should not feed all the way down ought not to be made, at least for the time being. The reason for that has to do with corporate governance. The whole concept of corporate governance—

Senator CONROY—Parmalat was a non-listed company, and that had major issues around governance.

Prof. Boymal—Yes, it did, but that was, as I understand it—

Senator CONROY—It had major difficulties around fraud as well.

Prof. Boymal—fraud and cheating in the numbers. But corporate governance is most important when the ownership and the management are quite disparate groups. The governance takes a different context when the owners and the management are the same groups or come closer and closer to being the same groups. It is that rationale which then brings you to the conclusion that not all disclosures relating to corporate governance that appear appropriate for publicly listed companies ought to feed all the way down to the smaller end of the marketplace.

Senator CONROY—I am talking about large non-listed companies.

Prof. Boymal—A large non-listed company can still be a closely held company. The difficulty is: where does one draw the line? If one said all disclosures should apply to all companies, no matter what, you would then get the smaller end of the market saying, 'We're being overburdened with all of these disclosures that have no meaning if the ownership and the management are the same group.' The difficult issue is: where does one draw the line? A very convenient point in drawing the line is to apply different rules to disclosing entities than to others, but there are other arguments that say that the line should be drawn somewhere else.

Senator CONROY—The Parmalat impact has been quite enormous. It has been much broader than just the individuals that own the closely held company, because of its sheer size. Its impact on its workers, its customers and its suppliers—

Ms Stoddart—Yes, it would not be cured.

Senator CONROY—has actually been enormous because of its sheer size.

Prof. Boymal—That is correct, but we have a number of standards dealing with related party transactions and those standards feed all the way down to smaller companies. Accounting standard 1046 is an explicit standard about the remuneration of top executives, which, at the moment, is a standard that is applied to disclosing entities only. Other related party transactions—for example, if the Parmalat family had transactions with the Parmalat company, even though it was a closely held company, in the Australian context—

Senator CONROY—So there are some required disclosures—

Prof. Boymal—There are requirements already.

Senator CONROY—If I wanted to extend some of these remuneration disclosure issues to non-listed companies, is it complicated?

Prof. Boymal—Drafting the standard is very easy. It comes down to the question of whether it is appropriate to disclose that sort of information when there is not the same level of public interest in it.

Ms Stoddart—Particularly when the law itself distinguishes.

Senator CONROY—I accept that. It is ultimately a policy decision, but I was just wondering if you had considered the position. A number of witnesses have rejected the Joint Standing Committee of Public Accounts and Audit recommendation in relation to the true and fair view—that the directors' report should set out the directors' reasons why compliance with accounting standards would not result in the financial statements giving a true and fair view. These witnesses say that the financial reports must stand alone and that to include the same information in the directors' report, which is not audited, will lead to unnecessary duplication and possible confusion. Can you comment on that?

Prof. Boymal—At the present time the legislation requires that financial statements satisfy two rules or fundamental requirements—one is compliance with accounting standards and the other is that the accounts should produce a true and fair view. In the Corporations Act the law appears to give those two requirements equal standing. That is fair enough, but, since they both get a mention, one would have to conclude that compliance with the accounting standards and the true and fair view cannot be identical because, if they were identical, why did they both get a mention in the law? So the next question is: what if, in the judgment of the directors, compliance with one produces non-compliance with the other?

A long time ago there was an override which basically said that you only had to comply with accounting standards if it also produced a true and fair view. This was very badly exploited by companies in that they argued that accounting standards did not produce a true and fair view and that was a reason why the companies did not comply with the accounting standards. The law was then changed so that, instead of 'true and fair view' being given predominance, both of the requirements had equal standing. So the question was: if they are different, what if compliance with one means non-compliance with the other? The law acknowledged this by saying that you must comply with the accounting standards. If, in so complying, you did not give a true and fair view, you must explain why. That was the way it was built into the law. Interestingly enough, since that law was introduced—and it is now many years—I have never seen a company argue that complying with the accounting standards did not give a true and fair view, which demonstrated that it was being exploited before that. Since this has not produced any problems in practice, I cannot see why it should be tampered with in any way.

Senator CONROY—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 AUASB be the employing body but that the staffing of the AUASB and the AASB be merged into a new entity called the Australian Financial Reporting and Assurance Institute. He says that this body could provide both the technical and administrative support to both the AASB and the AUASB. He is concerned that:

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

Do you have any views? Do you agree or disagree with Keith Alfredson's concern?

Prof. Boymal—I basically agree with that. Being, in effect, the chief executive of a government agency, I have learnt that there is—

Senator CONROY—Sorry, you are not a government agency. That is a very important distinction. You are actually not a government agency.

Prof. Boymal—How I explain the organisation is that it is an agency of government.

Ms Stoddart—We are forced to adopt a logo.

Senator CONROY—You may be set up by legislation. There are statutorily—

Prof. Boymal—You are distinguishing between government and parliament, I guess.

Senator CONROY—No, I am distinguishing between a statutorily independent organisation and a government department, and you are not—

ACTING CHAIR—A government agency is a statutorily independent organisation. The ACCC is a government agency but it is statutorily independent.

Senator CONROY—And you are statutorily independent. You are known as the independent standards setter in this country, not as a government standards setting organisation.

Prof. Boymal—I am not denying that. We have gone away from the point, though. As the CEO of this particular agency, I have discovered that there is really an enormous amount of form filling that is required of such an agency.

Senator CONROY—Welcome to the public sector.

Prof. Boymal—I am in the public sector. I have a staff of 24. The auditing standards board, it is envisaged, might have a staff of five. If it is a separate employer, as the AASB is, there will be duplication of that administrative effort for very few people. Whilst the rules might be quite appropriate for large organisations, they are quite burdensome for organisations that employ either 24 or five people, and therefore there would be some administrative relief if the staff of both of these boards could be employed by the one entity. I think that is what Keith Alfredson is driving at. I would have to agree that it seems inappropriate that this newly established audit and assurance standards board ought to be the employer of only five people and then has to go through the administrative burden of being a Commonwealth employer. I too would suggest that there might be a more efficient way of dealing with this.

Senator CONROY—Bearing in mind that we have got only 20 minutes, can you explain the working relationship between the FRC and the AASB? For example, how often do you meet?

Prof. Boymal—I attend every FRC meeting—

Senator CONROY—They just had one. Were you—

Prof. Boymal—They had one last Friday.

Senator CONROY—You were not overseas then?

Prof. Boymal—No, I went on Saturday. I attend every FRC meeting. I have all of their agenda papers. I am at the table; I can speak on any issue and any topic; I do not have a vote. In practical terms, other than not voting, I act—

Senator CONROY—And you liaise with them on an ongoing basis?

Prof. Boymal—I liaise very frequently with the chairman, Charles Macek, and, when needed, with the secretariat, which is the Treasury. I would say that the relationship between the AASB and the FRC is a good, healthy working relationship at this point in time.

Senator CONROY—Keith Alfredson advised the committee that when the decision to adopt international accounting standards was taken 'the whole process lacked robust and formal consultation'. We have had quite a debate. You might want to get a briefing from Ms Stoddart or perhaps, to help you sleep tonight or over the next few nights, see if you can get a copy of the *Hansard* to help send you to sleep. He also said that the decision to adopt IAS by 2005:

... was made without any FRC paper that firmly debated the issues or all of the arguments in favour and against.

Mr Macek accepted that it was the case that there was at most 48 hours notice, and probably less, that this was on the agenda and that there was no significant paper put before the FRC before it made its announcement. He did concede that there was a robust discussion, but that is where it went. Do you believe that was a satisfactory process?

Prof. Boymal—On the basis of the way you have described it, I would say no.

Senator CONROY—I was not trying to put words in your mouth.

Prof. Boymal—As described, I could not agree that that was a satisfactory process.

Senator CONROY—Do you think the FRC should meet in public?

Prof. Boymal—I see no reason why they should not. The AASB meets in public. We have to be careful we do not issue profanities and that sort of thing—

Senator CONROY—If I can manage it, anyone can manage it!

Prof. Boymal—Indeed. We are not bothered by meeting in public, and therefore I can see no harm whatsoever in the FRC also meeting in public.

Senator CONROY—I had a discussion of some length with Mr Macek about this. Some funds were released by the government and the stock exchange to the FRC. Senator Ian Campbell outlined at Senate estimates that he approached the ASX about the release of these funds, but that was contingent on some conditions. I think there was actually a letter. I am sure some people in the room have a better recollection than me on this, but there was a letter written by the ASX to the FRC outlining the conditions, so I was surprised that the then deputy chair, and now chair, was not aware of the conditions under which that money was forwarded—that is, that international accounting standards be adopted by the FRC by 2005. That was the stated condition in the letter, so I was a bit surprised that Mr Macek could not remember that. Were those funds released to the FRC, as far as you are aware?

Prof. Boymal—Yes, those funds were released. I know that because the FRC does not have a bank account. The Australian Accounting Standards Board receives the money and acts as trustee for the FRC, so the money went into our bank account.

Senator CONROY—What did you do with it?

Ms Stoddart—It is earning interest.

Senator CONROY—Is that why you have all been touring the world? The whole board has been out there visiting every jurisdiction except Botswana!

Prof. Boymal—You have caught me! A considerable amount of that money is still in a bank account.

Senator CONROY—How much is 'considerable'? For the record, what was the total amount you received?

Prof. Boymal—Some of it was before my time, but I believe it was $2 million.

Senator CONROY—I also thought that it was $2 million. How much do you have left?

Prof. Boymal—I think we have $1.3 million or something in that vicinity in the bank at the moment. The reason for that is that some of that money was intended to be Australia's donation to the International Accounting Standards Board. That has not all been paid over to the IASB because of our disenchantment at the time they took to resolve this royalty question. The FRC resolved not to pay any more of the money to the International Accounting Standards Board until the royalty matter was finally resolved to our satisfaction. Some of the money would also have been used for the operations of the Australian Accounting Standards Board itself.

Senator CONROY—That is all I have. Thank you very much.

ACTING CHAIR—Thank you very much for your attendance.

Committee adjourned at 3.49 p.m.