

CLERP 9: impact on audit regulation

The Federal Government's corporate law reforms affecting audit regulation will materialise between now and the end of the year, according to a media release issued by Senator Ian Campbell in the past fortnight.

Senator Campbell says the so-called CLERP 9 suite of reforms will be introduced into parliament this year. He asserts the legislation will come into force from July 1, 2004.

Areas of regulation that will be impacted by changes in the CLERP 9 draft bill include the formation of a statutory board to set auditing standards, broader powers for the ASIC to fine companies for breaches of continuous disclosure rules, greater oversight responsibilities for the Financial Reporting Council and the creation of some laws to better communicate with shareholders.

Senator Campbell's remarks on the release of CLERP 9 coincided with the release of a study on the independence of investment analysts and their research by the Australian Securities and Investments Commission.

The ASIC's study is seen by Senator Campbell as providing useful insights for the final reform package that will form CLERP 9 itself.

"The review will be a very valuable contribution in shaping the final legal and policy framework for CLERP 9 to address analyst independence," the Senator notes.

"ASIC's examination did not uncover any indications of the wrongdoing that occurred on Wall St – and we should not underestimate the significance of that – however, weaknesses have been identified in a number of areas, notably how firms manage conflicts of interest, but there was encouraging evidence that industry is addressing these issues."

The Commission's study, which involved the review of eight investment banks, revealed there are weaknesses in the processes used by some investment analysts and their organisations to manage conflicts of interest.

"While these deficiencies are not systemic in nature, ASIC was concerned to find that some of the entities it reviewed had failed to implement adequate conflict management procedures, and placed an unreasonable level of reliance on their staff to identify, and then manage and disclose conflicts of interests. In particular, while many of the entities reviewed had some form of conflicts management procedure, most failed to fully and effectively implement, monitor and enforce them," the Commission notes.

There is also apparently a half-hearted implementation of industry guidelines on the management of conflicts of interest established by bodies such as the Securities and Derivatives Industry Association and the Securities Institute of Australia.

"ASIC considers that there is still a risk that conflicts of interest will occur and will remain unmanaged. Even if fully implemented, ASIC does not believe that these industry guidelines adequately address the deficiencies identified in this report," the Commission asserts.

A common device used by investment banks to deal with managing the risk of conflicts is the Chinese wall. The Commission's review found the use and operation of Chinese walls could be improved.

"Most firms have Chinese walls in place around the research area, as well as processes for bringing analysts across the walls," the Commission's report says. "Analysts have crossed the Chinese wall for a number of reasons, often to allow them access to corporate finance staff/documentation in order to facilitate the rapid publication of research."

The report notes that the procedure of giving analysts access to the corporate finance staff handling a particular entity's affairs and to documentation on the securities of that entity could prejudice the recommendations of an individual analyst. That material, the ASIC observes, could unduly influence the thinking of an analyst preparing a research report.

"We were disappointed in the heavy reliance on the existence of a Chinese wall structure as a holistic conflict management mechanism," the report says.

"Such mechanisms must be both tailored to the exigencies of the business, properly documented, implemented, enforced and reviewed, and must form part of a complete matrix of compliance tools in order to be effective."