

The Auditor-General
Audit Report No.18 2006–07
Performance Audit

**ASIC's Processes for Receiving and
Referring for Investigation Statutory Reports
of Suspected Breaches of the
Corporations Act 2001**

Australian Securities and Investments Commission

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of Australia 2007

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Canberra ACT
24 January 2007

Dear Mr President
Dear Mr Speaker

The Australian National Audit Office has undertaken a performance audit in the Australian Securities and Investment Commission in accordance with the authority contained in the *Auditor-General Act 1997*. Pursuant to Senate Standing Order 166 relating to the presentation of documents when the Senate is not sitting, I present the report of this audit and the accompanying brochure. The report is titled *ASIC's Processes for Receiving and Referring for Investigation Statutory Reports of Suspected Breaches of the Corporations Act 2001*.

Following its presentation and receipt, the report will be placed on the Australian National Audit Office's Homepage—<http://www.anao.gov.au>.

Yours sincerely



Ian McPhee
Auditor-General

The Honourable the President of the Senate
The Honourable the Speaker of the House of Representatives
Parliament House
Canberra ACT

AUDITING FOR AUSTRALIA

The Auditor-General is head of the Australian National Audit Office. The ANAO assists the Auditor-General to carry out his duties under the *Auditor-General Act 1997* to undertake performance audits and financial statement audits of Commonwealth public sector bodies and to provide independent reports and advice for the Parliament, the Government and the community. The aim is to improve Commonwealth public sector administration and accountability.

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Abbreviations and Glossary

AAT	Administrative Appeals Tribunal
AAF	Assetless Administration Fund
Administrator	An administrator may be a voluntary administrator, or an administrator under a deed of company arrangement. A voluntary administration is an insolvency procedure where the directors of a financially troubled company or a secured creditor with a charge over most of the company's assets appoint an external administrator (the voluntary administrator). The role of the voluntary administrator is to investigate the company's affairs, to report to creditors and to recommend to creditors whether the company should enter into a deed of company arrangement, go into liquidation or be returned to the directors.
ANAO	Australian National Audit Office
Annual Report Overview	A document prepared by ASIC for the ANAO in March 2006, and revised in September 2006, to provide information on ASIC's annual reporting processes in relation to statutory reports.
ASIC	Australian Securities and Investments Commission
ASIC Act	<i>Australian Securities and Investments Commission Act 2001</i>
CDPP	Office of the Commonwealth Director of Public Prosecutions
Corporations Act	<i>Corporations Act 2001</i>

Deed of company arrangement	A deed of company arrangement is a binding arrangement between a company and its creditors governing how the company's affairs will be dealt with, which may be agreed to as a result of the company entering voluntary administration. It aims to maximise the chances of a company, or as much as possible of its business, continuing, or to provide a better return for creditors than an immediate winding up of the company, or both.
JCCFS	Parliamentary Joint Committee on Corporations and Financial Services
Liquidator	A liquidator is the person appointed to administer the liquidation of a company. Liquidation is the orderly winding up of a company's affairs. It involves realising the company's assets, cessation or sale of its operations, distributing the proceeds of realisation among its creditors and distributing any surplus among its shareholders.
PN50	Practice Note 50. An ASIC guidance document relating to the reporting and lodging obligations of external administrators.
Prosecution Policy	The <i>Prosecution Policy of the Commonwealth</i>
Receiver	A receiver is an external administrator appointed by a secured creditor to realise enough of the assets subject to the charge to repay the secured debt. Less commonly, a receiver may also be appointed by a court to protect the company's assets or to carry out specific tasks.
Statutory report	A report lodged with ASIC by an external administrator under sections 422, 438D or 533 of the Corporations Act.

Summary and Recommendations

Summary

Background

1. The Australian Securities and Investments Commission (ASIC) enforces and regulates company and financial services laws to protect consumers, investors and creditors¹. It was established under section 261 of the *Australian Securities and Investments Commission Act 2001* (ASIC Act). The ASIC Act provides ASIC with a range of powers and functions as are conferred on it by or under the corporations legislation. The *Corporations Act 2001* (Corporations Act) provides the regulatory framework within which Australian companies must operate and also provides that ASIC has general administration of the Corporations Act.

2. Chapter 5 of the Corporations Act is entitled 'External Administration'. It deals with the different means of reorganising the manner in which a company is controlled or arranging for a company to be wound up. These circumstances may arise simply because the company's directors and shareholders wish to cease operations. However, the primary focus of Chapter 5 is on companies that have become insolvent and is intended to protect the interests of various stakeholders, especially creditors of insolvent companies.

3. If a company is about to become, or has become, insolvent, an independent person may be appointed to protect stakeholders' interests. Depending on circumstances, this person may be a receiver, an administrator or a liquidator (collectively referred to in this report as external administrators). An external administrator's primary task is to examine the company's records and recommend the most appropriate course of action to the company's stakeholders. This may include allowing the company to continue trading in an attempt to restore it to financial health or winding it up in an orderly fashion that best preserves stakeholders' interests.

4. As part of external administrators' responsibilities under Chapter 5, sections 422, 438D and 533 of the Corporations Act require them to report to ASIC, among other things:

- suspected breaches of the Corporations Act;

¹ ASIC website <www.asic.gov.au>.

- any misapplication or retention of funds; and
- any negligence, default, breach of duty or breach of trust,

by past and present company officers or members. Liquidators are under a further specific obligation to report to ASIC where a corporation may be unable to pay its unsecured creditors more than fifty cents in the dollar. Reports made pursuant to these sections are referred to in this report as statutory reports.

Role of the Parliamentary Joint Committee on Corporations and Financial Services in relation to the Corporations Act

5. Section 243 of the ASIC Act creates a role for the Parliamentary Joint Committee on Corporations and Financial Services (JCCFS) to, among other things, inquire into the operations of the corporations legislation. Since ASIC's establishment, the JCCFS has held a number of inquiries in accordance with this mandate.

6. On 14 November 2002, the JCCFS resolved to 'consider and report on the operations of Australia's insolvency and voluntary administration laws'. One of the Inquiry's Terms of Reference was to consider 'the reporting and consequences of suspected breaches of the Corporations Act' as required by sections 422, 438D and 533 of the Corporations Act.

7. In its June 2004 report, the JCCFS stated that the reporting obligations:

are among the most important mechanisms in the law for bringing to light possible breaches of the Corporations Act [and] it is vital that this function be performed to a high standard as external administrators are the primary investigators of the affairs of insolvent companies.²

8. In its Report, the Committee raised a number of concerns about ASIC's investigation of reported breaches and stated that it was 'not convinced that sufficient priority is being given to the assessment and investigation of reported possibly serious breaches of the Corporations Act'. The Committee also raised concerns that there may be a lack of resources for that task.

9. Among the 63 recommendations that the JCCFS made in its report was the following:

² Parliamentary Joint Committee on Corporations and Financial Services, *Corporate Insolvency Laws: a Stocktake*, June 2004.

The Committee requests that ANAO conduct a performance audit of ASIC's processes in receiving and investigating statutory reports.

10. In response to the JCCFS' recommendation, a potential audit of ASIC's Processes for Receiving and Referring for Investigation Statutory Reports of Suspected Breaches of the *Corporations Act 2001* was included by the Auditor-General in the 2005–06 Performance Audit Work Programme.

Audit approach

11. The objectives of this audit were to:

- examine the effectiveness of ASIC's processes for receiving reports of suspected breaches of the Corporations Act; and
- assess the efficiency with which statutory reports are referred and investigated by ASIC.

12. The audit commenced in February 2006. ANAO undertook an assessment of ASIC's processes for receiving and referring for investigation statutory reports. ANAO also undertook a detailed examination of a random sample of 416 statutory reports received by ASIC in the period 2002–03 to 2004–05.

13. The audit scope did not extend to the role of the Commonwealth Director of Public Prosecutions in prosecuting offences referred to it by ASIC.

Audit conclusions

14. A key role for ASIC is to investigate serious corporate crime and misconduct. In this respect, effective enforcement and regulation engenders confidence in Australia's financial markets, products and services. In its June 2004 report, the JCCFS stated that the provisions of the Corporations Act which require external administrators to report breaches of the Act to ASIC are among the most important mechanisms of the law.

15. Statutory reports lodged by external administrators are an important source of 'front line' information for ASIC about possible breaches of the Corporations Act. ASIC has effective processes in place to 'risk score' initial reports from external administrators so as to, among other things, identify those matters of most regulatory significance in which case further information

is sought from the external administrator.³ However, ASIC has not had processes in place to ensure this further information is actually obtained.

16. Additional information obtained from external administrators is subject to a further process of evaluation. This is undertaken so as to identify those matters where regulatory action is available and appropriate. Subject to various enforcement resourcing and other considerations, action may then be taken by ASIC to act upon reports of suspected breaches of the Corporations Act reported by the external administrator.

17. Over time, ASIC has acted on fewer statutory reports, both in absolute terms and as a proportion of reports received.⁴ For example, in the three years between 1997–98 and 1999–00, ASIC received an average of almost 2 700 statutory reports of alleged breaches of the Corporations Act and undertook investigation or surveillance activities on an average of almost 200 in each year. In comparison, in each of the three years between 2002–03 and 2004–05, ASIC received an average of almost 5 300 reports of alleged breaches but undertook investigation or surveillance activities on an average of 27 each year.⁵

18. The JCCFS was concerned that insufficient priority was being given to the assessment and investigation of statutory reports of suspected breaches of the Corporations Act. In this respect, the significant reduction in activity with respect to statutory reports was not the result of a decision to act on fewer reports. Rather, ASIC advised ANAO in December 2006 that the reduction had occurred mainly in surveillance activity (rather than formal investigations) as a result of a deliberate regulatory strategy to move from 'reactive' to 'proactive' surveillances in the area of insolvency.

19. It is properly a matter for ASIC to determine where the balance lies in deciding whether to act upon reports of suspected breaches of the Corporations Act reported by external administrators. However, in light of the marked reduction in regulatory activity and of the concerns expressed by the

³ In 2004–05, ASIC requested further information in relation to 12 per cent of the statutory reports received from external administrators.

⁴ Over the period 1997–98 to 2004–05, the number of reports received alleging offences increased by almost 90 per cent, while the number of reports that ASIC investigated or subjected to surveillance decreased by more than 90 per cent.

⁵ Of the remainder, an average of 90 per cent in each of the three years were 'analysed, assessed and recorded' which resulted in external administrators being advised that ASIC did not intend to take any further action.

JCCFS, it is timely for ASIC to review its current approach, including the opportunities for increasing the number of reports it investigates.

Key findings

Receipt and assessment of reports (Chapter 2)

20. The processes by which statutory reports are received and assessed by ASIC have changed over time. In relation to the receipt of reports, one of the most notable changes has been the introduction in 2002–03 of a facility to allow external administrators to be able to lodge an initial statutory report (known as a Schedule B report) electronically. In 2005–06, 83 per cent of Schedule B reports were lodged electronically. ASIC uses a computer system to ‘risk score’ the Schedule B reports that it receives electronically.

21. Since 2004–05, where the risk score for a report does not meet a predetermined threshold, the report for the activity is finalised and a letter is automatically generated and sent to inform the external administrator that no further action will be taken. Risk scoring is intended to allow ASIC to quickly identify the matters of most regulatory significance with minimal use of the liquidators time. ASIC advised the ANAO that this enables it to devote its resources to more intensive work on more detailed reports and provide liquidators with assistance to complete and manage their administrations in a timely manner according to law.

22. External administrators are required by law to report to ASIC suspected breaches of the Corporations Act. In addition to this obligation, administrators have the discretion to lodge further reports. In this context, ASIC advised the ANAO that correct recording of statutory reports is important for the following reasons:

- it is of critical importance to external administrators that when they provide certain types of information to ASIC, particularly information that comprises suspected but unsubstantiated or bare allegations of contraventions by an individual or entity, that such statements attract the qualified privilege afforded by ss 426, 442E and 535 of the Corporations Act;
- ASIC is required to maintain a register and make all documents lodged with it publicly available for inspection, unless the document is specifically exempted by the law. Sub-section 1274(2)(a)(iv) of the Corporations Act creates an exception to the public inspection rule for

statutory reports and consequently they must be differentiated from publicly available information; and

- Section 15 of the ASIC Act provides that ASIC may conduct a particular type of investigation with respect to statutory reports received under sections 422 and 533 of the Corporations Act. Clear identification of reports received under those sections allows ASIC to preserve as many bases for investigation as the legislation provides.

23. ANAO found that ASIC's recording of statutory report information was accurate to a high degree. However, its reporting to the Parliament and other stakeholders has been deficient in the following respects:

- Prior to ANAO's audit, ASIC had not documented its procedures for calculating figures relating to statutory reports for publication in ASIC Annual Reports.⁶
- The form in which information on statutory reports has been presented in ASIC's Annual Reports has varied over time, and there have been a series of methodological changes. The changes to the methodologies used by ASIC in successive Annual Reports impede year-on-year comparison of the extent to which ASIC has taken regulatory action on statutory reports.
- In some years ASIC reclassified its recording of statutory reports from the 'analysed, assessed and recorded' category to the 'resolved' or 'investigation' categories in its Annual Reports. However, there was no auditable trail of the activities that ASIC had reclassified for 2002–03 and 2003–04. In addition, for 2004–05, ASIC did not conduct an examination of the records underlying the reclassified activities. Following ANAO enquiries, ASIC identified that the reclassification of some activities in 2004–05 had been erroneous. As a result, in 2004–05, ASIC reported that seven per cent of statutory reports had been 'resolved' when in fact the correct figure was only one per cent.⁷

⁶ ASIC prepared for ANAO a document entitled 'Statutory Reports – Annual Report Overview' which was intended to explain these changes. However, ANAO analysis showed that the Annual Report Overview did not correctly reflect the processes used in the calculation of the statistics for the 2004–05 Annual Report.

⁷ This error was disclosed in ASIC's 2005–06 Annual Report.

Investigation and enforcement (Chapter 3)

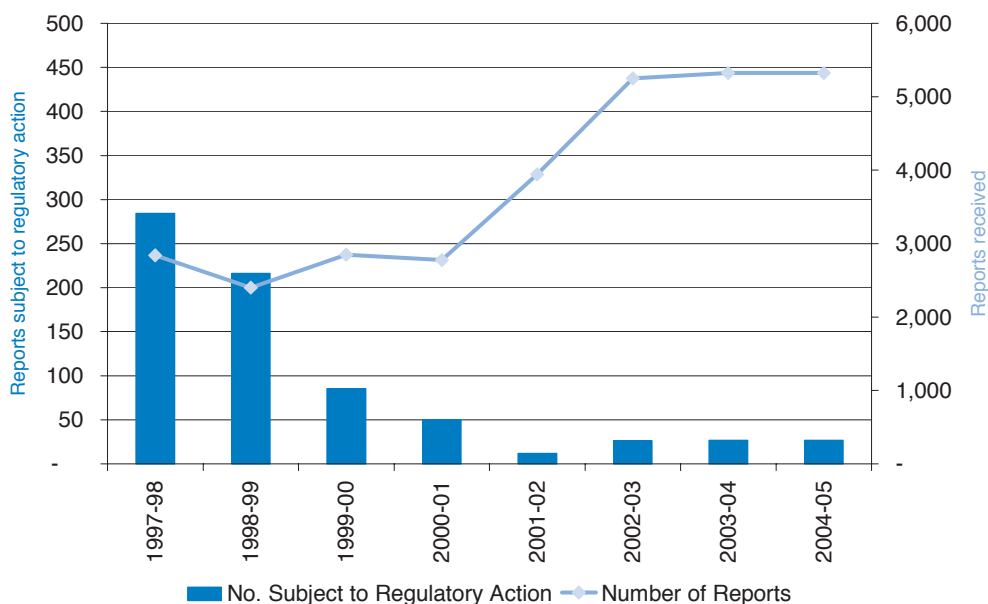
24. Where ASIC identifies that a statutory report raises issues of regulatory significance, further information about the matter is sought by ASIC from the external administrator. However, that additional information is not always obtained by ASIC. Specifically, in ANAO's sample, no further report was obtained by ASIC in almost 40 per cent of instances where the additional information was requested.

25. ASIC has a wide range of possible remedies available to it to deal with offences identified in statutory reports or other deficiencies which warrant some sort of regulatory action. These range from warning letters to directors of companies for less serious offences, to prosecution and potentially imprisonment for more serious offences. However, ANAO's analysis revealed that, although the number of statutory reports alleging offences received by ASIC has increased significantly over time, regulatory action⁸ is taken by ASIC in relation to a relatively small number of those reports. Specifically, of the average 5 300 statutory reports received in each year from 2002–03 to 2004–05, ASIC took regulatory action on no more than 27 in any one year (0.5 per cent). This is illustrated in Figure 1.

⁸ That is, reports referred for compliance, investigation or surveillance (see page 23 of ASIC's 2005–06 Annual Report).

Figure 1

Reports alleging offences received and reports subject to investigation or surveillance activity: 1997–98 to 2004–05



Source: ASIC Annual Reports and ANAO analysis.

26. Given the large number of statutory reports received by ASIC each year that allege offences against the Corporations Act, it is appropriate that ASIC has systems in place to prioritise its regulatory actions, through risk scoring. Nevertheless, as stated by the JCCFS, the statutory reporting obligations are among the most important mechanisms in the law for bringing to light possible breaches of the Corporations Act. Accordingly, the small number of statutory reports subject to regulatory action by ASIC each year indicates that there is opportunity for greater regulatory action on these reports.

Prosecutions initiated by ASIC

27. Under the terms of the *Prosecution Policy of the Commonwealth*, the Commonwealth Director of Public Prosecutions (CDPP) has the primary responsibility for instituting and conducting prosecution of offences against Commonwealth law. This gives effect to the principle enunciated in the *Prosecution Policy* that there should be a separation of the investigative and prosecutorial functions in the Commonwealth criminal justice system. However, the *Prosecution Policy* allows for a few Commonwealth agencies,

with the agreement of the CDPP, to conduct their own summary prosecutions for ‘high volume matters of minimal complexity’.

28. In 1992, the CDPP and ASIC agreed a set of Guidelines under which ASIC was permitted to conduct prosecution of minor regulatory offences. In 2003 the two organisations reached agreement that ASIC could prosecute offences under a number of explicitly nominated sections of the Corporations Act. In its enforcement procedures, ASIC did not pay due regard to the clear terms of the agreement. As a result, on 26 occasions between 2002 and 2006 ASIC had, without consulting the CDPP, prosecuted offences for which it had no specific agreement to do so from the CDPP.⁹

Disqualification from acting as a director

29. The Corporations Act empowers ASIC, independently of the Courts or the CDPP, to disqualify a person from managing corporations for up to five years. This power is intended to protect the public from the conduct of a person who has demonstrated an inability to manage corporations, rather than to punish the person.

30. Exercise of this power requires accurate recording of statutory reports, which ASIC has demonstrably achieved. ASIC’s use of its disqualification power has decreased considerably over time. In addition, where ASIC has exercised its disqualification power, there have often been delays in its application. There are a number of factors leading to these two circumstances, including:

- ‘risk scoring’ and other processes intended to focus ASIC’s attention on the most serious regulatory matters;
- guidance material provided to analysts not accurately reflecting the circumstances in which ASIC can exercise its power to disqualify persons; and
- incorrect application of the legislative requirements by analysts when assessing which matters are eligible for disqualification action.

31. ASIC advised ANAO that it has recently conducted national training in relation to its banning powers. However, there remains a need to ensure guidance material relied upon by analysts is accurate.

⁹ This did not affect the validity of the prosecutions.

Improvement opportunities

32. The ANAO made five recommendations arising from this audit. Given the large number of reports received each year that allege offences, and the JCCFS' concerns that sufficient regulatory priority be given to such reports, the key recommendation (Recommendation No. 2) is that ASIC identify opportunities for increasing the number of statutory reports that it currently investigates.

33. The remaining recommendations are aimed at:

- improving the clarity of ASIC's reporting to the Parliament;
- maintaining the separation between investigatory and prosecution roles, except where the Commonwealth Director of Public Prosecutions has agreed otherwise;
- timely follow-up of additional information requested from external administrators where an initial report has raised significant issues; and
- ensuring that ASIC's guidance material to analysts correctly reflects the provisions of the Corporations Act relating to the disqualification of directors.

Agency response

34. ASIC agreed to all the audit recommendations. ASIC's full response to the audit is provided at Appendix 1. ASIC also provided a summary of its comments as follows:

ASIC generally agrees with the recommendations made by the ANAO. In particular ASIC recognises that as a result of its Assetless Administration and External Administrator Assistance programs and additional funding provided by the Government in 2005, there are greater opportunities to increase the number of statutory reports that ASIC investigates. ASIC confirms that all recommendations have been or are currently being reviewed for implementation.

ASIC is continuing to work closely with the insolvency industry to increase the quality and timeliness of statutory reports alleging offences, and thereby increase the levels of regulatory action available to ASIC to take in response to statutory reports.

ASIC also believes that the additional funding provided by the Government will allow ASIC to increase its impact in this area going forward. Early indications of the success of these initiatives has been the disqualification of 43

company officers for a total of 163.5 years in 2006; and prosecution of 494 company officers for the failure to assist external administrators, resulting in fines and costs awards of \$1 039 613.

ASIC welcomes the confirmation by the ANAO of the high degree of accuracy of our processes for the receipt and recording of statutory reports of suspected breaches of the Corporations Act 2001. Since our introduction of electronic reporting by external administrators and automated risk assessment for these electronic reports on 1 July 2004, ASIC has been consistently working to improve the quality of our data capture and more importantly the analysis of information collected to ensure a timely and appropriate regulatory response to statutory reports.

Recommendations

Set out below are ANAO's recommendations and ASIC's abbreviated responses. More detailed responses are shown in the body of the report immediately after each recommendation. ASIC's full response to the audit is at Appendix 1.

Recommendation No.1
Para 2.43

ANAO *recommends* that the Australian Securities and Investments Commission disclose in its Annual Reports to the Parliament any changes between years in the underlying processes or assumptions for calculating the statistics on actions taken on statutory reports, and the effect of these changes, to enable readers of the Annual Reports to make a fair comparison.

ASIC response: Agreed

Recommendation No.2
Para 3.12

ANAO *recommends* that, given the large number of reports received each year that allege offences, and the JCCFS' concerns that sufficient regulatory priority be given to such reports, the Australian Securities and Investments Commission identify opportunities for increasing the number of statutory reports that are investigated.

ASIC response: Agreed

Recommendation No.3
Para 3.28

ANAO *recommends* that the Australian Securities and Investments Commission promptly refer to the Commonwealth Director of Public Prosecutions any proposed prosecutions of minor regulatory matters which it has not been explicitly authorised to undertake.

ASIC response: Agreed

**Recommendation
No.4**

Para 3.40

ANAO *recommends* that the Australian Securities and Investments Commission develop and implement procedures for the timely follow-up of external administrators where a supplementary report has been requested but not received.

ASIC response: Agreed

**Recommendation
No.5**

Para 3.83

ANAO *recommends* that the Australian Securities and Investments Commission amend the guidance material provided to analysts so that it correctly reflects ASIC’s powers under the Corporations Act to disqualify persons from acting as directors of companies.

ASIC response: Agreed

Audit Findings and Conclusions

1. Introduction

This chapter outlines the Australian Securities and Investments Commission's role and responsibilities in receiving and processing statutory reports from external administrators; examines the regulatory framework for statutory reporting; and describes the audit approach and objectives.

Background

1.1 The Australian Securities and Investments Commission (ASIC) enforces and regulates company and financial services laws to protect consumers, investors and creditors.¹⁰ It was established under section 261 of the *Australian Securities and Investments Commission Act 2001* (ASIC Act). The ASIC Act provides ASIC with a range of powers and functions, as are conferred on it by or under the corporations legislation. The *Corporations Act 2001* (Corporations Act) provides the regulatory framework within which Australian companies must operate and also provides that ASIC has general administration of the Corporations Act.

1.2 Chapter 5 of the Corporations Act is entitled 'External Administration'. It deals with the different means of reorganising the manner in which a company is controlled or arranging for a company to be wound up. These circumstances may arise simply because the company's directors and shareholders wish to cease operations. However, the primary focus of Chapter 5 is on companies that have become insolvent and is intended to protect the interests of various stakeholders, especially creditors of insolvent companies.

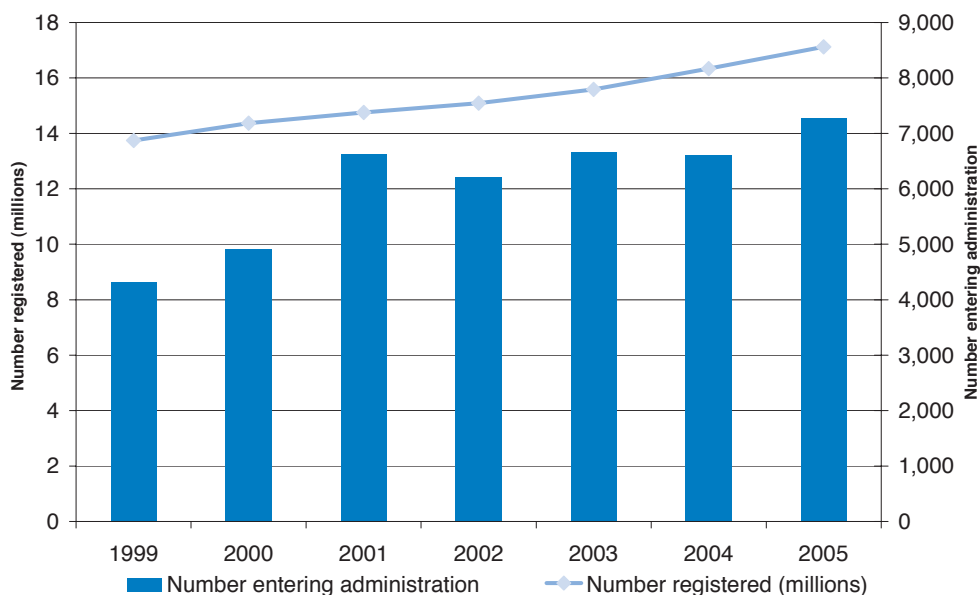
Trends

1.3 Since 1999, ASIC has published a variety of statistics about the general corporate environment in Australia. These show that the total number of registered Australian companies has increased from 13.7 million to just over 17 million in the six years between 1999 and 2005, which represents an increase of almost 25 per cent. By contrast, the number of companies reported by ASIC as entering external administration has increased over the same period from 4 314 to 7 277, representing an increase of almost 70 per cent. These figures are illustrated in Figure 1.1 below.

¹⁰ ASIC website <www.asic.gov.au>.

Figure 1.1

Number of registered companies and number of companies entering administration 1999–2005



Source: ASIC website <www.asic.gov.au>, ASIC insolvency figures

1.4 If a company is about to become, or has become, insolvent, an independent person may be appointed to protect stakeholders’ interests. Depending on circumstances, this person may be a receiver, an administrator or a liquidator (collectively referred to in this report as external administrators). An external administrator’s primary task is to examine the company’s records and recommend the most appropriate course of action to the company’s stakeholders. This may include allowing the company to continue trading in an attempt to restore it to financial health or winding it up in an orderly fashion that best preserves stakeholders’ interests.

Role of the Parliamentary Joint Committee on Corporations and Financial Services in relation to the Corporations Act

1.5 Section 243 of the ASIC Act creates a role for the Parliamentary Joint Committee on Corporations and Financial Services (JCCFS) to, among other things, inquire into the operations of the corporations legislation. Since ASIC’s establishment, the JCCFS has held a number of inquiries in accordance with this mandate.

1.6 On 14 November 2002, the JCCFS resolved to ‘consider and report on the operations of Australia’s insolvency and voluntary administration laws’. One of the Inquiry’s Terms of Reference was to consider ‘the reporting and consequences of suspected breaches of the Corporations Act’ as required by sections 422, 438D and 533 of the Corporations Act.

1.7 In its June 2004 report, the JCCFS stated that the reporting obligations:¹¹
are among the most important mechanisms in the law for bringing to light possible breaches of the Corporations Act [and] it is vital that this function be performed to a high standard as external administrators are the primary investigators of the affairs of insolvent companies.

1.8 The Committee raised a number of concerns about ASIC’s investigation of reported breaches and stated that it was ‘not convinced that sufficient priority is being given to the assessment and investigation of reported possibly serious breaches of the Corporations Act’. The Committee also raised concerns that there may be a lack of resources for that task.¹²

1.9 Among the 63 recommendations that the JCCFS made in its report was the following:

The Committee requests that ANAO conduct a performance audit of ASIC’s processes in receiving and investigating statutory reports.

ASIC’s structure and resourcing

1.10 ASIC’s 2005–06 Annual Report stated that, during the year, 1 471 average full-time equivalent staff were employed by ASIC. The Annual Report also shows that these staff were employed across the six major directorates within ASIC, each of which has specific functions and roles, as shown in Figure 1.2 below.

¹¹ Parliamentary Joint Committee on Corporations and Financial Services, *Corporate Insolvency Laws: a Stocktake*, June 2004.

¹² *ibid.*

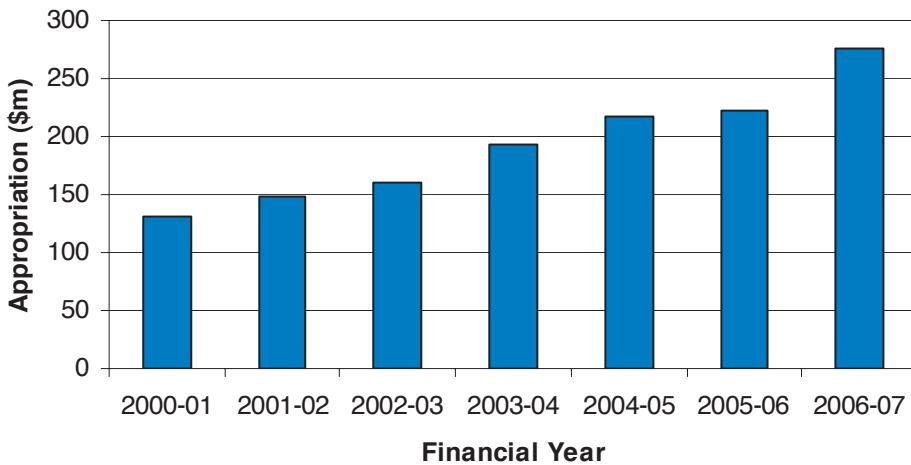
Figure 1.2

ASIC Directorate Structure

Directorate	Key Roles/Functions	No. of Staff
Operations	Company data, insolvency, information technology and human resources	480
Enforcement	Investigate and act against misconduct	373
Compliance	Ensure companies and licensees comply with the law	187
Regulation	Set ASIC policy on regulating markets and business	137
Finance	Finance, risk, knowledge management and corporate services	117
Consumer Protection	Protect consumers	100
		1 394^A
Note: ^A There were also: 30 staff members supporting the Commission, General Counsel, 39 staff supporting the Superannuation Complaints Tribunal and other statutory bodies and 8 staff members working on international relations in the Consumer Protection Directorate..		

Source: ASIC 2005–06 Annual Report.

1.11 ASIC is a Budget-funded entity. The 2006–07 annual Appropriation Acts No.1 and No.2 show that ASIC will receive a total appropriation of \$275.7 million for 2006–07. This represents an increase of almost 24 per cent in funding on ASIC’s 2005–06 appropriation of \$222.7 million. As Figure 1.3 demonstrates, ASIC’s appropriation has more than doubled in the past seven years.

Figure 1.3**ASIC Appropriations**

Source: Agency Resourcing Budget Papers figures of actual available appropriation.

1.12 On its increased funding base, ASIC advised ANAO as follows in August 2006:

Across the board in almost every category ASIC's workload has increased and on the back of more than 14 years of domestic economic growth this trend shows no sign of abating. Furthermore ASIC's mandate has expanded over this period, partly as a result of higher expectations about the performance of corporate regulators from various stakeholder groups including Federal Parliament, but also from the expansion of ASIC's activities arising from legislative reform and changes in Government policy (particularly in the financial services domain).

Over the same period as in [Figure 1.3] the complexity of ASIC's workload has also increased. Recent trends have seen the proliferation of highly complex products and schemes entering the market as entities seek to make available a broadening range of financial services and products and explore new markets. Reviewing and assessing these products requires an in-depth understanding of how the market operates, industry knowledge and expertise in superannuation, managed funds, the bonds market, derivatives, hedge funds, insurance etc to name but a few. This is time consuming and resource intensive and again a basis for ASIC's increased appropriation.

1.13 ASIC has only one Outcome, which is *'a fair and efficient market characterised by integrity and transparency and supporting confident and informed*

participation of investors and consumers'. The amounts provided to ASIC through the annual Appropriation Acts are therefore able to be applied to any aspect of ASIC's operations to deliver that Outcome. This means that, although the additional funding measures are provided with reference to specific activities,¹³ there is no requirement for ASIC to apply some or all of that funding specifically to those measures.¹⁴ On this issue, ASIC advised ANAO in September 2004 that:

ASIC is required to report quarterly to DoFA in respect of expenditure against the referenced, and previous, NPP funded activities. The ANAO itself in previous audits (refer to the Implementation of Financial Services Licences) has made the point of evaluating actual expenditure against specific purpose funding. Irrespective of the theory the fact remains that there is an expectation from DoFA and indeed Treasury that ASIC will report on the actual expenditure against specific purpose funding notwithstanding that the outputs of various initiatives all contribute to ASIC's outputs and therefore ASIC's outcome.

1.14 In its report, the JCCFS raised concerns that there may be a lack of resources available for sufficient priority to be given to the assessment and investigation of possible breaches of the corporations legislation by ASIC.¹⁵ Specifically, the Committee stated that:

It is not clear to the Committee whether the regulator [ASIC] has the resources to perform its functions in relation to corporate insolvencies or that the

¹³ For example, the increased funding for 2006–07 included funds being provided for the following measures:

- \$8.6 million for broadening surveillance capability (\$29.1 million over four years);
- \$30 million for enforcement funding, which is to fund potential costs arising from the investigation and litigation of exceptional matters of significant public interest (\$120 million over four years);
- \$15.2 million for sustaining supervision and oversight capability (\$71.3 million over four years); and
- \$9.3 million for enhancement of information technology security and risk management (\$14.2 million over four years).

¹⁴ The additional funding for Enforcement for 2006–07 (\$30 million) is to be provided through a Special Account. Special Account funds are subject to specific requirements under the FMA Act. Depending on how broad or narrow the expenditure purposes of the Special Account are, there may be some restrictions on the use of the funds provided for enforcement. See ANAO Audit Report No. 24 of 2003–04, *Agency Management of Special Accounts*.

¹⁵ Parliamentary Joint Committee on Corporations and Financial Services, *Corporate Insolvency Laws: a Stocktake*, June 2004.

importance of ASIC's insolvency functions are adequately recognised in the law.¹⁶

... inadequate funding of the designated regulatory authority in relation to corporate insolvency laws can represent a serious misallocation of a country's resources given that the impact of corporate insolvencies can be widespread and devastating for so many people.

1.15 The Senate Finance and Public Administration Committee is currently conducting an inquiry into the transparency and accountability to Parliament of Commonwealth public funding and expenditure. The Committee's terms of reference include examining the impact on the Parliament's ability to scrutinise, approve and monitor proposed and actual expenditure of outcome budget appropriations and reporting. ANAO's submission to the Committee concluded that the experience to date suggests that there would be merit in further reviewing the breadth and presentation of outcome descriptions; and examining whether the greater use of programme-level information would assist Parliament in its work, and improve the transparency and accountability of Commonwealth public funding and expenditure.

The reporting obligation

1.16 Under sections 422, 438D and 533 of the Corporations Act, receivers, administrators and liquidators respectively are subject to a continuing obligation to report to ASIC, among other things:

- suspected breaches of the Corporations Act;¹⁷
- any misapplication or retention of funds; and
- any negligence, default, breach of duty or breach of trust,

by past and present company officers or members. Liquidators are under a further specific obligation to report to ASIC where a corporation may be unable to pay its unsecured creditors more than fifty cents in the dollar. Extracts of sections 422, 438D and 533 of the Corporations Act are reproduced in Figure 1.4. Reports made pursuant to these sections are referred to in this report as statutory reports.

¹⁶ The Committee noted in this regard that there was no specific mention of ASIC's insolvency role provided in the statement of its corporate aims in s1(2) of the ASIC Act.

¹⁷ Sections 422, 438D and 533 of the Corporations Act relate to breaches of both the corporations law and other Commonwealth, State or Territory laws. However, this report is concerned specifically with suspected breaches of the Corporations Act.

1.17 ANAO's analysis of the above sections identified that the conditions that must be met before a liquidator is required to lodge a report with ASIC appear to be more onerous than for a receiver or administrator. This is because section 533(1) requires subsections (a) and (b) to be met, whereas sections 422(1) and 438D(1) require only one of the subsections to be met. ANAO raised this issue with ASIC in June 2006. In August 2006, ASIC advised ANAO that:

This is a drafting slip which was accidentally introduced into the Corporations Act at the time when it was 'federalised' in 2001. In the previous Corporations Law it was clear that paragraphs 533(1)(a), (b) and (c) were alternatives, and that represents the only sensible policy position.

...ASIC reads paragraphs 533(1)(a), (b) and (c) as alternatives, and would encourage liquidators and others to do likewise.

It is expected that this drafting slip will be corrected in due course. In the meantime the Act should be read and applied so as to correct the slip.

1.18 It is recognised that 'drafting slips' occur. However, it is not desirable that there should be any confusion about when a liquidator is required to lodge a statutory report. In this respect, ASIC advised ANAO in September 2006 that it would work with the Department of the Treasury to correct the inclusion of the word 'and' in section 533(1)(a).¹⁸

¹⁸ The Treasury advised ANAO on 13 December 2006 that the correction has been included in the draft Corporations Amendment (Insolvency) Bill 2007.

Figure 1.4

Reports required by ss422, 438D and 533 of the *Corporations Act 2001*

Section 422 Report by receiver	Section 438D Report by administrator	Section 533 Report by liquidator
<p>(1) If it appears to the receiver of property of a corporation that:</p> <p>(a) a past or present officer or employee, or a member, of the corporation may have been guilty of an offence in relation to the corporation; or</p> <p>(b) a person who has taken part in the formation, promotion, administration, management or winding up of the corporation;</p> <p>(i) may have misapplied or retained, or may have become liable or accountable for, any money or property (whether property is in Australia or elsewhere) of the corporation; or</p> <p>(ii) may have been guilty of any negligence, default, breach of duty or breach of trust in relation to the corporation;</p> <p>the receiver must:</p> <p>(c) lodge as soon as practicable a report about the matter; and</p> <p>(d) give to ASIC such information, and such access to and facilities for inspecting and taking copies of any documents, as ASIC requires.</p> <p>(2) The receiver may also lodge further reports specifying any other matter that, in the receiver's opinion, it is desirable to bring to the notice of ASIC.</p>	<p>(1) If it appears to the administrator of a company under administration that:</p> <p>(a) a past or present officer or employee, or a member, of the company may have been guilty of an offence in relation to the company; or</p> <p>(b) a person who has taken part in the formation, promotion, administration, management or winding up of the company;</p> <p>(i) may have misapplied or retained, or may have become liable or accountable for, any money or property (in Australia or elsewhere) of the company; or</p> <p>(ii) may have been guilty of negligence, default, breach of duty or breach of trust in relation to the company;</p> <p>the administrator must:</p> <p>(c) lodge a report about the matter as soon as practicable; and</p> <p>(d) give ASIC such information, and such access to and facilities for inspecting and taking copies of documents, as ASIC requires.</p> <p>(2) The administrator may also lodge further reports specifying any other matter that, in his or her opinion, it is desirable to bring to ASIC's notice.</p>	<p>(1) If it appears to the liquidator of a company, in the course of a winding up of the company, that:</p> <p>(a) a past or present officer or employee, or a member or contributory, of the company may have been guilty of an offence under a law of the Commonwealth or a State or Territory in relation to the company; and</p> <p>(b) a person who has taken part in the formation, promotion, administration, management or winding up of the company;</p> <p>(i) may have misapplied or retained, or may have become liable or accountable for, any money or property of the company; or</p> <p>(ii) may have been guilty of any negligence, default, breach of duty or breach of trust in relation to the company; or</p> <p>(c) the company may be unable to pay its unsecured creditors more than 50 cents in the dollar;</p> <p>the liquidator must:</p> <p>(d) as soon as practicable lodge a report with respect to the matter and state in the report whether he or she proposes to make an application for an examination or order under section 597; and</p> <p>(e) give ASIC such information, and give to it such access to and facilities for inspecting and taking copies of any documents, as ASIC requires.</p> <p>(2) The liquidator may also, if he or she thinks fit, lodge further reports specifying any other matter that, in his or her opinion, it is desirable to bring to the notice of ASIC.</p>

Source: *Corporations Act 2001*.

Guidance from ASIC to external administrators

1.19 In December 2002, ASIC issued a revised Practice Note (PN) relating to the reporting and lodging obligations of external administrators. The revision and issuance of *External Administrators: reporting and lodging* (PN50) was part of a major project by ASIC to enable insolvency practitioners to lodge documents with ASIC electronically.

1.20 PN50 provides guidance to external administrators on their reporting obligations to ASIC under the Corporations Act. PN50 establishes a framework and arrangements for lodging reports, indicates the minimum content of reports, and outlines measures to enforce external administrators' obligations with respect to reports.

1.21 Specifically, PN50 sets out guidance on:

- reporting obligations and lodging reports and documents with ASIC;¹⁹
- lodging preliminary reports (s476);
- lodging reports of suspected contraventions (ss 422(1), 438D(1) and 533(1));²⁰
- lodging supplementary reports (ss 422(2), 438D(2) and 533(2)); and
- lodging other documents such as reports as to affairs, and accounts, notifications and resolutions.

1.22 Part A of PN50 states that 'external administrators are the front line investigators of insolvent corporations'. It also states that external administrators who promptly lodge statutory notices and other reports support ASIC's obligations under the ASIC Act to strive to 'receive, process and store, efficiently and quickly, the information given to ASIC under the laws that confer functions and powers on it'.

1.23 Parts C and D of PN50 relate specifically to the lodgement by external administrators of reports relating to suspected breaches of the Corporations Act. In Part C, it is noted that ASIC uses reports of suspected contraventions to decide whether or not further regulatory or enforcement action is required in relation to the affairs of an insolvent company. PN50 further states that, in

¹⁹ PN50 states that 'while this practice note sets out some of the reporting obligations to clarify areas of uncertainty, it does not set out every reporting obligation'.

²⁰ When these reports are being lodged as a result of a court order, and not on an external administrators own initiative, the relevant subsections are 422(3), 438D(3) and 533(3).

order for ASIC to carry out its assessment in an effective and timely manner, it needs external administrators to provide information that is both specific and timely.

1.24 In this regard, PN50 provides external administrators with proformas for the provision to ASIC of initial and supplementary reports relating to suspected breaches of sections 422, 438D or 533 of the Corporations Act, or for statistical purposes.²¹

Assetless Administration Fund

1.25 In October 2005, the Government announced a funding package relating to reforms to improve the operation of Australia's insolvency laws. Included in this package was funding for ASIC of \$23 million over four years for the establishment of an Assetless Administration Fund (the AAF).

1.26 The AAF finances preliminary investigations and reports by liquidators into the failure of companies with few or no assets, where it appears to ASIC that enforcement action may result from the investigation and report. Guidelines issued by ASIC for liquidators state that a particular focus of the AAF is to curb fraudulent phoenix activity.²²

1.27 Applications for funding under the AAF were accepted by ASIC from the beginning of 2006. Funding is provided to eligible applicants to undertake investigations and prepare statutory reports under section 533 of the Corporations Act. To be eligible for funding, the following conditions must be met:

- the liquidation must be 'assetless' (ASIC's Guidelines state that ASIC considers an administration to be 'assetless' where a liquidation has net realisable assets of less than \$10 000, and as such there are insufficient resources to enable the liquidator to conduct proper investigations of breaches of the Corporations Act);
- an initial section 533 report must have been lodged with ASIC;

²¹ PN50 encourages all external administrators to complete an initial report proforma for all external administrations within two months of the date of appointment of the administrator, so that the collated data will be useful for statistical purposes. It is further noted that ASIC will use the information provided from the initial reports for statistical purposes and that the data will be collated and published in an aggregate, anonymous form, and made available to Government, the profession, and others.

²² *Assetless Administration Fund Funding Criteria and Guidelines – an ASIC Guide*, ASIC, June 2006.

- the matter must be of a type that 'ASIC may consider actioning' (ASIC's Guidelines note that there are two types of matters that it will consider funding. That is, in circumstances where section 206F director banning proceedings may be appropriate, or where court proceedings for breaches of the Corporations Act may be warranted);²³ and
- there is or may be material or information available to support any allegations or concerns of the liquidator.

1.28 In terms of the two types of matters that are eligible to be funded from the AAF, ASIC's Guidelines state that:

It is anticipated that all applications, which relate to possible director bannings under s206F, that meet the criteria and seek funding of \$5 000 or less will be funded, other than in exceptional circumstances. Where these applications meet the criteria but are seeking funding of more than \$5 000, approval for funding will only be given where:

- ASIC considers the extent and nature of the work proposed to be undertaken is necessary and justifies the additional cost; and
- ASIC and the liquidator come to an agreement on the amount of funding.

Applications for funding, which relate to matters other than director bannings under s206F, that meet the funding criteria...will only be approved where:

- it appears to ASIC that material breaches of the [Corporations] Act are likely to have occurred;
- it appears to ASIC that there is likely to be sufficient evidence from the investigation and supplementary s533 report to support enforcement action;
- ASIC considers the extent and nature of the work proposed to be undertaken is necessary and justifies the additional cost; and
- ASIC and the liquidator come to an agreement on the amount of funding.

1.29 ASIC's Guidelines also provide liquidators with proformas for the submission of the statutory reports where an application for funding from the AAF has been successful. Separate proformas are provided in the Guidelines for reports being submitted in circumstances where a section 206F banning is to be considered, and for reports relating to the investigation of other matters.

²³ ASIC's use of its powers under section 206F of the Corporations Act is discussed later in this report.

1.30 As the AAF has commenced operation only recently, ANAO has not assessed its effect on ASIC's level of regulatory activity in respect of statutory reports as part of this performance audit.

Audit approach

1.31 In response to the JCCFS' recommendation, a potential audit of ASIC's Processes for Receiving and Referring for Investigation Statutory Reports of Suspected Breaches of the *Corporations Act 2001* was included by the Auditor-General in the 2005–06 Performance Audit Work Programme.

1.32 In December 2005, ASIC was advised that the Auditor-General had decided to conduct a performance audit of this topic, under section 18 of the *Auditor-General Act 1997*. The objectives of this audit were to:

- examine the effectiveness of ASIC's processes for receiving reports of suspected breaches of the Corporations Act; and
- assess the efficiency with which statutory reports are referred and investigated by ASIC.

1.33 The audit commenced in February 2006. ANAO undertook an assessment of ASIC's processes for receiving and referring for investigation statutory reports. ANAO also undertook a detailed examination of a random sample of 416 statutory reports received by ASIC in the period 2002–03 to 2004–05.

1.34 The audit scope did not extend to the role of the Commonwealth Director of Public Prosecutions in prosecuting offences referred to it by ASIC.

1.35 The audit was conducted in accordance with ANAO auditing standards, at a cost of \$455 000.

2. Receipt and assessment of reports

This chapter examines ASIC's resources available for, and used in, receiving and processing statutory reports of suspected breaches of the Corporations Act, and details the type and format of information on statutory report activity presented by ASIC to the Parliament, through its Annual Reports.

Introduction

2.1 External administrators are required by the law (sections 422(1), 438D(1) and 533(1) of the Corporations Act) to report²⁴ certain things to ASIC, as soon as practicable after they are detected or a view is formed by the particular practitioner in the course of the company's external administration. This is a continuing obligation and may require the lodgement of more than one report by the practitioner, depending on the status and course of their administration.

2.2 In addition to this obligation, the practitioner has the discretion to lodge 'further reports' pursuant to sections 422(2), 438D(2) and 533(2). The legislation does not limit the number of reports an external administrator may lodge under these provisions.

2.3 The legal framework underlying external administration has a single entity basis. The appointment of an external administrator occurs to a single company - the law does not provide for a group appointment. The law then provides for powers and obligations of external administrators (including the requirement to lodge documents or reports) which are specific to their appointment to a particular corporate entity.

2.4 Although a group of companies may be the subject of the same type of external administration with the same administrator, ASIC advised ANAO in August 2006 that this does not alter the need to lodge a report for each company, pursuant to sections 422, 438D and 533. One reason for this is that, although a single external administrator may be appointed to a group of companies, each company in the group may have different directors, members or contributories, and each may have different corporate histories and

²⁴ There is no express statutory form for a 'report' under subsections 422, 438D and 533. In August 2006, ASIC advised ANAO that it is the regulator's view that such reports may be afforded a broad definition. This means that reports registered by ASIC include, for example, free text correspondence and attached documents as well as paper-based or electronic reports in the form suggested by ASIC.

relationships with different entities. This is relevant to ASIC's determination of whether or not to take particular action on a report for a particular company.

2.5 Nonetheless, some external administrators appointed to a group of companies have reported to ASIC with a single statutory report pertaining to all of the companies in the group. In August 2006, ASIC advised ANAO that:

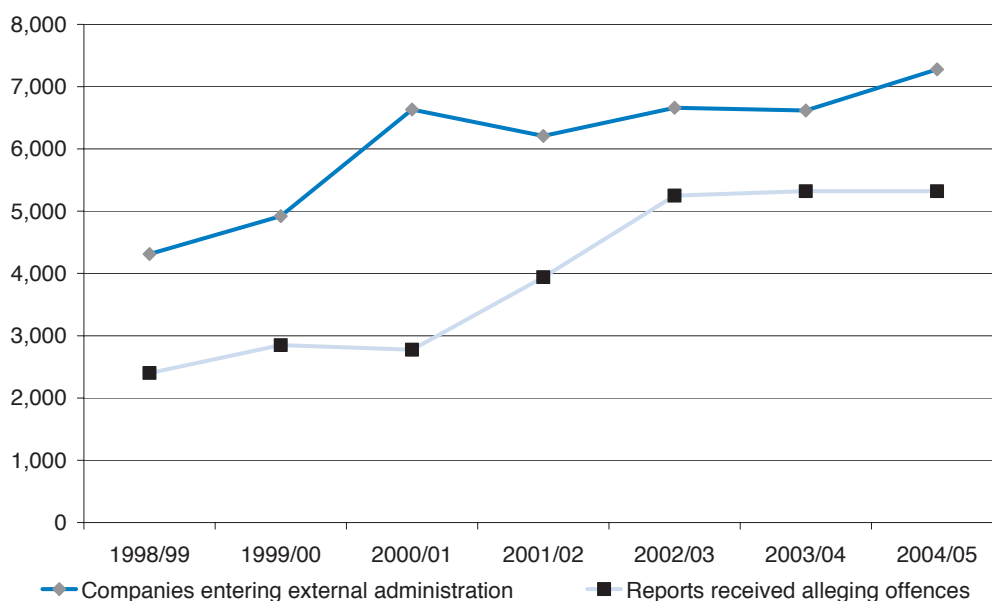
As statutory reports pursuant to ss 422, 438D and 533 are not public documents, we do not insist on separate lodgement of signed reports for each company by the administrator, but rather undertake the administrative task ourselves to record the report against each legal entity it names as a subject. When external administrators lodge reports about a group of companies, this is a matter of ease and efficiency for administrators, not ASIC, and ASIC ultimately saves costs for creditors in undertaking this administrative task ourselves.

Number of statutory reports received

2.6 ASIC records in its Annual Report each year the number of statutory reports it receives. While ASIC records all statutory reports it receives, not all statutory reports allege offences (see paragraph 2.20). As noted at paragraph 1.3, there has been a significant upwards trend in the number of companies entering external administration. As might be expected, this trend is broadly reflected in the numbers of statutory reports ASIC received: the number of statutory reports received by ASIC alleging offences increased by 87 per cent between 1998–99 and 2004–05. More detailed analysis of the numbers of reports received and the actions ASIC took with respect to them follows, but Figure 2.1 shows the trends in reports received by ASIC between 1998–99 and 2004–05.

Figure 2.1

Statutory reports alleging offences received by ASIC 1998–99 to 2004–05



Source: ASIC website <www.asic.gov.au>, ASIC insolvency figures and ASIC Annual Reports.

Processes in receiving statutory reports

2.7 Given the large number of statutory reports received by ASIC each year that allege offences against the Corporations Act, it is appropriate that ASIC has systems in place to prioritise its investigatory actions.

2.8 Over time, the processes by which statutory reports have been received and dealt with by ASIC have evolved. Prior to 2002–03 (and the introduction of PN50 and its associated proformas), all statutory reports were received and assessed manually by ASIC.

2.9 In 2002–03, external administrators were for the first time able to lodge simplified reports with ASIC on-line. These reports are lodged in the format prescribed in Schedule B to PN50. During 2003–04, ASIC introduced systems that allowed automatic ‘risk scoring’ of these simplified reports. ASIC advised ANAO in August 2006 that the risk-scoring system:

allows us to quickly assess which matters require our attention (the matters of most regulatory significance) with minimal use of the liquidator’s time (and creditor’s money), so that we can devote our resources to more intensive work on more detailed reports (about the matters we have pre-selected) and provide

liquidators with assistance to complete and manage their administrations in a timely manner according to law.

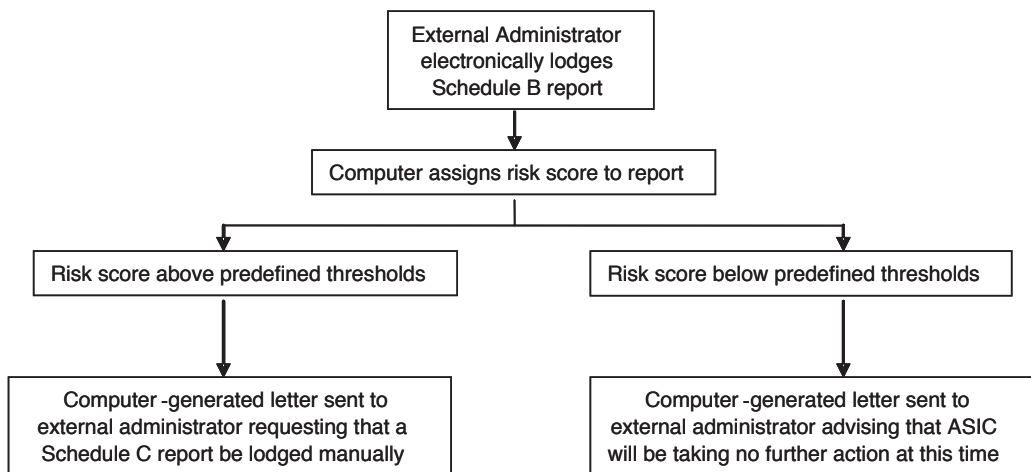
2.10 Where simplified statutory reports are lodged electronically, ASIC’s computer systems assess the report against a set of predefined criteria and assign a ‘risk score’ to the report.²⁵ Where the ‘risk score’ meets ASIC’s predetermined thresholds, a supplementary report is automatically requested by ASIC. Where the scores fall below the thresholds, the activity for the report is finalised and a letter is automatically generated advising the external administrator that ASIC will not be taking further action on the matter at that time. Since late 2003–04, these ‘no further action’ letters have also asked external administrators to submit further reports should circumstances change.

2.11 At the time of the JCCFS Inquiry, ASIC advised the Committee that approximately half of all reports received were lodged electronically. ASIC advised ANAO in August 2006 that in the 2005–06 financial year, 83 per cent of initial reports were lodged electronically, with 17 per cent manually processed.

2.12 Figure 2.2 shows ASIC’s processes following receipt of an electronically-lodged initial report (Schedule B report).

Figure 2.2

Processes following receipt of electronically lodged report



Source: ANAO analysis.

²⁵ ANAO notes that 2004–05 was the first full financial year in which ASIC’s processes included this fully-automated assessment of electronically-lodged statutory reports. In prior years, reports that were lodged electronically were required to be manually assessed by an ASIC analyst.

2.13 Supplementary reports (Schedule C reports) are submitted by external administrators in paper form to ASIC, due to the free text nature and variable form of these reports. PN50 provides guidance to external administrators on the format of these supplementary reports. Where these reports are submitted, or where Schedule B reports are submitted manually, there are a number of possible outcomes (noting that there are only two possible outcomes following electronic lodgement, as described above). Part A of PN50 outlines the actions that ASIC may take following the lodgement of a statutory report, or an investigation of matters raised in those reports by external administrators, as follows:

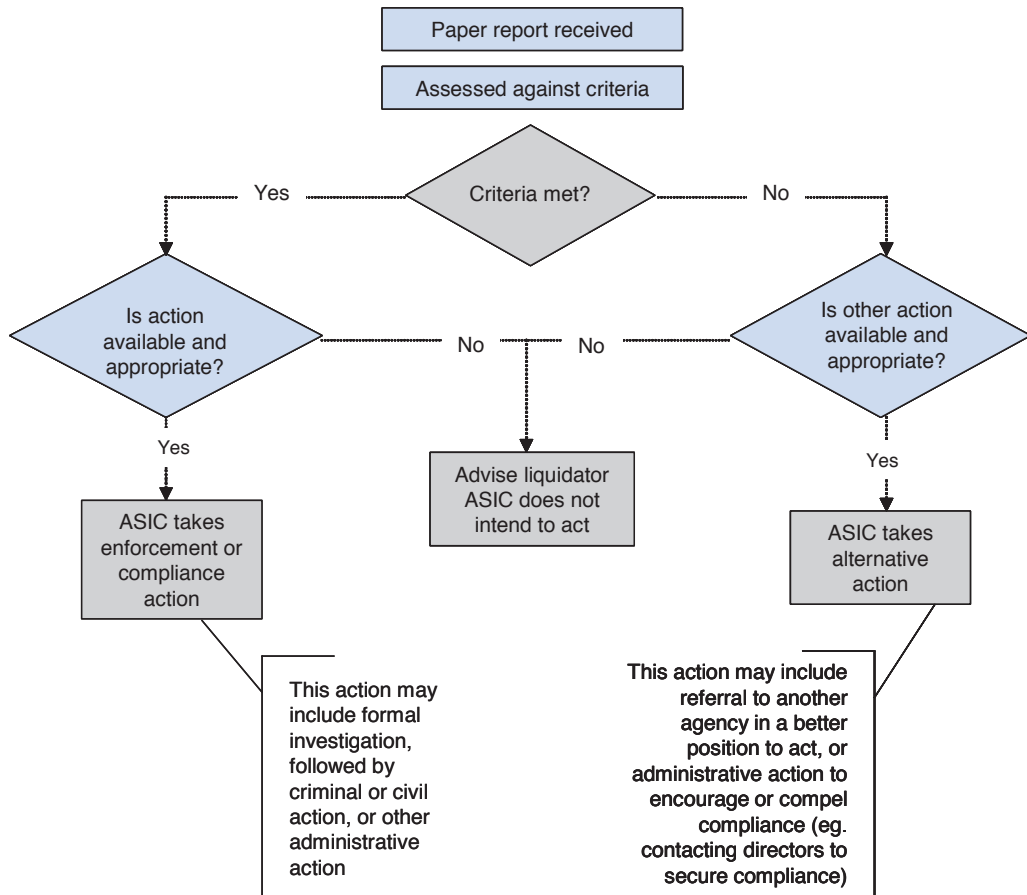
- institute enforcement proceedings against a person (by commencing appropriate civil, criminal or administrative proceedings);
- release information to a more appropriate law enforcement agency in accordance with the provisions of s127 of the ASIC Act;²⁶
- release information under s25 of the ASIC Act to an external administrator or other person who is carrying on, or is contemplating, a proceeding in good faith; or
- having considered the report, inform the administrator that the matter is one in which [ASIC] does not intend to institute proceedings or release information.

2.14 Figure 2.3 below illustrates ASIC's processes following receipt of Schedule C reports, and Schedule B reports that have been manually lodged.

²⁶ Section 127 of the ASIC Act relates to confidentiality and the authorised use and disclosure of information.

Figure 2.3

Processes following receipt of hard-copy reports



Source: ASIC.

Recording of reports received

2.15 ASIC separately records the receipt of each statutory report. That is, for a single entity to which any combination of receiver, voluntary administrator or liquidator may be appointed, the lodgement of any section 422 report, section 438D report or section 533 report for that entity is recorded separately. Further, multiple reports under sections 422(1) and (2), 438D(1) and (2) and 533(1) and (2), lodged by any combination of receiver, voluntary administrator or liquidator, during the course of their appointment to a single entity are recorded separately.

2.16 There may be a number of statutory reports lodged with ASIC in respect of a single company. Each statutory report that alleges offences that is received by ASIC is recorded in ASIC's systems with a unique identifier, or 'Activity ID'.

2.17 In August 2006, ASIC advised ANAO of the importance of the regulator correctly recording a report of information that is received from an external administrator as a 'report'. This is because such recording has important consequences, advised by ASIC as follows:

First, it is of critical importance to external administrators that when they provide certain types of information to ASIC, particularly information that comprises suspected but unsubstantiated or bare allegations of contraventions by an individual or entity, that such statements attract the qualified privilege afforded by ss 426, 442E and 535 [of the Corporations Act], being statements officially made by a person in the course of his or her duties as a receiver, voluntary administrator or liquidator. This information must be differentiated from information provided by an external administrator in a personal capacity (a personal complaint) as such information will not invoke the privilege. It is ASIC's experience that external administrators will rarely make verbal reports to ASIC and prefer to formally report specific information in writing to ASIC, due to their concern to clearly invoke this privilege.

It is also important that this information is differentiated from information which should be lodged as a publicly available external administration document. ASIC is required to maintain a register and make all documents lodged with ASIC publicly available for inspection, unless the document is specifically exempted by the law. Sub-section 1274(2)(a)(iv) creates an exception to the public inspection rule, for reports made or lodged under section 422, 438D or 533. Both ASIC and external administrators are concerned to expressly ensure that all appropriate reports of information by external administrators to ASIC fall into this public reporting exception, by separately recording each report of information pursuant to these sections as individual reports.

Finally, ASIC is also concerned to preserve as many bases for the commencement of a formal investigation or exercise of compulsory powers, as the legislation provides to ASIC. Section 15 of the ASIC Act 2001, provides that if a report is lodged under section 422 or 533 of the Corporations Act, ASIC may commence a particular type of investigation. As such, ASIC must take care to record all appropriate reports of information under these provisions, to enliven this particular investigatory power.

2.18 ANAO's examination of the statutory report activities contained in its sample showed that ASIC's recording of statutory report information was 97 per cent accurate. In three per cent of cases, information provided to ASIC by external administrators was incorrectly classified as a statutory report, or a duplicate of a previously submitted statutory report was recorded by ASIC as a new statutory report.

Reporting of action taken on statutory reports

2.19 For a number of years, ASIC has reported in its Annual Reports statistics on the number of statutory reports that have been received and actioned in the financial year. In this respect, information prepared by ASIC for ANAO as part of this performance audit advised that:²⁷

The figures included in the annual report each year are intended only to provide information about the total number of reports we received, and some information about the way we responded to them. Given the breadth of activity undertaken by ASIC in any one year, and the regulatory priority given to action on statutory reports in that year, our commentary on statutory reporting is usually limited.

2.20 Figure 2.4 outlines the number of statutory reports received by ASIC between 1997–98 and 2004–05, and the actions that ASIC's data indicates were instigated for those reports. ASIC advised ANAO in February 2006 that it:

only assesses reports which allege offences as there is no utility in taking further action on a report which does not allege offences...there is no useful comparison to be made between total reports received and total reports assessed, as only reports alleging offences are assessed and 100 per cent of these reports are assessed, however this may not necessarily occur in the same financial year they are received.

2.21 With regard to the 'made inquiries into' category, ASIC advised ANAO that in 2004–05, due to the completion of system coding enhancements, it was able for the first time to report on the number of simplified reports that triggered a request for a further supplementary report – 'notably the 12 per cent of reports triggering further inquiries'. In the two prior years, activities that resulted in a supplementary report being requested were included either in the 'Resolved' or 'Analysed, assessed and recorded' categories.²⁸ Prior to

²⁷ ASIC, *Statutory Reports – Annual Report Overview*, 4 September 2006, p. 3.

²⁸ In this context, in ANAO's sample, prior to the introduction of a specific code for requesting a supplementary report, 79 per cent of activities where a supplementary report was requested by ASIC were included in the 'Resolved' category.

2002–03, ASIC did not have a formalised process for requesting supplementary reports, as the introduction of simplified Schedule B reports and supplementary Schedule C reports did not occur until the 2002–03 financial year.

2.22 In respect of the ‘Analysed, assessed and recorded’ category, ASIC advised ANAO in February 2006 that:

the descriptors ‘no action taken’ and ‘analysed, assessed and recorded’ represent the same outcome. ‘Analysed, assessed and recorded’ is a better descriptor, as ‘no action taken’ implies that no enquiries have been made into the report.

2.23 Some of the figures in Figure 2.4 were not reported in, or differ from those reported in ASIC’s Annual Reports. These are highlighted in bold in Figure 2.4.

Figure 2.4

Statutory reports received and actions taken by ASIC 1997–98 to 2004–05

Year	Total Reports Received	Total Reports Alleging Offences Received	Total Reports Alleging Offences Assessed	% Reports 'Surveillance' Assessed	% Reports 'Investigated'	% Reports 'Resolved'	% Reports 'Made Inquiries Into'	% Reports 'Analysed, Assessed and Recorded'	% Reports 'No Action Taken'	% Reports received accounted for
1997–98	4,071	2,842	2,842	9.0	1.0	4.0	N/A	See Para 2.22	86.0	100.0
1998–99	2,522	2,402	2,367	8.0	1.0	2.0	N/A	89.0	89.0	100.0
1999–00	3,825	2,850	2,850	2.4	0.6	1.6	N/A	95.4		100.0
2000–01	3,866	2,775	2,824	0.6	1.2	4.5	N/A	93.7		100.0
2001–02	4,070	3,942	4,064	0.0	0.3	6.3	N/A	93.0	See Para 2.22	99.6 ^A
2002–03	6,176	5,251	5,262	0.0	0.5	7.0	See Para 2.21	92.5		100.0
2003–04	6,946	5,321	5,345	0.5	0.5	7.8		91.7		100.0
2004–05	6,878	5,321	5,423	0.5	0.5	0.7 ^B	12.8	86.0		100.0

^A ASIC advised ANAO that it was 'unable to account for 0.4 per cent of reports'.

^B ASIC's 2004-05 Annual Report stated that 7 per cent of reports were 'resolved'. However, less than 1 per cent of reports were actually 'resolved' in 2004-05. See Paras 2.27, 2.37 and 2.38.

Source: ANAO analysis of ASIC data and ASIC advice to ANAO.

Procedures and methodologies for reporting to the Parliament

2.24 Shortly after the end of the financial year, ASIC calculates the number of statutory reports received so as to include relevant information in its Annual Report. The data is drawn from ASIC's company database (ASCOT). Specifically, a statistical reporting function is used to count the number of various types of forms lodged during the year.

2.25 Prior to ANAO's audit, ASIC had not documented its procedures for calculating figures relating to statutory reports for publication in ASIC Annual Reports. In response to ANAO inquiries, on 1 March 2006, ASIC documented its procedures in a document titled 'Statutory Reports – Annual Report Overview' (hereinafter referred to as the Annual Report Overview).²⁹

2.26 ANAO's analysis of the Annual Report Overview showed that the document did not correctly reflect the processes used in the calculation of the statistics for the 2004–05 Annual Report. Specifically, it was not identified in the Annual Report Overview that the methodology used in calculating the 2004–05 statistics differed from the methodology used in 2003–04. The Annual Report Overview also did not identify that the methodology that was proposed to be used in calculating the statistics for ASIC's 2005–06 Annual Report was different again to the methodologies used in previous years.

2.27 Following discussions with ANAO on 31 August 2006, a revised version of the Annual Report Overview was prepared on 1 September 2006. The amended document was subsequently provided to ANAO. The key differences were that:

- the changes in the methodology used by ASIC in calculating its 2004–05 statistics (compared to the two prior years) were highlighted;
- the new methodology being used to calculate the statistics for ASIC's 2005–06 Annual Report was identified; and
- ASIC advised that there was an error in the information presented in ASIC's 2004–05 Annual Report to the Parliament, in that ASIC had reported that it had 'resolved' seven per cent of reports in 2004–05, when in fact it 'resolved' only one per cent. ASIC also advised that a

²⁹ The Annual Report Overview was a version-controlled document, prepared by ASIC's Performance & Review Division. It was quality reviewed by ASIC's National Assessment & Action Division.

qualification would be added to its 2005–06 Annual Report to reflect this error.³⁰

2.28 The correction to the number of reports ‘resolved’ is significant because, although the error arose from the misclassification of a small proportion of total reports assessed in the year, the low number of reports that ASIC actually ‘resolved’ (35 reports in 2004–05) means that the effect on the reported figures is considerable.

Inconsistencies and variations in reporting processes

2.29 The form in which information on statutory reports has been presented in ASIC’s Annual Reports to the Parliament has varied over time. For example, in some years, the information has been presented in a tabulated form, while in other years the statistics have been incorporated in text.

2.30 In addition, there have also been a series of methodological changes. Figure 2.5 summarises the major differences in the methodologies employed by ASIC in calculating the statistics for each Annual Report from 2002–03 to 2005–06.

³⁰ In this respect, ASIC’s 2005–06 Annual Report stated: ‘Last year, due to an analytical error, we stated 7 per cent of reports were resolved; it was in fact 1 per cent’.

Figure 2.5
Changes in ASIC's calculation of statutory report statistics

	2002-03	2002-03 restated	2003-04	2004-05	2004-05 restated	2005-06
Multiple or Single Outcomes Counted?	Single	Multiple	Multiple	Single	Single	Single
Referrals to Investigation & Litigation Management Committee (ILMC) included in 'Investigation' or 'Resolved' category? ^A	Resolved	Investigation	Investigation	Investigation	Investigation	Investigation
Reported percentage of actions taken calculated including or excluding 'Merged' totals? ^B	Including	Excluding	Excluding	Including	Including	Excluding
Activities reclassified from 'Analysed, assessed & recorded' category to 'Investigation' or 'Resolved' category?	N/A – no reclassification	Investigation	Investigation	Investigation & Resolved	Investigation	N/A – no reclassification
Auditable trail of reclassified activities available?	N/A – no reclassification	No	No	Yes	Yes	N/A – no reclassification

Notes:
^A The 'Investigation' category has been referred to in ASIC's Annual Reports in different ways over time, including 'compliance, investigation or surveillance' and 'referred for more action or investigation'.
^B The Annual Report Overview stated that activities that are finalised by ASIC as having been 'merged with another activity' are excluded from the Annual Report statistics calculations 'on the basis that it is impossible to trace their final outcome, and [ASIC] assumes that their outcomes are roughly proportional to all recorded outcomes'. There is no reason provided in the Annual Report Overview as to why this type of activity has been included in some years' calculations.

Source: ANAO analysis.

2.31 As Figure 2.5 shows, certain aspects of the methodologies employed by ASIC across the years have varied. In this context, the absence of a consistent methodology in the calculation of the statistics reported in ASIC's Annual Reports impedes year-on-year comparison of the extent to which ASIC has taken regulatory action on statutory reports. In respect of the 2005–06 Annual Report, a further significant change in ASIC's methodology has been made in respect of the manner in which activity outcomes are counted, which means that year-on-year comparison continues to be impeded. Specifically:

- Since 2002–03, ASIC's systems have allowed analysts to finalise an activity with more than one activity outcome. ASIC advised ANAO in August 2006 that, after it began recording multiple outcomes, it was not possible for ASIC to sensibly report on the more detailed data until after it had two years to report on. Accordingly, in 2002–03, only single outcomes were counted.
- In 2003–04, ASIC had two years of multiple-outcome data capture and was able to report accordingly. The revised Annual Report Overview stated that it was ASIC's view that multiple outcome reporting gave a more accurate representation of how ASIC dealt with the issues raised with it. However, in the years in which ASIC's calculation methodology used multiple outcomes, the number of statutory report activities that were actually finalised by ASIC in more than one way was between just 0.76 per cent and 0.82 per cent of all activities finalised in the year (for 2002–03 and 2003–04 respectively).
- In 2004–05, ASIC counted only single outcomes. The revised Annual Report Overview stated that there were 'no specific reasons recorded for the decision to revert to single outcome analysis in 2004–05'.
- For 2005–06, the revised Annual Report Overview advises that ASIC has deliberately chosen single outcome analysis in interpreting the 2005–06 data due to an enhancement in ASIC's recording of outcomes that was not available in previous years. Specifically, ASIC's systems now include the creation of an 'ultimate result' for each finalised activity. This means that while multiple outcomes are able to be recorded for each activity, an 'ultimate outcome' is now automatically recorded in ASIC's systems, based on a priority system of activity

outcomes.³¹ Where there are multiple outcomes for a single activity, ASIC defines the ultimate outcome as the outcome that involves the greatest level of regulatory action.

Reclassification of activity outcomes

2.32 The Annual Report Overview stated that, for 2003–04 and 2004–05:³²

as well as [the] primary classification, we did a sweep of activities in the ‘Analysed, assessed and recorded’ outcome category to collect actions taken. Where an action was taken that suggested we had done more than ‘analysed, assessed and recorded’ the complaint, the result was moved from that category to the ‘Investigation and surveillance’ category.

2.33 Figure 2.6 shows the outcome descriptions captured in each Annual Report category following ASIC’s primary classification. The Annual Report Overview also stated that:

Further analysis of the data marked [with an asterisk] in the Analysed, Assessed & Recorded Category [in Figure 2.6] was then conducted using [the action descriptors in the third column in Figure 2.6]. These activities were then redistributed and apportioned as categories within the Broad Outcome [in the first column in Figure 2.6].

³¹ ANAO notes in this respect that the finalisation codes able to be applied to statutory report activities differ from those available to ASIC analysts in previous years.

³² And for the 2002–03 figures that were restated in ASIC’s 2003–04 Annual Report.

Figure 2.6

Reclassification of activities in Annual Report categories

Annual Report Category	Primary Classification	Action forming basis for re-categorisation of activities
Resolved	Consumer Focused Public Assistance	
		Provide Information to Complainant
		Public Assistance Action
Investigation & Surveillance	Referred for Internal Investigation/Surveillance	Refer to Investigation & Litigation Management Committee (ILMC)
	Referred for Surveillance (Other Directorates)	Refer to National Insolvency Co-ordination Unit for surveillance
	Enforcement Actioned	
		Compliance Visit
		Seek Compliance
Analysed, Assessed & Recorded	Enforcement Did Not Action *	Enforcement Did Not Action
	Enforcement Unable to Resource *	Enforcement Unable to Resource
	Unable to Assist *	
	Executive Director/Assistant Director Unable to Resource *	
	No Identifiable Offences	
		Refer to Enforcement ³³
		Referral to Executive Director or Assistant Director
		Refer to Complaints Assistant Director
Automatically processed reports		
	Unable to Assist	
Made Further Inquiries	Supplementary Report Requested	

Source: ANAO analysis of ASIC Annual Report Overview.

2.34 As Figure 2.5 above indicates, 2004–05 was the only year in which ASIC was able to produce an auditable trail of the activities that had been reclassified from the ‘Analysed, assessed and recorded’ Annual Report category. ASIC had no record of the 56 activities³⁴ that were reclassified from

³³ This action descriptor was incorrectly included in the ‘Investigation & Surveillance’ category in the March 2006 version of the Annual Report Overview. The amended September 2006 version of the Annual Report Overview correctly reflected the category in which this action descriptor fell.

³⁴ ASIC’s calculations indicate that 31 activities were reclassified in 2003–04, and 25 activities were reclassified in restating the 2002–03 figures.

that category to the 'Investigation & surveillance' category across the 2002–03 and 2003–04 financial years.³⁵

2.35 In respect of the 2004–05 financial year, there was a considerable increase in the number of activities reclassified, with 369 activities redistributed. Of these, 345 were reclassified to the 'Resolved' Annual Report category, with the remaining 24 activities being reclassified to the 'Investigation & surveillance' category.

2.36 At the time of producing the statistics for the 2004–05 Annual Report, ASIC did not conduct an examination of the records underlying the 369 reclassified activities to identify whether the issues raised in the statutory reports had in fact been resolved by ASIC, or whether any investigation or surveillance activity had been instituted by ASIC. In other words, there was no validation of the assumption that was made that the ASIC analyst had erred in their classification of the regulatory outcome.

2.37 As noted at paragraph 2.27 above, the revised version of the Annual Report Overview, issued by ASIC following discussions with ANAO, acknowledged that there was an error in the reported number of statutory report activities that ASIC had 'resolved' in 2004–05. ASIC advised as follows:

ASIC has reviewed the activities included [with the action descriptor] 'Provide information to complainant', and as a result it is ASIC's view that this action description has been used in error...by the analysts concerned to describe the action taken in finalising these statutory reports...the correct action description for these reports that should have been recorded...was 'Unable to assist' and these activities would then have been included in the Annual Report Classification 'Analysed, assessed and recorded'.

2.38 In essence, this means that the reclassification of the 345 activities from the 'Analysed, assessed and recorded' category to the 'resolved' category in ASIC's calculations for its 2004–05 Annual Report statistics was erroneous. To address this, ASIC advised that the figure of seven per cent that was reported in relation to the number of statutory report activities that were 'resolved' by ASIC in 2004–05 would be restated in ASIC's 2005–06 Annual Report to the Parliament to reflect the fact that just one per cent of activities were in fact

³⁵ In response to ANAO inquiries, ASIC endeavoured to re-perform the reclassification for 2003–04 (and the restatement of the 2002–03 figures), but was only able to identify 53 activities that satisfied the criteria it believes it would have used for those years. In October 2006, ASIC advised the ANAO that the discrepancy 'may be attributable to various reasons, including a corruption of a portion of the data stored in ASIC's data warehouse, or the changing of a finalisation code for an activity finalised in 2002–03 or 2003–04 after the date of the original extraction'.

'resolved'.³⁶ While the error occurred in relation to 0.06 per cent of activities in the 2004–05 financial year, because relatively few reports are actually 'resolved' (35 activities in 2004–05), the error had a considerable effect on the proportion of reports reported as 'resolved'.

2.39 For 2005–06, and as indicated in Figure 2.5 above, ASIC has not conducted any reclassification of activities from any Annual Report category. In the revised Annual Report Overview, ASIC advised that:

in preparing the statistics for the 2005–06 annual report, the 'Action taken' percentages for 'Resolved'; 'Compliance, Investigation or Surveillance'; 'Analysed, Assessed & Recorded'; and 'Supplementary Reports requested'³⁷ were entirely derived from the ultimate outcomes³⁸ recorded for the statutory report activities finalised.

Effect on reported statistics

2.40 The different methodologies adopted by ASIC in arriving at the statistics on actions taken on statutory reports, as reported in its Annual Reports, and the process of reclassifying activities from one Annual Report category to another on an undocumented basis without an adequate audit trail being maintained, has meant readers of ASIC's Annual Reports are not well placed to make fair comparisons between years of the levels to which ASIC has instituted particular forms of regulatory action.

2.41 Accordingly, ANAO recalculated the statistics for each year from 2002–03 to 2004–05, using the following method:

- only single outcomes are counted;
- activities are not reclassified, but rather are categorised based on their nominal primary outcome classifications; and
- proportions are calculated with total 'net statutory reports' excluding those activities that were finalised as having been 'merged with another activity'.

2.42 Figure 2.7 below shows the results of this recalculation, and compares the figures to those reported in ASIC's Annual Reports in each year.

³⁶ To this end, ASIC's 2005–06 Annual Report included a footnote to its 2005–06 statistics advising that the 2004–05 figure of seven per cent was incorrect.

³⁷ ANAO notes that this category was reported in ASIC's 2005–06 Annual Report as 'Reports triggering further inquiries' and equates to the 2004–05 Annual Report category 'Made further inquiries'.

³⁸ See paragraph 2.31.

Figure 2.7
Comparison of reported statistics

	2002-03			2003-04		2004-05		
	Annual Report Figures	Restated Annual Report Figures	ANAO Recalculation	Annual Report Figures	ANAO Recalculation	Annual Report Figures	Restated Annual Report Figures ^A	ANAO Recalculation
Investigation & surveillance	% 0.5	% 2.0	% 0.5	% 2.0	% 0.5	% 1.0	% 1.0	% 0.5
Resolved	7.0	8.0	7.0	10.0	7.8	7.0	1.0	0.7
Analysed, assessed & recorded	92.5	90.0	92.5	88.0	91.7	80.0 ^B	86.0	86.0
Made inquiries	ASIC's systems did not capture this information before 2004-05 ^C							
TOTALS	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Notes:

^A ASIC's 2005-06 Annual Report disclosed an error to the number of reports that it had 'resolved' in 2004-05. The other figures were not restated in the 2005-06 Annual Report, but are calculated here by reference to the corrected 'resolved' figure.

^B This figure was not reported in ASIC's 2004-05 Annual Report. By reference to the other actions taken by ASIC in the year, the percentage of reports that were 'Analysed, assessed and recorded' is 80 per cent.

^C The 'Made inquiries' category relates to those activities that were finalised by ASIC as 'supplementary report requested'. 2004-05 was the first year in which this information was separately captured by ASIC. In the two prior years, activities where ASIC requested a supplementary report were included in either the 'Resolved' or 'Analysed, assessed and recorded' category.

Source: ANAO analysis.

Recommendation No.1

2.43 ANAO *recommends* that the Australian Securities and Investments Commission disclose in its Annual Reports to the Parliament any changes between years in the underlying processes or assumptions for calculating the statistics on actions taken on statutory reports, and the effect of these changes, to enable readers of the Annual Reports to make a fair comparison.

ASIC response

2.44 ASIC agreed to this recommendation.

3. Investigation and enforcement

This chapter discusses ASIC's powers of investigation, and the regulatory action taken by ASIC in relation to statutory reports lodged by external administrators.

ASIC's powers of investigation

3.1 Section 13 of the ASIC Act provides ASIC with general powers of investigation. Section 13(1)(a) of the ASIC Act provides that ASIC may make such investigations as it thinks expedient for the due administration of the corporations legislation where it has reason to suspect that a contravention of a relevant law may have occurred.

3.2 Section 15 of the ASIC Act further provides that, where a report is lodged under sections 422 or 533 of the Corporations Act (by receivers and liquidators), ASIC may investigate a matter to which the report relates for the purposes of determining whether or not a person should be prosecuted for an offence against the corporations legislation. In terms of whether ASIC is able to investigate where a report under sections 422 or 533 of the Corporations Act alleges offences against laws other than the corporations legislation, ASIC advised ANAO as follows in August 2006:

ASIC is *not* precluded from investigating where a section 422 report or section 533 report refers to suspected offences against laws other than the corporations legislation. Such an investigation may be commenced under section 13 of the ASIC Act. Section 15 of the ASIC Act allows ASIC to investigate some matters even in the absence of a 'reason to suspect' of the kind required by section 13, but section 15 will be used to ground an investigation only rarely.

3.3 External administrators are subject to a continuing obligation to report to ASIC. However, ASIC advised ANAO that it does not have power to compel lodgement. In these circumstances, it is important that external administrators have confidence in ASIC's handling of their reports so that they will be encouraged to provide ASIC with quality reports in a timely manner. In this regard, in its report, the JCCFS stated as follows:

Clearly, a number of insolvency practitioners have the firm impression that insufficient attention is being given to their reports. It is a feature of many enforcement regimes including corporate regulation that regulatory authorities often have insufficient resources to ensure compliance with regulations. Further, full enforcement of insolvency related legislation is not always desirable or possible and resource decisions inevitably involve

trade-offs between different government programs and objectives. Nevertheless, the Committee is concerned that there is a widespread perception by parties affected by the collapse of insolvent enterprises that corporate laws are inadequately enforced in the context of insolvencies.

3.4 In this context, ASIC's induction manual for new analysts states that, 'in some cases the best response from the regulator will be none at all, while in other cases we will need to take swift and forceful action'. ASIC's 2006–07 PBS lists a number of qualitative performance indicators, including '70 per cent of investigations resourced that lead to an enforcement outcome'.³⁹ This provides a measure of ASIC's expectations of its performance in terms of the outcome of those matters that it has chosen to investigate.

Investigation and surveillance activity

3.5 In its report, the JCCFS concluded as follows in relation to ASIC's investigation of statutory reports:

Despite the explanations from ASIC on its procedures in following-up reports of possible offences, the Committee is not convinced that sufficient priority is being given to the assessment and investigation of reported possible serious breaches of the Corporations Act. If this is a matter of perception over substance, then ASIC has a responsibility to establish with insolvency practitioners a better system of conveying to them that it has given due and careful attention to the contents of their reports. ASIC needs to reassure insolvency practitioners that their reports are taken seriously and investigated where necessary.

3.6 ASIC's Annual Reports have, for some time, reported the total number of statutory reports received in the year, and the proportion of those reports that have been investigated by ASIC in the year. However, the terminology used by ASIC in its Annual Reports has changed over time, as follows:

- in 2002–03, the figure provided related to reports that were subject to 'investigation';
- in 2003–04, the figure was provided for reports that were subject to 'compliance, investigation or surveillance';
- in 2004–05, the figure related to reports that were 'referred for more action or investigation'; and

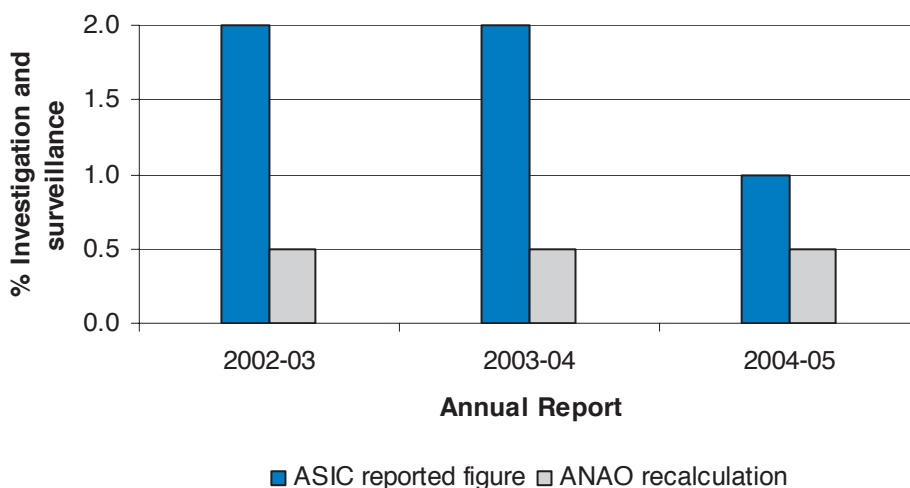
³⁹ This is a new measure. No similar measures have been included in ASIC's prior year PBSs.

- in 2005–06, the figure provided was for those reports that were ‘referred for compliance, investigation or surveillance’.

3.7 As discussed in the previous Chapter, in each year from 2002–03 to 2004–05, ASIC’s methodology in calculating statistics on statutory reports for its Annual Report has included reclassifying some activities from the ‘Analysed, assessed and recorded’ Annual Report category to the ‘Investigation and surveillance’ category. Combined with other changes in ASIC’s methodology, such as counting multiple outcomes in some years and single outcomes in others, there has been significant variation in the reported levels of statutory reports referred for investigation by ASIC, compared with the levels achieved utilising a consistent methodology, as described in paragraph 2.41. This is highlighted in Figure 3.1, which shows that ASIC’s use of inconsistent calculation methodologies has increased the reported levels of reports being referred for investigation and surveillance by up to four times.

Figure 3.1

Statutory reports reported as being referred for investigation and surveillance activity



Source: ANAO analysis

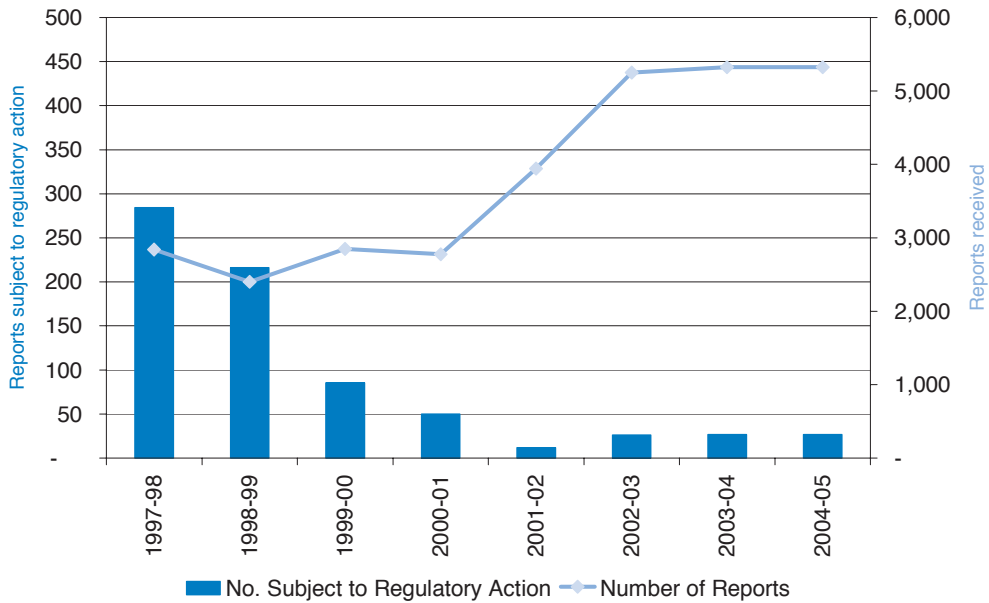
3.8 As noted at paragraph 2.6, the number of statutory reports alleging offences received by ASIC increased by almost 90 per cent between 1997–98 and 2004–05.⁴⁰ In comparison, the number of reports subject to ASIC regulatory

⁴⁰ From 2 842 to 5 321.

action (investigation or surveillance activity) has fallen by more than 90 per cent over the same period.⁴¹ This is illustrated in Figure 3.2 below.

Figure 3.2

Comparison of reports received with reports subject to investigation or surveillance activity: 1997–98 to 2004–05



Source: ANAO analysis and ASIC advice

3.9 In total, between 2002–03 and 2004–05, ASIC took regulatory action on 80 statutory reports, from nearly 16 000 that were assessed. This is outlined in Figure 3.3.

⁴¹ From 284 to 27.

Figure 3.3

ASIC’s levels of investigation or surveillance activity

Annual Report	Total Reports	Reports assessed	Proportion involving investigation or surveillance ^A	Resulting number involving investigation or surveillance ^B
2002-03	6,176	5,262	0.5%	26
2003-04	6,946	5,345	0.5%	27
2004-05	6,878	5,423	0.5%	27
TOTALS	20,000	15,893	0.5%	80

Notes:
^A The proportions are those recalculated by ANAO using a consistent methodology. The figures reported in ASIC’s Annual Reports for each year from 2002–03 to 2004–05 were 0.5 per cent, 2 per cent and 1 per cent respectively.
^B This is the number of reports by reference to the total number of reports alleging offences that are assessed and the proportion of those reports investigated or subject to surveillance.

Source: ANAO analysis

3.10 The JCCFS was concerned that insufficient priority was being given to the assessment and investigation of statutory reports of suspected breaches of the Corporations Act. In this respect, the significant reduction in activity with respect to statutory reports was not the result of a decision to investigate fewer reports. Rather, ASIC advised ANAO in December 2006 that:

Separate from our formal investigation activity, what has decreased over time has been the amount of surveillance activity undertaken by ASIC resulting from the lodgement of statutory reports, dropping from 9 per cent as reported in the 1997–98 ASIC annual report, to 2.4 per cent in the 1999–2000 year, and continuing to decrease to zero as reported in 2002–03. This reduction in surveillance activity resulted from a deliberate regulatory strategy to move from 'reactive' to 'proactive' surveillances in the area of insolvency, with the launch of ASIC's National Insolvent Trading Program in January 2003 to deal with possible insolvent trading before it occurs. Since this time, ASIC has dedicated significant resources to proactive surveillance of trading companies with suspected solvency concerns, with potential targets identified from a variety of sources, including public complaints.

3.11 It is properly a matter for ASIC to determine where the balance lies in deciding whether to act upon reports of suspected breaches of the Corporations Act reported by external administrators. However, in light of the marked reduction in regulatory action and of the concerns expressed by the

JCCFS, it is timely for ASIC to review its current approach, including the opportunities for increasing the number of reports it investigates.

Recommendation No.2

3.12 ANAO *recommends* that, given the large number of reports received each year that allege offences, and the JCCFS' concerns that sufficient regulatory priority be given to such reports, the Australian Securities and Investments Commission identify opportunities for increasing the number of statutory reports that are investigated.

ASIC response

3.13 ASIC agreed to this recommendation and commented as follows:

ASIC agrees with this recommendation and notes our current activity in the areas of external administrator assistance (assisting external administrators to obtain higher quality information from company officers and access to company books and records) and assetless administrations (by funding external administrators to conduct preliminary investigations and provide higher quality reports to ASIC), thereby increasing the likelihood of regulatory action.

ASIC's regulatory remedies for statutory reports

3.14 ASIC has a wide range of possible remedies available to it to deal with offences identified in statutory reports or other deficiencies which warrant some sort of regulatory action. For less serious matters which may not warrant detailed investigation, ASIC may issue directors of companies with warning letters about the potential consequences of, for example, trading while insolvent or continuing to act as a director of a company after becoming bankrupt. ASIC may also seek and obtain an Enforceable Undertaking from a company and/or its directors.⁴² The Corporations Act also provides ASIC with a number of mechanisms to institute proceedings to disqualify persons from managing corporations. ASIC's use of these provisions is discussed later in this Chapter.

⁴² Section 93AA of the ASIC Act relates to the enforcement of undertakings. An Enforceable Undertaking is an undertaking given by a person or company that is enforceable in a court. Enforceable Undertakings are generally accepted by ASIC as an alternative to civil or administrative action where there has been a contravention of the corporations legislation. Source: ASIC website, <www.asic.gov.au>.

ASIC's relationship with the Office of the Commonwealth Director of Public Prosecutions

3.15 The agency with the primary responsibility for instituting and conducting prosecution of offences against Commonwealth law is the Office of the Commonwealth Director of Public Prosecutions (CDPP).

3.16 The initial consideration by the CDPP in exercising the discretion whether or not to prosecute is whether the evidence is sufficient to justify the institution or continuation of a prosecution.⁴³ The *Prosecution Policy of the Commonwealth* (Prosecution Policy) states that:

A prosecution should not be instituted or continued unless there is admissible, substantial and reliable evidence that a criminal offence known to the law has been committed by the alleged offender...A prosecution should not proceed if there is no reasonable prospect of a conviction being secured.

3.17 One of the reasons for the establishment of the CDPP was to enable the 'removal of the prosecution process from the political arena by affording the Director an independent status in the process'.⁴⁴ It also means that 'the decision whether to proceed with [a] prosecution is made by the CDPP independently of those who were responsible for the investigation'.⁴⁵ This was emphasised by the Director of Public Prosecutions, Mr Damian Bugg AM QC, who said:⁴⁶

The severance of the functions of investigating and prosecuting has had the effect of injecting a degree of objectivity into the prosecution process.

3.18 Notwithstanding the above, the Prosecution Policy allows for certain Commonwealth agencies to conduct their own summary prosecutions. The relevant part of the Prosecution Policy reads as follows:

These [prosecutions] are generally high volume matters of minimal complexity where, for example, pleas of guilty are common (or averment provisions can be relied upon) and where prison sentences are rarely imposed (in many instances the maximum penalty involved is a fine). It is expected that those responsible for such prosecutions will observe these guidelines, and that they will consult the CDPP when difficult questions of fact or law arise. The CDPP

⁴³ Prosecution Policy of the Commonwealth, *Guidelines for the making of decisions in the prosecution process*, March 1992.

⁴⁴ *ibid.*

⁴⁵ *ibid.*

⁴⁶ ASIC media release 06-049, 22 February 2006, referring to an address given by Mr Bugg to ASIC's Summer School.

has guidelines with a number of these agencies regulating, among other things, those cases which should be referred to the CDPP.

Memorandum of Understanding

3.19 In September 1992, ASIC⁴⁷ and the CDPP entered into a Memorandum of Understanding (MOU)⁴⁸ which sets out the views of the CDPP and ASIC on:

the nature of the guidelines and other matters relevant to the working arrangements between the two offices...

3.20 In December 1992, the CDPP and ASIC settled the terms of some Guidelines as contemplated by the MOU, entitled '*Guidelines for working arrangements between ASC and DPP*'. The Guidelines contained a section entitled '*Prosecution of minor regulatory matters*' which contained the following paragraph:

8.1 The ASC will prosecute under the National Scheme laws minor regulatory offences contained in the Corporations Law. Examples of these types of offences include failure to keep a register, failure to lodge an annual return and failure to lodge a prescribed statement.

3.21 On 16 June 1998, the CDPP wrote to ASIC, noting that 'at the time that the Guidelines were negotiated it was appreciated that there was a grey area in precisely what was meant by the term 'minor regulatory offences'. The letter went on to 'provide some guidance' as to which offences constituted 'minor' as follows:

- offences where the maximum penalty is a fine (that is, where imprisonment is not available); and
- offences with a maximum penalty of ten penalty units⁴⁹ and/or imprisonment for 3 months but only if the defendant pleads guilty.

3.22 The letter then went on to refer to offences where the maximum penalty is 25 penalty units and/or imprisonment for six months and stated that:

These offences should not be categorised as minor regulatory offences and possible contraventions should be referred to the CDPP...

⁴⁷ The MOU was entered into by the Australian Securities Commission (ASC), ASIC's predecessor.

⁴⁸ A new MOU was entered into by the CDPP and ASIC on 1 March 2006. However, for the period covered by this audit, the 1992 MOU was in force.

⁴⁹ Since 1992, all pecuniary penalties under Commonwealth legislation have been expressed as penalty units. Since April 1997, one penalty unit is equivalent to \$110. Thus, ten penalty units is equivalent to \$1 100.

3.23 On 6 May 2002, ASIC wrote to the CDPP informing it that ASIC intended to:

...initiate a program of prosecuting company directors pursuant to sections 475(1) and 530A(6) of the Corporations Act.

3.24 The maximum penalty for offences under Section 475(1) is 25 penalty units and/or six months imprisonment and for section 530A(6), 50 penalty units and/or one year imprisonment. Both of these provisions exceed the threshold identified by the CDPP as referred to in paragraph 3.21 above. Accordingly, on 30 May 2002, the CDPP replied to ASIC's letter stating that 'CDPP's Head Office has advised me that the CDPP does not regard these [section 475(1) and 530A(6)] matters as minor regulatory offences as contemplated by the ASIC/DPP guidelines' and asked that the matters be referred to the CDPP. The CDPP wrote to ASIC again on 23 July 2002, referring to two specific 475(1) and 530A(6) prosecutions that ASIC had instituted. In addition to reiterating that the CDPP did not consider these matters to be minor, the CDPP letter stated:

Would you please forward the briefs in these two matters to this Office.

3.25 Over the next 12 months, there were further exchanges of correspondence and a number of meetings between CDPP and ASIC officials during which time an agreement was reached as to exactly which offences ASIC could prosecute. This agreement took the form of a letter dated 7 July 2003 from CDPP to ASIC. The relevant part of the letter reads:

Accordingly the arrangement as agreed between our organisations is as follows. ASIC may institute proceedings for offences against sections 142(1) and (2), 146(1), 156, 188, 205B(1), (2), (4) and (5), 205E, 286(1), 429, 430, 438B, 438C(5), 471A(1), 475, 530A(6) and 530B(3) of the *Corporations Act 2001*.

3.26 ASIC acknowledged the CDPP's letter on 28 July 2003, in which ASIC's Executive Director – Public and Commercial Services stated:

I confirm that ASIC agrees to the arrangement, as detailed in your letter, concerning the division of prosecutorial responsibilities between ASIC and the DPP in respect of minor regulatory offences.

ASIC's adherence to the July 2003 agreement

3.27 From time to time, ASIC publishes details of prosecutions it (as distinct from the CDPP) has undertaken and the results of those prosecutions. The ANAO compared these lists with the terms of the agreement shown at paragraph 3.25 above and identified that on 26 occasions (relating to a total of

30 charges), ASIC had prosecuted companies or individuals under sections of the Act which were not part of the agreement. Three of these prosecutions carried a maximum penalty of 50 penalty units and/or one year imprisonment.⁵⁰

Recommendation No.3

3.28 ANAO *recommends* that the Australian Securities and Investments Commission promptly refer to the Commonwealth Director of Public Prosecutions any proposed prosecutions of minor regulatory matters which it has not been explicitly authorised to undertake.

ASIC response

3.29 ASIC agreed to this recommendation and commented as follows:

On 1 March 2006 ASIC and the CDPP entered into a new Memorandum of Understanding which provides in part that:

- ASIC may prosecute such summary regulatory matters as are agreed from time to time between ASIC and the CDPP at the national level.

ASIC will continue to abide by the terms of that MOU and agreements reached from time to time with the CDPP on the prosecution of minor regulatory matters.

3.30 In addition, the CDPP commented to ANAO as follows:

We have had the opportunity to consider ASIC's response to the draft report and agree with the comments made in relation to recommendation 3.

We would note that ASIC and the CDPP enjoy a strong working relationship and there is regular liaison at the head of agency, management and operational levels to address issues such as the one raised in the draft report.

What regulatory action has ASIC taken?

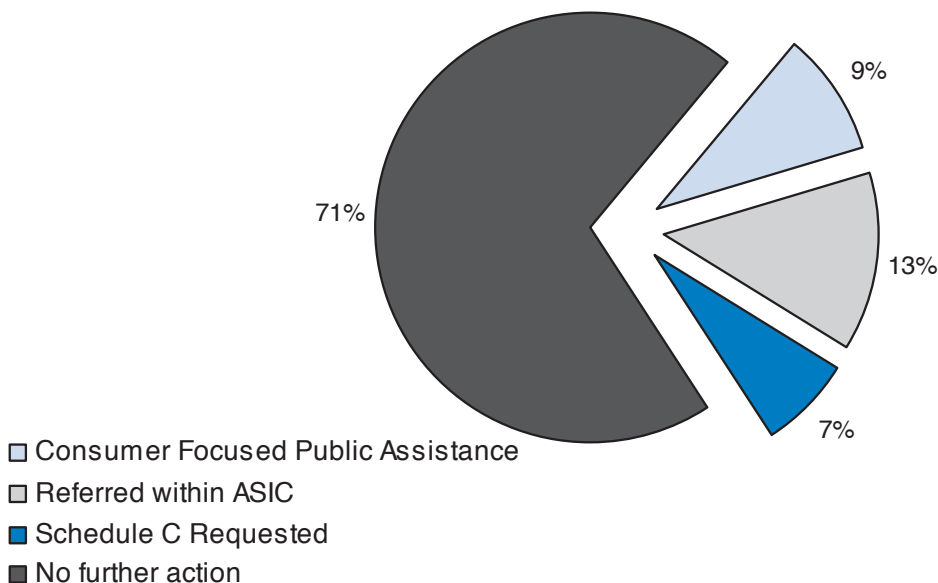
3.31 In ANAO's sample, there were 416 statutory report activities. ANAO undertook an assessment of the actions taken by ASIC, if any, in respect of each of these activities. The results of this analysis, based on the activity

⁵⁰ The remaining prosecutions carried penalties less than 25 penalty units and/or six months imprisonment.

outcome recorded by ASIC⁵¹ for each sampled activity, are shown in Figure 3.4 below.⁵²

Figure 3.4

ASIC’s finalisation of sampled activities



Source: ANAO analysis of ASIC data.

3.32 As Figure 3.4 shows, more than 70 per cent of activities in the ANAO sample were finalised by ASIC with no further action.

3.33 In the remaining instances, the statutory reports resulted in one of three types of actions being taken by ASIC: a supplementary report was requested from the external administrator; the report was referred within ASIC for consideration of regulatory action; or public assistance action was recorded. ANAO’s analysis of the statutory report activities in its sample that resulted in these types of actions is discussed in the following sections.

⁵¹ Where a single activity was recorded with more than one activity outcome, ANAO has used the outcome with the greatest level of regulatory action taken, in line with the ‘ultimate outcome’ system that ASIC has used in calculating the statistics for its 2005–06 Annual Report, as outlined in the Annual Report Overview and discussed in Chapter 2.

⁵² ANAO’s analysis excludes 100 activities in the sample that were finalised by ASIC as having been ‘merged with another activity’, based on ASIC’s advice that it does not include these types of activities in its analysis for reporting in ASIC Annual Reports.

Supplementary report requested

3.34 As discussed previously, when a Schedule B report is lodged with ASIC electronically, one of two things can happen. If the issues raised in the report do not trigger ASIC's risk score thresholds, no further action is taken on the matter by ASIC, other than to advise the liquidator that the matter will not be investigated and to request the liquidator to advise ASIC if circumstances change. If, however, the risk score for the report exceeds the thresholds, a supplementary report from the external administrator is automatically requested by ASIC.

3.35 As discussed in the previous chapter, ASIC advised ANAO that, in 2004–05, ASIC was able to report for the first time on the number of simplified reports that 'triggered a request for a further supplementary report – notably the 12 per cent of reports triggering further inquiries [as reported in the 2004–05 Annual Report]'.

3.36 As Figure 3.4 above shows, a supplementary report was requested by ASIC in seven per cent of cases in the ANAO sample. However, ANAO's analysis of the sampled activities revealed that a Schedule C report was not received by ASIC in every instance that one was requested. Specifically, from the 16 instances in ANAO's sample for 2004–05 where ASIC finalised an activity as 'Supplementary report requested', no further report was received in six instances (37.5 per cent). On this issue, ASIC advised ANAO in August 2006 that:

It is entirely within an external administrator's discretion to lodge a further report. The legislation provides no power to ASIC to compel lodgement of a further report.

3.37 Nonetheless, ANAO considers it would be prudent for ASIC, as the corporate regulator, to have proper processes in place to ensure that it is provided with all possible information to make a full assessment of a statutory report alleging offences. In this respect, ANAO also notes that ASIC does not currently have a system in place to follow up with external administrators where requested Schedule C reports have not been received.

3.38 Further, where a Schedule C report is received, there is no clear link between the act of 'making further inquiries', and the final outcome of those inquiries. That is, although those activities that are finalised with an activity outcome of 'supplementary report requested' are included in ASIC's Annual Report in the number of instances where it 'made further inquiries', the

outcome of those inquiries, from assessment of the supplementary report, is reported in whichever category encompasses the particular actions taken for the supplementary report. In this context, in ANAO's sample, of the 10 instances in 2004–05 where ASIC requested and received a Schedule C report, seven of these (70 per cent) ultimately resulted in no further action being taken on the matter by ASIC.

3.39 In this respect, ANAO notes that the categorisation used in ASIC's 2005–06 Annual Report is 'Reports triggering further inquiries', and not 'Made further inquiries' as was used in the 2004–05 Annual Report. However, this means that ASIC continues to report in this category instances where a supplementary report has been requested but not received.

Recommendation No.4

3.40 ANAO *recommends* that the Australian Securities and Investments Commission develop and implement procedures for the timely follow-up of external administrators where a supplementary report has been requested but not received.

ASIC response

3.41 ASIC agreed to this recommendation and commented as follows:

ASIC agrees with this recommendation and will commence a review of available options and costings for such options in 2007. While ASIC has no specific power to compel the production of a supplementary report, as noted in the report, it is the responsibility of the external administrator to provide a report to ASIC in the circumstances set out in the legislation.

Referral within ASIC

3.42 A submission to the JCCFS inquiry stated:⁵³

Receivers and Administrators often reported what they believe to be quite serious breaches of the Corporations Act to the regulator, only to receive the response that due to a lack of resources and the number of complaints received not all matters can be investigated and therefore no further action will be taken.

3.43 In this context, often where a statutory report raises regulatory issues, it will be necessary for ASIC analysts to refer the matter to another directorate

⁵³ Parliamentary Joint Committee on Corporations and Financial Services, *Corporate Insolvency Laws: a Stocktake*, June 2004.

for consideration of those issues. In addition, within ASIC's directorates, there are a number of divisions and committees to which matters may be referred for consideration and action. ASIC advised the ANAO in October 2006 that:

the fact that a matter has been accepted for investigation or surveillance is a reasonably reliable indication that an investigation or surveillance will be undertaken.

3.44 Where a statutory report activity is assessed by ASIC analysts as meeting predefined case selection criteria, that activity is required to be referred to the Enforcement Directorate for consideration. An Enforcement resourcing committee considers the referred matters based on merit, available resourcing, and alignment with strategic goals. In this regard, internal ASIC guidance states that:

it is conceivable that [the committee] will decline all matters on a given day if there is no link to our strategic goals.

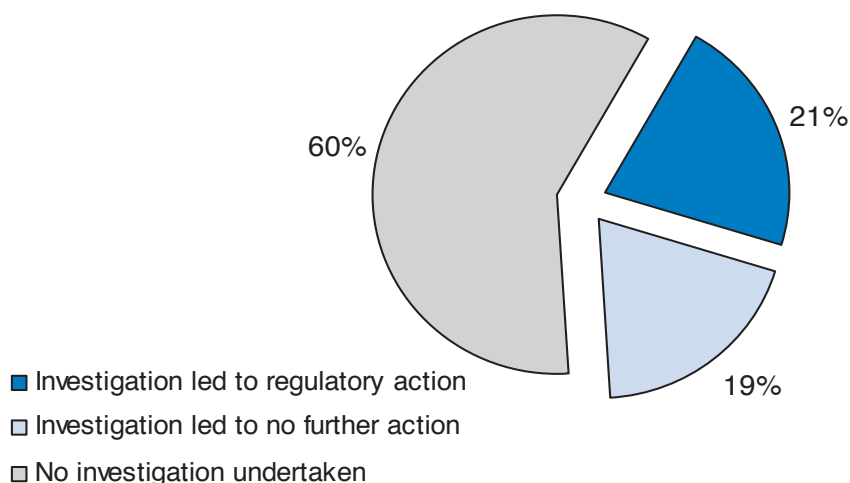
3.45 The guidance also states that giving consideration to strategic goals and the position of the Enforcement Directorate before considering referrals:

guides [the committee's] resourcing decisions and counters the tendency to resource the best referral presented on the day, by focusing on the realisation of our goals for the year.

3.46 In this context, ANAO assessed each of the 42 activities in its sample where the issues raised in the statutory report were referred within ASIC for consideration of regulatory action, to determine what proportion of the statutory reports that were referred within ASIC ultimately resulted in regulatory action being initiated by ASIC. The results of this analysis are shown in Figure 3.5.

Figure 3.5

Results of ASIC’s internal referrals of statutory reports



Source: ANAO analysis of ASIC data.

3.47 As Figure 3.5 above illustrates, no investigatory action resulted from the referral of the activity in 60 per cent of cases in ANAO’s sample.

3.48 These types of activities (that is, those that have been referred within ASIC but ultimately not subject to any regulatory action) are included in the ‘Analysed, assessed and recorded’ category in ASIC’s Annual Reports. Combined with the activities shown in Figure 3.4 above where ASIC took no further action, this means that around 80 per cent of activities in the ANAO sample fall into the ‘Analysed, assessed and recorded’ category. This is consistent with the trend in ASIC’s regulatory activity over time, with the majority of statutory reports assessed by ASIC each year being included in the ‘Analysed, assessed and recorded’ category in its Annual Reports, which, as previously discussed, encompasses those activities where no regulatory action was initiated by ASIC.

3.49 In nine out of the 42 activities (21 per cent) in ANAO’s sample that were referred within ASIC, that referral resulted in regulatory action being taken by ASIC, as follows:

- three activities resulted in prosecution action. One of these related to the successful prosecution of a company director for breaching section 184 of the Corporations Act, which relates to good faith, use of position and use of information by company directors. At the time of audit, prosecution action was ongoing in respect of a further two activities;
- one activity resulted in ASIC accepting an Enforceable Undertaking from a company and its directors; and
- five activities led to ASIC initiating action under section 206F of the Corporations Act, with the company directors being banned from managing corporations for between three and five years.

3.50 With regard to the remaining eight activities (19 per cent), ASIC commenced an investigation into the matters raised in the statutory reports, but those investigations were terminated without any regulatory remedies being applied. No further action was taken by ASIC on these matters for a variety of reasons, including that:

- successful prosecution action had been undertaken by parties outside of ASIC, which automatically disqualified the company directors from managing corporations under section 206B of the Corporations Act, and ASIC had no jurisdiction in the matter;
- following preliminary investigations and the interviewing of witnesses, problems were encountered with obtaining sufficient evidence, limiting the prospects of securing a conviction; and
- investigations into the issues raised in the statutory reports were already substantially underway by other law enforcement agencies, with no criminal action remaining for ASIC to investigate.

Consumer Focused Public Assistance

3.51 ASIC's induction manual for new analysts provides guidance on the types of actions that constitute Consumer Focused Public Assistance (CFPA). The manual states that:

public assistance is any action performed...that will assist a complainant to resolve the concerns they have raised in their complaint.

3.52 The manual also provides some examples of solutions that ASIC analysts might apply to a particular situation that are, and are not, considered to be CFPA. These examples are shown in Figure 3.6 below.

Figure 3.6

Examples of Consumer Focused Public Assistance

Action	ASIC considers Consumer Focused Public Assistance?
Sending a warning letter to a company officer who has failed to complete a Report as to Affairs, or hand up books and records to a liquidator, and monitoring whether compliance is achieved.	✓
Calling the secretary of a public company to remind them of their obligations to hold an Annual General Meeting within a certain period following a complaint of non-compliance.	✓
Calling a share registry to conciliate a refusal to provide information about a shareholding, or resolve a refusal to register a transfer of shares.	✓
Locating a community legal service that will assist the complainant and arranging a first appointment for them.	✓
Referring the complainant to a relevant External Dispute Resolution Scheme, having checked first that the dispute in question is one in which the relevant body can deal with.	✓
Writing to the complainant and noting that their complaint is probably better handled by the Financial Industry Complaints Service (FICS) without investigating whether the dispute comes within FICS terms of reference.	✗
Writing to the complainant to advise that the issues they have raised are not being investigated by ASIC but that they may wish to seek their own private legal advice on other remedies available to them.	✗

Source: ASIC.

3.53 As shown in Figure 3.4 above, there were 30 activities in ANAO’s sample (nine per cent) that were finalised by ASIC with an activity outcome of CFPA. In 50 per cent of these instances, ASIC wrote to the external administrators requesting that a supplementary report be submitted (noting that, until late 2003–04, ASIC’s systems did not have a dedicated activity outcome to describe this type of action).

3.54 In a further four instances, ASIC sent warning letters to the company directors reminding them of their obligations under the Corporations Act.

3.55 ANAO’s assessment of the remaining 11 activities in its sample that were finalised by ASIC as CFPA (36 per cent) revealed that the actions taken by ASIC did not in every case appear to validly constitute having provided public assistance. Specifically:

- in four cases, ASIC decided to take no further action pending assessment of further reports, which had either already been lodged with ASIC, or the external administrator had indicated one would be forthcoming;
- in three instances, ASIC wrote to the external administrators advising that the issues that had been raised would not be investigated by ASIC;⁵⁴
- in one instance, ASIC decided to take no further action but failed to advise the external administrator of its decision in writing;⁵⁵
- in one instance, ASIC finalised the activity as having been previously dealt with in relation to another activity, with no letter sent to the external administrator in the present matter;⁵⁶
- in one case ASIC wrote to the liquidator noting that his investigations were still being conducted, and requesting that details of the final deficiency to unsecured creditors and the outcomes of any subsequent investigations be advised to ASIC in due course; and
- in one instance ASIC decided to request a supplementary report from the external administrator, but a letter requesting the report did not appear to have been sent by ASIC.⁵⁷

3.56 In each year from 2002–03 to 2004–05, the types of activity outcomes that ASIC has included in the ‘Resolved’ Annual Report category have changed, as follows:

- in 2002–03, activities that were finalised by ASIC as ‘CFPA’, or ‘Referred to ILMC’ were included;⁵⁸

⁵⁴ ANAO notes that in one of these cases ASIC placed an internal system alert with ASICs financial services licensing division about the director of the company.

⁵⁵ ANAO notes that the liquidator’s report in this case alleged breaches of s475 and 530A of the Corporations Act, relating to the provision of a Report as to Affairs and assisting the liquidator respectively. ASIC provided assistance to the liquidator on these matters through a separate activity.

⁵⁶ ANAO notes that ASIC dealt with some of the issues raised in the reports in a separate activity that ultimately resulted in successful prosecution action.

⁵⁷ In this respect, ASIC advised ANAO in August 2006 that ‘although a copy of the letter has not been retained on the electronic file, there is no evidence either way that a letter was or was not sent...the fact that this recommendation was made [to request a supplementary report] technically resolved ASIC’s concerns in relation to the Schedule B report’.

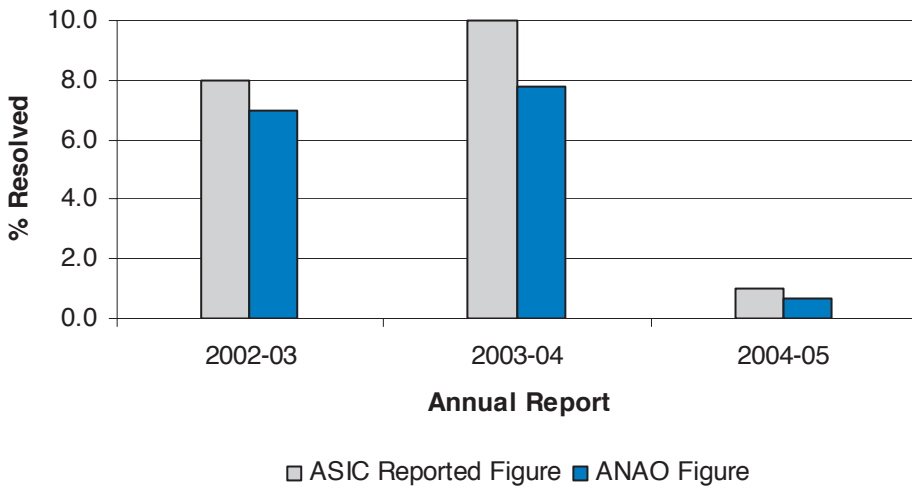
⁵⁸ In later years, activities that were finalised as ‘Referred to ILMC’ were included in the ‘Investigation and surveillance’ Annual Report category.

- in 2003–04, activities that were finalised by ASIC as ‘CFPA’ or ‘Supplementary report requested’ were included (noting that the latter activity outcome was only available to ASIC analysts in the later parts of that financial year);⁵⁹ and
- in 2004–05, activities that were finalised as ‘CFPA’ were included, and some activities were reclassified into the category from the ‘Analysed, assessed and recorded’ category.

3.57 In respect of the 2004–05 Annual Report, and as discussed in Chapter 2, ASIC’s revised Annual Report Overview acknowledged that an error had been made in the calculation of the number of reports in 2004–05 that ASIC had ‘resolved’, reducing the reported figure from seven per cent to one per cent. This change resulted from the ‘reversal’ of ASIC’s reclassification of activities. This means that the only activities actually included in the ‘Resolved’ category for 2004–05 (as it is corrected in ASIC’s 2005–06 Annual Report) are those finalised with an activity outcome of ‘CFPA’.

3.58 Changes to the content of the ‘Resolved’ Annual Report category, without such changes being disclosed in ASIC’s Annual Report further impedes year-on-year comparison of ASIC’s regulatory actions. Figure 3.7 below illustrates the proportion of reports ‘resolved’ as reported in ASIC’s Annual Reports from 2002–03, and the figures recalculated by ANAO using a consistent method that includes only those activities that ASIC finalised as ‘CFPA’ (noting that this activity outcome is the only common outcome included in ASIC’s reporting across the three year period).

⁵⁹ In 2004–05 when the ‘supplementary report requested’ activity outcome had been available to ASIC analysts for a full financial year, details of these activities were reported in a separate category in ASIC’s Annual Report.

Figure 3.7**Activities 'resolved' by ASIC**

Source: ANAO analysis of ASIC data.

Disqualification from managing corporations

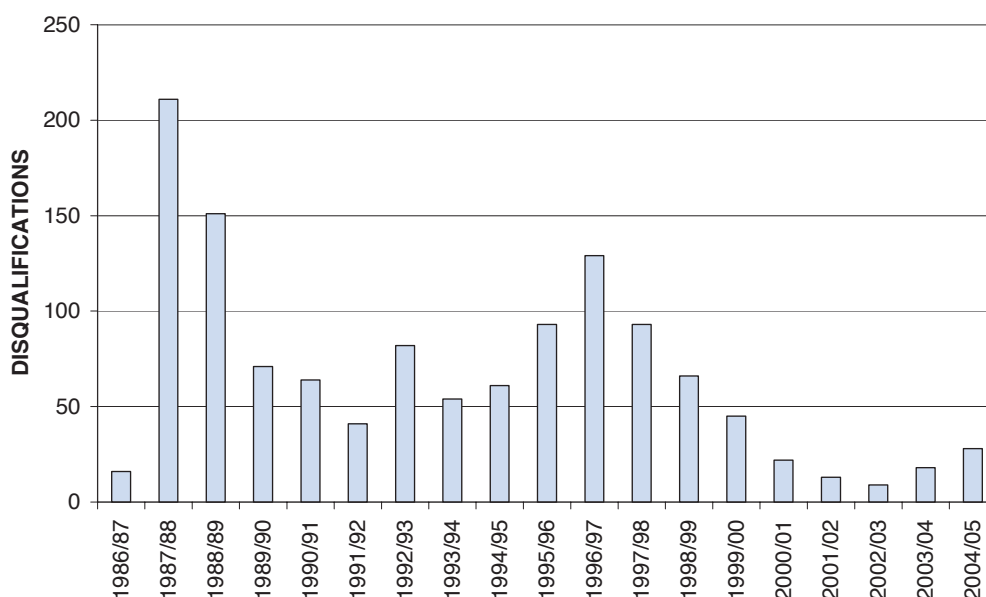
3.59 As discussed at paragraph 3.14, one of the alternatives to instituting civil or criminal prosecution that is available to ASIC under the Corporations Act is the power to disqualify persons from managing corporations. Part 2D.6 of the Corporations Act relates to the disqualification from managing corporations. Under certain specified circumstances, persons are able to be disqualified under the Corporations Act from managing corporations for varying periods of time.

3.60 The frequency of ASIC's use of the powers available to it under Part 2D.6 of the Corporations Act⁶⁰ has declined markedly from a peak of 211 disqualifications in 1987–88 to a low of nine in 2002–03 (although there have been small increases to 18 and 28 in 2003–04 and 2004–05 respectively). This is illustrated in Figure 3.8. The figures are taken from ASIC's *Register of Banned and Disqualified Persons*. Section 1274AA of the Corporations Act requires ASIC to keep a register of persons who have been disqualified from managing corporations under sections 206C, 206D, 206E or 206F. The register is a public document and is available on ASIC's website.

⁶⁰ Or the equivalent provisions under the old corporations law.

Figure 3.8

Frequency of ASIC's use of disqualification powers



Source: ASIC website <www.asic.gov.au>, Register of Banned & Disqualified Persons.

3.61 In December 2006 ASIC advised ANAO that:

The major cause of fluctuation in the number of disqualification orders made by ASIC from year to year, is ASIC's decision to redirect or prioritise its application of regulatory resources to other areas of corporate misconduct within ASIC's jurisdiction and ASIC's decision to pursue more serious court based remedies, involving a combination of disqualification, fines and, in appropriate cases, compensation.

ASIC's power of disqualification

3.62 Section 206F of the Corporations Act allows ASIC, independently of the Courts or the CDPP, to disqualify a person from managing corporations for up to five years.⁶¹ Such action is referred to as an administrative disqualification. Figure 3.9 below provides an extract of the provisions of Section 206F of the Corporations Act.

⁶¹ Sections 206B, C, D and E of the Corporations Act also contain provisions relating to disqualification from managing corporations. The penalty for continuing to manage a corporation while disqualified (section 206A) is \$5 500 or imprisonment for one year or both.

Figure 3.9

Extract of section 206F of the Corporations Act

206F ASIC's power of disqualification

Power to disqualify

- (1) ASIC may disqualify a person from managing corporations for up to 5 years if:
- (a) within 7 years immediately before ASIC gives a notice under paragraph (b)(i):
 - (i) the person has been an officer of 2 or more corporations; and
 - (ii) while the person was an officer, or within 12 months after the person ceased to be an officer of those corporations, each of the corporations was wound up and a liquidator lodged a report under subsection 533(1) about the corporation's inability to pay its debts; and
 - (b) ASIC has given the person:
 - (i) a notice in the prescribed form requiring them to demonstrate why they should not be disqualified; and
 - (ii) an opportunity to be heard on the question; and
 - (c) ASIC is satisfied that the disqualification is justified.

Grounds for disqualification

- (2) In determining whether disqualification is justified, ASIC:
- (a) must have regard to whether any of the corporations mentioned in subsection (1) were related to one another; and
 - (b) may have regard to:
 - (i) the person's conduct in relation to the management, business or property of any corporation; and
 - (ii) whether the disqualification would be in the public interest; and
 - (iii) any other matters that ASIC considers appropriate.

3.63 It is important to note that section 206F is intended to be protective and not punitive in nature. That is, the reason behind the disqualification power is not to punish the person involved, but to protect the public from the conduct of a person who has demonstrated an inability to manage corporations. This has been highlighted by the courts in a number of cases. For example, in *Kardas v ASC*,⁶² it was put by Justice Heerey that:

The bare fact of s533 reports being made in respect of two or more companies has been seen by the Parliament as sufficient to raise the question whether the director concerned should, for the protection of the public, be prevented for a substantial period from benefiting directly or indirectly from the privilege of limited liability.

⁶² (1998) 16 ACLC 1695.

3.64 As illustrated by Figure 3.8, in 2004–05, there were a total of 28 disqualifications by ASIC or the courts. In 2005–06, ASIC announced that it had banned 23 directors from managing corporations. There has been a recent significant increase in ASIC’s use of its power of disqualification. Specifically, between 7 July 2006 and 20 December 2006 ASIC announced that it had banned 31 directors from managing corporations, more than double the number of directors banned over the equivalent period in 2005–06.

Timeliness of section 206F banning action

3.65 The initial ‘trigger’ for eligibility for a disqualification under section 206F is that the person ASIC is seeking to disqualify has, within the last seven years, been an officer of at least two corporations that have been wound up and have been the subject of section 533 reports submitted to ASIC by a liquidator. In this respect, ASIC advised ANAO in August 2006 that:

it is critical that a report is registered individually against each corporate entity, so as to immediately, or at some future point in time, enliven ASIC’s power of disqualification under s206F, which refers to the winding-up and receipt by ASIC of s533 reports in relation to 2 or more corporations. Exercise of this power requires accurate recording of reports against single corporate entities.

3.66 In ANAO’s sample, there were five activities that ultimately resulted in the directors being banned under section 206F from managing corporations. There was one instance in ANAO’s sample where the administrative banning action under section 206F was initiated at the first point the trigger was met. That is, banning action was undertaken upon receipt of the second section 533 report relating to a company of which the person was a director.⁶³ This highlights that, where applied promptly, section 206F provides ASIC with an effective mechanism to protect the public and prevent the misuse of the corporate form, and associated benefits of limited liability, by company directors.

3.67 However, in the remaining four cases in ANAO’s sample, banning action was not initiated until section 533 reports for at least three, and up to eight, corporations of which the subjects were directors had been lodged with ASIC. There are a number of legitimate considerations to be taken into account when deciding whether to initiate banning action once the trigger of two

⁶³ ANAO notes that the section 533 report that was lodged for the second company, triggering disqualification eligibility, also related to a further four companies of which the person was a director.

reports has been met. In December 2006, ASIC advised ANAO that for these four cases the decision not to take banning action at an earlier stage was either due to insufficient evidence to warrant action or the conduct was being pursued by other regulatory agencies.

ASIC's application of the legislative provisions

3.68 In determining whether or not to disqualify a person under section 206F, the legislation requires that ASIC be satisfied that the disqualification is justified. There are a number of factors that ASIC may, or must, have regard to in coming to a decision that disqualification is warranted. However these matters are not determinative of the issue, in the sense that the basic issue remains – is ASIC satisfied that disqualification is justified?

3.69 ANAO's examination of matters in its sample, however, indicated that in considering what action (if any) should be taken, some of ASIC's analysts may have misinterpreted the provisions of section 206F of the Corporations Act with the effect that ASIC had not instigated disqualification action in cases where the company directors were candidates for such action. Further, it appeared that some of ASIC's guidance material for analysts did not correctly reflect the terms of the legislation. In order to ascertain whether this was the case, ANAO obtained legal advice concerning ASIC's interpretation of, and processes for, considering action under section 206F. The three areas of concern considered in the advice are discussed in the sections below.

Inability to pay debts

3.70 An ASIC guidance document dated 9 December 2005 for staff assessing a potential section 206F banning action (the Guidance Document) notes that section 206F sets out a three-part threshold test for disqualification action (see also the extract of the legislative provisions at Figure 3.9 above).

3.71 The Guidance Document states that:

To get over the threshold test in [section] 206F...the [section 533] reports should specifically contain information to satisfy [section] 533(1)(c) – namely they should state that in the liquidator's view, the company may be unable to pay its unsecured creditors more than 50 cents in the dollar. Some liquidators do not use this precise wording, for example, they might say 'the company has a deficiency of assets to liabilities of \$X'. This is not adequate for the purposes of [section] 206F and a further report from the liquidator will be necessary to clarify the point.

3.72 However, in relation to the Guidance Document, ANAO's legal advice is that:

To understand whether this statement is correct, it is necessary to look carefully at the wording of subparagraph 206F(1)(a)(ii). For the section to be able to be invoked a liquidator must have 'lodged a report under subsection 533(1) about the company's inability to pay its debts' (emphasis added). Under section 533(1) a liquidator must lodge a report with ASIC if 'it appears to the liquidator...that the company may be unable to pay its unsecured creditors more than 50 cents in the dollar'.

It can be seen that neither section [206F nor 533] specifies a particular form of words that must be used. The report to be lodged by the liquidator under section 533(1) follows from the liquidator being satisfied of a certain state of affairs but does not require that it specify in that report the company may be unable to pay its unsecured creditors more than 50 cents in the dollar. This circumstance is the trigger for the requirement to make the report, but it does not determine the form of the report.

As is noted above, [section] 206F requires only that a report have been made about the company's inability to pay its debts. It does not turn on the form that the report has followed. It could not do so as [section] 533 does not specify a form of words that must be used...

Accordingly, it seems to us that the ASIC requirement [from the Guidance Document] is too rigid...we do not agree with ASIC's requirement that a specific formula indicating the existence of the requisite opinion must be used by the liquidator before [section] 206F can be invoked.

3.73 This opinion is supported by a statement of the Administrative Appeals Tribunal (AAT) in *Healey v ASIC*⁶⁴(referring to section 600 of the old Corporations Law, which was the previous equivalent provision to section 206F):⁶⁵

...it is not necessary for the liquidator to show (let alone prove) a deficit of more than half. If a reasoned opinion of possible deficiency...is expressed, that alone is sufficient to enliven section 600(1).

3.74 On this issue, ASIC advised ANAO in October 2006 that:

⁶⁴ (2000) 18 ACLC 225 at 229.

⁶⁵ The legal advice noted that, while there is some difference in wording, it was not considered that there are significant differences in the intended operation of the two sections. Decisions on section 600 are therefore relevant to the interpretation of section 206F and have been so regarded by the courts and the AAT.

In the guidance document it is noted that the liquidator should specifically state that in his view the company may be unable to pay its unsecured creditors more than 50c in the dollar. It is further noted that many liquidators do not use this wording and may say something to the effect that 'the company has insufficiency of assets to liabilities of dollars x'. A liquidator should be able to make such a statement so that it is not necessary for the reader to extrapolate the liquidator's view that the company may be unable to pay unsecured creditors less than 50c in the dollar. This is the best and most appropriate evidence to rely on in a section 206F banning. The other statement may not be useful as it may include secured creditors. The NA&A guide seeks to provide guidance to staff about the need to elicit further information from the liquidator to ensure that they do in fact comply with section 533. The quality of many 533 reports is extremely poor and many liquidators appear to wish to shift liability with doing minimal work. Requiring a liquidator to make this assessment is an important part of the 206F process and it seems little to expect in the circumstances. The public policy behind this threshold is that a 206F banning is recognised as being a serious remedy and should only apply in cases where it appears (presumably on reasonable cause) that the return is going to be less than 50c in the dollar. It does not appear that the guide suggests it is necessary for the liquidator to show or prove a deficit of 50c in the dollar. However, it is clear from the guide that the liquidator must at least form a 'reasoned opinion of the possibility of deficiency.' Clearly if such deficiency is established the case becomes even stronger and more compelling and it is more likely that a lengthy period of disqualification, particularly for very low returns in the dollar, will be obtained.

Moreover, the guidance note does not suggest that if the words 50c in the dollar are not included then the banning should not proceed, it simply says that clarification should be sought from the liquidator. The liquidator will be able to confirm this issue in the affirmative. This guidance is not so rigid as to have any impact on ASIC taking action with respect to s206F candidates if appropriate.

As a model litigant, it is appropriate for ASIC to be satisfied that the basis for the lodgment of the s533 is sound, namely that the requirements under s533 of the Act are satisfied, before contemplating administrative banning of a director.

In addition, the majority of s533(1) reports are now lodged electronically. The electronic version has a specific question 'Cents in dollars dividend to unsecured creditors:' so this issue is addressed and in the vast majority of reports the cents in the dollar figure is provided by liquidators.

3.75 There were no statutory reports in ANAO's sample where ASIC did not pursue disqualification of a director on the basis that administrators did not use the precise wording required by ASIC's Guidance Document.

Assumption of misconduct

3.76 Section 206F(2)(b)(i) of the Corporations Act provides that in considering whether to invoke the disqualification power, ASIC 'may have regard to the person's conduct in relation to the management, business or property of any corporation'. In a 1994 decision on an appeal against a disqualification by ASIC, the AAT indicated that the conduct of a director had to demonstrate a 'breach of standards of commercial morality or some really gross incompetence' to justify disqualification.⁶⁶ However, the legal advice obtained by the ANAO stated that this approach was expressly rejected in later cases in 1997 and 1998⁶⁷ and went on to say:

Deputy President Olney put the position succinctly in the recent AAT case of *Re Guss and ASIC*:⁶⁸

'[section] 206F is aimed at the person who is a persistent failure, for whatever reason'...

It is thus not necessary to establish some form of misconduct on the part of a person who is the subject of a section 533 report before the discretion to disqualify under section 206F can be exercised. Misconduct will be a relevant factor to take into account as it increases the likelihood of reaching a conclusion that the public needs protecting from the future activities of the person concerned. However, it is not a prerequisite to exercising the s206F discretion. That may still occur where a director through no reason other than incompetence or misfortune or bad luck finds his or her companies in liquidation.

3.77 Notwithstanding the 1997 and 1998 cases which concluded that it was not necessary for ASIC to establish that there had been misconduct, there were three instances in ANAO's sample where ASIC considered that disqualification was not possible because there had been no allegations of misconduct in the section 533 reports.

⁶⁶ *Sheslow v ASC* (1994) 12 ACLC 740.

⁶⁷ *Laycock v Forbes and ASC* (1997) 15 ACLC 1,814 at 1821. This rejection was in turn followed in *Kardas v ASC* (1998) 16 ACLC 1,695 at 1703-4.

⁶⁸ [2006] AAT 401.

Related entities

3.78 As noted above, there are a number of factors that ASIC, under subsection 206F(2), may have regard to in determining whether disqualification is justified in a particular circumstance. However, there is only one factor to which ASIC must have regard. That is whether any of the corporations mentioned in subsection 206F(1) were related to one another. However, even if ASIC considers that the companies are related, this does not preclude it taking disqualification action.

3.79 There were 10 instances in ANAO's sample where the fact that corporations were related formed all or part of ASIC's reasons for not taking action under section 206F. This is illustrated in Figure 3.10 below.

Figure 3.10

Related corporations as a perceived barrier to administrative banning

Context	Number of instances
ASIC considered that banning action would not be available as a regulatory remedy because the corporations were related	3
ASIC did not pursue administrative banning because of a range of factors, including that the corporations were related	3
ASIC considered that for an administrative banning to be initiated, it would have to be demonstrated that the corporations were not related	4
Total instances	10

Source: ANAO analysis.

3.80 In three of the instances in Figure 3.10, the fact that the companies were related was cited by ASIC as the sole reason for not proceeding with disqualification action. On this issue, ANAO's legal advice was that:

[The examples provided] indicate that some decisions to take no action to disqualify a person from managing corporations have been based solely on the fact that the companies that have attracted an adverse report under s533 of the Corporations Act have been related. This fact of relationship, it has been said, prevents s 206F being invoked.

This approach seems to us to constitute a misunderstanding of s 206F. Paragraph 206F(2)(a) requires ASIC to 'have regard to' the relationship between companies referred to in a s 533 report when considering whether the discretion in s 206F should be exercised. Whether or not there is such a relationship is important to understanding the extent of a person's mismanagement of companies. The failure of related companies may all stem

from the one circumstance and it might be unfair to a person to judge their capacity to manage companies from that circumstance.

However, the section is clear in only requiring that regard be paid to the relationship between the failed companies. It does not say that if companies are related no action can be taken. This view is supported by the recent AAT decision of *Re Guss v ASIC*⁶⁹. ASIC had made some effort in the presentation of its case to show that companies, the subject of a s 533 reports were not related. Deputy President Olney said at para 14:

As a matter of relevant statutory construction, the Tribunal is of the opinion that a finding that the relevant corporations were related to one another would not deprive it of the ability to be satisfied that disqualification is justified if in the circumstances of the case other relevant matters support such a conclusion.

We consider that this statement correctly indicates the effect of paragraph 206F(2)(a). ASIC must have regard to whether the corporations concerned are related when considering whether to disqualify a person, but that is but one of the factors which it must take into account when reaching a conclusion whether disqualification is justified.

ASIC training and guidance material

3.81 In response to the issues raised above, ASIC advised ANAO in October 2006 that:

ASIC has recently conducted national training with respect to s206F and the success of this can be seen in the increases in banning matters currently being referred to ASIC delegates.

3.82 In addition to training analysts, there is a need to ensure guidance material relied upon by analysts is accurate.

⁶⁹ [2006] AATA 401.

Recommendation No.5

3.83 ANAO *recommends* that the Australian Securities and Investments Commission amend the guidance material provided to analysts so that it correctly reflects ASIC's powers under the Corporations Act to disqualify persons from acting as directors of companies.

ASIC response

3.84 ASIC agreed to this recommendation.



Ian McPhee
Auditor-General

Canberra ACT
24 January 2007

Appendices

Appendix 1: ASIC formal agency comments on the proposed report

ASIC generally agrees with the recommendations made by the ANAO. ASIC confirms that all recommendations have been or are currently being reviewed for implementation.

ASIC welcomes the confirmation by the ANAO of the high degree of accuracy of our processes for the receipt and recording of statutory reports of suspected breaches of the Corporations Act 2001. Since our introduction of electronic reporting by external administrators and automated risk assessment for these electronic reports on 1 July 2004, ASIC has been consistently working to improve the quality of our data capture and more importantly the analysis of information collected to ensure a timely and appropriate regulatory response to statutory reports.

The ANAO audit arose out of issues raised by the Joint Parliamentary Committee on Corporations and Financial Services (JCCFS) in its report of June 2004. One of the concerns raised by the JCCFS was whether ASIC had sufficient resources to adequately regulate corporate insolvency laws.

Since 1998, ASIC's regulatory responsibilities have increased significantly, with an increased role in consumer protection, managed investments and financial services and the reforms and investigations arising out of the corporate collapses in early 2000. Given these increased responsibilities, the increasing complexity of the financial markets and competing priorities across an expanding mandate, ASIC has taken a more proactive and strategic approach to the allocation of resources and to the matters it resources for investigation. Preventing harm or taking action (whether it be surveillance or investigation) in strategic areas of concern has been an important regulatory priority for ASIC in recent years.

While ASIC believes this approach has allowed for the most effective use of resources it has resulted in less regulatory attention to insolvent trading and misconduct at the smaller end of corporate failure. ASIC recognised the potential for a regulatory gap and made submissions to Government about the need for additional funding for assetless administrations and any enforcement action that may arise from this initiative. This funding bid was successful and in October 2005 ASIC was funded \$23 million over four years to establish an assetless administration scheme, including investigation and enforcement action.

ASIC is continuing to work closely with the insolvency industry, in particular through our Assetless Administration and External Administrator Assistance programs, which both aim to increase the quality and timeliness of statutory reports alleging offences, and thereby increase the levels of regulatory action available to ASIC to take in response to statutory reports.

ASIC also believes that the additional funding provided by the Government in 2005 will allow ASIC to increase its impact in this area going forward. Early indications of the success of these initiatives has been the disqualification of 43 company officers for a total of 163.5 years in 2006; and prosecution of 494 company officers for the failure to assist external administrators, resulting in fines and costs awards of \$1 039 613.

The ANAO have raised a specific concern that despite an almost 90 per cent increase in the number of reports received by ASIC alleging offences since 1997, the number of reports that ASIC has investigated or subjected to surveillance in this time has decreased by more than 90 per cent. The percentage of statutory reports received that have been investigated by ASIC from year to year, has remained relatively constant (save for 2001–2002), fluctuating above and below the 1 per cent level since 1997¹ and these figures have been publicly reported by ASIC in our annual reports over this time.²

Separate from our formal investigation activity, what has decreased over time has been the amount of surveillance activity undertaken by ASIC resulting from the lodgement of statutory reports, dropping from 9 per cent as reported in the 1997–98 ASIC annual report, to 2.4 per cent in the 1999–00 year, and continuing to decrease to zero as reported in 2002–03. This reduction in surveillance activity resulted from a deliberate regulatory strategy to move from 'reactive' to 'proactive' surveillances in the area of insolvency, with the

¹ In 1997–98 we separately reported in the annual report that we investigated 1% of reports and referred 9% for surveillance. In 1998/99, we reported that we investigated 1% of reports (revised in 1999/00 report to 0.5%) and referred for surveillance 8% of reports. In 1999/00 we reported that we investigated 0.6% of reports, and referred for surveillance 2.4%. In 2000/01, we reported that we investigated 1.2% of reports and referred for surveillance 0.6%. In 2001/02 we reported that we investigated 0.3% of reports and referred for surveillance 0.1%. In 2002/03 we reported that we investigated 0.5% of reports and that no reports were subject to surveillance. Overall, in this 6 year period since 1997/98, investigation percentages for statutory reports have remained fairly constant, averaging at 0.8% of reports alleging offences.

² In the 6 year period 1997/98 to 2002/03 ASIC separately reported percentages for investigation and surveillance in our annual reports. In the last 3 years, from 2003/04 to the current time, we have combined our figures for investigation, surveillance and compliance or more action.

launch of ASIC's National Insolvent Trading Program in January 2003 to deal with possible insolvent trading before it occurs. Since this time, ASIC has dedicated significant resources to proactive surveillance of trading companies with suspected solvency concerns, with potential targets identified from a variety of sources, including public complaints. Results of the program for the 2004/05 financial year included the conduct of surveillance visits to 488 companies suspected of trading while insolvent, ASIC's involvement in the appointment of external administrators 'sooner rather than later' to 63 of these companies, 10 of which ASIC was forced to apply to the court to secure the appointment. For the remainder, ASIC assisted the companies to achieve many positive outcomes, ranging from companies seeking professional advice or obtaining an accurate financial position, through to restructuring, refinancing or raising further capital.

With respect to the reported level of investigation activity directly resulting from statutory reports, ASIC notes that these figures are not indicative of the general resources applied by ASIC to the investigation of insolvency. Often, an investigation in relation to insolvency or misconduct associated with the failure of a company, may be ASIC-generated, in particular for large collapses, prior to the lodgement of reports by external administrators in these collapses (for example, in respect of HIH 6 statutory reports were received, in respect of OneTel 2 statutory reports were received and more recently, in respect of Westpoint 5 statutory reports were received). ASIC will request and receive statutory reports from external administrators in these matters which will significantly assist ASIC in the conduct of their investigation, but the reports are not attributed as the specific cause or trigger for such investigations in our annual reporting. Insolvency investigations are also regularly commenced following the receipt and analysis of public complaints, or as a result of a National Insolvent Trading Program surveillance (as detailed above).

In addition to these initiatives, ASIC supports the recommendation that we continue to identify opportunities for increasing the number of statutory reports that are investigated, in particular for external administrations where a statutory report may represent the first piece of intelligence about alleged misconduct that is received by ASIC. ASIC is committed to continuing our successful External Administrator Assistance program, which involves ASIC pursuing compliance (currently achieved in 72 per cent of cases) or the prosecution of company officers for minor regulatory offences, including failure to produce company books and records, or failure to assist the external

administrator in the conduct of the administration. By pursuing these offences (eg. securing the production of books and records or a report as to affairs), ASIC is working with the external administrator to increase the quality of the external administrator's investigation of the company affairs and subsequent reporting to ASIC in relation to suspected misconduct.

The ANAO has also raised a concern about ASIC's use of the disqualification power under section 206F of the Corporations Act, and more particularly that:

- i) ASIC's use of its disqualification power has decreased considerably over time, and when it has been used, its application has been delayed; and
- ii) According to the legal advice obtained by the ANAO, ASIC guidance material for analysts does not accurately reflect the law in relation to section 206F of the Corporations Act 2001 and analysts have incorrectly applied this legislative provision.

The major cause of fluctuation in the number of disqualification orders made by ASIC from year to year, is ASIC's decision to redirect or prioritise its application of regulatory resources to other areas of corporate misconduct within ASIC's jurisdiction and ASIC's decision to pursue more serious court based remedies, involving a combination of disqualification, fines and, in appropriate cases, compensation. Since 2001 ASIC has obtained 188 court orders for fines, disqualifications and compensation in relation to corporate misconduct, often arising from corporate collapse and insolvency. Since this time, 85 directors and officers have been disqualified from managing corporations by the court, in some cases for life, compared with 6 in the previous five years.

In 2005/06, ASIC determined that insolvency was a national regulatory priority, and with the benefit of recently announced funding to implement the Assetless Administration Fund, ASIC has increased the resources to be allocated to the identification of potential targets for disqualification and subsequent preparation of disqualification briefs to delegate. This initiative is designed to address phoenix activity, which was one of the concerns raised by the Cole Royal Commission into the Building and Construction Industry. As noted above, in 2006, ASIC disqualified 43 company officers for an aggregate of 163.5 years.

In relation to the second concern, and in particular that there is no legislative requirement for a particular wording of a liquidator's statement in relation to a company's inability to pay debts, it is ASIC's view that adopting an approach

which involves ASIC obtaining further supporting evidence from a liquidator prior to pursuing the disqualification of a director, is not a misinterpretation of section 206F.

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