Across the Board news

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REGULATION

¶1269 Companies not delisting because of corporate law

A research report published by The University of Melbourne's Centre for Corporate Law and Securities Regulation claims that while a significant number of companies continue to delist from the Australian Stock Exchange (ASX), corporate law reforms are not the main reason.

According to the University of Melbourne study, significant concern exists in the United States that the costly corporate law reforms introduced by the Sarbanes-Oxley Act of 2002 (SOX) are causing companies to delist and no longer be required to file information with stock exchanges and the US Securities and Exchange Commission (SEC). The study sought to see if a similar situation is happening in Australia.

The study, authored by Professor Ian Ramsay and Nicholas Lew, found that in the United States, the principal cause of increased compliance costs has been s 404 of SOX. This section requires annual reports to contain an internal control report setting out management's responsibility for establishing and maintaining an adequate internal control structure and procedures for financial reporting. The effectiveness of the internal control structure must be assessed by management and attested to by external auditors.

In a survey of 147 US public companies by Foley & Lardner, 70% of the companies felt overall company administrative costs increased a “great deal” as a result of SOX and other corporate governance reforms and 82% felt the reforms had been too strict. According to a survey of 217 public companies by Financial Executives International, nearly all companies (94%) thought the costs of s 404 compliance exceeded its benefits.

According to the study, as a result, a growing number of public companies in the US have sought to delist. Some 39% of the companies that went private in 2004 (44 of 114) cited SOX compliance costs as a reason for doing so.

Also, 20% of public companies surveyed in 2005 by Foley & Lardner were considering going private — compared to 21% in 2004 and 13% in 2003. Most of the companies within the 20% were small in size and all said that the disclosure reforms were too strict.

While Australia has introduced corporate law reforms in recent years — including the CLERP reforms — the study noted that these reforms have not been as extensive as SOX and Australia has not introduced an equivalent to s 404 of SOX. Australian corporate law reforms would therefore seem not as expensive to comply with as SOX and companies listed on ASX may not have the same incentive to delist as some US companies.

Researchers at the Centre for Corporate Law and Securities Regulation examined all delistings from the ASX for the 30-year period 1975 to 2004. There were 5,952 delistings during this period.

The study found the main reasons for delisting are: name changes (40% of all delistings); being acquired (19%); capitalisation changes (19%); and failure to pay listing fees (8% — typically because of the company being in financial difficulty). There was no evidence that companies are delisting because of corporate law reforms or excessive reporting requirements. There was a small number of delistings (23) where the company delisting stated that the cost of being listed exceeded the benefits.

The study found that the extent of delisting has been increasing each decade for the past three decades and is the equivalent of more than one whole board being turned over each decade. On average, 150% of the ASX board delists each decade. The extent of delisting decreases significantly if capitalisation changes and name changes are excluded from the analysis (60% each decade).

In a bid to examine the extent of the situation among large companies, the Top 150 ASX companies were examined for the period 1990–2005 in a separate analysis. Some 80% of the Top 150 companies in 1990 had delisted by 2005. Excluding delistings attributed to capitalisation changes and name changes, 62% of the Top 150 companies in 1990 had delisted by 2005.

The study found that the length of time companies are listed on the ASX before delisting was a mean of eight years and the median was four years. Some 50% of companies that delisted did so within their first four years of trading and another 22% delisted within the next five years. This means a total of 78% of companies that delisted did so within nine years of listing.

When delistings attributed to capitalisation and name changes are excluded from the sample, the mean is 10 years and the median is five years. Some 45% of companies which delisted did so within their first four years of trading and another 28% delisted within the next five years (ie a total of 73% within nine years of listing).

In conclusion, the study's authors found that companies were not delisting because of corporate law reforms but despite this the extent of delisting is high — for both large and small companies — and companies that delist tend not to be listed for extended periods of time (the mean is eight years and the median is four years). Some 78% of companies that delisted did so within nine years of listing.

Source: Centre for Corporate Law and Securities Regulation, The University of Melbourne, media release, 21 November 2006.

PUBLIC SECTOR

¶1270 Government cleared of charges, 12 executives face prosecution

Criminal charges may be laid against 12 executives from AWB and other companies involved in the scandal surrounding the UN Oil-for-Food program. However, the Cole Report has cleared all federal government officials of wrongdoing.

The inquiry found AWB misled the United Nations and took every effort to disguise the existence of $300 million paid to the Iraqi regime in kickbacks.

The report, tabled yesterday, has been seized on by the federal government as evidence that no minister was involved in any wrongdoing in relation to the affair.

However, the federal Opposition continues to maintain that the parameters of the inquiry were too narrow, making it impossible for criminal charges to be laid against any government minister.

In a press conference yesterday, Prime Minister John Howard said that from the beginning the process surrounding the inquiry conducted by Commissioner Terence Cole had been open and transparent.

> “The Government has hidden nothing. Almost without precedent ... I appeared, the Foreign Minister appeared, the Trade Minister appeared at the inquiry, we answered questions under oath and we were cross-examined and we were fully accountable with the same rules applying to us as apply to any citizen that is called to give oath before a court.
>
> “We didn’t have anything to hide and the Commissioner has found that there was no wrongdoing on the part of any of my ministers. And I am particularly pleased that Mr Downer and Mr Vaile, who’ve been subjected for the last year to abuse and character assassination by members of the Labor Party, they’ve been accused of dishonesty, of negligence, of incompetence, of cover-ups, of condoning bribes and of turning a blind eye; and the Commissioner after months of exhaustive examination bringing all the forensic skills that an outstanding lawyer can bring to something like this, has not found any evidence to support those allegations.”

He said that while he did not expect it to happen, the Opposition owed the government an apology.

> “Mr Downer and Mr Vaile are owed apologies by Mr Beazley and Mr Rudd. I am naturally, like everybody else, concerned at the findings of the inquiry in relation to the activities of the company.”

He promised that there would be swift action in pursuing the possibility of laying criminal charges against the 12 individuals named in the report.

> “It will be for the law enforcement authorities to decide whether those prosecutions go forward, it is not for me to comment on whether or not they should occur. But at every turn this government has been transparent. No country in the world established such a transparent investigation as did this country.”

The Opposition leader, Kim Beazley, responded to the report by noting that the government had received 35 warnings of suspicious behaviour by AWB that should have alerted officials to the possibility that the Oil-for-Food program was being rorted.

He said that if the Cole Inquiry had possessed the full terms of a Royal Commission, Commissioner

Cole would have been able to assess the competence of the government's actions around the issue. As it was, the Cole report only cleared the government of criminal negligence.

> He told ABC Radio: "They were getting warnings, the question of whether they should have listened to those warnings and should have been more diligent in upholding their obligations.
>
> "We will not know because this inquiry was not permitted to take a look at that."

Mr Beazley maintained that far from having to apologise to government ministers that were required to appear before the Cole Inquiry, the Australian Government should be apologising to Australian servicemen and women who may have been shot at by bullets bought by funds funnelled through AWB.

Sources: Press conference held by Prime Minister John Howard, 27 November 2006; interview with Kim Beazley by ABC Radio, 27 November 2006.

OVERSEAS NEWS

¶1271 Auditor independence requirements get international tick

The Parliamentary Secretary to the Treasurer, Chris Pearce, has released a comparative review of the Australian Auditor Independence Requirements, which finds that Australia's requirements compare well internationally.

> "The comparative review compares the Australian requirements with those in Canada, the European Union, the United Kingdom and the United States", Mr Pearce said.

He said that the globalisation of capital markets, and the cross-border activities of companies and audit firms, made it essential that the design of the regulatory framework in Australia's jurisdiction takes account of developments in other jurisdictions.

> "The overall conclusion of the comparative review, which was prepared by the Treasury, is that, despite differences in terminology, institutional arrangements and legal frameworks, there is a substantial underlying equivalence between the Australian requirements and international best practice standards."

He said that while the comparative review does not attempt to make policy recommendations, several of the key findings are directly relevant to the Australian Government's commitment to simplifying the regulatory system and reducing excessive red tape.

> However, he added: "There may be scope, in line with overseas developments, to refine the existing auditor independence requirements. This would reduce the compliance burden, without changing or weakening our existing robust regulatory framework."

He said that with this in mind, Treasury's comparative review will contribute to informing the policy debate in Australia on auditor independence issues among key stakeholders.

> "Treasury will conduct a targeted consultative process with key stakeholders, including the Australian Securities and Investments Commission, the Financial Reporting Council, the major audit firms and the three main professional accounting bodies", Mr Pearce said.

Mr Pearce encouraged other interested people to comment on the key findings in the comparative review, which is available at www.treasury.gov.au.

> "I will also consult with stakeholders to identify any additional measures that could be included in my Simpler Regulatory System Bill, which is scheduled to be introduced into Parliament in 2007", Mr Pearce added.

Source: Media release by Chris Pearce, 15 November 2006.

¶1272 Board members concerned about use of complex financial instruments

Three-quarters of board members of US financial services firms said that the increasing use of sophisticated financial instruments such as derivatives was looming as the next big area of regulatory focus for the industry, according to a survey of financial services board members conducted by PricewaterhouseCoopers.

Some 97% of board members said that the level of due diligence and understanding of sophisticated financial instruments being used in the market should be a major concern for boards.

The survey was conducted last month at PricewaterhouseCoopers' 2006 Financial Services Audit Committee Forum in New York. Approximately 300 board members attended, representing a cross-section of the financial services industry, including the banking, brokerage, investment management, insurance and real estate sectors.

Succession planning also was identified as a strategic area that may need greater board focus. While six in ten boards have recognised that succession planning for the executive management team is a board priority and should be a board-led initiative, only about one-quarter (28%) have actually approved a succession plan.

> "Over the past three years, board members have had to focus more of their attention on compliance issues rather than strategic business matters", chairman of the US Financial Services Industry Practice of PricewaterhouseCoopers, Timothy F Ryan, said. "But we are seeing boards making it a priority to spend more time on other important areas, including ways to gain market share in fast-growing markets and other key strategic business matters."

When asked where they have been focusing their attention some 73% of board members of US financial services firms report that they have been spending less time on strategic business issues than on compliance-related matters.

Some 51% said that the time devoted to compliance is beginning to decrease as they become more knowledgeable of the new requirements. However, 61% said that the lack of knowledgeable board members willing and able to serve is a challenge, particularly to the audit committee.

US board members said executive compensation is an area board members identified as needing more of their attention. Seven in 10 survey respondents do not think that audit committee members spend enough time and energy working with the compensation committee on this thorny subject. Nearly one-quarter (23%) said that compensation disclosures make them question the audit committee's ability to definitively sign off on required filings to the Securities and Exchange Commission.

The survey also found that six in 10 board members feel that the increased responsibilities, risk and accountability they have taken on in recent years is not adequately reflected in the compensation they receive.

While six in 10 of those surveyed felt that the insurance for the company's directors and officers is sufficient to address any potential lawsuits they may face as a board member, nearly four in 10 (37%) are nervous that they have assumed personal risk by serving on the board. More than half feel that their compensation does not adequately address the time they now spend on board-related matters.

The survey found that boards of financial services firms are actively engaged in expanding into new markets and adapting and planning for the impact of major market events. Nearly a third (32%) said they are working with management to prepare for a major market downturn. Twenty-two percent are investigating ways to gain market share in emerging countries or fast-growing markets such as

China and India.

Source: PWC US media release, 1 November 2006.

RISK MANAGEMENT

¶1273 Study finds companies only just waking up to privacy and data risks

Companies are only now starting to wake up to the need to invest in privacy and data protection, according to the ninth Ernst & Young Global Information Security survey of 1,200 public and private sector organisations in 48 countries.

The study found that in spite of the growing number of high profile cases spelling out the dangers and risks of mismanaging personal data, this is the first time organisations have proactively cited privacy and data protection as a significant issue in the study's nine-year history.

The study also found that over three-quarters of respondents said in the past they have invested most of their time, money and resources into formalising procedures for the capturing, storage and sharing of company, client and customer data, and would continue to do so in the future.

Head of Technology and Security Risk Services at Ernst & Young, Richard Brown, said: "Businesses are only just waking up to the dangers of having little or no privacy policy in place for managing sensitive data. The tipping point appears to be growing consumer concern and awareness — identity theft, loss of personal data, phishing attacks and other data infringements are no longer things you just hear about, they have probably happened to someone you know.

> "This intensifying pressure from the consumer to address privacy has forced companies to re-evaluate their data risk practices and procedures, particularly in the financial services sector."

He added that managing privacy could prove to be difficult in an organisation's primary country or region; however, when dealing with the issue at a global level and across multiple jurisdictions it could become much more complex.

The Ernst & Young study also found that while many organisations are beginning to understand the investment required to get their own houses in order, they are still failing to manage third party risk. Around 55% of companies admitted to having no formal agreements in place with their third party suppliers for the second year running.

> "In the last two years there has been little or no effort by organisations to address the risks associated with sharing data with a third party. A security breach in a third party partner could be enough to bring an organisation down and many more businesses will get burnt if this does not get better", Mr Brown said.

Mr Brown concluded that information security is an issue not just related to tackling computer crime but it is also about mitigating the risks to business, investors, customers and other stakeholders.

The study also found that whilst many organisations have business continuity plans, only half have actually tested these plans, one-third have not agreed recovery timescales with the business, and less than half have communication strategies in place.

Source: Ernst & Young media release, 14 November 2006.

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