Tom Ravlic
SIA (Aff.), BA (Journalism) RMIT, GradCert AccFinMan (CSU)
Phone · 61 3 **9551 1878**
Fax · 61 3 **9551 1877**
Mobile **0407 408 000**
Email travlic@bigpond.com
Address 4 Loddon Court, Clayton South, VIC 3169

24 April 2004

Dear Dr Dermody,

Very little flesh has been placed on the skeletal outline of the functions of the Financial Reporting Panel as it is proposed to exist under the Corporate Law Economic Reform Program changes. This change is one of the single most critical alterations to the manner in which disputes on accounting matters are resolved between a regulator and a company and there has been an absence of thought about the principles that underpin such a structure. The purpose of this submission is to give the committee some ideas to consider when it finalises its deliberations on how the panel should operate. I will, of course, repeat some points made in previous submissions, but that is done so what appears here is as complete as it can be without need for reference to extrinsic materials. I would be happy to take any questions or queries at any point in time.

The proposal

A core principle embedded within the FRP concept is to have experts determine what constitutes an appropriate accounting treatment where a dispute occurs between a regulator and a company over an aspect of financial reporting. A similar system has been running in the UK for many years and following a court case lost by the Australian Securities and Investments Commission over the application of an accounting standard, particularly provisions disallowed by the Senate, stronger calls began to emanate from various quarters about the need to an alternative system of dispute resolution. It is viewed by some commentators as being the accounting equivalent of the takeovers panel. That analogy needs to be reconsidered because the panel tends to hear matters arising between two companies participating in a takeover scenario rather than matters that have been point to by the corporate regulator as being a potential breach of accounting standards.

Analysis of the issues

It is probably wise to remember that there are several sides to this story over disputes on accounting matters that arise as a result of the activity of the corporate regulator. The

Tom Ravlic
SIA (Affl.), BA (Journalism) RMIT, GradCert AccFinMan (CSU)
Phone·61 3 **9551 1878**
Fax·61 3 **9551 1877**
Mobile **0407 408 000**
Email travlic@bigpond.com
Address 4 Loddon Court, Clayton South, VIC 3169

regulator may well have a legitimate view on an issue, but the party that is at the pointy end of the regulator's questioning will more often than not disagree with the regulator's reasoning on an accounting matter. There is also a general tension between those that are the targets of regulatory activity or fear the expansion of powers of regulators over certain parts of the corporate governance continuum that would argue for the involvement of a greater number of independent individuals in the process of deciding whether a company has applied an accounting standard correctly.

A corporate view

At times the ASIC has been criticised for bearing down heavily on companies involved in discussions with it. Some entities have contemplated legal action from time to time but the decision to not do so has frequently been rationalsed by the fact it is damaging to an entity's reputation to have a spat with the regulator in public. A company may take the stance it is better to change the accounting and continuing living life rather than engage in a costly court battle that would tie up company resources. Agreement to change the accounting treatment in a set of financial statements to the regulator's preferred approach may be viewed as a pragmatic decision rather than a decision based on the company's conviction that it had the right accounting treatment to begin with. This scenario has been a reason for discussions within the accounting profession and other parts of the community about the creation of a panel to deal with accounting disputes arising from issues the regulator has picked up along the way.

Benefits and dangers for the ASIC

Consider this from a regulator's viewpoint. If it is seen as attacking companies for dubious reasons then the system suffers because the regulator may not be trusted to be reasonable and fair by parts of the community that operate in areas falling within its regulatory charter as spelt out by the Australian Securities and Investments Commission Act 2001. This has certainly been the case from time to time when entities under the watchful gaze of the regulator have sought comfort and support from their compatriots in corporate Australia. Should a regulator's view be consistent with that of such a reporting panel then it receives the legitimacy bestowed upon it by a process that is using the intellectual capabilities of those chosen to hear an issue. Does this make the regulator wrong if a finding goes against the regulator's preferred view? If the process is one where arguments are tested and the force of numbers falls on the side of the company that is the subject of the commission's complaint then it could be argued the commission is wrong insofar as the specific facts of that circumstance are concerned. The existing state of play

Tom Ravlic
SIA (Aff.), BA (Journalism) RMIT, GradCert AccFinMan (CSU)
Phone · 61 3 **9551 1878**
Fax · 61 3 **9551 1877**
Mobile **0407 408 000**
Email travlic@bigpond.com
Address 4 Loddon Court, Clayton South, VIC 3169

means the regulator has the opportunity to get a regulatory outcome it desires because a target of its attention declines to take the option of pushing the matter through the adversarial court process.

Respite from less knowledgeable minds

There is a threat the outcome of a court case may be the result of an understand of an accounting principle set down in the law merely from the view of legal interpretation of a document such as an accounting standard without regard for the rest of the framework within which the application of a specific accounting standard takes place. The case involving the ASIC and MYOB Limited is the ideal example that embodies the very issue. Expert witnesses were engaged by the two sides to the case and much of what the expert witnesses had to say was disregarded because it was submitted in the form of opinion and not admissible evidence as the court rules would require. The Supreme Court judge dealing with the matter then decided to rely more on his own analysis of the evidence rather than give credence to the opinions of those that deal with the accounting literature on a daily basis. This then draws into sharp focus a very important issue. If the evidence of experts is to be ignored in such a court case because they express opinions in a manner that is inadmissible in court then it has some serious, wide-ranging implications for accounting practice generally. Should professionals be in a position where their judgments on technical matters are inadmissible in a court of law? Should they be entitled to put those arguments for or against an accounting practice in an environment where their analysis can be given a greater or heavier weighting? The latter question has two potential answers that could resolve the judicial 'blocked ear' syndrome that was so evident in the MYOB Limited case.

One means of resolution is the establishment of a panel such as the FRP that is conditioned to arguments presented as professional opinions and does not require them to meet the hurdles of admissibility that are required in a court of law as a part of the process of dispute resolution. The other way of resolving the issue is to give the professionals appearing as experts before a court greater freedom in the manner in which they present their evidence in order to ensure that the evolution of practice in dealing with specific accounting problems that are a part of a set of circumstances with a dispute being dealt with in a court of law. The latter proposition, I believe, is one that needs serious consideration even with an established reporting panel. If the decision made by the reporting panel is one that is contested by either party it could easily end up as a dispute being resolved by a court of law. Such a situation would require the rules of inadmissibility to be altered in my view so that professional views are given a greater

Tom Ravlic
SIA (Aff.), BA (Journalism) RMIT, GradCert AccFinMan (CSU)
Phone · 61 3 **9551 1878**
Fax · 61 3 **9551 1877**
Mobile **0407 408 000**
Email travlic@bigpond.com
Address 4 Loddon Court, Clayton South, VIC 3169

airing. It is clear to me the panel is being used as a way of wresting the power of decision making in this area from the legal fraternity because the accounting expertise does not reside exclusively within the judicial system and it provides the opportunity to ensure decisions are made by accounting experts.

Panel's processes

Several issues have been raised in public debate about what the panel should do, who it should do it with and the precise time at which the 'doing' should occur. It is worthwhile summarising a few of those issues here for the sake of completeness.

During the evidence I gave on April 14 I submitted that the panel should only here matters after the accounting firms acting as external auditors and their company clients have decided on a particular matter and the reports have been published. I have some grave difficulties with the suggestions some bodies are making about the need to have a pre-vetting 'marriage counseling' service on accounting issues before the auditor signs off on a set of financial statements as being in accordance with the relevant reporting framework and the Corporations Act. That would turn a financial reporting panel into nothing more than a corporate accounting nanny to which weak kneed professionals could ask clients to go and – the professionals knowing full well the appropriate accounting treatment – could then blame the financial reporting panel members for a decision that went against a client's preferred accounting treatment rather than taking the responsibility on themselves to fulfill their current, critical and moral obligation to shareholders of the audited entity. The panel could function as a convenient body to which blame for a decision on the appropriateness of accounting treatments could be transferred. It should not be the role of the proposed panel to give comfort to auditors that might feel uncomfortable about making a decision on the appropriateness of an accounting treatment because it might offend the accounting sensibilities of a corporate client.

Pre-vetting accounting treatments prior to publication also poses serious regulatory risks that need to be borne in mind by the committee as it considers the relevance and function of the panel. This panel has been proposed as a way in which the corporate regulator would be able to have disputes settled between companies. Pre-vetting would play into the hands of those individuals who would want to short circuit the regulator's ability to take action by creating a conflict within the panel structure itself. What is to occur in a situation where the matter is resolved by the panel but the regulator has an issue? Should that matter then be referred to the courts of law that have been vilified by the various

Tom Ravlic
SIA (Aff.), BA (Journalism) RMIT, GradCert AccFinMan (CSU)
Phone · 61 3 **9551 1878**
Fax · 61 3 **9551 1877**
Mobile **0407 408 000**
Email travlic@biqpond.com
Address 4 Loddon Court, Clayton South, VIC 3169

experts as being the inappropriate process for the resolution of such issues? That is the question that the supporters of the 'panel as professional nanny' need to seriously think through. It is either going to be a dispute resolution regime whereby the commission and a company will be parties in an application that will be judged by experts. Can you imagine a scenario where the panel gives advice to a company and an auditor on an accounting treatment, which is not the appropriate position for a panel that is effectively a pseudo-judicial forum, and that advice is then challenged by the ASIC and the ASIC view wins in a subsequent action? It would make the process that is supposed to provide assurance to the investor community about the robustness and transparency of our capital market look very poor.

You also need to bear in mind the membership of the panel will need to be as wide-ranging as possible because there is a very narrow group of experts involved in this area. The gene pool of talent is extremely small and that means that drawing together a completely independent panel to deal with specific matters is going to be a challenge at all times. There is a danger a 'club mentality' would make those participating in it reluctant to deal with some of these issues in public because of the fact they may be dealing with issues involving current or past colleagues. That is just the human dimension to this process the committee needs to bear in mind when it considers the work of such a body.

Should other people refer matters to the panel?

Where matters become apparent to others following the publication of a set of financial statements there should be some capacity for these matters to be heard by the financial reporting panel. How this would work at present is unclear to me but excluding other parties from putting matters to such a body after the publication of accounts - after auditors and companies have signed off on the accounts, that is – would appear to be unfair at first glance. Care would need to be taken that such matters are not frivolous claims and have some genuine issue.

Oversight of the panel

The current proposal supported by many people is that the FRC gets to oversee the panel. On reflection I would prefer a structure that places the FRP next to the Takeovers panel. Both bodies have a judicial function and they should be housed side by side. The FRC should be predominantly involved in overseeing rule makers such as the auditing and accounting standard setters.

Tom Ravlic
SIA (Alt.), BA (Journalism) RMIT, GradCert AccFinMan (CSU)
Phone · 61 3 **9551 1878**
Fax · 61 3 **9551 1877**
Mobile **0407 408 000**
Email travlic@bigpond.com
Address 4 Loddon Court, Clayton South, VIC 3169

Leonard Spacek and his 'accounting court'

I have provided the committee secretariat with a copy of a 1950s presentation by Leonard Spacek dealing with the 'Need for an accounting court'. I would bring to the committee's attention the fact that Spacek argues for the publication of all of the aspects of a decision reached by an 'accounting court'. Spacek's thinking was before its time and I believe it provides the committee with some historical perspectives with respect to the concept of an expert led problem resolution process.

Should the committee require any further information I am happy to either appear before it again or provide further comments in writing.

Kindest Regards

Tom Ravlic