Report of the HIH Royal Commission.

First we all give some basic details concerning HIH Insurance and the Royal Commission and its report. HIH Insurance had a deficiency of $5.3 billion. The collapse of HIH was blamed on mismanagement, not on fraud and embezzlement (Gettler 2003, p.1). Mismanagement occurred in the following areas.

- The company ran out of money;

- HIH made ill-fated overseas expansions that cost HIH more than $3 billion, without considering strategic or risk considerations. (Bartholmeucz, 2003, p.1); and

- there was inadequate provision for claims on insurance sold.

Finally, the Report is 1500 pages and recommends 56 matters that should be followed up by the ASIC or New South Wales Director of Public Prosecutions. The cost of Royal Commission was about $40 million.

Report emphasises elements of good corporate governance

Similar to arguments advanced by the Federal Treasurer and noted in last month's *Current Affairs in Auditing*, Justice Owen, states it would be "a mistake to dismiss the case of HIH as simply a corporate aberration which could be avoided in future by tougher legislation and corporate governance rules" (Owen, 2003, p.77). Justice Owen noted that a HIH could recur if directors, executives and professional advisors ask themselves:

> How far can the prescriptive dictates by stretched? Rather than: Is this right? Good governance, he warns, is not simply a set of boxes to be ticked. It requires the courage to question, and act, so safeguards to protect the public actually do so (Editorial in The Age, 18-19 April, p.10).

It is argued that corporate governance ultimately "relies on the integrity, honesty and morality of directors and managers involved - qualities which continue to be sorely tested whenever such individuals are exposed to big personal losses or gains" (Owen 2003, p.77). The notion that corporate governance is tested when individuals are exposed to big personal losses or gains suggests that corporate governance problems will always exist.

Recommendations and Significance of Report

The recommendations of the report relating to corporate governance and auditing/financial reporting are contained in Appendix 1. Most of these recommendations are similar or variations to existing proposed reforms. Bartholmeusz, 2003, states the recommendations of the HIH Report are of less significance due to the legal reforms already in progress and the *Australian Stock Exchange's Governance Counci*l best practice guidelines. He sees legal cases arising from the report could be of greater significance as the courts may apply principles outlined in the ASX's guidelines and therefore redefine various responsibilities (p.1). This was a factor considered by Austin J in arriving at his judgement of *Grieves case* Barthomeusz states

> (t)here is a potential interaction between the courts and the new governance framework – which themselves are redefining roles and responsibilities in ways that will have far-reaching consequences that could provide radical outcomes (p.1).

In view of the Grieves case, Kohler (2003), states that the Report's comments on the Chairman of HIH' Board of Directors, Geoffrey Cohen, were too light. Similar to Grieves, Cohen is a Chartered Accountant and he was also a former leading partner of Arthur Andersen. The Report describes Cohen as being an ineffective chairman. Kohler states that Justice Owen was aware of the *Grieves case* and wonders why Cohen's deficiencies as a chairman of the Board were not highlighted in the report. Kohler notes that two directors raised concerns relating to conflict of interest and corporate governance with Cohen, who merely referred the matters to Ray Williams. Finally, Kohler raises the hope that the "ASIC and Director of Public Prosecutions can do better" (p.65).

Extending duty of care

One recommendation that has caused comment is to widen the Corporations Act to "(h)old more individuals responsible for a breach of duty" (Gettler, 2003, p.1). Justice Owen would like to see the Corporations Act be amended so that middle managers, contractors and advisors owe a duty of care. He argues this would emphasise function, rather than legal relationship. These people provide advise or give information and Justice Owen would argue they should be responsible for the advice or information given. For example, if employees give misleading information to auditors or directors, Justice Owen sees no reason why they should not be held to contravene the law. (Wood, 2003, p.9) The Report notes that in HIH, several employees were engaged in undesirable practices in falsifying accounts or covering up the failing company's true financial position (Wood, 2003, p.9).

Corporate governance deficiencies of HIH

In regard to HIH Insurance's corporate governance practices the flowing comments are applicable.

- Consistent with many of the companies who collapsed in the late 1980s, 'HIH … reflected a "private company approach" where the hand and influence of Williams were paramount' (Owen, 2003, p.78). Ray Williams was chief executive of HIH Insurance. A dominant overbearing CEO was a prime factor in the collapse of many companies in the late 1980s. Other directors and staff were reluctant to criticise or take an opposing view to the CEO.

- The Board was provided with misleading information. (Owen 2003, p.77). Justice Owen noted that effective corporate governance should have "appropriate checks and balances… in place to minimise both the risk of that happening and its effect if it did occur" (Owen, 2003, p.78).

- HIH Insurance failed to examine periodically the effectiveness of its corporate governance model. Specific deficiencies in their corporate governance included a "lack of due process; no defined limits placed limits of authority on the CEO; lacked access to critical analysis; displayed no understanding of conflict of interest; and, was led by a board whose chairman was ineffective and allowed management to set meeting agendas" (Owen 2003. p.78).

- The true state of HIH's deteriorating financial state was deliberately hidden by staff and executives from the board (Harvey *et al*, 2003, p.5).

- There was inadequate leadership with unpleasant information being hidden, filtered or sanitised.

- Quality of accounting and information system was deficient.

- Risk management was deficient with risks not being properly identified and managed. (See The Age, 18-19 April p.10)

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