Speech by Royal Commissioner

Justice Owen delivered a speech at the Commonwealth Law Conference where he delivered his thoughts on directors' responsibilities. He stated that we should return to the basics of directorships whereby directors are regarded as stewards. Stewardship is a basic concept underlying accounting whereby shareholders entrust resources to management. Management are then obliged to maintain these resources intact and use these resources to produce a profit. In return for being entrusted with these resources, management must provide financial statements to shareholders, showing how they have used the resources entrusted and if the resources are maintained intact.

The stewardship concept has a shareholder emphasis in that it highlights that management holds the resources on behalf of the shareholders. In last month's *Current Affairs in Auditing*, it was noted that the 1990s that the Chief Executive Officer dominated corporate thinking. The emphasis was on meeting and beating market forecasts of profits. Justice Owen is suggesting that funds invested in companies are held on behalf of shareholders, and whilst these funds should be used to earn profits, they must be maintained and kept intact.

Justice Owen also offered comments upon corporate governance. He stated that he is

> opposed by to prescriptive or one size fits all approaches to corporate governance… The law may be too blunt an instrument to deal with corporate governance problems. It would be unproductive and ultimately self-defeating to impose a new layer of regulation (Priest, 2003, p.4).

Justice Owen is endorsing the approach taken in the ASX Best Practice guidelines, whereby a company chooses those corporate guidelines applicable to their company. They then must make a statement describing how the practices adopted vary from best practice and, and if there are variations, explain why best practice guidelines were not adopted. This approach allows the market to judge whether the reasons given for not adopting best practice are acceptable.

Justice Owen also suggested that the board be aware of a company's strategy so they can detect early signs of trouble. By understanding a company's strategy the board knows what they are looking for. Furthermore, he stated that the "climate of fear created by management if mistakes are made to be replaced by a climate of proactive problem solving" (Priest, 2003, p.1).

The attitude of a climate of fear no doubt arose when the market would heavily penalise the company's share price if earnings forecasts were not met. Earnings management could be used to disguise these mistakes. In effect, the impact of the mistakes could be delayed until later when the compound effect of many mistakes could cause the company to collapse.

David Knott, the Chairman of the ASIC, addressed the same conference and he warned of the dangers of disclosure being regarded as a regulatory panacea. Similarly to the ASX Best Practice Corporate Governance guidelines, many reforms are based upon information being disclosed in Financial statements allowing the user to judge the implications of this information and take account of the information in any decision made. An example of information disclosed is fees paid for the audit and the provision of other services. The reader is left to judge the impact on audit independence of fees paid for other services.

David Knott stated that “liability containment for companies and their officers can also result in disclosure that is overly complex and voluminous (Priest, 2003, p.4). He argues education to improve to improve financial and market literacy is needed.

Reference

Priest Marcus, 2003, “Judge urges Directors to end ‘climate of fear’ ”, *The Australian Financial Review*, 15 April 2003, p1 & 4.