LAWSUIT — APRA AND THE ACTUARY

The Federal Government and APRA[1] were sued for alleged 'negligent oversight by the regulator in the lead up to HIH's disastrous $300 million bid for FAI Insurance in September 1998' (Main and Fabro 2002, p. 1). It is alleged that the Insurance and Superannuation Commission (APRA's predecessor) was aware that one of FAI's companies had breached solvency requirements of the Insurance Act and failed to 'fulfil their regulatory duties and detect breaches of the Insurance Act, thereby breaching the duty of care they owed to the HIH group' (Main and Fabro 2002, p. 6). The Federal Government was included in this action as the 'Prime Minster John Howard was the critical player in overriding the regulator's reservation …and in ... allowing FAI to be an authorised insurer under the Insurance Act' (Ryan 2002, p. 7).

Ryan (2002) suggests there may be further legal suits issued in relation to FAI that may include the auditors of FAI (p. 7). This raises the question why the liquidator of HIH insurance chose to sue the government and APRA rather than the auditors of FAI. If it can be proven that the financial reports of FAI did not disclose the true financial position of FAI, then it could be argued that the auditor may have breached its duty of care.

Perhaps the reason for the liquidator not suing the auditor is two-fold. The first reason is that HIH Insurance is not a party to FAI's audit contract and must sue the auditor as a third party. Under current case law, HIH Insurance has to prove the auditor induced HIH Insurance to rely on the financial statements in taking over FAI. This is an onerous test and it would be difficult for the liquidator to prove that HIH was induced to rely on the reports. It has been suggested that because of this difficulty, third-party plaintiffs may use the Trade Practices Act to sue auditors. However, there have been no cases heard involving auditors and the Trade Practices Act and thus no principles of law have been established on this point.

However, the second reason may be more significant and that is if one sues auditors the most one can reasonably expect to recover is the limit of the auditor's indemnity insurance. Audit partners divest themselves of personal assets, and partnership assets will not result in considerable funds being made available to cover payment of damages awarded. This leaves only the audit firm's indemnity insurance as a source of funds to satisfy damages awarded under negligence suits (Johnson 2001, p. 9). Thus, it may be felt that more funds can be obtained from an action against the regulator and the Federal Government.

The actuary has been sued for excessively underestimating the liability for claims arising out of insurance policies as he did not 'collect necessary policyholder claims data, incorrectly analysed HIH's claims experience and conducted inappropriate valuations' (Sexton 2002, p. 3).

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[1] It is ironic that the liquidator is suing APRA. The liquidator of HIH insurance is a partner of KPMG, a major supplier of audit services in Australia. In September, APRA critcised auditors stating that 'a disturbing number of auditors seem to be ignorant of the relevant statutes and standards and are failing to detect and flag weaknesses' (Tingle and Fabro 2002, p. 1). This lawsuit would exacerbate any existing tensions between APRA and the auditing profession.

This writ alleging that the regulator has breached its duty of care to a failed company may cause the regulator to be more proactive in ensuring auditors fulfil their responsibilities in auditing accounts. This may apply especially to auditors dealing with companies that appear to be violating statutes and standards. Consequently, standards imposed upon auditors may increase. At the very least, queries from regulators to auditors of failed companies will increase.

References

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