AUSTRALIA

KEY POINTS

- Over the past two decades, major trade and microeconomic reforms have exposed Australian firms to more competitive markets, disciplining their behaviour.
- A major recession, related corporate collapses and moves to keep abreast of world best practice encouraged on-going regulatory reform, creating a sound corporate governance environment.
- Corporates balance debt and equity financing, encouraging direct financing markets. Strong household demand for shares supports capital raising on the share market, exposing firms to regulatory and shareholder activism. Banks are highly independent and competitive, lowering interest margins for debt finance.
- Minority shareholders are increasingly prominent and institutional investors generally exercise their rights as large shareholders.
- Recent corporate failures may provide an impetus to further finetune the role of directors and auditors and further prioritise corporate ethical standards.
- The press closely scrutinises corporate behaviour, including financial performance.

In the last two decades, two waves of corporate failures spurred Australian corporate governance reforms; corporate governance now largely accords with international best practice. Over the same period, Australia developed large and deep direct finance markets and very open goods and service markets, disciplining corporations. The 2001 failure of several high profile corporates may test aspects of the current corporate governance framework and lead to its further evolution. These collapses and consequent shareholder and creditor losses will increase their financial and corporate governance scrutiny of corporates.

CORPORATE STRUCTURE

Large public companies dominate Australia's corporate structure, resulting in managerial autonomy; very few have significant family or government ownership. Shareholders actively trade on markets, strongly influencing management behaviour. In 2000, 52 per cent of Australia's adult population owned shares, 40 percentage points of whom owned them directly, up from just 22 per cent in 1991. This gives Australia one of the highest levels of share ownership in the world (Australian Stock Exchange, 2001).[1] The Government used public floats to privatise, fully or partially, several public corporations, including Telstra, Commonwealth Bank and Qantas and several mutual societies, including AMP, the largest insurance company, demutualised, boosting ownership growth.

MARKETS DISCIPLINE CORPORATES

Australian goods, services and financial markets are generally very competitive and have few barriers to new entrants. Corporates usually finance investment directly through the equity and bond markets, producing modest debt to equity ratios. Over recent decades, the Government progressively deregulated goods and financial markets and withdrew from direct production in most sectors, increasing domestic competition. It also reduced import barriers and direct industry assistance, exposing industries more to international competition. Significant tariffs remain only in the auto, footwear, clothing and textile industries and in some agricultural industries; all these also have declined steeply in the last decade and are scheduled to fall to modest levels in future years. While the Government maintains pre-establishment screening of foreign investment, few sectoral restrictions apply to foreign direct investment. Market conduct regulation, principally the 1974 Trade Practices Act, is designed to promote competition and fair trading.

FINANCIAL MARKETS

Financial markets discipline Australian firms; managers closely attend to share price movements and increasingly to shareholder concerns. Vigorous banking system competition eliminates incentives for corporates to deal with only one bank and direct financing increases market scrutiny of firm behaviour.

1 This could well be higher than the ownership levels in the United States, where, in 1998, 49 per cent of families, not individuals, owned stock equity (Kennickell et al., 2000).

Independent and Competitive Banking System

Australia's big four banks are listed publicly and feature dispersed shareholders; the last significant state owned bank was sold in the 1990s. Australia's highly competitive banking system is not regulated excessively and relies mainly on a disclosure based approach. The mergers and acquisitions market is active; recent takeovers include the privatised and widely held Commonwealth Bank's 2000 acquisition of Colonial, a bank and insurance company.

Deregulating financial markets encourages greater competition for equity and credit. In the 1970s and 1980s, the Government removed interest rate controls, floated the exchange rate and opened the financial sector to foreign competition. Deregulation in mortgage finance and deposit taking markets allowed new entrants to challenge the banks; since then, margins have contracted by about 40 per cent (Battellino, 2000). Australia's 33 foreign banks operate without branching or other restrictions (Australian Prudential Regulation Authority, 2001).

FINANCIAL DEREGULATION PRECURSOR TO EXCESSES OF THE 1980S

As occurred in East Asia in the mid 1990s, significant deregulation of the banking sector from 1983 removed interest rate caps and prudential controls on asset holding, encouraging some Australian banks and corporates to undertake risky lending and investment. Financial market deregulation allowed new banks to enter the market for the first time in many decades. Competition for market share was intense and some lenders relaxed lending standards. These factors, combined with overall global economic conditions, contributed to an explosion in bank lending and private debt, which grew at an average rate of 17 per cent per year during the 1980s (Lavarch, 1994). Subsequent company disclosures reveal some banks made poor business decisions, including lending to unscrupulous borrowers. Several major corporates collapsed, many revealing illegal and unethical behaviour by their major owner managers; one major bank, Westpac, came close to collapse due to high non performing loans. Regulators, corporates and banks learnt many valuable lessons from this salutary experience; in part these helped protect Australia from corporate excesses in the mid 1990s.

Partly stimulated by a banking crisis in the late 1980s and early 1990s, Australian banks now are highly focused on risk measurement and management. For example, Australian banks have long maintained credit bureaus to separate credit management from credit origination and manage credit risk at the group level. More recently, banks have established independent risk management groups to assess all risks that bank groups face (Gruen et al., 1998).

Corporate Finance Balanced, Deep

Australian firms balance their funding sources, prudently mixing debt and equity finance. After the late 1980s' debt excesses, listed companies reduced their debt to equity ratios and banks closely scrutinised these ratios, encouraging equity financing. By regional standards, Australia's debt to equity ratio for private non-financial firms is low, at just under 100 per cent (Figure 17.1). Over the past two decades, authorities removed tax and regulatory biases against equity financing, including removing double taxation of company income and dividends through introducing dividend imputation.

Figure 17.1

Low Debt to Equity Ratio Continues

Debt to Equity Ratio, 1989-2001

Source: Australian Bureau of Statistics, unpublished data.

Reflecting corporates' balanced approach to financing, bond, equity and foreign exchange markets have expanded at broadly similar rates since banking sector deregulation (Battellino, 2000). By December 2000, the market capitalisation of domestic equities was A$671 billion, after growing at an average 17 per cent per year in the previous decade. Bond market capitalisation also grew, peaking at A$118 billion in December 1996 but dropping back to A$106 billion by December 2000 (Australian Stock Exchange, 2001).

International analysts consider Australia's capital markets to be strong. In 1998, Global Securities Consulting Services rated Australia one of the world's top three equities markets for settlement services and operational risk (Lee-Tulliss, 1998). Australia is building on its well established domestic government bond market, with rapidly growing markets for corporate bonds and for foreigners who raise funds in Australia's domestic debt markets.[2]

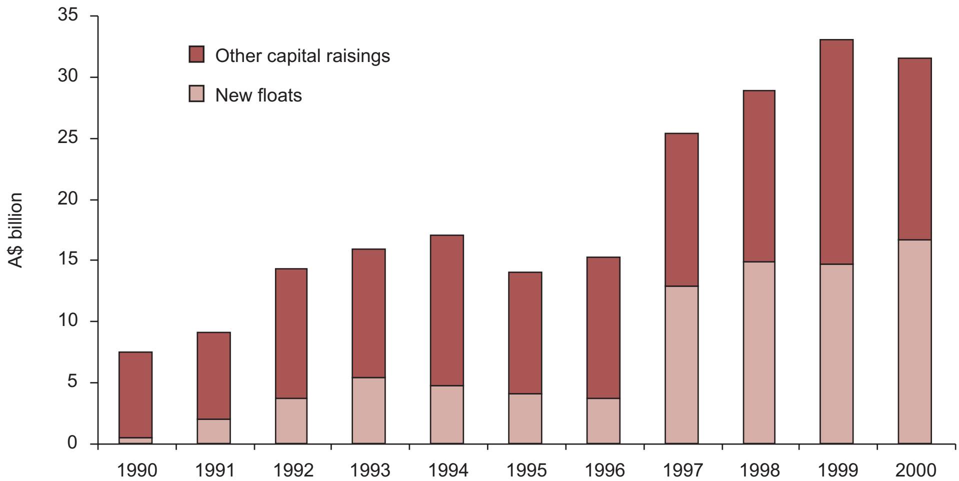
Hence, direct financing has grown strongly; in 2000, firms raised A$31.5 billion in equity capital on the Australian Stock Exchange, up from A$7.4 billion in 1990. New floats increased dramatically, particularly from large privatisations or demutualisations (Figure 17.2).

2 In 1998 and 1999, issuers included the Asian Development Bank, the German Development Bank, German Development Agency and Nordic Investment Bank (*Asiamoney* Supplement, July/August 1999, pp. 14-19).

Figure 17.2

Big Rise in Direct Financing

Australian Equity Capital Raisings, 1990-2000



Source: Australian Stock Exchange, 2001.

Hybrid equity securities, combining the positive aspects of debt and equity, also are increasingly popular (*Asiamoney*, November 2001, p. 35). Reset preference shares, income securities and convertible notes and bonds offer companies more repayment flexibility than debt, without the performance demands associated with equity. They also tap into demand for income earning securities when continuing budget surpluses reduce the supply of government securities. Of the Australian Stock Exchange's top 50 companies, 20 issue hybrid securities and more plan to. Hybrid security issues peaked at A$5.9 billion in 1999, up from A$100 million in 1995 and exceeded A$3.1 billion in 2001.

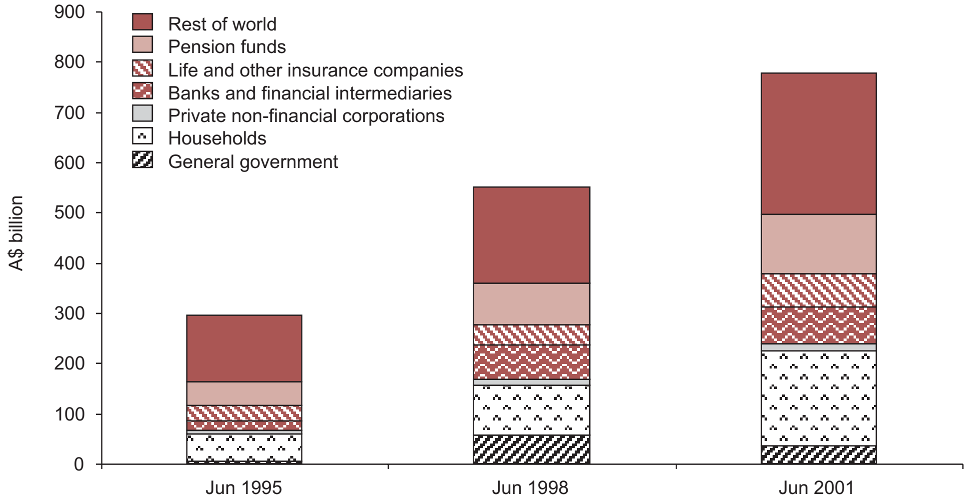
Institutional Investors

Over the past decade, Australian institutional investors' numbers and activism increased dramatically. In the 1980s, the Government introduced mandatory superannuation contributions to privately operated, competing pension funds. This policy, combined with the population's gradual aging, boosted superannuation funds' size and their power as large shareholders. In June 2001, funds under management stood at A$650 billion, of which A$160 billion was invested in domestic equities (Investment and Financial Services Association of Australia, 2001). At that time, pension funds and insurance companies owned 24 per cent of total domestic equity market capitalisation; households owned 24 per cent; and foreign investors owned 36 per cent (Figure 17.3).

Figure 17.3

Institutional Investors and Households Have Strong Presence

Australian Listed Equity by Ownership, 1995-2001



Source: Australian Bureau of Statistics, various years.

Vigorous competition between fund managers lowers management fees and pressures managers to achieve high returns. Independent ratings firms, such as CANNEX and ASSIRT, publish performance ratings and grade individual funds. In addition, in the investment fund market, indexed funds like Vanguard offer reduced management fees, providing added competition.

MERGERS AND ACQUISITIONS

An active merger and acquisition market disciplines firm managers, protecting outside investors and eliminating inefficient business models. By 2000, over one third of 1990's top 100 companies had merged, been acquired or restructured (*The Australian*, 15 August 2001, p. 44). Mergers and acquisitions far outweigh bankruptcy as a reason for delisting. Due mainly to strong economic growth, the rate of business bankruptcy fell from 10.4 failures per 1000 enterprises in 1991-92 to 3.6 in 1999-2000 (Bickerdyke et al., 2000). Nevertheless, the recent collapse of prominent Australian companies such as HIH Insurance, Ansett and One.Tel has focussed Australia's attention on its system of company regulation, insolvency and prudential supervision.

PRODUCT MARKETS COMPETITIVE

Competition in Australian product markets is generally high, with few entry barriers and legislation guaranteeing third party access. Competition authorities also actively promote competition to increase market efficiency. These factors and high exposure to international markets create competitive product markets.

Trade Liberalisation

Since the mid 1970s, Australia has instituted wide ranging trade liberalisation. Average effective rates of manufacturing assistance fell from 22 per cent in 1984-85 to 5 per cent in 2000-01 (Industry Commission, 1995; Productivity Commission, 2001a).[3] Rates of assistance remain significant only in the car and textiles, clothing and footwear industries; outside these two sectors, average levels of manufacturing assistance are very low.[4] Exposing Australian industries to international competition has encouraged more efficient corporate leadership.

Foreign Investment Liberalisation

Over the past two decades, foreign investment liberalisation has created one of the region's most liberal investment regimes, resulting in strong competition in goods and service markets. Limited restrictions remain in aviation, media and established residential real estate. The *Foreign Acquisitions and Takeovers Act 1975* empowers the Government to examine investment proposals on a pre-establishment basis. Proposals may only be rejected where they are found to be contrary to the 'national interest'. However, since 1975, only two major foreign investment proposals have not met this criterion.[5]

TREASURER BLOCKS SHELL'S BID FOR WOODSIDE PETROLEUM

In late 2000, Royal Dutch Shell bid for a controlling stake in Woodside Petroleum, which is the operator and a major shareholder in Australia's largest resource development project, the North West Shelf natural gas fields. Following the standard procedure for planned acquisitions of substantial foreign investments interests in Australian businesses valued over A$50 million, Shell notified the Foreign Investment Review Board, which advises the Treasurer, of the bid. In April 2001, the Government blocked the bid, notwithstanding Shell's claims it would operate the North West Shelf project in line with Australia's national interest, rather than the global Shell group's interest.

Source: Costello, 2001.

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[3] Effective rates of assistance measures include trade barriers, budgetary assistance and other measures that raise the return to producers.

[4] In 2000-01, effective rates of assistance (the percentage increase in returns that assistance delivers) for cars was 14 per cent and textiles, clothing and footwear was 23 per cent, down from 165 per cent and 68 per cent respectively in 1984-85. For all other manufacturing, effective rates of protection were between -1 and 6 per cent.

[5] These were proposals to demolish and redevelop the historic, inner Sydney harbour side suburb of Woolloomooloo and Shell's bid to take over Woodside Petroleum.

DEREGULATION AND COMPETITION

During the 1980s and 1990s, wide ranging Australian economic reforms included financial market deregulation in 1983, labour market and taxation reforms and National Competition Policy reforms from 1995. These reforms significantly improved the incentive structures managers face.

Privatisation Well Advanced

Australia has undertaken one of the world's largest privatisation programs, so now government plays a relatively low direct role in production; this increases access for new market players and competition. Historically, Australia's economy included both federal and state government-owned enterprises, some operating natural monopoly infrastructure and others operating alongside private enterprises in markets including banking, insurance and air transport. Over the last decade, governments at all levels have corporatised and privatised state owned firms. Governments also have opened a range of sectors previously reserved for state enterprises to competition, including utilities, railways, telecommunications networks and off-course betting. They have separated, corporatised and in many cases privatised former monopoly enterprises. However, this process is still on-going; while states like Victoria have privatised their power industry, due to union and electoral resistance other states like New South Wales have not.

Competition Policy

The Australian Competition and Consumer Commission can pursue companies undertaking anti-competitive conduct, such as predatory pricing, which companies may use to sustain market power in industries without natural entry barriers. The national competition statute, the *Trade Practices Act 1974*, prohibits certain firms' conduct which would prevent or deter market entry. In particular, the Act prohibits horizontal and vertical arrangements between firms which result in a substantial lessening of competition and prohibits individual firms with substantial market power from taking advantage of that power. In industries where insurmountable entry barriers create a natural monopoly, Australia now has a national access regime promoting competition in service provision that uses this monopoly network infrastructure. Electricity transmission now operates within a national code and telecommunications service providers have guaranteed access to the national fixed line grid.

NATIONAL ACCESS REGIME

The Government introduced the National Access Regime as part of the 1995 National Competition Policy reforms. It facilitates third party access to certain infrastructure on reasonable terms and conditions, where replicating the infrastructure is not economically feasible. The regime seeks to enhance incentives for negotiation and provide a means of access if negotiations fail. Such access is particularly important for electricity, gas, rail and telecommunication networks.[6] Both regimes promote efficient pricing in upstream or downstream markets which benefits the broader economy.

Source: Productivity Commission, 2001b.

Anti-monopoly Legislation

The *Trade Practices Act* neither prohibits monopolies nor provides for them to be broken up. Rather, it seeks to regulate monopolies either by preventing them being created (by prohibiting mergers or acquisitions which result in a substantial lessening of competition) or by preventing a monopolist from misusing its market power. The independent regulator established under the Act, the Australian Competition and Consumer Commission, plays a significant role in relation to merger and acquisition enforcement and, if it would result in a net public benefit, also may grant ‘authorisation’ under the Act to allow a merger or acquisition which would otherwise be prohibited by the Act. Private litigants have often succeeded in courts prohibiting misuse of market power, but the commission recently has become more active in taking court actions (Australian Competition and Consumer Commission, 2000).

CORPORATES WELL REGULATED

Australia’s robust regulatory framework represents international best practice in virtually all areas. After corporate sector excesses in the late 1980s, successive governments implemented numerous corporate governance and prudential reforms. Laws back internationally sound accounting standards and auditing standards reflect international norms. Increasingly, minority shareholders are prominent and institutional investors exercise their responsibility as large shareholders. Recent corporate failures may provide impetus for further evolution in corporate regulation, including regarding directors’ duties and accounting for workers’ entitlements.

6 There is a separate sector-specific access regime for telecommunications.

AUSTRALIA'S CORPORATE GOVERNANCE FRAMEWORK

Australia's corporate governance framework consists of a matrix of legislation, accounting standards which have the force of law, Australian Stock Exchange Listing Rules and voluntary self-regulatory codes of practice. For example, protection of shareholders' basic rights and descriptions of directors' duties are contained in both legislation, the *Corporations Act* and common law. Financial reporting requirements are contained in the *Corporations Act*, in enforceable accounting standards and in the Listing Rules. Non-financial reporting requirements are contained in the *Corporations Act* and in the Listing Rules. Self-regulatory codes of practice also cover aspects of the internal management of companies, including the structure and operation of boards.

Overseeing this matrix of regulation is an independent statutory authority, the Australian Securities and Investments Commission; it has a wide-ranging role in regulating companies, including:

- investigating and enforcing alleged breaches of the *Corporations Act*
- setting and enforcing standards for investment advice and managed investments, prospectuses, takeover documents and financial reporting
- applying standards described in the law to business problems, explaining how the law works and contributing to law reform
- guiding companies on the interface between legal requirements and corporate practice
- publishing reports on investigations where the commission considers it desirable, or where the Minister directs.

Private action by market participants also enforces the *Corporations Act*. Listing Rules ensure timely dissemination of price sensitive information to the market, which can act to discipline listed companies. Various professional organisations also enforce corporate governance standards and publish guidance on corporate governance.

In 1999, the Government's Corporate Law Economic Reform Program reviewed business regulation policy with the aim of facilitating a more efficient and competitive business environment. The resulting *Corporate Law Economic Reform Program Act 2000* clarified directors' duties, introduced a statutory form of business judgement rule and a statutory derivative action. Other areas of reform in the Act involved takeovers, fundraising and accounting standards. The recent *Financial Services Reform Act 2001* introduced a harmonised regulatory framework for consumer protection and market integrity in the financial services industry.

CORPORATE LAW REFORM

Since the early 1990s, corporate law reform increasingly strengthened Australia's investment environment. Establishing a national enforcement body, the Australian Securities and Investments Commission, and developing corporations legislation to improve disclosure of all relevant matters was the main approach taken. The Corporate Law Economic Reform Program and its predecessors drove these changes, overcoming legal inconsistencies and limitations arising from Australia's federal system of government and closely aligning business regulation with international best practice. The program mainly aimed to modernise regulation of financial reporting and financial markets, corporate governance, takeovers, directors' duties, fundraising and investment products to enhance transparency and accountability (Australian Treasury, 1999).

TRANSPARENCY

Australian financial reporting provisions and accounting and auditing standards align with international standards. Through successive reforms the chief corporate regulator, the Australian Securities and Investments Commission, has improved transparency by gaining more powers to enforce standards.

Financial Reporting

Australia now legally prescribes full market disclosure; authorities require larger companies to:

- provide annual and half-yearly reports to shareholders
- disclose promptly and continuously events that may affect the company's share price
- notify investors of specific information relating to obtaining shareholder approval for related party transactions
- disclose directors' remuneration and their attendance at board meetings.

The Australian Securities and Investments Commission surveys companies' financial reports, targeting weaknesses. The commission selectively examines companies according to its intelligence, complaints received and matters its staff note during other activities.

During the 1990s, federal governments amended the Corporations Law to further improve the information companies disclose, including:

- removing the true and fair override, so companies could not avoid applicable accounting standards
- enhancing disclosure requirements for economically important entities, usually listed corporations
- transferring detailed disclosure requirements from the Corporations Law and the Corporations Regulations to accounting standards, so the environment for making any necessary changes to disclosure and reporting requirements became more flexible.

Accounting Standards

The Australian Accounting Standards Board, established under the *Australian Securities and Investments Commission Act 1989*, specifies accounting standards companies use to report under the Corporations Act. Accounting standards have legal backing. Currently, the board is harmonising Australian accounting standards with International Accounting Standards and working with the International Accounting Standards Board and other national standard setters to develop a single set of high quality accounting standards for world-wide use. Overall, Australian standards differ little from international standards and some exceed international requirements.

The Australian Securities and Investments Commission ensures companies comply with legal disclosure requirements, including accounting standards. If a company does not comply, the commission revises the financial statements with the company or if necessary, formally investigates and prosecutes it.

The Financial Reporting Council provides broad oversight of Australia's accounting standard setting arrangements.

Auditing Standards

The Auditing and Assurance Standards Board of the Australian Accounting Research Foundation develops standards and guidance on audits and related functions. These benchmark appropriate professional conduct for members of the Institute of Chartered Accountants in Australia and CPA Australia. However, they do not have the force of law.[7] The Auditing and Assurance Standards Board implements International Auditing Practices Committee statements; Australian Auditing Standards align with international standards.[8]

While auditing standards do not have force of law, ethical standards apply. In addition, the Australian Securities and Investments Commission registers company auditors; it may refer auditors who do not carry out their duties adequately and properly to the Companies Auditors and Liquidators Disciplinary Board for appropriate action.

The Business Council's Bosch Report recommended establishing an audit committee with a majority of non-executive directors on it. A survey of the top 100 listed companies in 1995 found that a 98 per cent had audit committees (Business Council of Australia, 1991; Ernst & Young, 1999).

The Government is currently considering a report on audit independence in Australia prepared by Professor Ian Ramsay of Melbourne University and a survey by the Australian Securities and

7 This is because auditing standards tend to require auditors to form more qualitative judgements on a wide range of matters than accounting standards do.

8 Most differences reflect the board's consistent application of a more general approach to setting a standard, establishing a basic principle and providing guidance on relevant procedures in the standard and allowing auditors to exercise their judgement. International standards often prescribe detailed procedures that apply in certain situations (Australian Treasury, 1999).

Investments Commission, which both found that as auditors' frequently provide non-audit services to their Australian clients, processes for dealing with potential conflicts of interest require attention (Australian Securities and Investments Commission, 2002).

MINORITY SHAREHOLDER PROTECTION

The Australian Securities and Investments Commission recognises institutional shareholders play a key role in monitoring company performance. The commission encourages active institutional shareholders to improve corporate governance. In recent years, the commission lifted various restrictions, enabling discussion and cooperative voting agreements between institutional and other minority investors on governance issues; it now allows shareholders holding more than 20 per cent of the voting shares to associate (Australian Securities and Investments Commission, 1998).

However, some observers question whether institutional investors sufficiently exercise their voting power. For example, some institutions were concerned BHP's merger with Billiton would be counter to BHP shareholders' interests, yet did not oppose it. BHP's Chairman and CEO promised to resign if the merger failed, contributing to investor reluctance. Some press observers also allege institutions simultaneously advising and investing in BHP faced conflicts of interest, weakening their ability to oppose the merger (Ethical Investor, www.ethicalinvestor.com.au, 2001).

Proxy advisers also actively encourage good corporate governance; Computershare Analytics and Institutional Shareholder Services Australia offer services soliciting proxy votes from institutional investors and rating corporates' corporate governance standards (OECD, 2000).

LISTING REQUIREMENTS

The Australian Stock Exchange requires extensive listed company disclosure and disciplines companies breaching listing rules, including suspending or de-listing them. Companies must outline their main corporate governance practices during the reporting period. Most companies comply as it promotes high quality and consistent disclosure.

If companies selectively disclose price sensitive information to market analysts prior to public disclosure, as AMP was alleged to have done in mid 2001, the Australian Securities and Investments Commission acts against them. It also issues guidelines encouraging companies to develop disclosure policies on distributing company information and conducting analysts' briefings.

Composition of Boards of Directors

Australian authorities take a disclosure approach rather than prescribe board structure. Companies can decide many matters about board composition, including the ratio of executive to non-executive directors, whether the chairperson is a non-executive director and if appropriate committees and procedures deal with conflicts of interest, dissent and resignation. Companies must detail these practices in their annual statement of corporate governance practices.

The Bosch Report recommended boards comprise a majority non-executive directors. A survey of the practices of 90 of 1993's top 500 listed companies found Australian companies already complied broadly with recommended practice, on average having twice as many non-executive directors as executive directors (Business Council of Australia, 1991; Clifford et al., 1995). In addition, 70 per cent of companies had an independent non-executive chair and another 14 per cent had a separate CEO and chair.

Directors' Obligations

The Corporations Law specifies directors' basic duties, which are largely unchanged from the original UK common law. In 2000, the Government's statutory business judgement rule clarified shareholders' reasonable expectations of company officers and ensured company officers' personal liability did not deter management from responsibly taking risk. Also in 2000, the Australian Securities and Investments Commission campaigned to ensure listed company directors inform the market when they traded their companies' shares. Compliance has increased significantly since.

Legal Action against Directors

The Australian Securities and Investments Commission and a range of other parties may bring criminal or civil proceedings against directors failing to comply with their Corporations Law duties, causing damage to the company, its creditors or shareholders.[9] The Government recently changed the law to provide individual shareholders with the statutory right to bring an action against a company for its wrongdoings.

CREDITOR PROTECTION

Australia's insolvency framework is generally sound and efficient. It is known as relatively 'creditor friendly', although restructuring and reorganisation provisions are very often successful. However, a small number of recent high profile corporate collapses raised questions about the efficacy of regulatory oversight, directors' ethics and the protection hierarchy of some creditors, including workers. The recent collapses of prominent Australian companies such as HIH Insurance, Ansett and One.Tel were significant, highlighting in particular the importance of effective disclosure provisions and insolvency laws and practices. In 1999, the Australian Government announced it would commission a wide ranging review of the framework for liquidation, voluntary administration and reconstruction of companies (Hockey, 1999).

9 Authorities act against directors who transfer assets belonging to a company either to themselves or another company, depriving creditors of access to assets. This conduct occurred both in small private unlisted companies and, particularly during the late 1980s, in some major listed companies. Other common criminal cases involve people acting as directors or in company management when they were disqualified, either because they carried past convictions involving fraud or were bankrupt.

Bankruptcy

Australian corporate law provides four ways to administer insolvent corporations: liquidation, receivership, voluntary administration and schemes of arrangement. 1992 Corporations Law amendments included voluntary administration provisions, offering companies greater scope to trade out of difficulty when they faced insolvency.

THE IMPACT OF CORPORATE FAILURES

Over the past 15 years, several waves of corporate failure have prompted changes, including regulatory reform. The first failures came after Australia's 1980s 'bubble' burst, producing a spate of non performing loans and corporate collapses; this sparked revised banking practices and accounting standard reforms. Later, in 2001, HIH, One.Tel, Ansett and many other smaller companies, particularly in the information, communication and technology industries, collapsed.

HIH went into provisional liquidation in March 2001. In the previous three to four years, it had made several major acquisitions and a number of directors had resigned from its board. Speculation about HIH's solvency arose in late 2000 as commentators questioned the adequacy of its reserves. With around one million general insurance policy holders affected by the company's collapse, the Government announced a royal commission into HIH in June 2001. The commission will examine whether directors', officers' or associated advisers' decisions or actions contributed to the company's failure and whether they were involved in any undesirable or illegal corporate governance practices. The commission will report and recommend changes to the regulatory system by 30 June 2002.

In May 2001, telecommunications company One.Tel went under administration and the Australian Securities and Investments Commission launched an investigation into its collapse. Ansett went under administration in September 2001 and also is under investigation. Both investigations will examine whether the companies continued to trade while insolvent and whether the directors breached their fiduciary duties.

These failures reflect primarily sectoral and company specific factors as well as failures of aspects of corporate governance. The investigations may provoke a review of directors' duties, particularly of independent directors and certain accounting and auditing standards. In particular, the inquiries are likely to examine how auditors can be kept independent when many corporates contract the same auditing companies for management consultancies. Reform of the insurance supervisory framework was underway prior to the failure of HIH, but that failure provides more impetus to this process.

Source: CCH Australia, 2001.

Laws require directors to cease trading when a company becomes insolvent; failing to do so makes them personally liable for the company's debts. The Australian Securities and Investments Commission licenses specialised accounting professionals to conduct external corporate administrations and administer corporate insolvency. Some administration types entail a significant supervisory role for the court, while others, notably voluntary administration, require a smaller role. In all cases, the commission has an overall supervisory role. The objective of the corporate insolvency system is to balance the public interest in preserving enterprises wherever possible with the need for efficiency, certainty and predictability for creditors.

PRUDENTIAL SUPERVISION

Following several decades of ongoing reform, Australia's financial sector prudential framework is close to international best practice. In 1997, the Government accepted the recommendations of its second major Financial System Inquiry, consolidating prudential regulation of all deposit taking institutions, including banks, building societies, credit unions, life and general insurance companies and superannuation funds, under a single new institution, the Australian Prudential Regulation Authority.[10] The authority's supervisory approach is forward looking, primarily risk based and consultative.[11] The authority is in the process of developing standards relating to the supervision of financial conglomerates, to prudentially accommodate the changing nature of the financial system. Australia is among the first group of countries to tackle issues of financial conglomerate supervision and has issued several papers outlining a proposed policy, which is in future expected to apply to all financial and mixed conglomerate groups.

The other major reform resulting from the 1997 Financial System Inquiry was to consolidate responsibility for securities market supervision into a single regulator, the Australian Securities and Investments Commission.[12] This initiative overcame regulatory gaps under previous arrangements and also ensures Australian financial markets will remain well regulated as corporate fund raising shifts from financial sector intermediaries to capital markets, where disclosure regulation is critical.

10 The Financial System Inquiry, headed by Stan Wallis, with a Secretariat provided by the Australian Treasury, was the first major inquiry into the Australian financial system since the Campbell Committee Inquiry in 1981.

11 At the forefront of developing innovative supervisory techniques, the authority actively encourages agencies to monitor their own risks and ensure adequate capitalisation occurs. These techniques are designed to reduce the regulatory burden on the sector, while maintaining a secure environment for depositors. The expected application of the draft proposals of the Basel Capital Accord, released in 2001 by the Basel Committee on Banking and Supervision, will increase flexibility in the financial sector by ensuring that capital requirements are more responsive to the underlying risk profile of each regulated institution. Consolidation facilitates coherent regulation of financial institutions with activities in many financial markets and sectors.

12 State based institutions came under its consolidated regulatory umbrella on 1 July 1999. These changes have produced a more effective regulatory framework for dealing with financial conglomerates, providing scope for greater regulatory consistency across institutions undertaking similar activities and provides a better focussed, more accountable structure for addressing community expectations regarding issues of consumer protection.

These two agencies were granted substantial autonomy and clear charters of objectives with a mechanism instituted to ensure effective coordination between the agencies.[13] Regulations aim to minimise the risk of depositors losing their funds and to be consistent with international standards. Prudential standards are as far as possible reinforced through encouraging financial institutions to increase the public disclosure of their risk and management systems.

COMPLIANCE

Strong market discipline and effective regulation means most companies comply with most standards. Key regulators, major accounting firms and universities run relevant training courses, while private professional groups, other non-government organisations and a highly effective commercial media encourage generally sound practices and scrutinise corporate behaviour.

Enforcement

The Australian Securities and Investments Commission ensures compliance with corporations law disclosure requirements, accounting standards and auditing practices. It enforces mostly through negotiation, but can apply legal sanctions. Individuals also can access legal redress; for example, in November 2001, liquidators of the Bond group of companies acted against Arthur Anderson, auditors of the companies' 1987-88 accounts, alleging an incompetent audit (ABC, 21 November 2001, abc.net.au).

Professional Education

Regulatory authorities and professional associations, including the Australian Securities and Investments Commission and the Australian Institute of Company Directors, run training and education programs to improve corporate governance practices. The commission also publishes *The Watchdog's Guide*, a plain language explanation of small company directors' and secretaries' legal responsibilities. Commission officers also regularly speak on directors' duties and good governance at small business seminars.

[13] The Reserve Bank of Australia also has responsibility for ensuring overall systemic stability of the financial system.

PROMOTION OF GOOD PRACTICE

Industry and professional groups sponsor initiatives to support regulatory reform and compliance. The first was in 1991, when the Business Council of Australia produced the 'Bosch Report' to encourage company boards and their chairs to follow sound practices; define the roles of audit committees, non-executive directors, company accountants and auditors; detail codes of ethics and introduce guidelines for directors' conduct regarding conflict of interest, confidentiality and insider trading.

Many other reports followed, including *Strictly Boardroom* in 1993. It outlines guidelines for good corporate governance and reminds reformers that legislative reforms should aim to encourage good corporate behaviour but be sensitive to the compliance costs (Hilmer, 1993). Increasingly, governments share the view society must shift the corporate governance focus from 'conformance' to 'performance', encouraging good practice, rather than coercing companies.

Various private sector organisations also produced documents providing guidance on corporate governance, including the Australian Investment Managers' Association's *Guide for Investment Managers* and Corporations and the Australian Institute of Company Directors' *General Protocol for Company Directors*. Such guidelines provide examples of 'best practice' in the context of globalised capital markets and emerging international best practice, helping companies determine the best corporate governance model for their own circumstances.

Media

Australia generally is well served by the financial media; the high quality *Australian Financial Review* focuses mainly on financial and corporate developments. With *The Australian* and *The Age,* the *Australian Financial Review* leads press scrutiny of corporate behaviour.

IMPLICATIONS

Australia's competitive economy has diverse ownership and a mature and robust corporate governance regime. It could act as a model for regional economies that seek to improve their regimes. However, Australia's corporate governance system could improve further, with several recent corporate failures highlighting the role of directors and auditors in ensuring good governance.

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