We should speak . . . of the immorality of accounting; for it has been the quirks of accounting that have provided many of the opportunities for misdemeanours of . . . corporate officers. (Chambers, 1991, pp. 16–17)

This book is set against a background of inquiries into discrepancies between what has been disclosed by corporations about their trading affairs and the financial outcomes of them, and what is more likely the ‘truth’ in respect of both – corporations gilding the lily. Matters that are its focus are currently being played-out across several continents.¹

In this regard 2006 may yet have proved to be a pivotal year. In Houston in the middle of the year, the world witnessed the lengthy trials and convictions of Kenneth Lay and Jeffrey Skilling on charges relating to alleged wrongdoings that resulted in misleading the investing public about Enron’s financial health. Prior to its collapse the utilities giant could claim to be the seventh largest corporation in the nation.

Both men were convicted of having caused the downfall of the company they built into that colossus, but more importantly because they had misled the public, auditors and regulators about its financial health. Lay was also convicted in a separate trial on four charges that he misused bank loans to buy Enron stock. Prosecutors successfully contended that Lay and Skilling directed a conspiracy that hid billions of dollars in debt in dubious off-balance sheet deals, illegally shifted funds to hide losses at poorly performing units and tapped reserve accounts to impress Wall Street. The convictions emerged after 54 government and defence witnesses, including Lay and Skilling, had their say in the witness box. In a dramatic twist, the court adjourned till 11 September 2006 (9/11) for sentencing to occur, only to then delay it for another month.

Being convicted specifically on 19 of 28 counts of fraud, conspiracy, insider trading and lying to auditors, on 23 October 2006 Skilling was sentenced to serve 24 years and 4 months gaol for misleading the investing public about the financial health of a company. Kenneth Lay had a different fate. Initially found guilty on counts of federal fraud and conspiracy that carry a maximum custodial penalty of 165 years, Lay suffered a fatal heart attack in early July. In
mid-October 2006, in accord with legal precedent, Judge Sim Lake vacated Lay’s conviction and dismissed the indictment against him. Other officers of Enron were not so fortunate – several were also imprisoned including: Richard Causey, chief accountant (5.5 years), CFO Andrew Fastow (after turning state’s witness and assisting the prosecution in the Lay and Skilling trial he received six years in prison, two years community service), and several other lower level officers for various lesser terms.2

Just prior to Skilling’s sentencing (and as this book was nearing completion), other notorious figures were also imprisoned, including: Bernie Ebbers of WorldCom infamy who began a 25-year gaol sentence; and Dennis Kozlowski, Tyco CEO who was convicted of misappropriating corporate funds and sentenced to a minimum of eight years gaol.

As the dust settled, the ‘Crooked E’s’ ordeal was nearing its end, but not before it had emerged as a watershed in corporate affairs, insofar as it was the catalyst for the Bush administration’s sudden interest in corporate America’s dubious record of living up to its financial reporting claims and its dismal performance in meeting its quarterly earnings disclosures. Notwithstanding previous experiences with Sunbeam, Cendant, Waste Management, Tyco, Adelphia, Qwest, WorldCom and (say) Vivendi, and the frequency of restatements downward from quarterly earnings predictions, Enron was possibly the straw that broke the corporate camel’s back, too big and too well connected with Capitol Hill to ignore, and all the more so when WorldCom collapsed soon afterwards. However, as a commentator noted, this period and events had all been seen before – ‘with their Gilded Age predecessors, combining financial legerdemain and political influence peddling’.3

As in the 1930s, the regulatory response was swift. Mimicking Roosevelt’s New Deal ‘truth in securities’ mantra of the early 1930s, ‘corporate governance reform’ would dominate in the first decade of the twenty-first century. New corporate rules of engagement for the US were set out in the 2002 Sarbanes-Oxley Act (SOX), and this supposedly was ‘problem fixed’!

In Australia, with its Enron equivalent dramas in the form of the collapses and subsequent revelations at HIH and One.Tel, the regulatory response also was swift, though of questionable wisdom. Once again corporate governance matters were to the fore – this time the plea was to ensure auditor independence. In mid-2001 the federal government commissioned an inquiry which produced the Ramsay Report, Independence of Australian Company Auditors: Review of current Australian requirements and proposals for reform. It was submitted for ministerial approval in October.

But follow-up legislative initiatives would take longer than in the US. There was greater resistance to endorsing government-imposed black-letter law prescriptions. The proposed independence and other audit-related reforms from the Ramsay Report eventually would be included in deliberations by the

Drawing on such developments, the contestable claim being made by some is that corporate governance is no longer a fad, that the altered system has teeth. But it will be shown below that attempts to water-down the regulations were just over the horizon.

Concurrently with the Enron fallout, European courts and regulators were busy untangling the Parmalat failure in Italy. There, the somewhat different corporate ownership structure, a ‘closely held’ pattern in contrast with the diffuse US, capital-ownership pattern, revealed that misleading disclosure is a critical ploy in befuddling not only regulators, but financiers and the investing public at large. Members of the well-placed Tanzi family emerged as corporate malefactors with alleged deeds rivalling those in Italy a quarter of a century earlier by ‘God’s bankers’, Michele Sindona and Roberto Calvi, and in the US three-quarters of a century earlier of the likes of the household names, Ivar Kreuger and Samuel Insull; and of the many other financial rogues in the decades in between, everywhere. Particularly significant is that neither the different legal framework underpinning (say) Parmalat’s incorporation, different board structure, nor rules relating to auditor appointments of the kind injected into the Sarbanes-Oxley regime, prevented a stark similarity between the alleged acts of deception by Parmalat and those by contemporary US corporates.

In Australia, having achieved minor convictions of HIH’s Ray Williams and Rodney Adler on charges not directly related to the causes of HIH’s collapse in 2001, ASIC’s action to recover $90 million from One.Tel’s Jodee Rich and Mark Silbermann for overseeing One.Tel’s alleged trading when it was insolvent rolls on. A judgment is not expected until the end of 2007. Of particular interest have been the insights into the workings of non-executive directors in the revelations by Lachlan Murdoch and James Packer that they are able to recall very little about their involvements with One.Tel, other than that they were ‘profoundly misled’ by the disclosures to them of the company’s financial performance and position: a performance and position so poor as to cost their companies in the order of $900 million. Amongst other things, their experiences raise a cloud over the corporate governance movement’s claim of the invaluable monitoring role of independent, non-executive directors.

Concurrently, nearby in another part of Sydney, throughout 2006 other matters involving corporate groups and transactions that were difficult to unravel
were being examined. Evidence was taken at the federal government’s Cole Commission of Enquiry into alleged bribes associated with the Australian Wheat Board Ltd’s contracts for the sale of wheat to Iraq under the United Nations’ ‘Oil-for-food’ program. Under scrutiny are allegations that the alleged bribes were reported as ‘trucking fees’ so as to not disclose alleged kick-backs to Saddam Hussein’s Iraqi government in contravention of UN sanctions under the program. At issue is who knew what, and when it was known. Disclosure again is the issue. On the final days of the Cole Enquiry directors and other witnesses would reveal contrary disclosures to those previously in the public domain for years.5

On the other side of the country, the Western Australian Supreme Court was considering two major corporate group imbroglios. In the first, ASIC claims that the directors of the Westpoint property group had misled investors about the use of funds raised by its ‘mezzanine’ finance companies and an apparent use of a loophole in the corporate reporting regime. Westpoint allegedly used investment schemes to seek funds from investors via $2 companies rather than licensed responsible entities. In this context, questions have emerged in respect of the corporate regulator’s supposed inaction, evoking questions such as ‘Did ASIC fail over Westpoint?’. Legitimate grounds are raised here for asking whether the national regulator’s role should be that of an essentially ex post corporate policeman, apprehending and prosecuting, or of a more proactive agent bringing pressure to create an orderly commercial environment.

Westpoint’s particulars evoke memories of the notorious early 1990s Estate Mortgage Trusts real estate property saga, with convoluted shuffling of funds between trusts which then invested in several property projects that already had obtained supposedly secured finance. Commonalities include complex corporate structures and equally complex financing arrangements, factors that eventually facilitated the ensuing suffering of the unaware investors, many of whom were pensioners.

In the second case before the WA Supreme Court, The Bell Group Limited (In Liquidation) & Ors v Westpac Banking Corporation & Ors,6 began in 1995 with interlocutory hearings when the Bell Group liquidator, with financial backing from the WA Insurance Commission, sought legal action to the tune of up to $1.5 billion (which includes interest on the amount being sought over more than 15 years). This action concerns the allegation ‘that when the [twenty major – Australian and overseas] banks took security for [the $250 million] loans in 1990 they knew the companies were close to insolvency’.7 By the time the main case finished in October 2006, it was the longest running court case in Australia’s history with over 400 days of evidence in three years, a legal cost estimated at $300 million, 63 000 items of evidence and more than 36 000 pages of transcript, not to mention the many trees that had been felled in response to the legal discovery process.8
Illustration 1: Alan Bond

Briefly, the Bell action relates to financing arrangements entered into as the Bell Group of around 80 companies sought loan refinancing from six major Australian and overseas banks, in response to what some have described as a financial meltdown in 1989 and 1990. The liquidator has argued that the banks agreed to extend (restructure) loans to the Bell group of companies, provided they obtained security over assets relative to other unsecured creditors. It needs to be understood that, previously, nearly all debt had been arranged primarily on a negative pledge basis. At issue is how to assess solvency or insolvency from internal and reported financial information within a group setting.

Meanwhile, back in the US, all of the above interest in Enron et al. had emerged on top of claims by the New York Attorney-General, Eliot Spitzer, that many large financial intermediaries had engaged in creative financing practices, resulting in companies reporting healthier balance sheets than were justified – as at Enron. This included several large insurance companies that allegedly failed to disclose the full particulars of so-called reinsurance contracts. Specifically, undisclosed side-letters arguably have reduced the claimed reinsurance to that of loans. Indecently, those loans were not disclosed as such to the public. In late
September 2006 the US Department of Justice indicted four former executives of Berkshire Hathaway's General Re Corp. and a former executive of the American International Group Inc. on charges that they participated in a scheme to manipulate AIG's financial statements. At issue, reportedly, are two reinsurance transactions between AIG and General Re that allegedly were initiated by an AIG senior executive to quell criticism by analysts of a reduction in AIG's loss reserves in the third quarter of 2000, prosecutors claimed. "The indictment alleges that the aim was to make it appear as if AIG – one of the world's largest insurance companies – increased its loss reserves, pacifying the analysts and investors and artificially boosting the company's stock price."\(^{10}\)

Interestingly, similar claims had featured in the 1930s US Pecora Hearings into the practices of financial intermediaries and investment trusts in the years preceding the Great Depression.

Further group actions involving transaction masking are evident in taxation investigations in the US and Australia. Recently it was reported that the US Internal Revenue Service has been engaged in a long-running battle in respect of the tax years 1989–2005 with pharmaceutical giant, Glaxo SmithKline Holdings Inc., and the company's foreign subsidiaries. At the end of 2006 a transfer pricing case in the US Tax Court was pending. Reportedly the issues relate to transactions 'between GSK and its foreign affiliates relating to US profits of pharmaceutical products and payments made by the US branch for products and trademarks developed by the company's UK-based parent company. It has been reported that the IRS and Glaxo have reached an historic settlement whereby Glaxo has agreed to pay the IRS approximately $3.4 billion (including interest).\(^{11}\) Similar tax issues also resonate in Australia, where ATO chief Michael D'Ascenzo, while acknowledging that tax 'havens [are] not all bad', reportedly stated that the ATO was increasingly aware of companies making complex transactions with foreign companies to avoid paying withholding tax, typically using 'hybrid entities and hybrid securities'.\(^{12}\)

It is worth contemplating how the advent of IFRSs, AIFRSs, or EU IFRSs will supposedly change this position. Regarding insurance, it is suggested by some in the industry that the position may be worsened. Two-thirds of respondents to a KPMG survey of Australian insurance companies perceived that the ‘adoption of IFRSs had actually increased the risk of inaccuracy in financial reporting’.\(^{13}\) In the areas of accounting for taxation, derivatives, goodwill impairment and business combinations (merger accounting), various parties including financial commentators, bodies representing directors, shareholders and analysts (inter alia) are raising serious questions about implementation and interpretation issues with the IFRSs. Some are suggesting that directors should report to shareholders in a myriad of ways, resulting in 'the annual report being less relevant'.\(^{14}\) Others are concerned about the volatility in earnings associated with applying IFRSs.\(^{15}\) Other concerns have been expressed, including those
in a recent set of empirical papers on the impact of IFRSs.\textsuperscript{16} Still others view the IFRSs as an unnecessary intervention, overly prescriptive, and argue that the market should be allowed to determine which voluntary disclosures will prevail.\textsuperscript{17}

Central to those discussions are questions regarding the reliability, accuracy and overall probity of corporate information disclosures. Contestable phrases or words, often touted by regulators and standards setters, imply a desire either to achieve \textit{quality accounting information} or \textit{transparency}. Such issues are supposed to be at the forefront of those seeking to produce an international conceptual framework, viz the IASB and FASB who are jointly undertaking such an exercise. While not questioning the motives, elsewhere the current authors have provided an assessment of the less than fruitful outcomes accompanying earlier national exercises that were underpinned by similar desires.\textsuperscript{18}

The above illustrations are important for the light they throw on the role of financial disclosure in creating the orderly commercial environment, essential to the proper functioning of market economies. Importantly, whereas the reports of defaults and anomalies might be taken to be indicative of the new corporate governance mechanism biting into and exposing corporate wrongdoing, on closer analysis they emerge to be repeat performances of the \textit{indecent disclosure} by companies over the past 160-odd years. They frequently are the product of their compliance with standards and rules issued by professional bodies with the best-of-intent result. Matching the current corporate governance regimes against those of the past offers little comfort, for it serves to indicate that, for the most part, the current regimes contain ‘more of the same’. Little that is new has been introduced. It would seem unlikely that the matters currently under judicial review would have been prevented (or disclosed) had the latest IFRSs been in place in their current formats.

In fact, the current talk of corporate governance and the various codifications, schema and recommendations might be doing more harm than good. For if, as we argue here, the rules they specify are impotent, the representation of them as panaceas for corporate ills is likely to lure investors into a sense of false security. There is a burgeoning literature reporting research associating compliance with the various governance regimes and ‘superior corporate performance’. In contrast, there is little addressing the problems of the modern corporation in this age of globalisation. ‘Legacy thinking’ draws upon experiences in the different corporate environments of the past, seducing would-be reformers into massaging the ways of dealing with corporate problems of the past, without much explicit recognition of differences between the past and the present. A critical issue is whether the conventional corporate form with which most are familiar (and in respect to which the current governance regimes are directed) can indeed be governed adequately, if by governing we are referring to its original notion of controlling or \textit{steering}.\textsuperscript{19}
The relatively easy access to international capital markets and the ease with which companies might move between alternative jurisdictions to exploit perceived advantageous trading, labour, stock exchange listing, and financial disclosure rules, militate against exercising control over conventional corporate structures with updated versions of past regulatory mechanisms that failed to override less sophisticated and less complex arrangements than those to which they are currently being applied. There is little ground to expect that they will be any more successful in the future.

The now Netherlands-based James Hardie group’s contemporary, worldwide ongoing battle with governments, unions and the victims of asbestos-related diseases has provided a salient example of the problems with the conventional perceptions of the corporate structure. That the form of the corporation, as it is generally understood and blithely accepted, has a legitimate place in modern society is contestable. Doubt that the corporation as we know it – with its grouping of subsidiaries under the umbrella of ‘limited liability within limited liability’ – can function for the benefit of modern commercial society is evoked by the conflict between commercial and legal realities inherent in the notion of a sacrosanct corporate veil. That situation is exacerbated by the seeming inconsistency between the traditional notion of the corporate objective to maximise shareholder wealth and the now popular notion of corporate social responsibility, the limitation of financial statements compliant with conventional accounting practices to show present financial position and past financial performance in terms of what the public expects, the potential conflict between legal obligations and alleged ethical responsibilities and the frequent misunderstanding of public perceptions regarding the nature of the corporate vehicle and the reality of it.

Possibly, the Hardie asbestos affair has better served to highlight those matters than various other failures. The series of transactions in 1997/98 involving the Lang Corporation (loosely described as the Patricks/MUA Waterfront affair) perhaps comes a close second. And whereas the legislative likes of the US’s Sarbanes-Oxley, Australia’s CLERP 9 and the ASX Corporate Governance Council’s Corporate Governance Guidelines (and their overseas equivalents) have poured out rules in particular for the internal management of corporations, the Hardie affair has drawn an outpouring of proposed rules regarding companies’ interactions with the public at large. Of particular interest is the manner in which the debate regarding Hardie’s alleged misdeeds has renewed the personification of corporate ethics. But whereas the artificial persona of the corporation has been translated (as we noted above) into an almost human equivalent, in a twist its true fictional character has been reinforced by the NSW state government’s threats to ‘lift the corporate veil’ were Hardie to not meet its perceived financial obligations to those suffering from or having died as a consequence of the toxic effects of its asbestos products. The NSW Attorney-General in
mid-2006 proposed to have a federal inquiry examine ways to prevent the type of episode at James Hardie, where a wealthy (solvent) parent company could avoid picking up ‘the personal injury compensation obligations of insolvent subsidiary companies’. That proposal is partial. It involves only considering issues related to this corporate group type of limited liability related to compensation for personal injury and death.

In a curious way, the plight of those victims of asbestos-related diseases has made it clear, possibly the clearest in 160-odd years, that the corporate structure (especially where groups are prevalent) is not sacred; that, at the end of the day, if it is no longer serving commerce in the way the UK Gladstone Committee and those 1840s politicians intended when pressing the British Parliament to enact the Companies Act of 1844, the present company structure can and ought to be changed.

That possibility doesn’t seem to have been contemplated by those reacting to the successive waves of corporate collapses and crises over the past century, and over the past several decades in particular, when shareholders’, finance and trade creditors’ and (more recently) employees’ financial woes have been to the fore. It is no surprise then, that the solutions being presented in the form of corporate governance rules have been framed with an underlying assumption that the current form of the corporate vehicle with its ‘limited liability within limited liability’, shareholder sovereignty and corporate veil framework, is untouchable.

A peculiar feature of the current debate over corporate shenanigans in the recent past is the similarity they bear to those revealed following the worldwide 1929 crash and ensuing Depression, to the effect that the financial statements of many companies were grossly misleading: grossly misleading, not only by virtue of deliberate acts of deceit, but also as a consequence of following the prescribed accounting conventions (rules) of the day, possibly with the best of intentions. Now, as then, few seem to appreciate the prospect that the reported financials of the companies that have not failed, those deemed the current high-fliers and ‘travelling swimmingly’ so it seems, are possibly as misleading as those that have crashed or are noted to be in trouble.

In the early 1930s the general lead taken in the US was to specify accounting ‘rules’ (incorrectly labelled then, and now, as ‘principles’) for the processing of financial aspects of business transactions, and disclosure rules for reporting the financial outcomes of them. That push for rules (enabling the tick-a-box mentality) to govern accounting practices has been pursued for the best part of 70 years, underpinned by the idea that comparability would be achieved were each company’s financials prepared in accord with the same rules. The mistaken proposition is that uniformity of essentially input and processing rules would produce uniform, comparable financial statements. Yet the falsity in the reasoning of that proposition was clearly demonstrable, and clearly evidenced...
by the variances in the outputs in the form of financial statements of companies following the same rules.

Few seem to recall that, just as in the 1920s when the UK Royal Mail’s drawing upon past profits to pay current dividends accorded with the rules of the day, in the new millennium Enron’s use of special purpose entities to hide debt was facilitated by a professionally prescribed ownership rule. Nor do they recall that the mark-to-model valuations to bring prospective profits to account had regulatory approval; as did Cambridge Credit’s front-end-loading mechanism to calculate current profits in 1970s Australia; while in the new millennium WorldCom’s expense capitalisation was arguably the product of the conventional accrual system, differing little from Australia’s Reid Murray’s capitalisation of development expenses in 1960s Australia.

Little has been recalled in the context of WorldCom’s woes of the UK’s Rolls-Royce’s 1970s fall following its capitalisation of the costs of developing its innovative RB-211 engine. Waste Management’s alleged depreciation charge scam is as much a product of accountants’ contestable idea that depreciation is ‘an allocation of cost’, rather than a ‘decrease in price’. Again, that the same problem had arisen with US airline companies in the 1950s passes without mention. Perversely, following the rules has emerged a legitimate, often as well-intentioned as intentionally deceitful, means of misleading accounting, a simulacrum of a quality mechanism.

Significantly, the practices causing the shaking of heads in outrage now, in one form or another have all happened previously. In other disciplines the habitual recurrence of undesirable events would provoke thoughts that perhaps there was something awry with the system within which they were being repeated. And certainly, failed means of preventing the repetition of unwanted outcomes would be abandoned. Curiously, in business matters the response of legislators and professional standards setters has been precisely the opposite. The failed remedies of the past have not only been repeated, in most instances they have been multiplied – more rules of the kind known to have failed in the past have been heaped upon existing ones, even though their deterrent effect and their clout to back up imposing penalties on individuals for wrongdoing have dismal histories.

Throughout all this the ways and means of lessening culpability have been encouraged by regulators, including plea-bargaining which has become the norm in the US and seems to be growing in Australia. Regulators have traded-off their responsibility to apprehend and penalise wrongdoers with the prospect of potentially easier convictions of others. Plea-bargainers have become primary witnesses for prosecuting regulators. Andrew Fastow was thus a primary witness against Kenneth Lay and Jeffrey Skilling in the Enron case. His evidence shows that the case against those officers rests more upon what their previous collaborators disclose than what the regulatory machinery has uncovered from