



# Parliamentary Joint Committee on Corporations and Financial Services

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Statutory Oversight of the Australian Securities and  
Investments Commission, the Takeovers Panel and  
the Corporations Legislation  
Report No. 1 of the 45th Parliament

February 2019

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# **Recommendations**

## **Recommendation 1**

**2.79** The committee recommends that ASIC devise and conduct, alongside or within its current Audit Inspection Program, a study which will generate results which are comparable over time to reflect changes in audit quality.

## **Recommendation 2**

**3.63** The committee recommends that ASIC work with the International Organisation of Securities Commissions to conduct a comparative analysis of integrity and anti-corruption measures being undertaken in similar jurisdictions.





# Chapter 1

## Introduction and Background

### Duties of the committee

1.1 The Parliamentary Joint Committee on Corporations and Financial Services (the committee) is established by Part 14 of the *Australian Securities and Investments Commission Act 2001* (the ASIC Act). Section 243 of the ASIC Act sets out the committee's duties as follows:

- (a) to inquire into, and report to both Houses on:
- (i) activities of ASIC or the [Takeovers] Panel, or matters connected with such activities, to which, in the Parliamentary Committee's opinion, the Parliament's attention should be directed; or
  - (ii) the operation of the corporations legislation (other than the excluded provisions); or
  - (iii) the operation of any other law of the Commonwealth, or any law of a State or Territory, that appears to the Parliamentary Committee to affect significantly the operation of the corporations legislation (other than the excluded provisions); or
  - (iv) the operation of any foreign business law, or of any other law of a foreign country, that appears to the Parliamentary Committee to affect significantly the operation of the corporations legislation (other than the excluded provisions); and
- (b) to examine each annual report that is prepared by a body established by this Act and of which a copy has been laid before a House, and to report to both Houses on matters that appear in, or arise out of, that annual report and to which, in the Parliamentary Committee's opinion, the Parliament's attention should be directed; and
- (c) to inquire into any question in connection with its duties that is referred to it by a House, and to report to that House on that question.<sup>1</sup>

### Conduct of the inquiry

1.2 The committee advertised this oversight inquiry on its webpage and held the following public hearings:

- 25 November 2016 in Sydney;
- 16 June 2017 in Canberra;
- 11 August 2017 in Mascot, NSW;
- 27 October 2017 in Sydney;

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1 *Australian Securities and Investments Commission Act 2001*, s. 243.

- 1 December 2017 in Canberra;
- 16 February 2018 in Mascot, NSW;
- 17 August 2018 in Melbourne;
- 18 October 2018 in Canberra; and
- 19 October 2018 in Canberra.

1.3 A list of witnesses who gave evidence at the public hearings is detailed in Appendix 1. The committee also received a number of private briefings. Details of the inquiry and associated documents including the *Hansard* transcripts of evidence may be accessed through the committee webpage.

1.4 The committee thanks all those who assisted with the inquiry, especially the witnesses who put in extra time and effort to answer written questions on notice and provide further valuable feedback to the committee as it gathered evidence.

1.5 References to the committee *Hansard* are to the proof *Hansard*. Page number may vary relative to the official *Hansard*.

## **Background**

1.6 The performance of the Australian Securities and Investments Commission (ASIC) as the regulator for financial conduct and consumer protections, particularly since the Global Financial Crisis (GFC), has been the subject of much debate and inquiry. While not comprehensive, the committee notes that reports into ASIC's functions and conduct have been undertaken by this committee, the Senate Economics References Committee and, most recently, the Financial Services Royal Commission.

### ***Parliamentary Joint Committee on Corporations and Financial Services***

1.7 In previous parliaments, this committee has presented a number of ASIC oversight reports on various issues, including:

- audit quality;<sup>2</sup>
- emergent behaviours, such as high-frequency trading and dark pools, which have the potential to result in insider trading and market manipulation;<sup>3</sup>
- penalties;<sup>4</sup> and

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2 Parliamentary Joint Committee on Corporations and Financial Services, *Statutory Oversight of the Australian Securities and Investments Commission*, No. 2 of 43<sup>rd</sup> Parliament, May 2013; and Parliamentary Joint Committee on Corporations and Financial Services, *Statutory Oversight of the Australian Securities and Investments Commission: the role of gatekeepers in Australia's financial services system*, No. 3 of 43<sup>rd</sup> Parliament, July 2013.

3 Parliamentary Joint Committee on Corporations and Financial Services, *Statutory Oversight of the Australian Securities and Investments Commission, the Takeovers Panel and the Corporations Legislation*, Report No. 1 of the 44<sup>th</sup> Parliament, November 2014; and Parliamentary Joint Committee on Corporations and Financial Services, *Statutory Oversight of the Australian Securities and Investments Commission*, No. 2 of 43<sup>rd</sup> Parliament, May 2013.

- gatekeepers in the financial services system.<sup>5</sup>

### ***Senate Economics References Committee***

1.8 The Senate Economics References Committee released a comprehensive report in June 2014 on its inquiry into the *Performance of the Australian Securities and Investments Commission*. The report contained 61 recommendations, including Recommendation 52, relating to the committee's oversight role:

The committee notes that the Parliamentary Joint Committee on Corporations and Financial Services could be well-placed to monitor ASIC's performance against the government's statement of expectations and ASIC's statement of intent. The committee recommends that the Parliamentary Joint Committee consider this as part of its statutory ASIC oversight function.<sup>6</sup>

1.9 The report also queried whether the committee could pivot its oversight function towards emerging risks with a view to limiting the number of minor issues that become major scandals.<sup>7</sup>

### ***Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry***

1.10 The Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (the Royal Commission) was established on 14 December 2017.

1.11 Its interim report (released on 28 September 2018) documented a range of misconduct across the financial services sector that affected hundreds of thousands of customers. The interim report was critical of ASIC's efforts to address such an extensive range of misconduct under its regulatory regime.<sup>8</sup>

1.12 The final report (released on 4 February 2019) noted that ASIC's remit is very large and has greatly increased since ASIC was first established.<sup>9</sup> The final report argued for a change in the enforcement culture within ASIC so that all forms of

4 Parliamentary Joint Committee on Corporations and Financial Services, *Statutory Oversight of the Australian Securities and Investments Commission, the Takeovers Panel and the Corporations Legislation*, Report No. 1 of the 44<sup>th</sup> Parliament, November 2014.

5 Parliamentary Joint Committee on Corporations and Financial Services, *Statutory Oversight of the Australian Securities and Investments Commission: the role of gatekeepers in Australia's financial services system*, No. 3 of 43<sup>rd</sup> Parliament, July 2013.

6 Senate Economics References Committee, *Performance of the Australian Securities and Investments Commission*, June 2014, p. 426.

7 Senate Economics References Committee, *Performance of the Australian Securities and Investments Commission*, June 2014, p. 426.

8 Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, *Interim Report*, September 2018, pp. 271–280.

9 Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, *Final Report*, January 2019, vol. 1, p. 421.

regulatory enforcement, including litigation, remain under active consideration when considering misconduct.<sup>10</sup> The final report emphasised that 'adequate deterrence of misconduct depends upon visible public denunciation and punishment'.<sup>11</sup> It also recommended that enforcement staff be separated, as much as possible, from non-enforcement related contact with regulated entities.<sup>12</sup>

1.13 The Royal Commission also noted that the joint committee is the principal external oversight body of ASIC but that parliamentary oversight has limitations:

Parliamentary oversight of ASIC and APRA [Australian Prudential Regulation Authority] is essential. It is essential because although broadly independent, regulators form part of the executive government and are therefore accountable to the legislature. But parliamentary oversight necessarily has some limitations. Those limitations include the amount of time that can be devoted to a particular entity or topic, the time available to committee members to prepare for the hearings and the training, skill and experience of the members of the committee, who will sometimes need to review and assess complex information on matters of expertise.<sup>13</sup>

1.14 That said, ways to improve the committee's parliamentary scrutiny of ASIC were discussed:

Mr Shipton [Chairman of ASIC] acknowledged that the current arrangements for parliamentary scrutiny of ASIC could be improved. He suggested that ASIC could develop frameworks, metrics and methodologies for review of its performance. The Joint Committee could then review ASIC's performance against the agreed benchmarks.<sup>14</sup>

1.15 The insights and recommendations of the reports of the Royal Commission have implications for ASIC's role and functions, and by extension, for the committee's oversight of ASIC. The committee intends to explore the issues raised by the Royal Commission in more detail during the next parliament.

1.16 The committee was informed by ASIC that its workload has increased significantly due to matters the subject of or arising out of the Royal Commission. ASIC also noted that it expects there to be an 82 per cent increase in the amount of work going from ASIC to the Commonwealth Director of Public Prosecutions.<sup>15</sup>

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10 Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, *Final Report*, January 2019, vol. 1, pp. 426–7.

11 Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, *Final Report*, January 2019, vol. 1, p. 433.

12 Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, *Final Report*, January 2019, vol. 1, p. 446.

13 Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, *Final Report*, January 2019, vol. 1, pp. 472–3.

14 Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, *Final Report*, January 2019, vol. 1, p. 473.

15 Mr Daniel Crennan QC, Deputy Chair, Australian Securities and Investments Commission, *Committee Hansard*, 19 October 2018, p. 40.

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## **Focus of this report**

1.17 This report fulfils the committee's statutory oversight duties in respect of paragraph (a) of section 243 of the ASIC Act.

1.18 Extensive attention has been devoted to ASIC's functions and conduct since the GFC. With the finalisation of the Royal Commission, the committee considers that its oversight role is more important than ever.

1.19 This report focuses on some of the areas of ASIC's role which the committee considers have not been given adequate attention throughout recent investigations—that is, concerns about audit quality and integrity.

1.20 The report also considers whether the Takeovers Panel is working effectively.

## **Structure of the report**

1.21 The report is structured as follows:

- chapter 1 provides information about the oversight process and outlines the scope of the report;
- chapter 2 considers audit quality and ways in which it may be improved;
- chapter 3 examines ASIC's integrity measures; and
- chapter 4 reflects on the conduct of the Takeovers Panel.



# Chapter 2

## Audit quality

2.1 This chapter explores the ongoing concerns that the committee has with the quality of company auditing, particularly for large businesses. Given the relatively small number of companies that can undertake audits for large business, reasonable concerns about conflicts of interest are examined.

### **The function of auditing**

2.2 A principal/agent problem exists with the corporate form of business. As Adam Smith recognised, a corporation using and managing other people's money could not be trusted to be as prudent with that money as they would be if it were their own.<sup>1</sup>

2.3 In addition, a profound and unavoidable asymmetry of information exists between the management of a company and the investors, or potential investors, in it. Of necessity, management has access to far more detailed information about the company and its operations than an ordinary investor can hope to have.

2.4 These are problematic issues not just for individual investors but also for the existence of open, fair and efficient markets and, ultimately, for capitalism itself. If investors do not have access to accurate, risk-weighted information about the prospects of a firm, the risks of corporate collapse may remain undisclosed and investors may be unable to make fully informed and rational investment decisions.

2.5 In the final analysis, if investors cannot properly assess the value of firms and investments, there is a risk of systemic failure, as happened in the Global Financial Crisis (GFC).

2.6 The function of an audit is to provide an independent review of the financial statements and compliance plans of the company or financial entity and certify that they are a true and fair view of the business. By rigorously examining corporate accounts, an audit should expose false accounting and detect business risks and potentially serious problems, thereby presenting an accurate picture of business fundamentals and reducing the asymmetry of information between the management of a company and investors.

2.7 This chapter begins by considering the core objectives for regulators in a 'light touch' regulatory system, the requirements of auditors, Australia's auditing arrangements, and concerns about the auditing system. It then considers various limitations of the auditing system including the inherent difficulties of the task, the structure of the industry, and associated conflicts of interest. The chapter concludes by canvassing some of the options for improving audit quality.

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1 Adam Smith, *An inquiry into the nature and causes of the wealth of nations*, 1776, p. 311.

## A light touch system of regulation

2.8 The three core objectives for regulators defined by the International Organization of Securities Commissions (IOSCO) are:

- the protection of investors;
- ensuring that markets are fair, efficient and transparent; and
- the reduction of systemic risk.<sup>2</sup>

2.9 There can be a tension within the regulatory system for corporations between, on the one hand, promoting efficient, open and flexible markets in order to attract capital, create wealth, stimulate growth, and promote Australia as a global financial centre, and, on the other hand, the degree of regulation—which is intended to constrain behaviour—necessary to protect investors (particularly retail investors).<sup>3</sup>

2.10 Since the market-oriented reforms of the 1980s, Australia, like other English speaking countries, has opted for 'light touch' regulation. Consequently, it has relied on market forces to ensure honest behaviour towards shareholders and consumers.

2.11 The auditing arrangements described in the following sections form part of the gatekeeper framework of 'light touch' regulation in the financial services sector. The key gatekeepers in the financial services system include financial planners and financial advisers, custodians, research houses, trustees, responsible entities, directors, and auditors. The various gatekeepers have particular roles and responsibilities, exercised both separately and, in some instances, in concert.

2.12 At the outset, it is worth noting that auditors play a critical and unique role in the gatekeeper system. As has been previously recognised, gatekeepers such as financial planners and financial advisers, custodians, research houses, trustees, and responsible entities may all be part of large corporate conglomerates. By contrast, auditors should be external parties that stand alone. Their independence is essential to the proper functioning of the system. And yet, as this chapter reveals, this notion of independence is under question.

## Requirements of auditors

2.13 Under section 307 of the *Corporations Act 2001* (Corporations Act), it is the auditor's responsibility to form an opinion about whether:

- the financial report being audited or reviewed complies with accounting standards and gives a true and fair view of the financial position and performance of the entity;

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2 International Organization of Securities Commissions, *IOSCO objectives*, [https://www.iosco.org/about/?subsection=about\\_iosco](https://www.iosco.org/about/?subsection=about_iosco) (accessed 12 February 2019).

3 See evidence from Dr George Gilligan in Parliamentary Joint Committee on Corporations and Financial Services, *Statutory oversight of the Australian Securities and Investments Commission*, March 2012, p. 4.



- 
- the auditor has been given all information, explanation and assistance necessary for the conduct of the audit;
  - the entity has kept financial records sufficient to enable a financial report to be prepared and audited; and
  - the entity has kept other records and registers required by the Corporations Act.<sup>4</sup>

2.14 The Auditing and Assurance Standards Board (AUASB), whose function is described below, has developed guidance as to how an auditor should operate. An auditor requires:

- independence;
- professional scepticism;
- professional judgement; and
- sufficient appropriate information on which to base an opinion with an acceptable level of risk.<sup>5</sup>

### **Australia's auditing arrangements**

2.15 Auditing standards in Australia are governed by the *Corporations Act 2001*. Audits must be conducted in accordance with legally enforceable auditing standards that were introduced for financial reporting periods from 1 July 2006 following the *Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Act 2004* (CLERP 9).

2.16 Australia's financial reporting system is established by Part 12 of the *Australian Securities and Investments Commission Act 2001* (the ASIC Act). One of the main objects of section 224 of the ASIC Act is to develop auditing and assurance standards that:

- provide Australian auditors with relevant and comprehensive guidance in forming an opinion about, and reporting on, whether financial reports comply with the requirements of the Corporations Act; and
- require the preparation of auditors' reports that are reliable and readily understandable by the users of the financial reports to which they relate.<sup>6</sup>

2.17 The AUASB is established by section 227 of the ASIC Act. It is under the strategic direction of the Financial Reporting Council (FRC), the body responsible for overseeing the effectiveness of the financial reporting framework. The AUASB is

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4 Australian Securities and Investments Commission, *Auditor independence and audit quality*, <https://asic.gov.au/regulatory-resources/financial-reporting-and-audit/auditors/auditor-independence-and-audit-quality/> (accessed 12 February 2019).

5 Auditing and Assurance Standards Board, *Auditing Standard ASA 200 Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Australian Auditing Standards*, December 2015, paras 14–17.

6 *Australian Securities and Investments Commission Act 2001*, ss. 224(aa).

responsible for developing Australian Auditing Standards, which in turn are based on the International Standards on Auditing.<sup>7</sup> Where there are gaps in the international framework, the AUASB develops principles-based domestic standards and guidance.<sup>8</sup>

2.18 Audit processes are overseen by ASIC. ASIC registers individuals as company auditors, and conducts inspections of audit firms, including, where appropriate, inspecting audit files and company financial reports.<sup>9</sup> The professional accounting bodies, including Chartered Accountants Australia and New Zealand, CPA Australia and the Institute of Public Accountants, enforce professional standards.<sup>10</sup>

2.19 The FRC receives information from these bodies on the quality of audits, what initiatives are being taken to ensure a high standard of auditing, and what changes to standards are necessary. It provides strategic advice to government on audit quality.<sup>11</sup>

### ***ASIC's audit inspection program***

2.20 ASIC is responsible for the surveillance, investigation and enforcement of the financial reporting and auditing requirements of the Corporations Act. As noted in ASIC's report for 2009–10, the aim of ASIC's audit inspection program is to:

...promote high quality external audits of financial reports of listed entities and other public interest entities so that users can have greater confidence in these financial reports and Australia's capital markets.<sup>12</sup>

2.21 ASIC states that its audit firm inspections and auditor surveillances are 'key compliance tools aimed at educating and influencing the behaviour of registered company auditors and audit firms'.<sup>13</sup> Its focus is on 'audit quality and promoting compliance with the requirements of the Corporations Act, Australian auditing standards, and Australian accounting professional and ethical standards'.<sup>14</sup>

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7 Strategic Direction issued by the Financial Reporting Council to the Auditing and Assurance Standards Board on 6 April 2005, published in Auditing and Assurance Standards Board, *AUASB Functions and Processes*, September 2014, p. 5.

8 Professor Roger Simnett, Chair, Auditing and Assurance Standards Board, *Committee Hansard*, 16 February 2018, p. 13.

9 Mr John Price, Commissioner, Australian Securities and Investments Commission, *Committee Hansard*, 16 February 2018, p. 11.

10 Mr William Edge, Chair, Financial Reporting Council, *Committee Hansard*, 16 February 2018, p. 12.

11 Mr William Edge, Chair, Financial Reporting Council, *Committee Hansard*, 16 February 2018, p. 12.

12 Australian Securities and Investments Commission, *Report 242—Audit inspection program public report for 2009–10*, June 2011, p. 6.

13 Australian Securities and Investments Commission, *Audit inspection and surveillance programs*, <https://asic.gov.au/regulatory-resources/financial-reporting-and-audit/auditors/audit-inspection-and-surveillance-programs/> (accessed 12 February 2019).

14 Australian Securities and Investments Commission, *Report 242—Audit inspection program public report for 2009–10*, June 2011, p. 6.

2.22 ASIC reports on its audit inspection programs for an eighteen month period. It uses a risk-based method to select firms, engagement files, and audit areas for review.<sup>15</sup>

### ***Enforcement***

2.23 ASIC has enforcement powers, which it appears to have used sparingly, against auditors where deficiencies are found in their work. In the six years to February 2018, ASIC took action against 20 registered company auditors and 33 self-managed superannuation fund auditors. In 2016, ASIC cancelled the registration of 133 self-managed superannuation fund auditors who had not lodged annual statements with ASIC after repeated reminders.<sup>16</sup>

### **Concerns about audit quality**

2.24 For some years now the committee has been commenting about the quality of auditing, generally echoing concerns raised by ASIC.

2.25 In evidence to the committee in 2012, the then ASIC Chairman, Mr Greg Medcraft, stated that 15 per cent of audit files reviewed in the 2009–10 report on its audit inspection program had 'inadequate evidence to support an audit opinion'.<sup>17</sup>

2.26 At that time, Mr Medcraft expressed considerable disappointment and frustration that the audit quality inspection results were so poor. Mr Medcraft was firmly of the view that the number of audit files with insufficient evidence to support an audit opinion should be substantially less than 10 per cent.<sup>18</sup>

2.27 The issue of audit quality was thrown into sharp relief with the collapse of Trio Capital in 2010 and the collapse of Victorian debenture issuer, Banksia Securities Limited (Banksia), in October 2012.<sup>19</sup>

2.28 Mr Medcraft drew the committee's attention to the fact that the auditors had signed off the accounts of Banksia in September 2012, only a few weeks before the group collapsed.<sup>20</sup>

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15 Australian Securities and Investments Commission, *Audit inspection program report for 2017–18*, p. 2.

16 Mr John Price, Commissioner, Australian Securities and Investments Commission, *Committee Hansard*, 16 February 2018, p. 11.

17 Mr Greg Medcraft, Chairman, Australian Securities and Investments Commission, *Committee Hansard*, 3 December 2012, p. 15.

18 Mr Greg Medcraft, Chairman, Australian Securities and Investments Commission, *Committee Hansard*, 3 December 2012, p. 15.

19 See, for example, Parliamentary Joint Committee on Corporations and Financial Services, *Statutory oversight of the Australian Securities and Investments Commission*, No. 1 of 43<sup>rd</sup> Parliament, February 2013, p. 15.

20 Mr Greg Medcraft, Chairman, Australian Securities and Investments Commission, *Committee Hansard*, 3 December 2012, p. 21 cited in Parliamentary Joint Committee on Corporations and Financial Services, *Statutory oversight of the Australian Securities and Investments Commission*, No. 1 of 43<sup>rd</sup> Parliament, February 2013, p. 18.

2.29 In the committee's inquiry into Trio Capital in 2012, both regulators and investors expressed frustration at the role of Trio Capital's financial statement and compliance plan auditors, particularly their inability to verify information.<sup>21</sup>

2.30 As part of its report into Trio Capital, the committee endorsed 'ASIC's forward program to improve the rigour of compliance plans, the auditing of these plans and the composition and governance of compliance committees'.<sup>22</sup>

2.31 However, the audit quality results in ASIC's inspection report for 2011–12 represented a further decline in auditing standards from those that ASIC had previously reported. In 2011–12, ASIC found that in 18 per cent of the 602 key audit areas that it reviewed across 117 audit files over firms of all sizes, auditors did not:

- obtain sufficient appropriate audit evidence;
- exercise sufficient scepticism; or
- otherwise comply with auditing standards in a significant audit area.<sup>23</sup>

2.32 Commenting on the findings from the 2011–12 report, Mr Medcraft stated that there was clearly a lack of professional scepticism that pointed to a cultural problem in the audit profession. Mr Medcraft expressed the view that unless the audit industry improved its standards, measures such as audit firm rotation would need to be considered.<sup>24</sup>

2.33 In a later report, the committee remarked that ASIC had put auditing firms on notice regarding the quality of financial statement audits, and noted the development by the biggest six audit firms in Australia to action plans to improve audit quality. This was in response to a request from ASIC that they address the three broad areas requiring improvement that had been identified in the inspection report for 2011–12:

- the sufficiency and appropriateness of audit evidence obtained by the auditor;
- the level of professional scepticism exercised by auditors; and
- the extent of reliance that can be placed on the work of other auditors and experts.<sup>25</sup>

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21 Parliamentary Joint Committee on Corporations and Financial Services, *Inquiry into the collapse of Trio Capital*, May 2012, p. 123.

22 Parliamentary Joint Committee on Corporations and Financial Services, *Inquiry into the collapse of Trio Capital*, May 2012, p. 154.

23 Australian Securities and Investments Commission, *Report 317—Audit inspection progress report for 2011–12*, December 2012, p. 4.

24 Mr Greg Medcraft, Chairman, Australian Securities and Investments Commission, *Committee Hansard*, 3 December 2012, p. 20 cited in Parliamentary Joint Committee on Corporations and Financial Services, *Statutory oversight of the Australian Securities and Investments Commission*, No. 1 of 43<sup>rd</sup> Parliament, February 2013, p. 17.

25 Parliamentary Joint Committee on Corporations and Financial Services, *Statutory oversight of the Australian Securities and Investments Commission: the role of gatekeepers in Australia's financial services system*, No. 3 of 43<sup>rd</sup> Parliament, July 2013, pp. 33–34.

2.34 With regard to its audit inspection program for 2015–16, ASIC stated:

In our view, in 25% of the total 390 key audit areas that we reviewed across 93 audit files at firms of different sizes, auditors did not obtain reasonable assurance that the financial report as a whole was free of material misstatement. This compares to 19% of 463 key audit areas in the previous 18-month period ended 30 June 2015.<sup>26</sup>

2.35 ASIC's audit inspection program appears to show an ongoing deterioration in audit quality. In 2009–10, 17 per cent of audit files did not have adequate evidence, through to 18 per cent in 2011–12 and 19 per cent in 2014–15, to 25 per cent of cases where auditors 'did not obtain reasonable assurance that the financial report as a whole was free of material misstatement' in 2015–16. In 2017–18, this figure was 24 per cent.<sup>27</sup>

2.36 However, a decline in audit quality may not be the only conclusion that could be drawn from these figures. It is important to recognise that ASIC inspects audit firms and audit files that it believes to be of higher risk, and the size of its sample varies. The number of key areas audited also varies, and one might expect that more areas audited would produce more shortcomings. There is no attempt at randomisation and no suggestion that statistical comparisons can be made. It is, therefore, plausible that what may be happening is that ASIC is improving its targeting.<sup>28</sup>

2.37 Further, ASIC has pointed out that the existence of a faulty audit does not necessarily mean that there is anything wrong in the company's reports, or with the company's operations.<sup>29</sup>

2.38 Nonetheless, the persistence of the issues raises a question as to why the quality of audits is still a problem. Mr Medcraft told the committee in October 2017 that 'audit quality continues to decline, as reflected in our reports every 18 months. The audit firms themselves are concerned about it'.<sup>30</sup>

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26 Australian Securities and Investments Commission, *Report 534 Audit inspection program report for 2015–16*, June 2017, p. 4.

27 Australian Securities and Investments Commission, *Report 607 Audit inspection program report for 2017–18*, January 2019, p. 9; *Report 534 Audit inspection program report for 2015–16*, June 2017, p. 4; *Report 461 Audit inspection program report for 2014–16*, December 2015, p. 5; *Report 317 Audit inspection program for 2011–12*, December 2012, p. 4; *Report 242 Audit inspection program for 2009–10*, June 2011, p. 18.

28 These caveats have been made repeatedly by Australian Securities and Investments Commission (eg, ASIC, *Report 534—Audit inspection program report for 2015–16*, p.7) and by Financial Reporting Council (eg FRC, *Annual Report 2016–17*, p. 17).

29 Mr John Price, Commissioner, Australian Securities and Investments Commission, *Committee Hansard*, 16 February 2018, p. 11.

30 Mr Greg Medcraft, Chairman, Australian Securities and Investments Commission, *Committee Hansard*, 27 October 2017, p. 21.

2.39 More recently, the committee expressed concern about the quality of auditing in its report on the 2016–17 annual reports of bodies established under the ASIC Act.<sup>31</sup>

2.40 In that report, with reference to the annual reports of the FRC and the AUASB (and the Australian Accounting Standards Board, AASB), the committee considered that the bodies had fulfilled their annual reporting obligations, but reserved its judgement about whether they had fulfilled their regulatory functions, due to concerns about audit quality.<sup>32</sup>

2.41 The committee discussed ASIC's report of its inspections of audit firms noted above and concluded that it was not satisfied with these outcomes:

The committee recognises the critical importance of audit quality. The committee has had a long-standing interest in this matter and is particularly concerned that audit quality continues to deteriorate. This raises questions about ASIC's response over the past decade and the measures that ASIC, the FRC and the standards boards have taken thus far.<sup>33</sup>

## **Limitations of the auditing system**

### ***The inherent difficulty of the task***

2.42 The information asymmetry referred to earlier between the management of a company and investors, or potential investors is very difficult to counter. Even for sophisticated investment companies, 'reading a set of accounts is like reading a mystery novel'.<sup>34</sup> Although it is the job of auditors to approach this task with professional expertise, scepticism and judgement, the difficulties are inherent.

2.43 As a result, many audits tend to focus on whether correct processes have been followed, and have to rely on assurances that financial reports are accurate and complete.

2.44 However, if a company chooses to deliberately conceal information and to mislead an auditor, or indeed has made errors it is unaware of, it may be difficult for an auditor to detect issues.

2.45 Even the claimed existence of an offshore asset may be difficult to challenge. For example, in the inquiry into Trio Capital, the auditors cited the limitations on their role and pointed out that the primary responsibility for detecting fraud rests with the

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31 Parliamentary Joint Committee on Corporations and Financial Services, *Report on the 2016–2017 annual reports of bodies established under the ASIC Act*, July 2018.

32 Parliamentary Joint Committee on Corporations and Financial Services, *Report on the 2016–2017 annual reports of bodies established under the ASIC Act*, July 2018, paras. 3.20, 3.29 and 3.37.

33 Parliamentary Joint Committee on Corporations and Financial Services, *Report on the 2016–2017 annual reports of bodies established under the ASIC Act*, July 2018, para. 4.58.

34 A representative of Aberdeen Standard Investments quoted in House of Commons, Business, Energy and Industrial Strategy and Work and Pensions Committees, *Carillion*, Report HC 769, 16 May 2018, p. 79.

responsible entity. Auditors noted that they can only obtain reasonable assurance that a financial report is free from material misstatement, whether caused by fraud or error.<sup>35</sup>

2.46 Further, in some circumstances, it is unlikely that an auditor will have the expertise to question some information. Valuations of some assets such as listed securities, which have a known market price, are relatively straightforward—though even here, the value is accurate only for a point in time. However, for more complex assets, such as unlisted securities and going concerns that are taken over, it is much more difficult to confirm a valuation. The misadventures of Bunnings and National Australia Bank in the United Kingdom (UK) show that even 'experts' with the best will in the world and the best information available cannot necessarily assess value accurately. Sometimes valuations are deliberately obscured. For example, valuations of securitised assets in the period before the GFC were notoriously opaque.<sup>36</sup>

2.47 CPA Australia has summarised the limitations on audits:

Obtaining absolute assurance is not possible in financial statement audits for a number of reasons, including:

- It would be impractical for the auditor to test and audit every transaction.
- Financial statements involve judgements and estimates which often cannot be determined exactly, and may be contingent on future events.<sup>37</sup>

2.48 Thus, there are difficulties and uncertainties in the process of auditing which might surprise both investors and members of the public. As the committee has previously noted, there are a series of expectation gaps between what investors and the public expect of gatekeepers such as auditors, and what those gatekeepers are legally obliged to do, and what their roles involve in practice.<sup>38</sup> Furthermore, the existence of a system of checks may give investors a false sense of security.

### ***Structure of the audit industry***

2.49 The structure of the audit industry gives rise to two further issues, namely:

- the concentration of major company auditing in a few hands; and
- the diversified nature of the operations of the big four accounting firms and associated conflicts of interest.

First, the industry is dominated both locally and globally by four big firms: PricewaterhouseCoopers (PwC), KPMG, Deloitte and Ernst and Young (EY).

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35 Parliamentary Joint Committee on Corporations and Financial Services, *Inquiry into the collapse of Trio Capital*, May 2012, p. 121.

36 See, for example: Gregory Jones and Graham Bowrey, *NSW Local Council investment exposures*, 2010, University of Wollongong, Research Online, p. 8.

37 CPA Australia Ltd, *A guide to understanding auditing and assurance: listed companies*, October 2014, p. 7.

38 See Parliamentary Joint Committee on Corporations and Financial Services, *Inquiry into the collapse of Trio Capital*, May 2012, pp. 123–124.

2.50 The big four accounting firms audit 97 per cent of United States public companies and all of the top 100 corporations in the UK. Richard Brooks argues that the big four accounting firms 'are the only players large enough to check the numbers for these multinational organisations, and thus enjoy effective cartel status'. Furthermore, Mr Brooks argues that because there are no serious rivals to undercut the big four, and because audits are a legal requirement almost everywhere, the arrangement effectively becomes 'a state-guaranteed cartel'.<sup>39</sup>

2.51 The dominance of the big four accounting firms therefore raises questions about the extent to which effective competition operates within the audit industry with respect to the auditing of major corporations.

2.52 In addition, it appears that there are substantial barriers to entry into the top tier auditing market, thereby rendering greater competition unlikely, if not impossible. While the committee is not aware of a detailed study in Australia, it notes the findings of the UK parliamentary inquiry into the collapse of Carillion, a large diversified firm with numerous big and vital government contracts. Its Carillion report found that the market for audit services was dominated by the big four audit firms and there were barriers to market entry:

Substantial entry is unlikely to be attractive, due to significant barriers, including the perception bias against mid-tier firms, high costs of entry, a long payback period for any potential investment, and significant business risks when competing against the incumbents in the market.<sup>40</sup>

2.53 Secondly, these big four companies are integrated professional service providers. As such, the revenue that the big four accounting firms derived from auditing is less (and in some cases substantially less) than a quarter of total revenue, and has declined even further over the last four financial years (see Table 2.1). In 2017–18, the percentage of audit revenue at the big four accounting firms in Australia was as follows:

- Deloitte — 13.7 per cent;
- EY — 21 per cent;
- KPMG — 20 per cent; and
- PwC — 17.4 per cent.

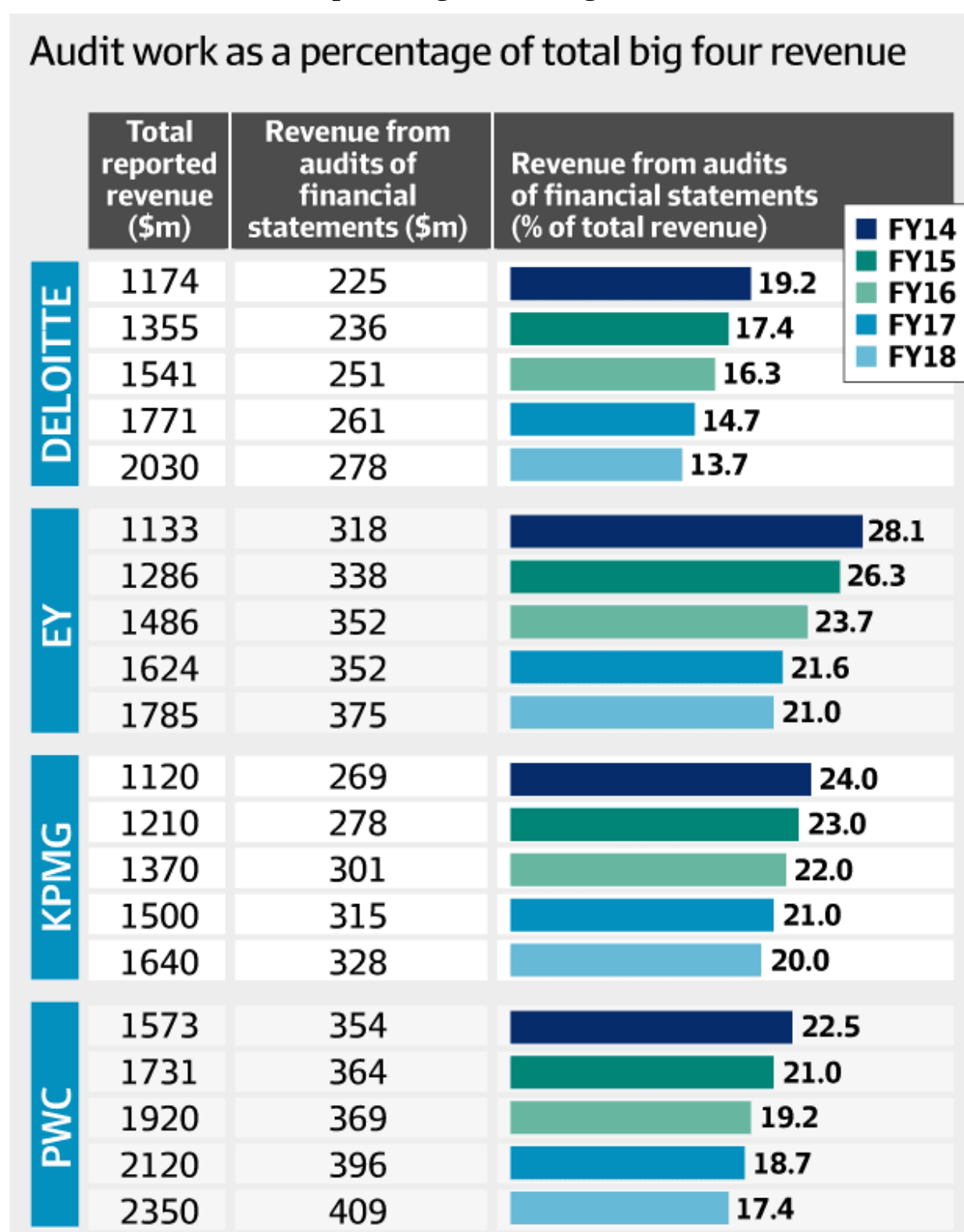
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39 Richard Brooks, 'The financial scandal no one is talking about', *The Guardian*, 29 May 2018, [https://www.theguardian.com/news/2018/may/29/the-financial-scandal-no-one-is-talking-about-big-four-accountancy-firms?CMP=share\\_btn\\_link](https://www.theguardian.com/news/2018/may/29/the-financial-scandal-no-one-is-talking-about-big-four-accountancy-firms?CMP=share_btn_link) (accessed 12 February 2019).

40 House of Commons, Business, Energy and Industrial Strategy and Work and Pensions Committees, *Carillion*, Report HC 769, 16 May 2018, p. 80.



Table 2.1: Audit work as a percentage of total big four revenue



Source: Edmund Tadros and Vesna Poljak, 'Auditors 'compromised' by providing consulting work: ASIC', *Australian Financial Review*, 24 January 2018, <https://www.afr.com/business/accounting/auditors-compromised-by-providing-consulting-work-asic-20190124-h1agav> (accessed 12 February 2019).

2.54 The big four accounting firms offer, alongside audit services, research, human resources, strategic planning, government advice, marketing and a wide variety of other services.<sup>41</sup>

2.55 While the big four firms are growing rapidly, they are not publicly listed, so there is less available information about them compared to other firms of similar size.

2.56 There is at least a theoretical conflict of interest where an auditor is selected by the directors of a company and is paid by that company, but the investors which rely on the independence and accuracy of the audit report have no input into the selection of the auditor. Indeed, there is potential for a serious conflict of interest where an audit firm sees an unfavourable audit as reducing its chances of further work with the company being audited. It is important to remember that, given the current nature of the audit industry, further work is not restricted to auditing and may include the whole gamut of services provided by the big four accounting firms to their clients.

2.57 The Carillion Report noted that a big accounting firm could have several different relationships with a major company at the same time. It also noted that in the UK 'two-thirds of chief financial officers of large listed and private companies were Big Four alumni', so their influence was magnified.<sup>42</sup>

2.58 A former forensic investigator with ASIC, Mr Glen Unicomb, was recently quoted as saying that:

...he believed the 'big four' accounting firms — PwC, Deloitte, EY and KPMG — risked being exposed to pressure to approve reports to protect lucrative advisory relationships...Mr Unicomb said today's business model for accounting firms was potentially conflicted, given the balance between a traditional pipeline of external audit work with a separate advisory arm which attracted big fees.<sup>43</sup>

2.59 Mr Brooks argued that the big accounting companies should be examined by the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (Royal Commission):

'They don't just audit, they advise on financial transactions. They advise on financial products. They package up derivative products,' he said.

'They are right in there and they are heavily conflicted.'

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41 Daniel Ziffer, quoting Stuart Kells in 'KPMG, Deloitte, PwC and EY diversifying to have 'fingers in all sorts of pies'', *ABC News*, 10 April 2018, <http://www.abc.net.au/news/2018-04-09/kpmg-deloitte-pwc-ey-diversify-and-become-more-powerful/9634774> (accessed 12 February 2019).

42 House of Commons, Business, Energy and Industrial Strategy and Work and Pensions Committees, *Carillion*, Report HC 769, 16 May 2018, p. 79.

43 Peter Ryan, 'Big four' accounting firms should face banking royal commission to prove independence, former ASIC investigator says', *ABC News*, 5 October 2018, <http://www.abc.net.au/news/2018-10-05/big-four-accounting-firms-should-face-royal-commission/10339504> (accessed 12 February 2019).

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'We are relying on them to tell us everything is sound. You can't review that industry without looking at the auditors.'<sup>44</sup>

### ***Stability of audit relationships***

2.60 It is common for the same audit company to audit a particular firm for many years running. The UK Carillion inquiry noted that KPMG had been auditing Carillion for all 19 years of the company's existence.<sup>45</sup>

2.61 This stability can have advantages, because the audit company becomes familiar with the complexities of the firm's operations and financial statements. Changing auditors can result in a loss of knowledge and consequent deterioration in quality of audit.<sup>46</sup>

2.62 On the other hand, stability can lend itself to complacency, personal relationships which can obscure objectivity, an unwillingness to find an error that was overlooked the previous year, and even corruption. It is also a barrier to entry for new firms to the industry.<sup>47</sup>

2.63 It was noted above that Mr Medcraft, then Chairman of ASIC, saw rotation of auditors as one solution to poor audit quality.<sup>48</sup> Some countries in the European Union have policies of audit firm rotation.<sup>49</sup> In Australia, there is a requirement for rotation of the audit partner, but not the audit firm, roughly every five years.<sup>50</sup>

2.64 The need for auditors to be independent was stressed above. It is a necessary, though not sufficient, condition for professional scepticism. Clearly, independence can be jeopardised by recognising that the other business of the firm can be affected by the outcome of an audit, as discussed above. Also as suggested above, it can be lessened by familiarity in a longstanding, stable relationship.

2.65 The process of auditing can also reduce the exercise of scepticism:

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44 Richard Brooks, quoted by Steve Cannane, 'Banking royal commission: 'Big four' accountancy firms 'heavily conflicted, should be under inquiry spotlight', *ABC News*, 25 June 2018, <http://www.abc.net.au/news/2018-06-25/banking-inquiry-should-investigate-accountancy-firms-brooks-says/9904592> (accessed 9 October 2018).

45 House of Commons, Business, Energy and Industrial Strategy and Work and Pensions Committees, *Carillion*, Report HC 769, 16 May 2018, p. 79.

46 Mr John Price, Commissioner, Australian Securities and Investments Commission, *Committee Hansard*, 27 October 2017, p. 21; Mr John Price, Commissioner, Australian Securities and Investments Commission, *Committee Hansard*, 16 February 2018, p. 19.

47 House of Commons, Business, Energy and Industrial Strategy and Work and Pensions Committees, *Carillion*, Report HC 769, 16 May 2018, p. 79.

48 Mr Greg Medcraft, Chairman, Australian Securities and Investments Commission, *Committee Hansard*, 3 December 2012, p. 20.

49 Mr John Price, Commissioner, Australian Securities and Investments Commission, *Committee Hansard*, 27 October 2017, p. 21.

50 Mr William Edge, Chair, Financial Reporting Council, *Committee Hansard*, 16 February 2018, p. 18.

Professional scepticism is often an issue around the complexity of the rules, the accounting standards and the auditing standards that need to be applied. It's not necessarily because of your familiarity with the client; it's more that you're so focused on the rules, the different calculations and the different disclosure modes that sometimes you're not taking a moment to sit back.<sup>51</sup>

2.66 Finally, it has also been suggested that not enough resources are devoted to audits. As the Chair of the FRC told the committee, if a company sees an audit as a commodity and pays the lowest audit fee it can, it will get a poor standard of audit.<sup>52</sup> Mr Medcraft put it even more bluntly:

The fundamental driver of [poor audit quality] is, frankly, they [the audit firms] don't get paid enough to do the job...Whenever they compete, they cut fees...If you lower the fee, often the audit quality suffers.<sup>53</sup>

## Potential solutions

### *Changing the task*

2.67 An auditor's task would be easier if financial reports were made more transparent. The AASB states that it designs accounting standards (which shape reporting) with auditability in mind. The standards are principles-based, so that interpretations sometimes require professional judgement. But the AASB does not believe that audit quality issues arise from ineffective accounting standards.<sup>54</sup>

2.68 The FRC believes that Australian accounting standards are 'world's best practice'.<sup>55</sup> ASIC is of the view that principles-based standards lend themselves less to gaming than specific rules.<sup>56</sup>

2.69 Nonetheless, all the bodies involved are constantly working to improve the standards. In particular, the AASB is about to issue a new revenue standard and is reviewing impairment testing of goodwill.<sup>57</sup>

2.70 That said, the quality of an audit ultimately depends on the accessibility and transparency of the company information underlying the financial statements. If this

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51 Mr William Edge, Chair, Financial Reporting Council, *Committee Hansard*, 16 February 2018, p. 22.

52 Mr William Edge, Chair, Financial Reporting Council, *Committee Hansard*, 16 February 2018, p. 23.

53 Mr Greg Medcraft, Chairman, Australian Securities and Investments Commission, *Committee Hansard*, 27 October 2017, pp. 21–22.

54 Ms Kris Peach, Chair, Australian Accounting Standards Board, *Committee Hansard*, 16 February 2018, p. 12.

55 Mr William Edge, Chair, Financial Reporting Council, *Committee Hansard*, 16 February 2018, p. 17.

56 Mr Doug Niven, Senior Executive Leader, Financial Reporting and Audit, Australian Securities and Investments Commission, *Committee Hansard*, 16 February 2018, p. 15.

57 Ms Kris Peach, Chair, Australian Accounting Standards Board, *Committee Hansard*, 16 February 2018, p. 13.

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information is not available, it will be difficult for any auditor, no matter how diligent or skilled, to be comprehensive and thorough. Consequently, it would appear that, along with the continued education of auditors and the updating of audit standards, there needs to be greater education of company executives and staff to ensure that the information underlying financial statements is more accessible and transparent.

### ***Incentives for auditors***

2.71 The committee heard that one measure that is known to work is a remuneration policy where the finding of a deficiency in an audit has an impact on the income of the partner in the auditing firm.<sup>58</sup> More generally, the culture of the organisation has a big influence on audit quality. ASIC believes the big firms are now sending strong messages from senior management about the importance of audit quality, and are also bringing in coaching, review processes, and internal accountability measures.<sup>59</sup>

2.72 While there are penalties after the event for poor audits, this appears to be fairly rare. Were ASIC to enforce appropriate penalties for misconduct, this would send a strong message to the audit industry and drive standards higher.

2.73 Where audit firms accept the lowest competitive price and then skimp on the product, one solution could be to have government set the price and engage the auditor. This would also reduce the conflict of interest where an auditor may be concerned about the renewal of their contract with the firm. Apparently, this solution was canvassed after the Enron debacle.<sup>60</sup>

### ***Structure of the industry***

2.74 The dominance of the big four accounting firms in the Australian auditing market—and indeed markets for other sources—is at least worth examining. It may be that there is sufficient competition in the provision of services, and that barriers to entry are not as high as has been suggested. Alternatively, greater rotation of auditors, and of audit firms, has been discussed above and would be worth further investigation.

2.75 There is also an argument for structural separation to end the provision of a variety of services alongside auditing by the same firm. This might be done by mandating audit-only firms, or making a rule that a firm cannot purchase other products from the firm that does its audit (although this could also set up perverse

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58 Mr John Price, Commissioner, Australian Securities and Investments Commission and Mr William Edge, Chair, Financial Reporting Council, *Committee Hansard*, 16 February 2018, p. 22.

59 Mr John Price, Commissioner, Australian Securities and Investments Commission, *Committee Hansard*, 16 February 2018, p. 22.

60 Mr Greg Medcraft, Chairman, Australian Securities and Investments Commission, *Committee Hansard*, 27 October 2017, p. 21.

Note: in the wake of the Enron fraud, Arthur Anderson and Co, a major accounting firm, was convicted of obstructing justice and lost its licence.

incentives). These questions are being considered in the UK in the wake of the Carillion collapse.<sup>61</sup>

### **Committee view**

2.76 The committee has been concerned for some years about audit quality in Australia. While rigorous audits should provide a fair and accurate picture of business fundamentals, the committee acknowledges the important roles that other gatekeepers in the financial system, such as directors, must play in keeping companies honest and transparent.

2.77 The committee also acknowledges that the problem of audit quality is an international one, and that there is debate about both the severity of the problem, and the potential solutions.

2.78 Before addressing some of the bigger and more fundamental questions, the committee considers that the conflicting views on audit quality enunciated by the FRC and ASIC require further examination. The FRC disputes the view put forward by ASIC that audit quality in Australia is unacceptably poor. However, one of the fundamental points of dispute appears to be the risk-based nature of ASIC's audit inspection program and the inferences and conclusions that may be reasonably drawn from the results over time. To this end, the committee considers that it would be useful if ASIC, perhaps in consultation with the FRC, were to devise and conduct, alongside or within its current Audit Inspection Program, a study which will generate results which are comparable over time to reflect changes in audit quality.

### **Recommendation 1**

**2.79 The committee recommends that ASIC devise and conduct, alongside or within its current Audit Inspection Program, a study which will generate results which are comparable over time to reflect changes in audit quality.**

2.80 Acknowledging that issues around the measurement of audit quality may benefit from being more precisely articulated does not, however, detract from the seriousness of the various conflicts of interest that are apparent in the audit industry. For example, the traditional view of the audit firms is that they operate as independent outsiders scrutinising the accounts of major corporations. In effect, however, the big four audit firms have become corporate insiders embedded within the business world. The risk here, of course, is that the big four audit firms now fail to fearlessly scrutinise the accounts and risks of the corporations that they audit because it may be detrimental to the pursuit of their wider business interests.

2.81 Furthermore, it is precisely this diversification into a whole raft of other professional services, and the attendant conflicts of interest, that calls into question the view that a lack of competition in the audit industry is the root cause of poor audit

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61 Hans van Leeuwen, 'UK regulators ramp up pressure on Deloitte, EY, KPMG and PwC with new probes', *Australian Financial Review*, 10 October 2018, <https://www.afr.com/business/accounting/uk-regulators-ramp-up-pressure-on-deloitte-ey-kpmg-and-pwc-with-new-probes-20181009-h16fho> (accessed 12 February 2019).

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quality. It seems to the committee that this may be too simplistic an understanding of the problem.

2.82 Indeed, it has been argued that the audit industry is more competitive than generally portrayed, and that auditing is unprofitable but is used as a loss-leader to procure more profitable consulting, IT, and other professional service work. One implication to be drawn from this arrangement is that if an auditor produces a report that clearly identifies inaccuracies in a company's financial statements, or identifies previously undisclosed risks pertaining to the audited entity, there is no guarantee that a senior executive in the audit firm will support the auditor's findings because it may risk the audit firm's ongoing business across a whole range of other professional services.

2.83 And therein lies the dilemma. The incentive to overlook risks in an audit is inherent when the audit firm is conflicted because it relies so heavily on the sale of its other professional services to the same corporations that it audits. In this regard, the committee notes the findings of the UK parliamentary committee, namely that conflicts of interest cannot be managed but must in fact be removed. Hence the recommendations of that inquiry that the audit firms be required to divest themselves of their other businesses and be required to provide audit services only.

2.84 This is not, however, to suggest there are no problems with the market dominance of the big four per se. Indeed, following the criminal conviction of Arthur Anderson and Co for obstructing justice in the wake of the Enron fraud and the company's consequent loss of its licence, it could be argued that there are now too few accounting firms for any more to fail. In and of itself, this is a parlous state of affairs and perhaps explains the lack of scrutiny directed at the big four accounting firms in the wake of the GFC when major corporations, such as Lehman Brothers, were bought out and others salvaged with taxpayer funds despite their books having been audited by the big four accounting firms.

2.85 In terms of solutions, the committee reserves its judgment on the view expressed by ASIC that the big accounting firms are now sending strong messages from senior management about the importance of audit quality, and are also bringing in coaching, review processes and internal accountability measures.

2.86 However, it appears to the committee that the fundamental question at this juncture is whether the deep-rooted problems in the audit market can be resolved by more robust practices aimed at managing conflicts of interest, or whether action is required to remove those conflicts of interest.

2.87 In this regard, the committee notes that the competition watchdog in the UK, the Competition and Markets Authority, is currently consulting on some key proposals including forcing the big four accounting firms to legally separate their audit staff from the rest of their business, greater regulatory oversight of the company directors who select auditors, and requiring large listed companies to each use two audit firms. The committee also notes that the Competition and Markets Authority is still considering breaking up the big four accounting firms, or introducing caps on the number of large listed companies that they can audit.

2.88 Subject to the findings of the Royal Commission, the committee considers that the structure of the audit industry and associated conflicts of interest in Australia merit serious review, with particular reference to market dominance and conflicts of interest arising from the range of other activities also conducted by the major firms in the industry.



# Chapter 3

## Integrity risks

### Introduction

3.1 This chapter considers whether the integrity arrangements of the Australian Securities and Investments Commission (ASIC) are sufficient to meet current and future challenges. The chapter discusses the following issues:

- conflicts of interest that arise in the financial services sector;
- the adequacy of ASIC's integrity and anti-corruption arrangements; and
- specific integrity risks for ASIC employees.

### Background

3.2 Conflict of interest is a term widely used in the financial services sector. The Organisation for Economic Co-operation and Development (OECD) defines a conflict of interest as occurring when 'an individual or a corporation (either private or governmental) is in a position to exploit their own professional or official capacity in some way for personal or corporate benefit'.<sup>1</sup>

3.3 The Productivity Commission noted the impact of conflicts of interest on competition in the financial services sector, stating that:

...commission-based remuneration structures create conflicts that may limit competition and mean that at times the money flow is at odds with acting in a consumer's best interest. These conflicts are particularly apparent where banks, as the creators of a financial product, are integrated with other entities that market, sell or advise on these same products.<sup>2</sup>

3.4 For many in the community, the scandals revealed by the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (Royal Commission) appear to epitomise the conflicts of interest by individuals and corporations in positions of trust which have exploited customers for personal and/or corporate gain.

3.5 The Royal Commission's interim report noted that:

All the conduct identified and criticised in this report was conduct that provided a financial benefit to the individuals and entities concerned.<sup>3</sup>

But almost every piece of conduct identified and criticised in this report can be connected directly to the relevant actor gaining some monetary benefit

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1 Organisation for Economic Co-operation and Development, *Glossary of Statistical Terms*, July 2007, <https://stats.oecd.org/glossary/detail.asp?ID=7206> (accessed 12 February 2019).

2 Productivity Commission, *Competition in the Australian Financial System*, 29 June 2018, p. 24.

3 Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, *Interim Report*, 28 September 2018, p. 301.

from engaging in the conduct. And every piece of conduct that has been contrary to law is a case where the existing governance structures and practices of the entity and its risk management practices have not prevented that unlawful conduct.<sup>4</sup>

3.6 The World Bank considers that when a position of trust is abused and conflicts of interest are taken advantage of for private or corporate gain, these actions are corruption.<sup>5</sup> While conflicts of interest do not always lead to corruption, corruption almost always requires a conflict of interest:

When it comes to corruption, there is almost always a common denominator: a conflict of interest. A conflict of interest exists when an individual or corporation has the opportunity – real or perceived – to exploit their position for personal or corporate benefit. Corruption occurs when the individual or corporation takes advantage of that opportunity and indeed abuses their position for private gain.<sup>6</sup>

3.7 Regulatory agencies play a key role in ensuring integrity and public trust in government, but their location at the intersection of money and government power makes them particularly vulnerable to corruption.<sup>7</sup>

3.8 Victoria's Independent Broad-based Anti-corruption Commission (IBAC) noted that conflict of interest is a particular risk with regulatory authorities where employees work collaboratively with the industries they regulate, and because some regulatory bodies receive revenue from the industries they regulate. IBAC has summarised four factors that are drivers of corruption risks in regulatory authorities as follows:

**Lack of transparency**

IBAC found that reporting of regulatory outcomes varied across regulators, particularly the breadth of information being reported back to the regulated entities. The report notes that by providing transparency through public reporting, regulators can help assure the community that they are operating with integrity.

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4 Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, *Interim Report*, 28 September 2018, p. 302.

5 The World Bank, *Helping Countries Combat Corruption: The Role of the World Bank*, September 1997, p. 8.

6 Kelly Todd, Forensic Strategic Solutions, *Why corruption always requires a conflict of interest*, 28 October 2016, <https://www.forensicstrategic.com/blog/why-corruption-always-requires-a-conflict-of-interest> (accessed 12 February 2019).

7 David, Donaldson, The Mandarin, *Regulating the regulators: IBAC warns of corruption risks*, 26 July 2018, [https://www.themandarin.com.au/96333-regulating-the-regulators-ibac-warns-of-corruption-risks/?utm\\_campaign=TheJuice&utm\\_medium=email&utm\\_source=newsletter](https://www.themandarin.com.au/96333-regulating-the-regulators-ibac-warns-of-corruption-risks/?utm_campaign=TheJuice&utm_medium=email&utm_source=newsletter) (accessed 30 July 2018/12 February 2019).

### **Industry and regulatory capture**

With an increased reliance on private industry to deliver what were once public services, there is potential for conflicted relationships. This can lead to 'regulatory capture', where regulators and their employees potentially align their values and actions with that of the industry they are regulating – rather than with the values and legislated purpose of the regulator.

### **Integrity history of employees**

Regulators often require specialised skills and experience to perform work such as inspections and enforcement. It can be difficult to recruit and retain the best employees for these positions as these skills may also be in high demand in the private sector. Such competition could mean that employees with problematic histories of misconduct or corrupt conduct in other agencies are considered for employment in public bodies because they hold the requisite skills.

### **Targeting by organised crime groups**

Many employees of regulatory authorities have high levels of access to sensitive personal and business information, sometimes with low levels of accountability. The cultivation of these employees is an attractive way for organised crime groups to facilitate their criminal activities.<sup>8</sup>

3.9 Managing conflicts of interest and identifying and addressing corruption is central to building and maintaining integrity. The Western Australia Integrity Coordinating Group defines integrity as:

...earning and sustaining public trust by serving the public interest; using powers responsibly; acting with honesty and transparency; and preventing and addressing improper conduct.<sup>9</sup>

3.10 In the past, Australia has had a strong reputation for integrity and anti-corruption institutions. However, evidence suggests that Australia's standards on integrity and anti-corruption may be falling. Australia is now ranked 13<sup>th</sup> among OECD countries and its corruption perception index has fallen steadily from 85 in 2012 to 77 in 2017.<sup>10</sup>

3.11 The Australian Commission for Law Enforcement Integrity (ACLEI) considers that the starting point of anti-corruption system design is to consider how corruption occurs and who benefits. It has identified the following corruption prevention myths:

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8 Independent Broad-based Anti-corruption Commission, *Corruption risks associated with public regulatory authorities*, summary of report, July 2018, p. 2.

9 Chris Field, 'The fourth branch of government: the evolution of integrity agencies and enhanced government accountability', *Australian Institute of Administrative Law Forum*, No. 72, 2013, p. 25.

10 Transparency International, *Corruption Perceptions Index 2017*, [https://www.transparency.org/news/feature/corruption\\_perceptions\\_index\\_2017](https://www.transparency.org/news/feature/corruption_perceptions_index_2017), (accessed 12 February 2019).

- **Bad apples:** Thinking that corruption is always the domain of a 'bad apple' or rogue employee—a corrupt individual acting alone—can draw attention away from considering organisational vulnerability and integrity systems as a whole.
- **It's all about the money:** Assuming that vulnerability to corruption is always driven by financial gain can mean missing possible indicators. Personal benefit might take other forms, such as social reward, ideological satisfaction, or excitement.
- **Training will fix it all:** Formal training and education is often the first solution offered when issues become apparent—because it's measurable and quickly implementable. However, organisations should appreciate the influence that informal situations have on establishing a desired culture.
- **The slippery slope:** Believing that the 'slippery slope' to corruption is inevitable because of making one mistake or poor decision can be self-perpetuating. Early intervention is possible, if organisational integrity systems are strong, fair and employees have trust in them.
- **Only frontline staff are at risk:** Non-operational staff may be as vulnerable, and less prepared to respond, to improper approaches. Many have similar or higher levels of access to sensitive information and systems as their operational colleagues do.<sup>11</sup>

### ASIC's integrity and anti-corruption arrangements

3.12 ASIC informed the committee that it manages internal and external fraud risks under its Fraud Control Plan and Fraud Control Policy. The Fraud Control Plan includes a summary of identified internal and external fraud risks associated with ASIC's activities and functions, and sets out ASIC's approach to managing fraud risk through the risk management framework which is based on nine elements of the Commonwealth Risk Management Policy.<sup>12</sup>

3.13 Professor A J Brown argued that ASIC suffers from the same problem as most other Commonwealth agencies in lacking sufficient independent oversight, support and assurance to ensure the adequacy and performance of its internal integrity and anti-corruption systems, due to the general weaknesses of the Commonwealth integrity system. Professor Brown noted that:

In particular, the combination of the APS Code of Conduct regime and AFP-oversighted corruption investigations are not up to standard as a system for ensuring that integrity risks and issues are handled consistently and appropriately in agencies, nor for providing independent oversight or

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11 Australian Commission for Law Enforcement Integrity, *Corruption Prevention Myths: ACLEI top 5 corruption prevention myths*, <https://www.aclei.gov.au/corruption-prevention/corruption-prevention-myths> (accessed 12 February 2019).

12 Australian Securities and Investments Commission, answers to questions on notice, 1 August 2018 (received 15 August 2018).

ensuring that high-risk misconduct cases are independently investigated rather than simply dealt with 'in house', where necessary.

As one of the 7 agencies that are members of the AFP-led Fraud & Anti-Corruption Centre but not subject to the jurisdiction of ACLEI, ASIC is one of the agencies [where] these gaps are particularly evident.<sup>13</sup>

3.14 The ASIC Capability Review recommended that ASIC should no longer be required to employ staff under the *Public Service Act 1999*. This is consistent with the earlier findings of the Financial Systems Inquiry. The Treasury Laws Amendment (Enhancing ASIC's Capabilities) Bill 2018 which was passed on 17 September 2018 will give effect to the above recommendation. The change is intended to support ASIC to more effectively recruit and retain staff in positions requiring specialist skills. It will bring ASIC into line with other financial regulators (the Australian Prudential Regulation Authority and the Reserve Bank of Australia).<sup>14</sup>

3.15 ASIC staff will be employed on behalf of ASIC and not on behalf of the Commonwealth. ASIC staff will be subject to an ASIC Code of Conduct and ASIC Values, to be determined by the ASIC Chairperson. ASIC staff under the ASIC Act will not be subject to the Australian Public Service Values and Code of Conduct. The ASIC Chairperson is required to uphold and promote the ASIC Values. The Chairperson of ASIC is also required to take reasonable steps to minimise conflicts of interest by having adequate disclosure of interest requirements that apply to all staff employed by ASIC.<sup>15</sup>

3.16 While the above approach retains a set of values and code of conduct under an employment contract, it lacks the oversight by a statutory external agency and as a result, weakens ASIC integrity and anti-corruption measures.<sup>16</sup> A separate question remains as to whether a set of values and a code of conduct provide sufficient integrity and anti-corruption arrangements. On this point, Commissioner John Price indicated that:

...the existing arrangement we've had around contractual arrangements and staff needing to maintain appropriate professional standards have been most effective indeed, and I'm not sure that any change of legislation through moving out of the Public Service will alter that in any way.<sup>17</sup>

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13 Professor A J Brown, answers to questions on notice, 1 August 2018 (received 27 August 2018).

14 Treasury Laws Amendment (Enhancing ASIC's Capabilities) Bill 2018, *Explanatory Memorandum*, 28 March 2018, p. 9, [https://www.aph.gov.au/Parliamentary\\_Business/Bills\\_Legislation/Bills\\_Search\\_Results/Result?bId=r6087](https://www.aph.gov.au/Parliamentary_Business/Bills_Legislation/Bills_Search_Results/Result?bId=r6087) (accessed 12 February 2019).

15 Treasury Laws Amendment (Enhancing ASIC's Capabilities) Bill 2018, *Explanatory Memorandum*, 28 March 2018, pp. 9 and 10–11.

16 *Committee Hansard*, 17 August 2018, pp. 7–8.

17 Mr John Price, Commissioner, Australian Securities and Investments Commission, *Committee Hansard*, 17 August 2018, p. 8.

3.17 ASIC advised it had not undertaken a comparison of its integrity and anti-corruption arrangements with the arrangements for peer regulators in the United States, Canada, United Kingdom (UK), Singapore, Hong Kong and Japan. ASIC argued that such a comparison would cause an unreasonable and significant diversion of ASIC's regulatory and legal resources.<sup>18</sup> Such a comparison could be facilitated through ASIC's participation in the International Organisation of Securities Commissions (IOSCO). ASIC is on the board and the former ASIC Chairman Mr Greg Medcraft was Chairman of IOSCO for several years, starting from March 2013.<sup>19</sup>

3.18 The committee sought Treasury's view on the adequacy of ASIC's current integrity and anti-corruption arrangements. Initially, Treasury responded by stating that:

Treasury considers that ASIC is best placed to answer questions about the precise nature and range of the integrity and anti-corruption arrangements that apply to it.<sup>20</sup>

3.19 The committee informed Treasury that it considered it not best practice for agencies to be responsible for determining whether or not their own governance arrangements are adequate and, in particular, whether their own integrity and anti-corruption arrangements are adequate. The committee requested Treasury to reconsider its answer. In its second response, Treasury stated that:

Treasury refers to the information ASIC has provided on its internal and external governance frameworks in its response to the Parliamentary Joint Committee Secretary's letter of 1 August. Treasury notes that those frameworks are similar to those that govern other independent regulators such as the Australian Prudential Regulation Authority and the Australian Competition and Consumer Commission.<sup>21</sup>

3.20 The Commonwealth Ombudsman is able to investigate complaints from people who believe they have been treated unfairly or unreasonably. From 2016–17 to 2017–18, the Commonwealth Ombudsman received 352 complaints of which 20 were investigated. The Commonwealth Ombudsman receives less than one complaint per year about ASIC's Professional Standards Unit. The Commonwealth Ombudsman noted that, while it does not review the adequacy of ASIC's integrity arrangements, the complaints data do not indicate any inadequacy.<sup>22</sup>

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18 Australian Securities and Investments Commission, answers to questions on notice, 1 August 2018 (received 15 August 2018).

19 International Organisation of Securities Commissions, 'Greg Medcraft of ASIC re-elected IOSCO Board Chair', *Media release*, 2 October 2014, p. 1.

20 Department of the Treasury, answers to questions on notice, 1 August 2018 (received 15 August 2018).

21 Department of the Treasury, answers to questions on notice, 30 August 2018 (received 14 September 2018).

22 Office of the Commonwealth Ombudsman, answers to questions on notice, 1 August 2018 (received 14 August 2018).

3.21 The Commonwealth Ombudsman had conducted one own-motion investigation into an alleged conflict of interest regarding the granting of regulatory relief. The Ombudsman concluded that there was no evidence to suggest that ASIC's decision to grant regulatory relief was contaminated by conflict of interests. However, the Ombudsman did make three recommendations regarding ASIC's management of the disclosure of a possible conflict of interests and its efforts to address issues raised by the disclosure.<sup>23</sup>

3.22 ASIC has previously identified how corruption risks arise from its role as a regulator. These risks fall into three areas:

- (a) Potential corruptors may stand to make a financial profit, or otherwise enhance their commercial interests, by obtaining access to the information and intelligence that ASIC collects as a result of ASIC's regulatory functions.
- (b) Alternatively, potential corruptors may seek to benefit from favourable treatment such as the imposition of lower penalties, improper determinations of relief applications, or other biased decisions.
- (c) ASIC staff may seek to gain a profit or benefit for themselves or others...may use ASIC powers and discretions for an improper purpose, and may protect unlawful activity by diverting attention or otherwise manipulating surveillance and investigations.<sup>24</sup>

3.23 The rest of this chapter seeks to explore the integrity risks arising from favourable treatment (regulatory capture) and where staff seek to gain a benefit for themselves or others.

### **Regulatory capture risks**

3.24 Regulatory capture refers to instances where regulators are excessively influenced or effectively controlled by the industry they are supposed to be regulating. There are three areas in which particular risks arise for regulatory capture:

- staff moving between industry and regulatory jobs;
- secondments; and
- where regulatory staff are embedded in private sector organisations (that is, required to conduct their work within the workplace of industry participants, away from their home base at the regulator).

3.25 While all three types of staff movement bring certain advantages, there are also attendant risks for regulatory capture and corruption. Mr Shipton, Chairman of ASIC, acknowledged this at a recent hearing:

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23 Office of the Commonwealth Ombudsman, answers to questions on notice, 1 August 2018 (received 14 August 2018).

24 Australian Securities and Investments Commission, *Submission 5* to the Parliamentary Joint Committee on the Australian Commission for Law Enforcement Integrity, Inquiry into the jurisdiction of the Australian Commission for Law Enforcement Integrity, May 2016, p. 6.

Regulatory capture is a big issue for us. We have studied very closely some very interesting and important examples of regulatory capture out of the United States. We've actually already had training for our supervisory teams on regulatory capture. We will be having very frequent checks in with them and disclosures and training with the supervisory team about how to watch out for regulatory capture.<sup>25</sup>

### ***ASIC secondments***

3.26 ASIC uses secondments to and from industry to:

- fill temporary vacancies and provide opportunities for staff to increase their knowledge and skills;
- develop a multi-skilled workforce;
- strengthen relationships with key regulators and the private sector;
- deepen ASIC's regulatory expertise;
- retain and develop ASIC's high potential talent; or
- develop leaders with a diverse perspective.<sup>26</sup>

3.27 Private sector secondments are also facilitated through section 122 of the ASIC Act. This does not alter the existing employment relationship and means that the home organisation will continue to pay the secondee. Partial or full payment may be recovered from the host agency by invoice.<sup>27</sup> Senior Executive Leaders must approve all private sector secondments.<sup>28</sup>

3.28 ASIC's secondment policy recognises that conflicts of interests or compromised security may be risks, particularly with private sector organisations that ASIC regulates. The policy notes that these risks can be mitigated by:

- ensuring mandatory security clearances are completed and approved before the secondment commences;
- designing secondment positions to offer meaningful work without exposure to potential conflicts; and
- liaising with external secondment partners and risk and security services in advance and during the secondment to ensure any potential conflicts are considered and addressed by the Chief Legal Office. This includes any agency-specific legislation security protocols and mandatory training requirements.<sup>29</sup>

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25 Mr James Shipton, Chairman, Australian Securities and Investments Commission, *Committee Hansard*, 19 October 2018, p. 14.

26 Australian Securities and Investments Commission, *Secondment Policy*, 2013, p. 5.

27 Australian Securities and Investments Commission, *Secondment Policy*, 2013, p. 8.

28 Australian Securities and Investments Commission, *Secondment Policy*, 2013, p. 7.

29 Australian Securities and Investments Commission, *Secondment Policy*, 2013, p. 10.



3.29 The potential risks arising from secondments were highlighted when the Senate Economics References Committee recommended that the Commonwealth Ombudsman consider undertaking an own motion investigation into an allegation of a conflict of interest for a secondee from a financial services firm in relation to ASIC's decision to grant regulatory relief in 2005. The Ombudsman found that there was no evidence to suggest that ASIC's decision to grant relief was contaminated by conflict of interest or other undue influence.<sup>30</sup>

3.30 However, the Ombudsman noted that:

- ASIC did not comply with its own internal policies for dealing with conflicts of interest; and
- the final report of ASIC's internal investigation into the allegations could not be produced, making it difficult to assess whether the investigation was appropriate in all the circumstances.<sup>31</sup>

3.31 The Ombudsman went on to make the following observations:

The Ombudsman acknowledges that secondment arrangements can be highly beneficial. Secondments involving private sector organisations have the potential to improve a regulator's knowledge and understanding of the operating environment of the entities it regulates.

However, it is critical that public sector agencies, and regulators in particular, appropriately identify and manage the possible conflicts of interest that are inherent in secondment arrangements. The processes for doing so should be robust and transparent in order to maintain public confidence in the integrity of agencies' internal processes and decision making.<sup>32</sup>

3.32 In 2014, ASIC informed the committee that in the previous five years there had been 41 secondments of ASIC staff to industry, with 90 per cent of those being SES or executive staff. In the same period, 14 staff had been seconded from industry to ASIC, all at the executive level.<sup>33</sup>

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30 Commonwealth Ombudsman, *Australian Securities and Investments Commission: Own motion investigation into the management of a conflict of interest matter in 2005*, November 2015, p. 4.

31 Commonwealth Ombudsman, *Australian Securities and Investments Commission: Own motion investigation into the management of a conflict of interest matter in 2005*, November 2015, p. 4.

32 Commonwealth Ombudsman, *Australian Securities and Investments Commission: Own motion investigation into the management of a conflict of interest matter in 2005*, November 2015, p. 4.

33 Australian Securities and Investments Commission, answers to questions on notice 28 March 2014 (received 5 May 2014).

### ***ASIC staff embedded in banks***

3.33 In August 2017, ASIC announced that its supervisory staff will be embedded with banks to monitor governance and compliance with laws. The purpose is to detect, respond to and remediate any failures in systems, procedures or decision-making processes inside financial institutions that could lead to, or are leading to, unacceptable outcomes for the consumers of financial services. ASIC also noted that:

We want to increase the probability that the average person inside financial institutions will come across and spend time with a supervisory officer. We believe that that will change the mindset in thinking, decision-making and their application to the daily work.<sup>34</sup>

3.34 That said, embedded staff face increased risks of regulatory capture and corruption because of their proximity to those they regulate. ASIC informed the committee that it was aware of the risks and was taking precautions, including rotation between banks, limiting the amount of time away from ASIC, and ensuring the deployed staff are sufficiently senior. In addition, staff are also undergoing training, including examining case studies, to prevent regulatory capture in Australia.<sup>35</sup>

### **Other integrity risks**

#### ***Real-time surveillance of markets***

3.35 In 2013, ASIC assumed responsibility for supervision of real-time trading on Australia's domestic licensed equities and future markets. Since that time, the nature of the markets has changed dramatically and the scope of ASIC's supervisory responsibilities has increased. ASIC supervises 125 market participants, trading across seven equities and futures markets, on which the securities of more than 2000 listed entities are traded. More than 960 000 trades are made per day, compared with 520 000 in 2010.<sup>36</sup> Those seven markets are a subset of over 50 markets now operating in Australia.<sup>37</sup>

3.36 ASIC implemented its Market Analysis and Intelligence (MAI) system in 2013 to provide sophisticated data analytics and identify suspicious trading in real time and across markets, as well as greater levels of detection of insider trading. MAI is built around algorithmic trading technology, and gives ASIC the ability to analyse trade data for patterns and relationships. The new system was designed, built and hosted by First Derivatives, and is based on technology used in financial markets

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34 Mr James Shipton, Chairman, Australian Securities and Investments Commission, *Committee Hansard*, 17 August 2018, p. 3.

35 Mr James Shipton, Chairman, Australian Securities and Investments Commission, *Committee Hansard*, 17 August 2018, p. 3.

36 Australian Securities and Investments Commission, *Fifth anniversary of ASIC market supervision*.

37 Australian Securities and Investments Commission, *Annual report*, 2016–17, p. 20.

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for market data capture, alerts and analytics and high frequency and algorithmic trading.<sup>38</sup>

3.37 While the MAI system can provide substantial benefits to identifying suspicious activity, it also comes with some attendant integrity risks. In particular, the capacity of staff to discount or ignore information can allow others to benefit. Training and active supervisory monitoring are required to reduce the potential for such situations from arising.

### ***ASIC staff trading***

3.38 It is very important that any trading or participation in financial services by ASIC employees is legal and perceived by the public to be fair. Where ASIC staff engage in trading in shares and derivatives and participate in financial services in other ways, there is the potential for conflicts of interest to occur.

3.39 ASIC's Commissioners are subject to a Statement of Obligations, which includes a requirement to make the following disclosures to the Minister in writing:

- any direct or indirect pecuniary interest they have in a business in Australia, or any body corporate carrying on a business in Australia;
- any direct or indirect pecuniary interest in financial products or other interests regulated by ASIC; and
- any agreement, understanding or expectation that they will resume a previous business relationship or enter into a new business relationship when they cease to be a Commissioner and any related severance arrangement or ongoing financial arrangement (ASIC Act, s. 123).<sup>39</sup>

3.40 That said, the *Public Governance, Performance and Accountability Act 2013* (PGPA Act) also places the following obligations on ASIC Commissioners:

- exercise due care and diligence (s. 25);
- act honestly, in good faith and for a proper purpose (s. 26);
- not improperly use their position to gain an advantage for themselves or others or to cause detriment to ASIC or anyone else (s. 27);
- not improperly use information (s. 28); and
- disclose details of their material personal interests (s. 29).

3.41 The Statement of Obligations provides that Commission members, like all ASIC staff, must obtain approval before they or their connected persons trade in

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38 Australian Securities and Investments Commission, 'ASIC's next generation market surveillance system commences', *Media release 13 316MR*, 25 November 2013.

39 Australian Securities and Investments Commission, *Statement of obligations – ASIC Commissioners*, <https://asic.gov.au/about-asic/what-we-do/how-we-operate/asics-internal-governance/statement-of-obligations-asic-commissioners/>, (accessed 12 February 2019).

financial products (as defined in ASIC's Staff Trading Policy) or pre-register for an Initial Product Offering.<sup>40</sup>

3.42 The UK Financial Conduct Authority's published code of conduct includes a section on staff trading that requires staff to seek clearance in advance of carrying out any trades in relevant organisations (including contacting brokers) and must complete the trades in two working days. Approval is not normally given to dispose of investments held for less than six months to avoid any perception of an abuse of information. Employees are prohibited from trading in contracts for difference, spread betting, wagering contracts, and fixed odd bets on UK companies and UK markets. Investing in a fund of contracts for difference is permitted.<sup>41</sup>

3.43 The US Securities and Exchange Commission standards of ethical conduct also address employee share trading and include the following provisions:

- members and employees are prohibited from purchasing or selling any security while in possession of material non-public information regarding that security;
- members and employees are prohibited from recommending or suggesting to any person the purchase or sale of security; and
- members and employees are prohibited from a wide range of trading activities.<sup>42</sup>

#### ***ASIC's surveillance of the dark web***

3.44 The 'dark web' refers to the portion of the internet that can only be accessed with additional networking protocols and software. Within the dark web, marketplaces exist which enable criminals to anonymously buy, sell and exchange goods and services, including malicious software and illegal substances. The dark web can also provide access to sensitive networks, payment card data, bank account information, brokerage account information and hacking services. Some of these activities occur within closed internet forums which require both sellers and purchasers to have demonstrated trust or reputation with forum administrators and users before being provided with access.<sup>43</sup>

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40 Australian Securities and Investments Commission, *Statement of obligations – ASIC Commissioners*.

41 UK, Financial Conduct Authority, *Code of Conduct*, January 2016, p. 8.

42 US Securities and Exchange Commission, *Supplemental standards of ethical conduct for members and employees of the Securities and Exchange Commission*, July 2010, p. 775.

43 Australian Securities and Investments Commission, *Submission 11* to the Parliamentary Joint Committee on Law Enforcement, Inquiry into the impact of new and emerging information and communications technologies, January 2018, p. 4.

3.45 As the use of the dark web continues to grow, dark web marketplaces may be used to facilitate financial crime. The dark web presents challenges for law enforcement as it is difficult to directly access.<sup>44</sup>

3.46 ASIC has indicated that there are difficulties in developing surveillance capabilities to monitor the dark web, including:

- the ability to assume identities in order to 'gain trust' to access closed dark web forums;
- the protection of its systems and information from the dark web;
- the obscuring of internet protocol addresses to use the web anonymously;
- the immediate jurisdictional access to 'threat actors' who are largely operating outside Australia; and
- lack of technological software and tools that have a specific focus on financial crimes, as typically the focus is on narcotics and terrorism.<sup>45</sup>

***Other issues with implications for ASIC's integrity***

3.47 In addition to the issues already considered in this chapter, there are a number of other issues which have arisen since previous inquiries considered ASIC's integrity and anti-corruption arrangements:

- ASIC's increasing role as a law enforcement agency;<sup>46</sup>
- ASIC's proposal that it be prescribed as a law enforcement agency in the Crimes Regulations 1990 for the purposes of Part IAC of the *Crimes Act 1914* (Crimes Act) on assumed identities;<sup>47</sup>
- ASIC's indication that it would support law reform to:
  - harmonise and enhance ASIC's search warrant powers with those in the Crimes Act (for example, to allow ASIC to operate or secure electronic devices);
  - provide ASIC with access to telecommunications intercept material to investigate and prosecute serious offences; and

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44 Australian Securities and Investments Commission, *Submission 11* to the Parliamentary Joint Committee on Law Enforcement, Inquiry into the impact of new and emerging information and communications technologies, January 2018, p. 4.

45 Australian Securities and Investments Commission, *Submission 11* to the Parliamentary Joint Committee on Law Enforcement, Inquiry into the impact of new and emerging information and communications technologies, January 2018, p. 5.

46 Australian Securities and Investments Commission, *Submission 11* to the Parliamentary Joint Committee on Law Enforcement, Inquiry into the impact of new and emerging information and communications technologies, January 2018, p. 3.

47 Australian Securities and Investments Commission, *Submission 11* to the Parliamentary Joint Committee on Law Enforcement, Inquiry into the impact of new and emerging information and communications technologies, January 2018, p. 10.

- allow ASIC to obtain and share telecommunications data with its foreign counterparts which will help with, for example, the investigation of dark web activity facilitated by actors located overseas;<sup>48</sup>
- ASIC's participation in joint taskforces and operations with other law enforcement agencies;
- ASIC's industry funding model;<sup>49</sup>
- the proposal to grant ASIC broader competition powers;<sup>50</sup>
- the recommendation by the Productivity Commission that all banks should appoint a Principal Integrity Officer obliged by law to report directly to their board on the alignment of any payments made by the institution with the new customer best interest duty;<sup>51</sup>
- the scale of corporate crime which is estimated to cost Australia more than \$8.5 billion a year and account for approximately 40 per cent of the total cost of crime in Australia.<sup>52</sup> This figure is likely to increase following the revelations of the Royal Commission;
- the legislative proposal for ASIC's expanded role in relation to whistleblowing in the private sector, including the ability to make class orders to exempt companies from the requirement to have a whistle-blower policy;<sup>53</sup> and
- the extent to which ASIC would benefit from ACLEI's proactive educational role on anti-corruption measures.

### Committee view

3.48 The committee considers previous inquiries into ASIC's integrity and anti-corruption risks did not have access to evidence on:

- the revelations of the Royal Commission and the extent of the crime occurring in the financial services section;

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48 Australian Securities and Investments Commission, *Submission 11* to the Parliamentary Joint Committee on Law Enforcement, Inquiry into the impact of new and emerging information and communications technologies, January 2018, p. 10.

49 Australian Securities and Investments Commission, *Industry funding factsheet*, June 2018.

50 The Hon Kelly O'Dwyer MP, Minister for Revenue and Financial Services, 'Government takes action to enhance ASIC's capabilities', *Media release*, 28 March 2018.

51 Productivity Commission, *Competition in the Australian Financial System*, 29 June 2018, p. 24.

52 The estimates refer to figures quoted in Attorney General Department, 2016, Improving enforcement options for serious crime: Consideration of a Deferred Prosecution Agreements scheme in Australia, *Public Consultation Paper*, p. 1.), <https://www.ag.gov.au/Consultations/Documents/Deferred-prosecution-agreements/Deferred-Prosecution-Agreements-Discussion-Paper.pdf> (accessed 12 February 2019).

53 Treasury Laws Amendment (Enhancing Whistleblower Protections) Bill 2018.

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- the extent to which the definition of serious and organised crime law enforcement agencies does not accord with the community standards and legislated definitions by the Parliament;
  - the pervasive nature of conflicts of interest in the financial services sector that turn into corrupt events when positions of trust are abused;
  - regulatory capture risks arising from ASIC's secondments, flow of staff between ASIC and industry, and ASIC's new plan to embed its staff in industry;
  - corruption risks arising from the involvement of ASIC staff in trading;
  - corruption risks arising from ASIC's real-time surveillance; and
  - corruption risks arising from ASIC's surveillance of the dark web.

### ***Regulatory capture***

3.49 The committee considers that regulatory capture is a significant issue faced by Australian regulators generally, given the size and power of corporations that operate in Australia. ASIC faces particular risks due to the financial benefits to be gained by participants in the financial services sector and the close interaction of ASIC staff and the industry it regulates. The committee notes that ASIC has been criticised for being a timid regulator<sup>54</sup> and is concerned that such timidity could be a result of regulatory capture.

3.50 While the committee has not sought to examine in detail the nature and extent of regulatory capture, the perception that regulatory capture has occurred:

- weakens ASIC's ability to perform its role;
- increases ASIC's vulnerability to corruption risks; and
- deprives ASIC of vital information from consumers and industry participants that lose trust in ASIC and no longer report misconduct.

3.51 The committee notes that regulatory capture is a significant integrity issue which affects ASIC and this has been supported by the findings of the Royal Commission. This, together with the public perception of ASIC as a timid regulator, adds significant emphasis to the need for ASIC's integrity and anti-corruption arrangements to be strengthened.

### ***Other integrity risks***

3.52 The committee observes that ASIC officers working on the real-time surveillance system are exposed to two very significant corruption risks. Industry participants may seek to corrupt them to not notice or report certain events, or to leak insider information.

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<sup>54</sup> Senate Economics References Committee, *Performance of the Australian Securities and Investments Commission*, June 2014, p. xviii.

3.53 The committee notes that integrity and corruption risks arising from ASIC staff participating in trading were not considered by the Parliamentary Joint Committee on the ACLEI inquiry or the Senate Select Committee on a National Integrity Commission. ASIC staff being involved in trading presents an inherent conflict of interests. As noted earlier in this chapter, where conflicts of interest are acted on, they potentially become corrupt acts.

3.54 The committee considers that it is vital for ASIC staff to be beyond reproach and to be perceived to be so. The committee is not convinced that the measures that are currently in place are sufficient to guarantee that ASIC staff are perceived, by those they regulate and the public, to be free from conflicts of interest. In particular, the committee is not convinced that the existing share trading governance process in ASIC would be able to identify all instances where ASIC staff (particularly those involved in market monitoring and information technology) have access to inside information which could be used to benefit from trades.

3.55 The committee considers that the corruption risks arising from ASIC staff continuing to be involved in trading adds further weight to arguments to enhance ASIC's integrity and anti-corruption arrangements. Consequently, the committee believes that further consideration should be given to whether ASIC staff should be allowed to engage in trading at all.

3.56 The committee notes that ASIC is proposing reforms to allow it to address the challenges presented by the dark web. Some of these reforms, such as the ability to assume identities, would represent significant additional powers that warrant appropriate oversight. In addition, working undercover and gaining the trust of dark web forums would expose ASIC officers undertaking those roles to significantly greater corruption risks than has previously been the case.

3.57 The committee considers that, if such reforms are progressed, they would add significant weight to the case for ASIC to be placed under a suitable external integrity regime.

### ***Conclusion***

3.58 The committee notes that ASIC has embarked on a review of its conflicts of interest process and approach. During the next parliament, the committee will be interested in hearing from ASIC on the outcomes of this review and the steps that ASIC is taking to address conflicts of interest and associated integrity risks.

3.59 The committee is concerned that ASIC's responses to questions about integrity and anti-corruption arrangements are focussed on fraud and do not reflect a sufficiently broad and sophisticated understanding of the types of issues identified by the Victorian IBAC and the specific risks identified in this chapter. The committee is also concerned that the Treasury, as the portfolio agency responsible for ASIC, was not able to effectively respond to questions on the adequacy of ASIC's integrity and anti-corruption arrangements.

3.60 It is essential for ASIC to be perceived as being beyond reproach, and to be driven by an unconditional commitment to upholding the law without conflicts of interest that could lead to corruption.



3.61 Subject to the findings of the Royal Commission, the committee considers there is merit in an independent external risk assessment of ASIC's integrity and anti-corruption arrangements to be undertaken by an integrity and anti-corruption expert with reference to:

- the integrity of ASIC's performance of all its functions, particularly in the broader sense of observing proper practice;
- risks associated with regulatory capture;
- whether ASIC's decisions on whether to pursue litigation or negotiated settlements are completely unencumbered from the influence of those it regulates; and
- whether closer scrutiny of ASIC's integrity and anti-corruption arrangements would improve ASIC's performance as a regulator.

3.62 The committee also considers there is merit in ASIC working with IOSCO to conduct a comparative analysis of integrity and anti-corruption measures being undertaken in similar jurisdictions.

## **Recommendation 2**

**3.63 The committee recommends that ASIC work with the International Organisation of Securities Commissions to conduct a comparative analysis of integrity and anti-corruption measures being undertaken in similar jurisdictions.**



# Chapter 4

## Oversight of the Takeovers Panel

4.1 This chapter discusses the committee's inquiries into the Takeovers Panel (the Panel) as required under paragraph 243(a)(i) of the *Australian Securities and Investments Commission Act 2001* (ASIC Act). It also considers some academic work evaluating the Panel.

4.2 The committee previously reported on the Panel in its oversight report in November 2014.<sup>1</sup> The committee also reported on the annual report of the Panel in its report on the 2016–17 annual reports of bodies established under the ASIC Act.<sup>2</sup>

### About the Takeovers Panel<sup>3</sup>

4.3 Following implementation of the *Corporate Law Economic Reform Program Act 1999*, the Panel was established in its present form on 13 March 2000 by Part 10 of the ASIC Act. Its purpose is to resolve disputes arising in the course of takeovers in an efficient, effective, fair and speedy manner. The Panel was established, at least in part, because of a concern that disputes could be lodged in court during a takeover as a strategic measure, or, as a delaying tactic, and that the nature of legal processes encouraged this behaviour.<sup>4</sup>

4.4 Now, however, under section 659B of the *Corporations Act 2001* (Corporations Act), private parties to a takeover no longer have the right to commence civil litigation or seek injunctive relief from the courts while a takeover is in progress. Instead, a party to a takeover bid may make an application to the Panel to seek a resolution of a dispute.

4.5 The Panel is composed of part-time members who are specialists in mergers and acquisitions, such as investment bankers, lawyers, company directors or other professionals. This composition reflects the Panel's focus on commercial and policy issues rather than legal issues.

4.6 A takeover under Chapter 6 of the Corporations Act is defined as the acquisition of control over voting shares or voting interests in listed companies,

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1 Parliamentary Joint Committee on Corporations and Financial Services, *Statutory Oversight of the Australian Securities and Investments Commission, the Takeovers Panel and the Corporations Legislation*, Report No 1 of the 44<sup>th</sup> Parliament, November 2014.

2 Parliamentary Joint Committee on Corporations and Financial Services, *Report on the 2016–2017 annual reports of bodies established under the ASIC Act*, July 2018.

3 Except where otherwise indicated, material in this section is derived from The Takeovers Panel website, especially *About the Panel*, [https://www.takeovers.gov.au/content/DisplayDoc.aspx?doc=about/about\\_the\\_panel.htm#role](https://www.takeovers.gov.au/content/DisplayDoc.aspx?doc=about/about_the_panel.htm#role) (accessed 12 February 2019).

4 Michael Hoyle, 'An overview of the Role, Functions and Powers of the Takeovers Panel' in Ian Ramsay ed., *The Takeovers Panel and Takeovers Regulation in Australia*, Melbourne University Press, 2010, p. 47.

unlisted companies with more than 50 members, and listed managed investment schemes.

4.7 During a takeover bid, the Panel is able to declare unacceptable circumstances with respect to the public interest in relation to the affairs of a company. The Panel can establish orders to remedy those circumstances. There is no definition of 'unacceptable circumstances': it is up to the Panel. Its orders protect the rights of persons or groups (especially shareholders in the target company) and attempt to ensure that a takeover proceeds as it would have done if the unacceptable circumstances had not occurred.

4.8 The Panel acts in response to an application by a person who has standing in a takeover process as a bidder, target, or otherwise affected party, or by the Australian Securities and Investments Commission (ASIC). It also has power to review some decisions by ASIC, and matters may be referred to it by a court. The Panel cannot proceed on its own motion.

4.9 A sitting Panel consists of three members of the Panel nominated by the chair when an application is received. It usually comprises a lawyer, an investment banker, and a company director or market professional.<sup>5</sup> Its decisions may be reviewed by a new sitting Panel comprising three other members of the Panel.

4.10 The sitting Panel, on receiving an application, first decides whether to investigate the issue. If it does investigate, it proceeds informally: it is not bound by the rules of evidence, and it does not have to conduct hearings. It may call for submissions from interested parties.

4.11 The Panel issues Guidance Notes on various topics to help applicants and other parties. There are 18 current Guidance Notes.

4.12 Panel members are appointed by the Governor-General on the nomination of the Minister. Appointments are made on a part-time basis, usually for a period of three years. There must be a minimum of five members. At 8 November 2018, the Panel had 43 members.

4.13 The Panel operates under a memorandum of understanding (MOU) with ASIC, which was reviewed in March 2017. The effect of the review was to make the MOU an agreement between ASIC and the Panel executive, rather than the Panel itself, because that is where the liaison occurs. Other changes streamlined the MOU because experience showed that the level of prescription in the first MOU was unnecessary.<sup>6</sup>

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5 Mr Allan Bulman, Director, Takeovers Panel, *Committee Hansard*, 16 February 2018, p. 1.

6 Mr Allan Bulman, Director, Takeovers Panel, *Committee Hansard*, 16 February 2018, p. 9.

## The work of the Panel

4.14 The number of applications to the Panel fluctuates, but is partly dependent on the amount of merger and acquisition activity taking place. This, in turn, is partly a function of local and overseas economic conditions. A high level summary of the Panel's work is presented in Table 4.1.

**Table 4.1: Work of the Takeovers Panel, 2013–14 to 2017–18**

	2013–14	2014–15	2015–16	2016–17	2017–18
Applications	26	20	20	23	29
Matters where the Panel conducted proceedings	13	5	13	9	16
Matters where the Panel declined to conduct proceedings	13	12	6	11	12
Average days between application and decision	19.2	11.3	19.2	16.3	14.8

*Source:* Annual Reports of the Takeovers Panel, 2013–14 to 2017–18.

4.15 The average number of applications since 2000 has been 29 a year. Since 2009, that average has fallen to 23 a year. However, in 2017–18 the number of applications was back up to the long-term average. This probably reflects favourable global and local economic activity, and possibly fluctuations in commodity prices. However, Mr Allan Bulman, the Director of the Takeovers Panel, warned the committee that it was difficult to make simple connections because of the small number of cases coming before the Panel.<sup>7</sup>

4.16 Over the five years for which data are shown in the table, the Panel has conducted proceedings in roughly half of the cases. There does not seem to be any trend in the propensity to conduct proceedings in recent years, however as previously scrutinised by the committee, the rate at which the Panel declined to conduct proceedings did increase steadily from around 6 per cent to over 50 per cent during its first decade. The Panel argues that this probably reflects experience and growing confidence in being able to read the circumstances of a takeover.<sup>8</sup> In general, the Panel encourages the parties to sort out issues themselves if possible.<sup>9</sup>

4.17 Towards the end of 2017, the Panel had dealt with nearly 500 applications in total. Of those:

- 80 were concerned with the content of the bidder's statement in a takeover bid;

<sup>7</sup> Mr Allan Bulman, Director, Takeovers Panel, *Committee Hansard*, 16 February 2018, p. 5.

<sup>8</sup> Mr Allan Bulman, Director, Takeovers Panel, *Committee Hansard*, 16 February 2018, p. 8. This matter was also discussed in the Oversight report No. 1 of 44<sup>th</sup> Parliament, cited above, pp. 4–5.

<sup>9</sup> Mr Allan Bulman, Director, Takeovers Panel, *Committee Hansard*, 16 February 2018, p. 5.

- 55 alleged breaches of the 20 per cent threshold, above which an acquirer has to make a general offer for the shares of a company; and
- 74 alleged that parties were acting in association in order to obscure that the 20 per cent threshold was being breached.<sup>10</sup>

4.18 An important reason for the Panel's existence is its ability to deal quickly with applications. It has three months from when the circumstances occurred, or one month from the date of the application, to make a decision.<sup>11</sup> Since 2000, the Panel has taken an average of 16 days to make a decision. As the table shows, the time for the Panel to make a decision has been above that average in two of the last five years, but in general the time elapsed does not appear to have increased.

4.19 Applications alleging association are the most resource intensive, because the investigation requires 'almost a forensic audit within a month'. Occasionally, the Panel has expanded its resources by taking on contractors in such cases.<sup>12</sup>

4.20 Decisions of the Panel are open to judicial review, but there had been only about six applications for review to the end of 2017.<sup>13</sup>

### **Views of the Panel's performance**

4.21 The Takeovers Panel does not attract a great deal of public scrutiny, presumably partly because of the informality of its processes. Occasionally its decisions are analysed in the media. The case of Taurus Funds Management and Finders Resources, a Panel decision which was then judicially reviewed, attracted comment that was not entirely favourable to the Panel.<sup>14</sup>

4.22 The Panel has also been criticised for declining to conduct proceedings in what became a notorious insider trading case involving a US congressman.<sup>15</sup>

4.23 However, a comprehensive stakeholder survey conducted for the Panel found a very high 89 per cent of respondents were satisfied with the conduct of the Panel. Criticisms recorded during the survey included:

- sitting panel members' experience with mergers and acquisitions;
- the handling of novel issues; and

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10 Mr Allan Bulman, Director, Takeovers Panel, *Committee Hansard*, 16 February 2018, p. 2.

11 Mr Allan Bulman, Director, Takeovers Panel, *Committee Hansard*, 16 February 2018, p. 3.

12 Mr Allan Bulman, Director, Takeovers Panel, *Committee Hansard*, 16 February 2018, p. 3.

13 Mr Allan Bulman, Director, Takeovers Panel, *Committee Hansard*, 16 February 2018, p. 6.

14 For example: Matthew Stevens, 'Taurus Funds Management earns a big win in losing Takeovers Panel appeal', *Australian Financial Review*, 7 June 2018, <https://www.afr.com/business/mining/copper/taurus-funds--management-earns-a-big-win-in-losing-takeovers-panel-appeal-20180607-h113sj> (accessed 12 February 2019).

15 Myriam Robin, 'ASIC, Takeovers Panel missed red flags on Chris Collins at Innate Immunotherapeutics', *Australian Financial Review*, 12 August 2018, <https://www.afr.com/brand/rear-window/asic-takeovers-panel-missed-red-flags-on-chris-collins-at-innate-immunotherapeutics-20180812-h13v1d> (accessed 12 February 2019).

- the relatively gentle sanction when association is found, where the remedy the Panel usually applies is to vest the shares in breach of the 20 per cent rule with ASIC for on-sale. (The Taurus Funds Management case mentioned above involved a remedy along these lines).<sup>16</sup>

4.24 There has been a body of academic analysis of the Panel. Dr Emma Armson of the University of New South Wales has published assessments of the Panel against the three criteria of speed, flexibility and certainty.

4.25 With respect to speed in decision-making, Dr Armson notes that this was one of the main aims of establishing the Panel in its current form. She assessed the speed of the Panel's decision making to June 2016 by comparing the time it has taken against benchmarks applied to courts and other tribunals. She found that the Panel is a good deal faster than courts, taking an average of 16.6 days to make its decisions and 46.1 days from application to the publication of reasons (or, where judicial review is involved, 62.3 days), compared with a range of 11 months to 3.5 years for the courts. She concluded that the objective of speed has been met.<sup>17</sup>

4.26 Dr Armson examines flexibility in two dimensions, procedural and substantive, which are reflected in the informality which is part of the Panel's operations. The Panel has been designed for procedural flexibility: its powers, its processes, and the expertise of members. In particular, the Panel's proceedings are to be as informal as is consistent with fairness and speed. Substantive flexibility has to do with whether the Panel's approach to the use of discretion rather than rules. In essence, this involves a commercial and pragmatic approach rather than a legalistic one, and achieves its outcomes through negotiation rather than orders where possible. Dr Armson found that the Panel's arrangements result in a 'strong form of procedural flexibility'. She used a case study of the development of the Panel's frustrating action policy to conclude that there is also a strong form of substantive flexibility.<sup>18</sup>

4.27 The notion of certainty in decision-making has two key elements, consistency and finality. Dr Armson examined consistency through a case study of Panel decisions relating to ASIC's 'truth in takeovers' policy.<sup>19</sup> She noted that there has been criticism of the Panel because there was uncertainty as to whether it would apply the policy.

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16 Mr Alan Bulman, *Committee Hansard*, 16 February 2018, p. 3.

17 Emma Armson, 'Speed in decision-making: an assessment of the Australian Takeovers Panel', *Company and Securities Law Journal* 352, 2017, UNSW Law Research Series 2018, pp. 12–21.

18 Emma Armson, 'Flexibility in decision-making: an assessment of the Australian Takeovers Panel', *UNSW Law Journal*, vol. 40, no. 2, May 2017.

19 ASIC's 'truth in takeovers' policy is contained in ASIC Regulatory Guide 25, Takeovers: false and misleading statements. According to Michael Gajic and Ratha Nabanidham, 'ASIC Regulatory Guide 25 provides that a person who makes a statement in relation to a takeover bid should be held to that statement, and cannot depart from the statement, unless the person clearly and expressly qualifies it at the time of making it': Michael Gajic and Ratha Nabanidham, Minter Ellison, 'The continued erosion of ASIC's 'truth in takeovers' policy—is there now a new way to avoid the policy?', <https://www.minterellison.com/articles/the-continued-erosion-of-asics-truth-in-takeovers-policy> (accessed 12 February 2019).

The Panel has said that it would not automatically apply the policy, and that it would consider other matters including reasonableness and new circumstances. Dr Armson found that differences between ASIC's and the Panel's interpretations of events are explicable in terms of the different roles of the two bodies. The Panel's decisions displayed a high level of consistency over time. With respect to finality, Dr Armson examined court decisions involving judicial review of Panel decisions. She noted that there have not been many judicial reviews (four), but that the courts have overturned half the Panel decisions. Overall, Dr Armson concluded that the Panel has achieved a medium to high level of certainty.<sup>20</sup>

4.28 At its hearing in February 2018, the committee asked representatives of the Takeovers Panel whether they had views about reforms to the law and whether, in the course of their operations, they analysed information about the cases they processed in order to advise Treasury and legislators as to how the law might be improved.

4.29 Mr Bruce Dyer, Counsel to the Panel, responded:

There have been various reforms suggested by different people over the years. Generally, the Takeovers Panel, as you saw from the stakeholder survey results, has been well-received by the market and those who are most actively involved in this area. As a result, there is a bit of a hesitation about changing what seems to be working very well. You can have lots to reform ideas, but once you start to change something you don't know what the flow-on effects of that might be.<sup>21</sup>

4.30 Mr Dyer further noted that much of the Panel's policy is contained in its Guidance Notes, and the panel members meet twice a year to look at policy issues that can be dealt with within the broad power to declare circumstances unacceptable.<sup>22</sup> In developing or changing Guidance Notes, the Panel consults Treasury and ASIC.<sup>23</sup>

### **Committee view**

4.31 The committee notes the favourable views of the Takeovers Panel from its stakeholder survey and from academic analysts. It considers that the Takeovers Panel is working effectively.

## **Mr Michael Sukkar MP**

### **Committee Chair**

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20 Emma Armson, 'Certainty in decision-making: An assessment of the Australian Takeovers Panel', *Sydney Law Review* 17, vol. 38, no. 3, 2016, <http://www.austlii.edu.au/au/journals/SydLRev/2016/17.html> (accessed 12 February 2019).

21 Mr Bruce Dyer, Counsel, Takeovers Panel, *Committee Hansard*, 16 February 2018, p. 6.

22 Mr Bruce Dyer, Counsel, Takeovers Panel, *Committee Hansard*, 16 February 2018, pp. 8–9.

23 Mr Allan Bulman, Director, Takeovers Panel, *Committee Hansard*, 16 February 2018, p. 9.



# Appendix 1

## Additional information received by the Committee

### *Additional Information*

1. Findings by the Commonwealth Ombudsman regarding the Australian Securities and Investments Commission's handling of a matter raised by Mr Sweeney.
2. Table of enforcement outcomes provided by the Australian Securities and Investments Commission (received 23 August 2018).

### *Tabled documents*

1. Australian Securities and Investments Commission: Enforcement outcomes by financial year and as at 31 July 2018 (public hearing, Melbourne, 17 August 2018).
2. Australian Securities and Investments Commission: Review of ASIC's Enforcement Policies, Processes and Decision-Making Procedures (public hearing, Canberra, 19 October 2018).
3. Australian Securities and Investments Commission: Enforcement outcomes and Compensation and community benefit fund payments (public hearing, Canberra, 19 October 2018).

### *Answers to Questions on Notice*

1. Australian Securities and Investments Commission: Answers to questions 3–5 posed on 23 August 2017 (received 12 January 2018).
2. Australian Securities and Investments Commission: Answers to questions 6–8 posed 23 August 2017 (received 9 January 2018).
3. Australian Securities and Investments Commission: Answers to questions 5, 8–9 taken on notice from public hearing 1 December 2017 (received 2 March 2018).
4. Takeovers Panel: Answers to questions taken on notice from a public hearing on 16 February 2018 (received 1 March 2018).
5. Australian Securities and Investments Commission: Answers to questions on notice posed 8 February 2018 (received 12 February 2018).
6. Australian Securities and Investments Commission: Answers to question 2 posed 19 February 2018 (received 29 March 2018).
7. Australian Accounting Standards Board & Auditing and Assurance Standards Board: Answers to questions on notice from a public hearing on 16 February 2018 (received 13 March 2018).
8. Australian Securities and Investments Commission: Answers to questions 1, 3 posed 19 February 2018 (received 4 April 2018).
9. Australian Securities and Investments Commission: Answers to questions on notice posed 15 December 2017 (received 26 March 2018).
10. Commonwealth Director of Public Prosecutions: Answers to questions on notice posed 23 May 2018 (received 3 July 2018).

11. Office of the Commonwealth Ombudsman: Answers to questions on notice posed 1 August 2018 (received 14 August 2018).
12. Australian Securities and Investments Commission: Answers to questions on notice posed 1 August 2018 (received 15 August 2018).
13. Professor A J Brown: Answers to questions posed 1 August 2018 (received 27 August 2018).
14. Department of the Treasury: Answers to questions posed 1 August 2018 (received 14 September 2018).
15. Australian Securities and Investments Commission: Answers to questions 1, 5–8 posed 22 August 2018 (received 24 September 2018).
16. Australian Securities and Investments Commission: Answers to questions 2–4, 9–10 posed 22 August 2018 (received 27 September 2018).
17. Australian Securities and Investments Commission: Answers to questions taken on notice from a public hearing on 17 August 2018 (received 27 September 2018).
18. Australian Securities and Investments Commission: Answers to questions taken on notice from a public hearing on 17 August 2018 (received 3 October 2018).
19. Australian Securities and Investments Commission: Answers to questions taken on notice from a public hearing on 17 August 2018 (received 8 October 2018).
20. Australian Securities and Investments Commission: Answers to questions taken on notice from a public hearing on 17 August 2018 (received 12 October 2018).
21. Commonwealth Director of Public Prosecutions: Answers to questions on notice posed 30 August 2018 (received 15 October 2018).
22. Australian Securities and Investments Commission: Answers to questions taken on notice from a public hearing on 17 August 2018 (received 29 October 2018).
23. Australian Securities and Investments Commission: Answers to questions taken on notice from a public hearing on 17 August 2018 (received 30 October 2018).
24. Australian Securities and Investments Commission: Answers to questions taken on notice from a public hearing on 19 October 2018 (received 30 October 2018).
25. Australian Securities and Investments Commission: Answers to questions taken on notice from a public hearing on 19 October 2018 (received 14 November 2018).
26. Australian Securities and Investments Commission: Answers to questions taken on notice from a public hearing on 19 October 2018 (received 20 November 2018).
27. Commonwealth Director of Public Prosecutions: Answers to questions taken on notice from a public hearing on 18 October 2018 (received 26 November 2018).
28. Australian Securities and Investments Commission: Answers to questions taken on notice from a public hearing on 19 October 2018 (received 19 December 2018).
29. Australian Securities and Investments Commission: Answers to questions taken on notice from a public hearing on 19 October 2018 (received 20 December 2018).
30. Law Council of Australia: Answers to questions posed 1 August 2018 (received 15 August 2018).
31. Australian Securities and Investments Commission: Answers to questions taken on notice from a public hearing on 19 October 2018 (received 27 November 2018).

## **Appendix 2**

### **Public hearings and witnesses**

*Melbourne, 17 August 2018*

#### **Australian Securities and Investments Commission**

Mr James Shipton, Chair

Mr Daniel Crennan QC, Deputy Chair

Ms Cathie Armour, Commissioner

Mr John Price, Commissioner

Mr Warren Day, Senior Executive Leader, Assessment and Intelligence, and Regional Commissioner—Victoria

Mr Greg Kirk, Senior Executive Leader, Strategy Group

Ms Louise Macaulay, Senior Executive Leader, Financial Advisers

Mr Michael Saadat, Senior Executive Leader, Deposit Takers, Credit and Insurers, and Regional Commissioner—New South Wales

Mr David McGuinness, Senior Executive Leader, Financial Services Enforcement

Ms Alex Purvis, Senior Manager, Investors and Financial Consumers and Investment Managers and Superannuation

*Canberra, 18 October 2018*

#### **Commonwealth Director of Public Prosecutions**

Ms Sarah McNaughton, SC, Director

Mr Berdj Tchakerian, Acting Deputy Director, Commercial, Financial and Corruption Practice Group

Ms Fiona O'Brien, Acting Chief Corporate Officer

*Canberra, 19 October 2018*

**Australian Securities and Investments Commission**

Mr James Shipton, Chair

Mr Peter Kell, Deputy Chair

Mr Daniel Crennan QC, Deputy Chair

Ms Cathie Armour, Commissioner

Mr John Price, Commissioner

Ms Danielle Press, Commissioner

Mr Carlos Iglesias, Chief of Operations

Mr Warren Day, Senior Executive Leader, Assessment and Intelligence, and  
Regional Commissioner—Victoria,

Ms Jane Eccleston, Senior Executive Leader, Investment, Managers and  
Superannuation

Ms Laura Higgins, Senior Executive Leader, Financial Capability

Mr Greg Kirk, Senior Executive Leader, Strategy Group

Ms Louise Macaulay, Chief Supervisory Officer

Mr Tim Mullaly, Senior Executive Leader, Financial Services Enforcement

Mr Michael Saadat, Senior Executive Leader, Deposit Takers, Credit and  
Insurers, and Regional Commissioner—New South Wales