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Indecent Disclosure

Gilding the Corporate Lily

Indecent Disclosure: Gilding the Corporate Lily captures the concerns of the business community when misleading financial disclosures of a public corporation result in an unexpected corporate collapse. Here, the authors present four main themes underpinning the crisis in a company's financial disclosures:

- A company's compliance with accounting standards does not generally produce financial statements that disclose their wealth and financial progress.
- Misleading financial statements are more the result of compliance with accounting rules, with the best of intentions, than a result of deviation from them with the intent to mislead.
- The raft of knee-jerk corporate governance mechanisms imposed following recent high profile corporate malpractice are more directed at appearances than at rectifying problems.
- There is increasing evidence that the current group structures which organise corporate activities are incapable of effective regulation.

Indecent Disclosure explains, explores and illustrates these themes, within the framework of an agenda for true, effective reform.

Frank Clarke is Emeritus Professor of Accounting at the University of Newcastle, and Honorary Professor of Accounting at The University of Sydney.

Graeme Dean is Professor of Accounting at The University of Sydney.

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Dramatis personae

- Adler, Rodney** Chairman of FAI and non-executive director of HIH.
- Adsteam** Adsteam was a conglomerate with the flagship company, The Adelaide Steamship Co. Limited. John Spalvins was at its helm from 1977 to 1990. It was perceived as a 1980s corporate high-flier.
- Air New Zealand** New Zealand Government airline which acquired a 100 per cent shareholding in Ansett Australia Ltd. It subsequently allowed Ansett to be placed in receivership in 2001. Eventually Ansett was liquidated.
- Ansett** Ansett Transport Industries Ltd, a major transport company and 49 per cent shareholder in ASL, was headed by Sir Reginald Ansett. In 1979 Ansett declined to finance further ASL's operations, thereby precipitating its ultimate collapse.
- ASL** Associated Securities Limited (ASL group) was a leading Australian finance company in the 1970s that was not supported by its major shareholder Ansett, who 'baled out' in February 1979.
- BCH** Bond Corp (or Bond Corporation Holdings Limited), renamed in 1993 Southern Equities Corporation Limited, was one of Australia's largest and most internationally known entrepreneurial companies of the 1980s.
- Berle, Adolf and Gardiner Means** Co-authors of the 1932 classic, *The Modern Corporation and Private Property*.
- Bond, Alan** Alan Bond was BCH founder and chairman from 1967 to 1991.
- Bosch, Henry** Chairman of the NCSC (1985–90) and major spokesperson on corporate governance in the 1990s. He was extremely critical of the accounting practices of Westmex and Bond Corporation.
- Brierley, Sir Ron** Founder of Industrial Equity Limited and a major antipodean investor from the 1970s to the 1990s. A takeover proved to be a major factor in the downfall of Adsteam, especially his fatal 'consolidated' account of the conglomerate's state of affairs.
- Cambridge Credit** Cambridge Credit Corporation Limited (Cambridge group), run by R. E. M. (Mort) Hutcheson.
- Chambers, Ray** Foundation Professor of Accounting at The University of Sydney. His iconoclastic reforms included the development of the method of Continuously Contemporary Accounting (CoCoA), entailing a completely integrated mark-to-market system that incorporates changes in both specific and general price levels.

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Dallhold Dallhold Investments Proprietary Limited (Alan Bond's family company).

Ebbers, Bernie Former WordCom CEO; convicted on one count of conspiracy, one of securities fraud and seven of filing false statements with securities regulators in the \$US11 billion accounting fraud at WorldCom, renamed in 2004 as MCI. Imprisoned in 2005 for 25 years.

Enron Enron Corporation was once the seventh largest publicly listed entity in the US, but it became one of the US's largest bankruptcies. Its Chairman, Kenneth Lay, presided over a period of intense scrutiny of its accounting practices culminating in the demise of Enron's audit firm, Andersen (one of the then Big Five accounting firms), due to its alleged document shredding at Enron.

Fannie Mae Founded in 1938 in the US the Federal National Mortgage Association, known by the acronym 'Fannie Mae', bought mortgages on a secondary market and issued mortgage-backed securities to the public. In 1968 the FNMA was partitioned into two operations – the wholly owned Government National Mortgage Association (Ginnie Mae) and the other Fannie Mae retaining the original name, expanding its mortgage portfolio and becoming fully private in 1970. Its operations are insured by the Federal Housing Association and is overseen by the Office of Federal Housing Enterprise Oversight (OFHEO). Its revenues were reported to be \$US53.8 billion in 2003.

Fastow, Andrew CFO at Enron and major player in forming Enron's SPEs.

Freddie Mac Founded in 1970 the US the Federal Home Loan Mortgage Association, known by the acronym Freddie Mac, is stockholder owned, though government-backed and regulated by the Office of Federal Housing Enterprise Oversight (OFHEO). It offers similar mortgage-based securities to those offered by Fannie Mae, Ginnie Mae, and Sallie Mae (the 1972 founded quasi-government Student Loan Marketing Association). Its 2003 revenues were reported to be \$US36.8 billion.

Group of 100 An association comprising the CFOs of Australia's top public and private companies. The group's members are drawn from the nation's major private and public enterprises. Its declared overriding goal is to contribute positively to the development and maintenance of an Australian regulatory environment which best serves to advance the interests of Australian business in the context of international competition. Through such activity this CFO network attempts to set the agenda and lead the debate on financial reporting and management, corporate governance and regulatory issues influencing the future direction of corporate Australia.

H. G. Palmer H. G. Palmer (Consolidated) Limited, named after its founder Herbie Palmer. 'Palmer' refers to H. G. Palmer (Consolidated) Limited (Palmer group).

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- HIH** HIH was one of Australia's largest insurance companies, one of its largest liquidations. Its founder and Chairman was Ray Williams, a leading Sydney philanthropist before HIH's collapse early in 2001.
- HIHRC** HIH Royal Commission was appointed in May 2001 with Justice Neville Owen as its Royal Commissioner. Hearings were held throughout 2001 and 2002 generating nearly 2000 pages of transcript and several million pages of submissions. The report was published in March 2003.
- HSI** Home Security International, a subsidiary of HIH.
- Insull, Samuel** Insull Utility Investments Inc., a major 1920s US utility conglomerate which took its name from its founder, Samuel Insull.
- Kozlowski, Dennis** Former Tyco CEO who was convicted in 2005 of misappropriating funds and gaoled for eight years.
- Kreuger, Ivar** Kreuger and Toll Inc., a major 1920s multinational match company, was founded and controlled by Ivar Kreuger.
- Lay, Kenneth** Enron founder and Chairman, and CEO after Skilling resigned in August 2001 until Enron was placed in liquidation.
- Maxwell, Robert** British newspaper and communications baron throughout the 1970s and 1980s, who in 1991 was found drowned in the Mediterranean thereby sparking a series of investigations that revealed a mountain of corporate debt and raised many unanswered questions about his financial empire.
- MCI** WorldCom was renamed MCI in 2004 as it exited Ch 11 Bankruptcy as MCI. It was taken over in 2006 by Verizon.
- Minsec** Mineral Securities of Australia Limited, or MSAL, refers to a loose collection of companies known as the Minsec group managed by Ken McMahon and Tom Nestel in the late 1960s and early 1970s.
- One.Tel** One of Australia's most notorious 1990s telcos. It had a meteoric rise and fall in the late 1990s and early 2000s. Its founders, Jodee Rich and Brad Keeling, and some of its financiers, Lachlan Murdoch and James Packer, were described by journalist Paul Barry in a book *Rich Kids*.
- Parmalat** In early 2003 Parmalat was placed in provisional liquidation. Its unexpected collapse revealed a 'black hole' of around 14 billion euros in its accounts, making it one of Italy's and Europe's most notorious corporate collapses.
- Reid Murray** RMH, or Reid Murray Holdings Limited (Reid Murray group), headed in its latter days by Ossie O'Grady.
- RMA** Reid Murray Acceptance Limited, formed to act as a corporate 'banker' for Reid Murray Holdings Limited.
- Rothwells** Western Australia-based merchant bank headed by the colourful financier Laurie Connell. Rothwells was pejoratively described as a 'lender of last resort' for high-risk ventures. Rothwells' and Connell's activities were scrutinised during the WA Royal Commission into WA Inc.

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- Rowland, Tiny** Founder of the multinational Lonrho and a crucial player in the final downfall of Bond Corporation, especially the worldwide distribution in late 1988 of the notorious ‘Financial Analysis’ document detailing Bond Corporation’s ‘insolvent’ state of affairs.
- Royal Mail** Royal Mail group, headed by the Royal Mail Steam Packet Company Ltd – the world’s largest 1920s UK ocean liner group run by the former Governor of the City of London, Lord Kysant.
- Skilling, Jeffrey** Enron CEO who resigned in August 2001 just prior to Enron being placed in bankruptcy.
- Stanhill** Stanhill Proprietary Ltd, family company of Stanley Korman, founder of the SDF group including SCL (Stanhill Consolidated Limited), SDF (Stanhill Development Finance Limited), Chevron (Chevron Limited) and SD Pty Ltd (Stanhill Development Proprietary Limited).
- Tyco** One of the new millennium corporate collapses that presaged the SOX reforms. Its CEO was Dennis Kozlowski.
- Westmex** Westmex Limited was a 1980s conglomerate ‘high-flier’ headed by Russell Goward during its brief rise and fall from 1986 to 1990.
- Whitehead, Alfred North** UK educator and philosopher. One of his insights was that a major fallacy of argument involved recourse to a proposition *as if* it was a fact, simply because others had said so many times previously. He described this as the fallacy of ‘misplaced concreteness’ (1919/1925).
- Williams, Ray** One-time deputy chairman and CEO of HIH.

Abbreviations

AA	Arthur Andersen.
AARF	Australian Accounting Research Foundation, formed in 1966 as part of the profession's response to the spate of 1960s corporate collapses.
AAS	Australian Accounting Standards, which have had the force of law under Australia's Corporations Law since 1992.
AASB	Australian Accounting Standards Board, the major standards-setting body since 1992.
AICPA	American Institute of Certified Public Accountants.
AIFRSs	Australia's modified version of the IFRSs, officially adopted in 2005.
APB	Accounting Principles Board (United States Accounting principles-setting body, 1959–71).
APES	Accounting Professional and Ethical Standards
APESB	Accounting Professional and Ethical Standards Board
APRA	Since 1998 the Australian Prudential Regulatory Authority has been Australia's national prudential regulator of the activities of the banks and other financial intermediaries.
AQRB	Audit Quality Review Board, a self-regulatory body formed in 2005 and funded by the two major Australian accounting professional bodies to monitor the audit practices of the four major accounting firms.
ASA	Australian Society of Accountants (predecessor body of the ASCPA).
ASAu	Australian Standards on Auditing, which have had the force of law under Australia's Corporations Law since July 2006.
ASC	Australian Securities Commission, the successor to the NCSC as Australia's national corporate regulator (1991–98). It was replaced by ASIC in 1998.

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ABBREVIATIONS

ASCPA	Australian Society of Certified Practising Accountants; was renamed in the late 1990s as CPA Australia. Together with the ICAA, this body represents the public face of Australia's accounting profession.
ASIC	Australian Securities and Investments Commission, the successor to the ASC as Australia's national corporate regulator (1998–).
ASRC	Accounting Standards Review Committee which was set up in November 1977 by the NSW Attorney-General, Frank Walker. It reported in May 1978, under the title <i>Company Accounting Standards</i> .
ASX	Australian Stock Exchange Ltd, formed in 1990 from an amalgamation of Australia's state stock exchanges. In 2006 it merged with the Sydney Futures Exchange and was renamed ASX Ltd.
ASXCGC	ASX Corporate Governance Council.
ATO	Australian Taxation Office.
B&M (Berle and Means)	Adolf Berle and Gardiner Means, authors of the 1932 classic, <i>The Modern Corporation and Private Property</i> .
BCCI	Bank of Credit and Commerce International.
CAMAC	Corporations and Markets Advisory Committee.
CASAC	Companies and Securities Advisory Committee.
CCA	Current cost accounting. This was one of the proposed systems of accounting examined in many countries in the 1970s to replace or supplement historical-cost accounting.
CEO	Chief executive officer.
CFO	Chief financial officer.
CLERP 9	Australian Commonwealth Company Law and Economic Reform Program No 9 discussion paper, <i>Corporate disclosure: Strengthening the financial reporting framework</i> , September 2002; parts of which were enacted as legislation 30 June 2004 under the <i>Corporate Law Economic Reform Program (Audit Reform & Corporate Disclosure) Act</i> ; it includes a number of reforms to the <i>Corporations Act 2001</i> (Cth).
Conglomerate	The type of corporate vehicle that occurs when unrelated activities (companies) are acquired through takeover or merger.
Enron	Enron Corporation. It was later euphemistically referred to as the <i>Crooked E</i> .

EU IFRSs	The European Union version of IFRS adopted and effective from 2005.
Fair Value	This method of reporting items in financial statements has become the preferred basis in most national standards and the IFRSs for reporting many assets and liabilities. It is defined by the FASB as: the exchange price (exit price) in an orderly transaction between market participants to sell the asset or transfer the liability in the market in which the reporting entity would transact for the asset or liability. The transaction to sell the asset or transfer the liability is a hypothetical transaction at the measurement date.
FASB	Financial Accounting Standards Board (United States Accounting Standards-setting body, 1972–).
<i>Financial Review</i> (AFR)	<i>Australian Financial Review</i> , a major daily Australian business newspaper.
FITB	Future income tax benefit.
Foozle	A supposedly short-term managerial action deemed to be on the ‘grey line’ of what is lawful; subsequently often followed by clearly more fraudulent actions as the perceived ‘short-term’ financial problems worsen.
FRC	Australia’s Financial Reporting Council. Formed in 2001, it has oversight responsibility for the governance of corporate financial reporting practices under the <i>Corporations Act 2001</i> (Cth).
FRCLSE	Financial Reporting Council of the London Stock Exchange (1990–).
FRP	The Financial Reporting Panel, an alternative dispute resolution body in relation to the treatment of accounting standards, which alleviates ASIC from initiating court proceedings whenever a dispute arises regarding the application of accounting standards.
FTC	Federal Trade Commission, US regulatory agency formed in the first decades of the twentieth century. For a period it had responsibility for overseeing accounting practices.
GAAP	Generally Accepted Accounting Principles.
GAS	General Accounting Standard.
GEERS	Government Employee Entitlements Redundancy Scheme – implemented 12 September 2001 and revised

	1 November 2005 – provides a ‘safety net’ for employees made redundant, often in a group liquidation.
IASB	International Accounting Standards Board, formed in 2001, has carriage for the setting of International Financial Reporting Standards (IFRSs).
IASC	International Accounting Standards Committee, international accounting standards-setting body, 1973–2001.
ICAA	The Institute of Chartered Accountants in Australia (1928–).
ICAEW	The Institute of Chartered Accountants in England and Wales (1880–).
IESBA	International Ethics Standards Board for Accountants – a committee within IFAC.
IFAC	International Federation of Accountants.
IFRSs	International Financial Reporting Standards set by the IASB. Previously known as IASs.
INED	Independent Non-Executive Director.
IOSCO	International Organization of Securities Commissions emerged in April 1983 with the transformation of its ancestor, inter-American regional association (created in 1974), into a truly international cooperative body.
IRS	Internal Revenue Service (US).
ISA	International Standards on Auditing issued by the relevant arm of IFAC.
ISC	Insurance Supervisory Commission (1998). It was replaced by APRA in 1998.
JCCFS	Joint Committee on Corporations and Financial Services – a joint committee of Australia’s federal parliament.
JCPAA	Joint Committee on Public Accounts and Audit – a joint committee of Australia’s federal parliament.
Mark-to-market accounting	The process of stating all non-monetary assets at their current market prices.
Mark-to-model accounting	A method of mark-to-market accounting used by Enron. The model drew on discounting procedures to arrive at a ‘synthetic’ market price for Enron’s asset holdings of energy (and other) derivatives.
Matching	A convention (sometimes referred to as a rule) within the conventional historical cost-based accrual system of

	accounting. It is the accountant's method of building into the accounts the anticipated linkages between expenses incurred and the expected future revenues.
MUA	Maritime Union of Australia.
NAS	Non-audit services.
NCSC	National Companies and Securities Commission – national corporate regulatory body (1981–90). Replaced by the ASC.
NED	Non-Executive Director.
NPV	Net present value.
NSW	New South Wales.
OECD	Organisation for Economic Cooperation and Development.
Opting-in	An <i>ex ante</i> administrative arrangement proposed by CASAC and considered (but rejected) as part of Australia's <i>CLERP 9</i> corporate law reforms.
Opting-out	An <i>ex ante</i> administrative arrangement discussed in the 1982 UK Cork Insolvency Committee as a possible <i>ex ante</i> administrative arrangement. It was not put forward as a preferred proposal by Cork.
PCAOB	Public Company Accounting Oversight Board (a private-sector, non-profit corporation, created by the US <i>Sarbanes-Oxley Act</i> of 2002 in response to the wave of accounting and audit scandals); to oversee the activities of auditors of public companies in order to protect the interests of investors and the public by ensuring the provision of 'informative, fair and independent audit reports'.
POB	Public Oversight Board (part of the SEC Practice Section of the AICPA).
Pooling	A legislative arrangement whereby the assets and liabilities of separate entities may be pooled in an external administration. It has been recommended for adoption in the Australian Government's <i>ED Corporations Amendment (Insolvency) Bill 2007</i> .
Ramsay Report	<i>Independence of Australian Company Auditors: Review of current Australian requirements and proposals for reform</i> , prepared on invitation of the Australian federal government, October 2001, by Professor Ian Ramsay, the Harold Ford Professor of Law at the University of Melbourne.

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ABBREVIATIONS

SAC	Statement of Accounting Concept, issued by Australia's standards-setting body, AARF.
SEC	Securities and Exchange Commission, formed in the US in 1933 during the Depression as part of the New Deal. It assumed many functions previously held by the Federal Trade Commission.
SEESA	The Australian federal government established the Special Employment Entitlement Scheme for Ansett employees for the purpose of making these safety payments to Ansett employees if there was a shortfall in asset realisations.
SMH	<i>Sydney Morning Herald</i> , a major Australian daily newspaper.
SOX	<i>Sarbanes-Oxley Act, 2002</i> .
SPE	Special Purpose Entities.

Acknowledgements

We publicly acknowledge our gratitude to Angelika and Nicole Dean, and to Jeanette Clarke, for their continued encouragement and forbearance over the many years it took to bring our examination of corporate collapse and accounting to this point, and to the accounting iconoclast Ray Chambers, without whose mentorship and inspiration (even following his death in 1999) it would never have commenced or have continued into this third book in the series.

Hopefully through this work Ray Chambers' ideas will remain, in his words, 'an irritant to the accounting profession to ensure that it continues to seek ways of continually improving its practices', and concomitantly to improve the products on which users of accounting information so desperately rely. Only then will the market system be able to eliminate the continuing indecent disclosures, restore the public trust that has been so shaken over the years by events like those post-2000 at, say, HIH, One.Tel, Harris Scarfe, Enron, WorldCom, Parmalat, Vivendi and more recently at Fannie Mae, Westpoint, Fincorp, James Hardie, Sons of Gwalia and other *causes célèbres*.

This is the third in a series advocating the 'Sydney School' of accounting's push for reform of the law of company accounts, first proposed by Chambers in his 1973 *Securities and Obscurities* monograph – later published as *Accounting in Disarray*. It augments the ideas and evidence detailed in the first and second editions of our *Corporate Collapse* by drawing on some material therein, on subsequent works published by the authors, and on new material and ideas. By bringing these matters together, by connecting the pieces of the jigsaw into a complete picture, the historian, as Jordanova (2000) observes, 'bears witness' to decades of writing, comment, and debate, and reveals an issue of public importance that requires attention.

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