Campaign on insolvent trading and the John Elliott case

In April 2003, ASIC announced the results of a program entitled 'Directors Insolvent Trading pilot'. In January 2003, ASIC formed its National Insolvency Co-ordination Unit that worked with insolvency specialists from PricewaterhouseCoopers and Ernst & Young to 'target directors involved with companies suspected of insolvent trading' (ASIC 2003, p. 1). The aims of the program were:

- to make company directors aware of their company financial position:
- to encourage them to seek advice from insolvency specialists; and
- where necessary to take action to appoint voluntary administrators or liquidators.

In its media release announcing the results of the pilot program, ASIC included some operational and financial practices that indicate insolvency, such as poor cash flow, or no cash flow forecasts, disorganised internal accounting procedures, incomplete financial records, continuing loss making activities and accumulating debt and excess liabilities over assets (ASIC 2003, p. 1). To prevent or correct insolvency problems, the directors need reliable financial reporting data. Having obtained these data, the onus would be placed on directors to ensure that reliable financial data are reported to shareholders and other users of periodic financial statements.

Insolvency reviews were conducted for 130 companies, with 10 of these companies considering appointing voluntary administrators or liquidators (ASIC 2003, p. 2). For further details of the pilot program, you should read ASIC's media and information release '03-118', available from the ASIC website.

Given the pilot program on insolvent trading, the successful case launched by ASIC against John Elliott for allowing Water Wheel to trade insolvent became increasingly important. Bartholomeusz (2003, p. 3) states that:

> ASIC hasn't been particularly active or aggressive in bringing actions against directors of failed companies. With Elliott, it had an opportunity to pursue a high-flying target and took it. It appears it wanted to make a statement of intent on insolvent trading — and it has.
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> This probably relates not just to the more aggressive and litigious posture ASIC has adopted since Knott has become chairman, but to the heightened consciousness in relation to insolvent trading after One.Tel and HIH.

Bartholomeusz (2003, p. 3) notes the significance of the case is:

> not that it breaks new ground in relation to either insolvency law or directors' duties, but that it reflects a relatively new-found determination by ASIC to step up its litigation in this area.

This concludes the section on ASIC's and David Knott's contributions to increasing the responsibilities on directors to ensure financial statement reliability. ASIC and David Knott have played pivotal roles in the changes instrumental to increasing and focusing attention on directors' responsibilities. Perhaps the last word on these developments belongs to Henry Bosch, the chairman of ASIC's predecessor, the National Companies and Securities Commission (NCSC). He stated that the budget of ASIC is now $160 million, whereas the budget was $7 million when he was head of the NCSC. He added (Buffini, 2003, p. 8):

> The ASX did a survey of share ownership about the time of the 1987 crash, and 9.2 per cent of the adult Australian population owned shares. It's 52 per cent now. There are votes in investor protection now. Times have changed.

References

Australian Securities & Investments Commission 2003, '03-118 ASIC acts to prevent insolvent trading', media release, 7 April, pp. 1–3.

Bartholomeusz, Stephen 2003, 'HIH and One.Tel cast long shadows as justice takes a sword to Elliott', *Australian Financial Review,* 1 July, p. 3.

Buffini, Fiona 2003, 'Knott will be hard act to follow', *Australian Financial Review*, 14 August, p. 8.