COST-EFFECTIVE BUSINESS REGULATION

William Clifford
and
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Australian Institute of Criminology

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Views from the Australian Business Elite

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INTRODUCTION

This publication is the product of an attempt by the Australian Institute of Criminology to solicit the views of the leading business people in Australia to the question of the regulation of corporate conduct. Some of the people we approached declined the invitation to participate, but as can be seen from the list of participants on the previous page, those who cooperated constituted a significant slice of the Australian business elite.

The project proceeded through three states. First, interviews were conducted with thirteen of the executives listed on the previous page. Second, a discussion paper was written partly on the strength of these interviews and circulated to participants. Six participants - Messrs Adam, Brimacombe, Cotterill, Duprey, Hall and Kline - were then able to attend a roundtable discussion with us. The basis for this discussion was our paper and an introduction by Mr. A.T. Kline of Esso Australia. These three stages constitute the three sections of this report.

The report documents the gradual moving forward of our thinking on the regulation of business in Australia. It is a beginning and little more. We are tremendously grateful to the extremely busy people who made this beginning possible. Their openness in talking about a subject which is naturally somewhat sensitive is a credit to them and their companies.

I. SUMMARY REPORT ON THE PRELIMINARY INTERVIEWS

Discussions ranging from one to two hours in duration were held with thirteen business leaders in the preliminary interviews. All agreed that government regulations were necessary. As representatives of large companies, they tended to feel that the greatest problem was with small companies which operate on the fringe of an industry. Some conceded economic advantages for the large companies in forcing fringe competitors to comply with standards which they were already meeting.

It was pointed out that transnational companies have compliance checks imposed from corporate headquarters which may have a more profound impact than government regulations. These checks might include factory inspectors coming out from corporate headquarters, financial auditors arriving unannounced from the parent, or samples being sent to head office for purity and safety checks. In the face of these extra checks some of the executives felt that the tendency of government regulators to disproportionately focus their attention on transnational corporations was an irrational response to political resentments against multinationals. Other executives pointed out that since large companies controlled such significant proportions of markets, wider coverage for the regulatory dollar might be achieved by concentrating on the largest companies. One pointed out that even if large companies are more honest in their tax returns, government will still recoup more tax dollars by carefully scrutinizing the claims of massive conglomerates than by focusing on backyard operators.

A widespread view was that the American model of tight government regulatory control should not be followed in Australia. Sir James McNeil pointed out approvingly that recent times had seen a situation where BHP had only two in-house lawyers, while Republic Steel, an American steel company smaller than BHP, had 75.

Australian governments were criticised for not looking sufficiently critically at the cost of new regulatory requirements. It was pointed out that some state environmental legislation explicitly absolves regulators from a consideration of the commercial implications of their recommendations. The preparation of cost of regulation impact statements for significiant new regulatory initiatives was enthusiastically supported by some. A specific initiative which was mentioned by a number of the business leaders as raising the spectre of increased costs was the possibility of the introduction to Australia of consumer class action suits.

A common view was that an even greater concern than a proliferation of regulations was a proliferation of regulatory agencies. There were complaints that demands from one government department would conflict with requirements imposed by others. Most importantly, lack of federal-state and interstate uniformity was a great concern. For example, the same chemical might have very different classifications under the poisons regulations of different states. States have non-uniform requirements concerning the date-stamping of food packages. Multiple regulatory requirements escalate the costs of compliance, especially for national companies which might distribute to Northern New South Wales from Brisbane and to the Riverina from a warehouse in Victoria.

There was a consensus that for most purposes negotiation between government and business was a more efficient way of resolving disputes over regulations than litigation in the courts. Negotiation with the Taxation Department provides a model. Rather than argue over the meaning of laws, one executive pointed out that 'You say: "What's the deal".' Another business leader explained tax negotiation thus: 'So we say we'll let you win on this if you let us win on that'.

It was felt that if business could implement tough self-regulatory measures much of the need for government imposed regulation would be obviated.

However, there was general cynicism of measures which depended on the board of directors playing an important role in compliance. None of the business leaders expressed enthusiasm for the idea of public interest directors or even existing directors each being given a specific responsibility for say environment, occupational health and safety, product safety, financial audits, and so on. Audit committees of the board were seen by some as having value but by others as a management excuse to evade responsibility for problems when they occur by saying: 'But look we appointed an audit committee of the board to check this'. It was interesting that executives from companies which were all very different in the extent to which they relied on insiders and outsiders on their boards were uniformly persuaded that non-executive directors were too remote from the operations of the company to have a substantial impact on law observance within it. There were other ways in which the comprehension of outsiders as to what was going on was disparaged. One executive argued that outside computing auditors were invariably incompetent because of their limited familiarity with the particular computer system in a large company. It was preferable to rely on in-house computing auditors.

It was pointed out that the need for more effective internal controls had become more important because of the technological change wrought by computers. Quite apart from the new illegitimate opportunities they provide, computers have replaced many supervisory and checking functions which were formerly performed by people. Consequently, today there is a wider gap between the person doing the job and his or her supervisor. There being less interpersonal surveillance and more remote approval processes, unacceptable practices of employees can escape attention for longer.

A view shared by many of the executives was that detailed specification of corporate rules was not necessarily the best way of implementing self-regulation. The everchanging environmental circumstances confronting executives were thought to be so unique that 'almost everything is an exception'. Or as another business leader explained: 'It would be like drawing up a separate set of rules for each position on a football team. The left winger must do such and such, the centre something else'.

Some business leaders felt that putting in place organizational structures which reduce the chances of company standards being compromised was more important than writing rules. For example, one problem is incentive systems which encourage employees to cut corners. At GEC, workers who make certain types of electrical fuses are paid according to how many they produce. This is an incentive for productivity but a disincentive for quality. GEC puts aside the fuses for a day and has them checked for safety by another shift. We left the interviews with the question in our minds being whether it is more important for researchers to focus on the way organizational structures impact self-regulatory effectiveness rather than on what company rules are written.

II. DISCUSSION PAPER

TOWARDS COST-EFFECTIVE REGULATION OF BUSINESS

W. Clifford and J. Braithwaite

Regulation in Perspective

There is great and justifiable concern at the extent of corporate crime as boardroom delinquency extends transnationally and as swiftly formed unreliable companies find ever more ingenious ways of victimising the public.[1] However, the extent of corporate crime has never been properly measured, the most socially damaging consequences have usually occurred when the company operations were not yet criminal, and the demands for action are usually more general than specific.

The familiar response to the problem of corporate crime is almost a knee-jerk reaction on the part of the public and the politicians - more stringent laws, more detailed controls and increasing community pressure for social responsibility. Some legal measures are essential forms of protection - of life and property - but the worst companies who have deliberately set out to circumvent the law or to go into liquidation after making their gains are not usually deterred by this kind of official or community action. In the extreme cases they probably allowed for it before they embarked upon their questionable operations. Larger companies prepared to cut corners, can obtain the best possible legal advice on loopholes or on the ways of protracting legal proceedings to an extent which can render a rule practically ineffective. Policing many small companies for compliance with growing bodies of rules and identifying violations become difficult if not impossible tasks. So as rules proliferate, the problem becomes more intractable and reputable companies suffer more because they are the ones which are easier to control. Frequently governmental regulations do not control the actions for which they were drafted, but they seriously hamper operations which they were never intended to prevent.

It is a feature of legal history that regulations which fail are more likely to be added to than abolished.[2] The feeling of security which they give the public and the legislators - and the self-satisfaction of having 'done something' - is traditionally a more direct function of quantity than of quality. By definition regulations usually extend the scope for technical circumvention or procedural protraction. Income tax laws are a classical example of positive over-legislation generating its own negative evasion industry with a variety of consequent inequities which not only bring the law itself into disrepute but which blunt consciences.[3] Regulation can therefore be as ineffective in preventing commercial and industrial delinquency as it is effective in hamstringing the work on which the economy and the legal system ultimately depend.

The making and enforcing of regulations has already become an industry itself, complete with its own bureaucracy, its own structure of vested interests and its own consequential costs which grow and become inflationary. As a side effect, new and profitable consultancy businesses grow out of most forms of regulation whether these be environmental, security, trading, or concerned with tax liability. Whether commercially inspired or governmentally conceived the vested interests multiply. This is to say that costs increase and the public as tax payers or consumers ultimately pay.

In the United States the Brookings economist Edward Denison has claimed that he can account for 0.4 per cent of the annual productivity lag per worker (now down to less than 0.8 per cent per annum from 2.5 per cent per annum in the 1965-1973 period) by 'changes in the legal and human environment in which business operates'. By this he means the variety of pollution, safety, health and anti-corruption controls as well as the

increased private security costs for industry.[4] Against this Edward Graham[5] contends that the environmental, health and safety regulations of the past ten years have brought an improvement to standards of living which are not reflected in the usual output statistics. Brittan also refers to a possible side effect of regulations, the evasion of which produces a 'black economy' (black market?) of small scale domestic and unregistered activity dodging both the tax and regulation agencies and operating outside the scope of the usual productivity indicators. Again, someone pays for the economic activity within the 'black economy'.

The foregoing should not be taken to imply that regulation is unnecessary. There are certain basic standards of quality production, safety and waste control which just cannot be expected to develop from industrial self-regulation, market forces, or enlightened social responsibility. Here a degree of governmental intervention is both necessary an desirable: and, in providing it, the taxpayers are buying themselves a basic level of protection. While everyone argues that 'some' regulation is necessary, the crucial question is how much and in what circumstances?

Sometimes governmental regulations are necessary to avoid market regulation by the most powerful firms. Into this category fall trade practices legislation and other measures necessary to prevent industrial giants squeezing out existing competition. Here the regulations are actually designed to <u>avoid</u> the creation of order and to <u>avoid</u> that predictability in pricing which collusion in industry could well ensure.[6] Other regulations can work in the opposite way - setting necessary standards of production or performance so high as to prevent marginal companies from entering the market cheaply but at an unjustifiable risk to consumers.

The Impetus for Regulatory Reform in Australia

Many countries have seen efforts in recent years to make the cost of business regulation an issue. Last year a British study found that in that country at least 252 different government authorisations confer powers of entry to companies on inspectors, quite apart from the police.[7] A Business Roundtable study of 48 US companies found that in 1977 incremental costs of $2.6 billion were born to meet requirements imposed by six federal regulatory agencies.[8]

The sponsoring of this kind of research by the business community has now begun in Australia. During 1977, Eric White Associates surveyed the top 100 companies in Australia.[9] The survey found that the direct cost of monitoring and complying with the information requirements of regulatory agencies (including staff time and expenses) averaged $110,000 per company. A recently released Confederation of Australian Industry survey for the year 1978-79 put the costs of compliance with Federal and State government regulations at $3,720 million.[10] It was further concluded that business regulation tied up about 54,400 private-sector employees full-time in that year. The number of government regulations made in Australia per year has shown almost a three-fold increase since 1960. The study found the costs of state government regulations to be far more significant than federal regulation.

This evidence has produced a political response. The Minister for Business and Consumer Affairs, Mr. Garland, has announced that he sees the 1980s as a decade in which private enterprise will be forced to become more and more responsible for finding its own solutions to problems, as business becomes increasingly free from regulation.[11] Both the South Australian and Victorian governments have expressed support for the 'sunset' approach to business regulation which will be discussed later. The major forum for

the deregulation debate has become the Campbell inquiry into the Australian financial system.

While these developments are healthy and long overdue, the debate has proceeded in a rather one-sided fashion. While the documentation of the costs of regulation from industry-funded studies has been impressive, systematic enumeration of the benefits of regulation has been absent. The problem is that the benefits of say a cleaner environment are not so quantifiable as the costs of environmental protection technology. Douglas M. Costle, Chairman of President Carter's new Regulatory Council and Administrator of the Environmental Protection Agency, has made a valiant effort to enumerate the benefits side of the regulatory equation. We can do no better than quote him at length:

> Those benefits run from savings in lives at one end of the spectrum, to aesthetic benefits at the other. In between, you find benefits ranging from savings in property maintenance - not having to paint your house or clean your clothes as often -to the protection of farm and timber crops from saline soils and acid rains.
>
> Despite the difficulties, some economists are beginning to measure the benefits of regulation. In 1977, for example, after evaluating existing studies, the American Lung Association estimated that air pollution could be costing us $10,000 million annually in health damages. Dr. Lester Lave, chairman of the department of economics at Carnegie-Mellon University, and Dr. Eugene Seskin, a senior research associate at Resources for the Future, have published their study on Air Pollution and Human Health. They estimate that the annual health benefits

of controlling pollution from factories could be as much as $20.2 thousand million in 1976 dollars. In a forthcoming study, Dr. Edwin Mills of Princeton University has estimated the recreational, aesthetic and ecological benefits of water quality improvements to be of approximately the same magnitude.

Thus, now that economists have been asked to look for figures, they are beginning to find that health, safety, and environmental regulations have a sound economic base. To place such benefits on a more human scale, let me quote examples cited by Dr. Stewart Lee, chairman of the department of economics at Geneva College. He finds that in the regulated products groups, safety packaging requirements have produced a 40 percent drop in ingestion of poisons by children over a four-year period. Since the safety standards for cribs became effective in 1974, crib deaths have fallen by half, and injuries by 45 percent. The Burn Institute in Boston reports that in 1971 - prior to the children's sleepwear standards - 34 percent of its flameburn injuries involved sleepwear. In 1977, the figure was zero.

According to the U.S. government's General Accounting Office, 28,000 lives were saved between 1966 and 1974 because of federal motor vehicle safety regulations. The same report showed that in one state, where a detailed analysis was conducted, there was also a substantial reduction in the frequency and severity of injuries. With auto accidents the number one cause of paraplegia in the United States, these figures are significant.[12]

It is a barren exercise to argue that business in aggregate is overregulated or that it is underregulated. There are areas where it may be overregulated and others where the opposite is the case. The need is to develop strategies to ensure that both types of problems are subjected to critical scrutiny in which cost is an important element of the deliberation.

Putting a Price on Morals?

Traditionally the law is believed to embody principles of morality which are so central to the culture as to justify codification and enforcement by the state. Not all morals, but presumably only the most central ones, become laws. There is an influential body of thought in our culture which says that we should not set a price on morals, that justice should not be for sale.[13] Certainly, no one could dispute the undesirability of situations where people and organisations with greater wealth can buy superior treatment by the law than is available to the poor.[14] Nevertheless, it is our contention that considerations of cost should be a factor in determining which laws are enforced systematically, indeed in determining whether morals should become laws in the first place. This is not only desirable, it is inevitable. Police departments, for example, have finite resources to confront problems which are infinite in their dimensions and are forever making decisions to deploy enforcement resources in one area to the neglect of another. A police department which had a policy of systematically enforcing every law violation which came to the attention of its officers would spend all its time on prosecutions for obscene language and public drunkeness charges, while devoting much less attention than they do at the moment to solving murders. In other words, citizens implicitly accept the principle that police departments weigh up the cost of enforcement against its benefits.

This kind of reason has not always prevailed in the enforcement of business offences. Many consumer groups have regarded asking the question of the cost of regulation as selling out morality to economics. But the same reasoning does apply as with the police example. If scarce white-collar crime enforcement resources are concentrated in those areas where enforcement is cost-effective, then more companies who have engaged in serious offences will be brought to justice for the taxpayers' dollar. The argument is all the more compelling in the case of business crime because the resources available for regulating business are very much less than the resources at the disposal of the police, probation and parole, prisons and other departments responsible for regulating the conduct of individuals. Moreover, with corporate crime one ill-chosen enforcement action (such as the antitrust action against IBM in the United States) can use up almost the whole of a government agency's budget.

If we are genuinely concerned to provide as much protection as possible to the public, then cost-effectiveness questions must be asked. As was argued in the first section of this paper, it can be that the costs of regulation in a particular area become a greater social burden than the benefit at which the regulations are directed - the remedy can become worse than the disease.

The question which arises when all these broader issues are considered is the extent to which governmental regulation can become so extensive as to be self-defeating: the extent to which the established bureaucracies of the largest and most entrenched firms in an industry can be used to serve public as well as private purposes, namely, to set standards for the industry as well as to encourage self-policing, and the extent to which the interplay of law and discretion will serve the best interests of the citizen. In the last analysis these resolve themselves into questions of costs and benefits.

Beginning with the last point it is perfectly clear that in every country where regulation of industry or commerce is attempted there will be an area of cooperation between the corporations and government on the application of the regulations. With tax laws now so very complicated, with allowances for depreciation, transfer prices and other national figures so difficult to assign with accuracy and fairness there is often a form of negotiation at the end of the tax year with the Commissioner or a senior taxation officer eventually using his discretion (after a discussion with company experts) to fix the final assessment. On environmental controls, government departments and the firms involved will often agree on the private consultants to be appointed for an impact study - and they will generally agree to abide by their report. Or if there is no actual agreement, it becomes the established practice to abide by it. Frequently individuals who were engineers or other acknowledged experts with private firms succeed in getting supervisory jobs with the government, and not infrequently officials of supervisory governmental agencies retire to take up employment with, or to act as consultants to, the private firms. This interplay, and what amounts to a cross-fertilisation, can lead to greater cooperation or collusion according to the particular issue involved or the point of view of the observer. However regarded, it is a fact of modern business practice - the large bureaucracies, governmental and private, seek ways to interface for smoother day-to-day operations.

This is not an altogether undesirable reality. Given the complexity of law relating to the control of companies, settlements in the courts impose severe costs on everyone. Hence, to the extent that matters can be settled through a process of negotiation, considerable cost savings occur. Negotiation is a qualitatively different process from litigation: 'They [negotiators] seek not to reach a solution in terms of rules, but to create the rules by which they can organise

their relationship with one another.'[15] Negotiation has the advantage over litigation that it is predicated by the maintenance of harmonious relationships between the disputants rather than by a breakdown of cooperation in an adversarial confrontation. Anthropologists have noted that for disputants who must maintain ongoing cooperative relationships with each other (e.g. husband and wife) negotiation is more often the preferred mode of settlement, while for disputants who have only a transitory relationship (e.g. landlord and tenant) a definitive formal adjudication may be the preferred mode.[16]

While it matters little that a landlord and tenant come out of a courtroom bitter enemies, it matters a great deal if an industrial safety inspector emerges from a courtroom a sworn enemy of the safety manager of a certain company. The latter matters because these people should continue to work together to protect the public. The safety inspector wants the safety manager to be open with him and talk over the problems he is confronting; while the manager wants the inspector to warn him before the event of problems which might run the company afoul of the law, rather than let him go now and prosecute later. A government inspector who has a rapport with industry plays an important role in disseminating safety innovations from the industry leaders in safety to those who lag behind, even though the latter might be within legal limits. A government inspector must therefore confront many circumstances where the grounds of justice and equitable treatment under law call for prosecution, but protection of the public calls for a harmonious negotiated settlement.

This is all very well, but consumer groups are correct to point out that many negotiated settlements may be cosy arrangements suitable to both business and government, and not in the public interest at all. A strong

consumer movement combined with a meaningful Freedom of Information Act are essential protections in a democracy against this inevitable kind of accommodation. In spite of all this, prosecution will frequently be necessary. When prosecution must proceed, efforts should be made to insulate the front-line inspectors who must maintain cooperative relationships with people in the company from the most bitter adversarial interchanges.

Two types of choices therefore must be made. First, it must be decided whether the requirements imposed on industry by a given regulation involve costs of compliance greater than the benefits. Second, given that a regulation has been imposed, it must be decided whether for any given violation, the benefits of enforcement action exceed the costs.

Before major new regulations are introduced the government agencies introducing them should be required to prepare a cost of regulation impact statement. There should also be a requirement to call for submissions from business, consumer, trade union and other groups on the costs and benefits of any proposed new regulation. The United States Food and Drug Administration has a further requirement that the agency must offer in the Federal Register a defence against every substantive criticism made.

Moreover, there is a need for a built-in self-destruct mechanism which forces agencies to review their objectives and effectiveness periodically. A regulation which is cost-effective today may, with changing technological and economic realities, rapidly become cost-ineffective. The US Congress has been considering a number of strategies to give regulations a finite life. One is 'sunset' legislation which, at the end of a specified period, forces a regulatory agency to scrap all existing regulations and start again.

Of course, if the existing regulations can all be justified as working well, this set of regulations can be simply re-enacted in its entirety. One of the problems with proposals to review the costs of regulation is that they themselves might impose considerable costs. Senator Kennedy, arguing that a fixed routine of total review of all US government regulations would impose an impossible burden on Congressional oversight committees, has put forward a 'high noon' proposal as an alternative to 'sunset' legislation. Under 'high noon', one agency would be selected at a time for dismantling and rebuilding of its regulations. Presumably every regulatory agency would eventually have its 'high noon'. Australia does not have anything approaching the costly regulatory apparatus of the United States. Yet the proposals discussed above are worth considering for Australia precisely so we can avoid creating an unnecessarily complex regulatory morass.

Finally, a great many of the complications of regulation could be avoided by up-grading the quality of legal draftmanship. Too often the dull task of drafting regulations is left to those who cannot avoid it. This is an area of legislative activity in which expenditure on good drafting could save millions on futile litigation. It is also an area requiring detailed knowledge of the realities of the industry. To some extent the range of cooperation between industry and the government could be extended by increased consultation with industrial specialists on the control measures required or intended. Interests would not always coincide but the framing of regulations which could be effective in operation and relatively cheaply monitored would repay investment at this point.

The Possibilities for Self-Regulation

Self-regulation is a dirty word among many consumer groups. This is because certain business interests have attempted to portray self-regulation as a total alternative to externally imposed regulation. It

never can be. A situation cannot be tolerated where responsible companies self-regulate while others make quick profits by flouting accepted standards. However, companies which set up effective self-regulatory systems should obviously receive less attention from government inspectors than those that do not. Companies which set up meaningful internal compliance systems therefore assist in ensuring that scarce government enforcement resources are concentrated where they can do most good.

Many of the areas where the benefits of enforcing externally imposed regulations do not justify the costs might be handled by fostering, or even requiring, certain self-regulatory measures. While this smacks of common sense, the practical problem is how to make self-regulation work. Strategies for making the rhetoric of self-regulation a reality constitute one of the most worthwhile challenges for modern business.

The purpose of the research program we are undertaking is to attempt to draw out some general principles of effective self-regulation. This can only be done by relying heavily on the expertise and experience available in the business community. At this stage all we have are many questions and very few answers. We can do no more than conclude by listing a number of questions which could form the agenda for a research program.

1. What is the role of the Board of Directors in monitoring internal compliance programs?

2. Is it desirable to allocate to different Board members responsibility for certain areas of compliance?

3. Can corporate codes of conduct be made effective?

4. Can compliance with codes of conduct be made one of the criteria on which promotion is assessed?

5. Should corporate compliance be a separate function superimposed on normal operating functions or should compliance be integrated into all operating functions?

6. In a transnational corporation should headquarters superimpose compliance audits on subsidiaries or should subsidiaries have autonomous responsibility for compliance?

7. Once compliance reports have been written and deficiencies noted, what procedures should exist for ensuring that the report lands on the right desk and is acted upon?

8. Should government inspectors have routine access to internal compliance reports?

9. How can an organisation be structured so as to foster natural surveillance of the activities of officers to ensure compliance with corporate standards?

10. How should accountability be allocated in an organisation to ensure that a particular person can be held responsible for a particular problem for which he or she is adequately trained and experienced to handle?

These questions are but a beginning. They are all underpinned by the fundamental assumption that internal regulation is likely to be more

effective in many circumstances than externally imposed regulation. This is assumed because insiders are in a better position to know where the bodies are buried and are better trained in the technology in which their company specialises than any government employee could ever be. The quest for more cost-effective regulation is therefore seen to have three major thrusts. First, reducing government enforcement efforts which are not cost-effective;[17] second, replacing these with assurances that effective self-regulatory mechanisms are in place; and third, increasing government enforcement efforts which produce benefits which are greater than costs.

FOOTNOTES

1. Recent Australian manifestations have been Rodney N. Purvis, Corporate Crime, Sydney, Butterworths, 1979. Timothy Hall, White Collar Crime in Australia, Sydney, McGraw-Hill, 1979.

2. See Adam Sutton and Ron Wild, 'Corporate Crime and Social Structure', in P.R. Wilson and J. Braithwaite (eds), Two Faces of Deviance: Crimes of the Powerless and Powerful, Brisbane, University of Queensland Press, 1979.

3. See 'Simplification Symposium', Tax Law Review, 34, 1978. Hickman, 'Federal Tax Regulations: The Need to Expedite and Simplify', National Tax Journal, 30, 1975, 313-314. P.P. McGuinness, 'How the High Court has Helped Tax-Dodgers', National Times, 17 June 1978.

4. Samuel Brittan, 'How America fell into the No-Growth Rut', Australian Financial Review, 27 March 1980, 10-11.

5. Ibid quoting Edward Graham's article in a book called 'Technological Innovation for a Dynamic Economy', New York, Pergamon, 1979.

6. However, one of the problems with anti-trust enforcement around the world has been that forms of conduct which have been defined as illegal because of their normally adverse economic consequences are prohibited even in particular circumstances where the conduct produces economic benefits. Hence, monopolistic behaviour will be stamped upon even when it generates economies of scale with benefits much greater than anti-competitive costs. See Richard A. Posner, Antitrust Law: An Economic Perspective, Chicago, University of Chicago Press, 1976.

7. An Inspector at the Door, published by the Adam Smith Institute and the National Federation of Self-Employed and Small Business Ltd., London, 1979.

8. Arthur Andersen and Co, Cost of Government Regulation Study, Prepared for the Business Roundtable, New York, 1979.

9. Eric White Associates, The Cost Impact on Private Business of Dealing with Government Regulatory Agencies, 1977.

10. Canberra Times, 6 August 1980, p. 20.

11. Australian Financial Review, 29 July 1980, p. 19.

12. Douglas M. Costle, 'Innovative Regulation', Economic Impact, 29(4), 1979, 8-14.

13. See, for example, Gerald L. Barkdoll, 'The Perils and Promise of Economic Analysis for Regulatory Decision-Making', Food, Drug and Cosmetic Law Journal, 34, 1979, 625-630.

14. See Bruce Wasserstein and Mark J. Green (eds), With Justice for Some, Boston, Beacon Press, 1972.

15. P.H. Gulliver, 'Negotiations and Mediation', Working Paper No. 3, Program in Law and Society, University of California, Berkeley, 19 2-3.

16. See Max Gluckman, The Judicial Process Among the Barotse of Northern Rhodesia, Manchester, University Press for the Rhodes-Livingstone Institute, 1955. See also the critical assessment in L. Nader and H.F. Todd (eds), The Disputing Process: Law in Ten Societies, New York, Columbia University Press, 1978.

17. For further discussion of the costs of regulation see Donald P. Jacobs (ed), Regulating Business: The Search for an Optimum, San Francisco, Institute for Contemporary Studies, 1978. Arthur Andersen & Co, Cost of Government Regulation Study Prepared for The Business Roundtable, New York, 1979.

III. THE DISCUSSION

THE ESSO SYSTEM

Paper presented by Mr. A.T. Kline
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Esso Australia Ltd.,
SYDNEY

I happened to be the General Auditor of Exxon Corporation before I was lucky enough to be sent to Australia and so I had some direct contact with the questions under discussion today. I plan on providing some very brief background on Exxon and Esso Australia and our Corporation's overall system of management control, and also what might be of some interest to you, Exxon's internal Audit effort, the conflict of interest policy and the business ethics policy.

Exxon Corporation and its affiliates operate in almost 100 countries including Australia. Our major businesses are exploration, production, refining, marketing of crude oil, petroleum products and natural gas, manufacturing and marketing of petro-chemicals, and the exploration for and mining and sale of minerals, including coal and uranium -

Interjection:- and shale -

Yes, that is not a major business yet but we hope that it will be.

World wide we have about 170,000 employees. In Australia, as you probably know we produce about 65% of Australia's crude oil and the natural gas supply for the State of Victoria and we supply about 7% of the petroleum products marketed in Australia as well as petro-chemical and some other operations. With this background let me describe very briefly Exxon Corporation's overall system of management control. This is basically a decentralised system which delegates considerable responsibility to the Managing Directors of Affiliates and to Division Managers. However, this certainly does not mean that the managers are free to do their own thing in any way that they happen to deem expedient, so long as they make some money. Instead, Exxon

Corporation's top management expectations are communicated through specific policy statements on planning and investment guidelines. This process of delegating authority in a decentralised way combined with strict centralised policy making and guidelines provides the foundation upon which the management control process is built.

There are seven major components of this system. These are:

First - clear, well documented delegations of authority;

Second - careful selection and development of qualified managers;

Third - development and review of long term business and investment plans and strategies;

Fourth - control over capital and exploration expenditures by use of authorised budgets;

Fifth - near-term planning, performance, monitoring and stewardship;

Sixth - financial controls which assure the integrity and accuracy of books, records and accounts in accordance with appropriate regulations and accounting principles;

and Seventh - operational control systems for the safe and efficient conduct of field operations, and this includes safety procedures, and security measures.

Each of these components in turn is designed and used consistently with six major control concepts. These are:

First - the well known segregation of duties and responsibilities such that no single function, department or employee will have exclusive knowledge, authority or control over any significant transaction or group of transactions;

Second - the proper documentation of transactions and business events;

Third - the systematic and thoughtful supervision in documented reviews of managers and other employees work;

Fourth - the timely preparation of records, reports and reviews;

Fifth - control measures designed in such a way that they are responsible to the nature and degree of risk and exposure. In this respect, although we have never been successful in getting a cost-benefit dollar for dollar relationship, this is the area that I am talking about.

Sixth - the various aspects of control should not be so interdependent that a serious deficiency in any one would make other controls also ineffective.

However, just as important as the Corporation's control mechanisms is a total control environment. Some parts of this environment are visible, such as our comprehensive internal control Manual for our internal audit activity. Other factors are intangible like the competence and integrity of management and the way in which management communicates and enforces policy. However, the overall control environment is vital, including the intangible part.

For example, a poor control environment could make some accounting controls ineffective because an accountant might hesitate to challenge a higher placed manager who is violating or overriding a specific control procedure. We need to design our systems so that that does not happen. I mentioned auditors a moment ago - Exxon has an internal audit staff of over 200 professionals who audit all company operations, primarily to evaluate financial and other controls, assure compliance with company policies and assure adherence to contract provisions by those performing work under contract for Exxon or its affiliates.

Exxon Corporation itself has a Board Audit Committee in New York composed exclusively of outside, non-employee Directors. They have periodic reviews with Exxon's General Auditor and also with Price Waterhouse who is our public accountant. All violations of Exxon's business ethics policy are reported to the Board Audit Committee and I will talk about this policy in a moment.

One of the functions of this Committee is to act as a safety valve. In this regard, any internal auditor in Exxon is not only permitted but obligated to carry any matter through channels right up to the corporate Audit Committee if he feels that a serious control deficiency or a violation in the ethics policy has occurred and is not being properly reported and corrected. Such an independent channel of communication and the safety valve that it provides, is very important to Exxon's management as a large multi-national oil company constantly subjected to charges and criticisms. Exxon determined long ago that it could tolerate no major scandal or cover-up.

Now I would like to look specifically at our Conflict of Interest Policy -

Braithwaite - May I interrupt - you said there was an obligation to report up through the independent channels problems that are observed. It is not really the responsibility of the person who observes the questionable conduct and has the obligation to report to also make a judgement as to whether what he observes is legal or illegal, or ethical or unethical. There is just an obligation to report. Is there some kind of Corporate sanction for not reporting? How does that obligation work in practice?

Kline - Each auditor is briefed regarding this obligation and Price Waterhouse is aware of this too. They have the same policy regarding our Company. Say, for example - I was an auditor and uncovered something that was unsavoury or should have been reported and I told my supervisor and he said to let it go. Well, auditors are briefed that their obligations do not end there. The employee who makes the report knows that his supervisor should report it up the line and that if his supervisor does not, the auditor must. He cannot seek sanctuary so to speak just by saying, 'It was not my job.

I told my boss and that was it.'

Braithwaite - But isn't he in a sense innocent if he does report it to the boss and the boss says to shut up about it. Isn't the boss, the person it was reported to guilty? Should not that person be the culpable one?

Kline - Well the boss has a much greater burden to bear and I guess if this was a chap's first six months on the job we might forgive him but the point is there is a question of policy. This is struck home to each auditor that it is part of his or her job. We enforce it as best we can and we would expect him to comply with that.

Hall - I thought I heard you say that that audit function almost has a direct line through to God anyway, so that if there is an attempt to block along the line it would seem to be negated by the mandate of the audit people to go right through this system.

Kline - Yes, you have two lines - the preferred line of course is up through line management. The secondary safety valve is through the audit staff. But we are also making clear that an audit manager would not have the right to stop something that some of his people might believe should go up to the Board Audit Committee. We do not anticipate this ever needing to happen, but the line and the channels are there and that is the best the company can do.

Adam - You would not expect to see the sanction there would you in an internal control mechanism situation like that, where the interests of all people involved are relatively parallel?

Braithwaite - I guess what is implied in that is that the sanction would be loss of status and all the other things within the organisation that go with not following the corporation's standard.

Adam - Yes, its the same thing as a member of a family stepping out of line and being ostracised for a while, not a direct sanction.

Kline - Well I would not say that - I think it would be a pretty direct sanction in which people know what they are supposed to do.

Adam - Sometimes the sanction would be being sacked and other times he would not get promotion quite so quickly or be pushed around to Central Australia or something.

Kline - All I can say is that if I were one of these young guys and I did not report it and later it was found out, I would not stick around the Company because I would not have very much of a future. If they did not fire me I would do it myself.

Braithwaite - Could I follow up with another question - the obligation to report (a) through the line channel and (b) if that breaks down, through the freer channel to God. Is that an obligation for a written report or would a verbal report be adequate?

Kline - A written report is required for ethics violations. Say an employee disobeyed the law and bribed somebody and an auditor knew about it. The Company policy is that a written report must go up through to the Board Audit Committee. If the auditor's boss said, 'Forget about that we are not going to send one,' the auditor knows that his job is to say - 'I'm sorry but I am going to see your boss because a report has to go. I do not think this is being properly handled.'

Clifford - And he would presumably want to have that recorded somewhere, clearly because he would afterwards want to show that he did not .....

Kline - We do not insist that he write a letter: that is not specified. The point is that he goes up through the channels.

Brimacombe - Do you have a basic environment in your Company that allows this - as an example we have what has been called 'The Open Door Policy' which means that anybody can come in who feels they have been done in or they see

something that is wrong. They can write to the chairman and there are no recriminations and the thing gets investigated and blows over. Now if you have that environment and it is easier for an audit to follow through that (There are some multinationals where if you go to your manager's manager you might as well just cut your throat and disappear) so I am assuming that Esso has that open environment that allows the auditors not to be different from the other fellows, not the ones who are spying and doing that sort of thing but who in an open environment and for the good of the Company know that there is not going to be recriminations if they blow the whistle, that that is their job.

Kline - Yes, but the auditor is different from others in one respect and that is on certain types of matters, mainly important matters, where he feels that the company has disobeyed the law, or if it is an important control point even, if he thinks it is not handled he not only has the right but the obligation to report up the line. He can make a mistake and people are going to say, 'Well O.K., he made a mistake.' But it was his judgement and he carried out what he was supposed to do. A typical employee who is not an auditor may not feel that obligation. A typical employee may say, well I have done what I could do. Maybe I will go home and write a letter to the boss and not sign my name or whatever. So I think the obligation, the responsibility, is a little different. We are making a lot of a very important point, but it is a point which to my knowledge has never had to be used because when we have had a problem the reports have gone up and they are pretty openly handled.

Cotterill - But if the law is broken you are saying that the point does not arise because people will go up with that report and it is openly handled - good.

Kline - Much to the consternation, I guess, of some employees perhaps who would say, 'Surely the Company does not want me to put this in writing'; and the answer is 'yes'. We want it to be put in writing, exactly what happened, and we will send it right up to New York to the Board Audit Committee. There is no other way that we know that we can get the message across that we are very very serious about this.

Braithwaite - Could I interrupt about a problem with this writing of things down question. I have been doing some work on regulation of the pharmaceutical industry and there were a couple of crises in the pharmaceutical industry that involved fraudulent practices with the safety testing of new drugs. Running the drug on 100 rats or 100 monkeys, and a monkey would get sick and would be thrown out of the trial and replaced with a healthy monkey. Obviously a fairly serious business. Now, the upshot of that was that the Food and Drug Administration of the United States introduced a new set of regulations, understandably in this case; and the regulations required that each contract laboratory should have an audit function and that a report be written about compliance with regulations within the laboratory. That report would then go to top executives of the pharmaceutical company concerned. The question was whether that report written by the internal audit group within the laboratory should be available to government inspectors. The industry argument was - no - it should not be available because if an inspector could come in and ask for a copy of the audit report on the extent to which the regulations were being complied with, then that report would become a kind of public relations document and not a tough compliance document which says that there are certain problems which must be rectified. The United States government was persuaded by this and said that the compliance audits could be confidential Company documents. The government accepted the argument that there would be more effective self-regulation if they could not see such documents. Now, I wonder how that whole problem translates here? I mean are there disincentives in a company like Exxon

that is subject to so much outside public scrutiny for writing it down? Is there a worry in requiring people who see problems to write them down?

Kline - You are asking for an opinion now, and I will give you my personal opinion on that. I think turning over audit reports to outsiders is very dangerous because I think it will eventually result in an ineffective internal audit group. Contrary to popular belief, auditors are humans and they think they are doing the best for the company even if they do not have a very popular job. But if they see that not only do they have to do an unpopular job, but their reports are published and used against the company - nobody is going to want to do that.

Clifford - That is a very important part of that form of internal control.

Hall - If you create this internal voluntary audit system, then you are doing it for a variety of reasons. One is corporate responsibilities under normal management, prudence and responsibility. If you have to mend a fence you are doing it because you are expecting there is a need to do it. There is a risk that you are going to uncover something but that does not mean that it is consistent with corporate objectives to be doing something wrong. It is something that is just part of human nature that there will be an odd bad apple in the barrel, but if you find something wrong, surely you are entitled to mend your own fence internally without making this public? It is not a variation from the prime corporate objectives which can be clearly published - and can be legitimately expected to be observed by a majority of the employees and the management.

Cotterill - I would be quite terrified of a situation where a safety requirement was not being met and that the man who found that that safety requirement was not being met, was forced by company

policy to put that in writing through various channels, until it reached somebody who was likely to cause him trouble or his boss trouble because it was not being met. I would be much happier with a situation where that individual knew that morally it was incorrect and therefore got it changed quickly and promptly so no-one got into trouble and followed it up to see that it was changed and if his boss did not do anything about it, then sure, go ahead. We have one regulation in our organisation where the Finance Director of my organisation has direct access to the Finance Director in London, at the Head office, and he is expected to tell him not only if I am falsifying the figures, but if some perhaps unpalatable contracts may be around that we are not fully disclosing. The Finance Director here would get no relief if he did not do that simply because the boss said - 'do not worry about that, it will be alright' - but to put it on an absolutely formal line in writing would be very dangerous.

Clifford - This is a very important point, because this is the difference between the legislation and its enforcement. Let us take an example - if the legislation is such that there has to be a prosecution whenever the law is broken, then the very fact that you keep a document within the company that is not disclosed but the document is there and records what amounts to an infringement, could raise all sorts of questions like - compounding the offence in various ways - so there has to be a very clear understanding that when any legislation is made, the legislation is intended to apply in principle rather than in detail to every individual case. Now this flexibility in law is what we do not usually have and this is very clearly one of our real problems. Stealing is against the law, but if we start now applying the detailed legal definition of stealing to everything that happens, none of us could ever function. We would need a larger police force and we would have to question every act. Therefore, what we are really talking about here is the need for recognising that whatever legislation government decides to enact it must leave a certain area

of discretion for internal reports which may in fact reveal, technically an offence but which should not be prosecuted automatically, simply because this would create an intolerable situation all round; because you want to know that something has gone wrong, and to put it right; and if you are already doing that, you do not want outsiders coming in to insist that you prosecute because technically you have a breach of something which has been regulated against.

Duprey - Sure, that is right in general principle but like all things, there are exceptions. The exception that applies to our Company, and I'm sure equally to BP and Esso, is that if, for example, something happens in one of our terminals and we release some hydrocarbons into the Yarra River and somebody on our staff finds out about it, we will immediately tell the regulatory authorities. If somebody steals from the Company and we find out about it, we have a company policy that provides for a lower limit, which is currently something like $2000. With anything over $2000 stolen it is mandatory to report it to the police. Anything under $2000 it is a matter of discretion whether it should be reported or not. The reason for that is that we find the police are not terribly interested in chasing anything under $2000, so that there are exceptions to the rule.

Clifford - In fact the real exceptions come in terms of strict liability where you have a Company held responsible for something which caused or could have caused somebody's death or injury. Here there is usually a strict liability.

Duprey - Injury statistics are another case in point where there are no Brownie points for any supervisor who does not report an accident. Reporting a hazard is a totally different thing but once an accident happens it has to be reported.

Braithwaite - Let us make my original question specific. Let us say a financial auditor discovered a practice that he or she thought might be

a violation of the Trade Practices Act and reported that in writing. What is the corporate concern about the access of the Trade Practices Commission to that written report?

Kline - This is a good point and a particularly delicate one I think. When an auditor reaches a situation where he needs to question whether we have violated antitrust laws, then he needs to go to the Law Department in order to ascertain that. Most of our auditors are not lawyers and they are not qualified to find out whether we have committed a violation. When he does contact the Law Department, he makes a record of the fact that this was turned over to the Law Department and he sends word up through audit channels to New York that he has turned over a situation to the Law Department. The Law Department then sends up through the Law Department channels the fact that they are handling the situation, so the New York Law Department knows that it is not being covered up down in the individual territory sompelace. Anything having to do with antitrust is both a complicated and very delicate matter so we make sure it is carried up through the Law Department. We do not let an auditor walk out on a limb and carry something all the way to the Board Audit Committee and then the lawyers shrug their shoulders and say that is not an antitrust violation at all. That is the way we handle things when we are not sure it is a law violation.

Clifford - We have some problems with this question of discretion because our legal system does not allow as much discretion as would say the Continental style of Civil Law. If you have a Civil Law system as in Holland I suppose, certainly Japan and some other countries, then any violation would be a matter for the public prosecutor. The public prosecutor has very wide discretion and he can of course call you and other people together and say, 'What went on' and you tell your story and he says, 'O.K., fix it up and we won't prosecute'. Unfortunately in our Anglo-Saxon system it does not operate in quite that way, we have trouble trying to get this sort of discretion

operating and we are very concerned at the moment about the way in which it does operate because it means that there is not enough discretion to deal with things, to settle them when you can. So it may well be that what we are talking about here is not only discretion within the Company, but discretion within the government in terms of what action is taken. Sufficient discretion at the present moment does not exist.

Cotterill - In the tax area that discretion certainly exists.

Clifford - That is right. That is one area where the Commissioner can at last make his own assessment of what should happen, but even then it is certainly hedged about in such a way that he does not have too much discretion. He can do what he wants, given everything else is in order, but he is certainly tied very much to the legislation until he comes to the top and is determining the total amount. That is when he has discretion but generally our system is too rigid at the moment to allow for the kind of situation where you can get self-regulation pretty quickly; yet you are likely to be more effective doing that than by any legal prosecution.

Hall - I am a bit concerned in the actual way in which Ted's scheme works and he probably would be able to clarify it quickly. My assumption is that the auditor who has discovered such an error and done the appropriate things has informed the line manager of what he has discovered. Is that inherent in your .....

Kline - Yes, the first thing he does is that, and he would depend upon line management to send a report up through the line and ideally that is what happens. In fact every time that is what happens. The region general auditor must concur with the report in that he must agree that that report tells all the pertinent facts about what is occurring, or else he must send in his own report giving these facts.

Hall - We have a very similar system. But there is an opportunity for the line General Manager to act, to correct the problem. If, for example, the Finance Director feels that he has been overruled and that he has laid it on the line and the General Manager is not going to do anything about it. He says:'How am I going to live with that, and I tell you that I am going to report it further up.' But he has the option of living with it except under certain circumstances which are like antitrust or other situations. But it just seems to me that you have - its like the system we have for allowing people to complain - we say, you can write to the Chairman of the Board if you like, Miss Typist. She does from time to time, but that is a reflection on the company not being able to fix it. We suggest: why not try further up the management line or the personnel manager, or director of personnel, rather than go straight to the Chairman of the Board. Let him fix it. If he does not fix it, then exercise your other right, but this one seemed to me to be automatically going beyond the General Manager when the situation could have been fixed.

Kline - That is why I call it a safety valve. What the Company is really saying is, they would expect line management to have the primary responsibility to enforce policies and report violations. But there is another side channel that every auditor has too, and that is what we call a safety valve.

Clifford - Could I ask Fred if that pattern works. You have a very clear distinction drawn on your ethics policy as well as your Company instructions. Do you have the same thing in I.B.M.?

Hall - Absolutely, we even have three. We have basic principles and practices by which the Company has operated, is operating and will operate forever more. You teach them to every management class, from beginning to end. Any breaches are dealt with firmly. The second part is the written instructions, the rules. The

third part is business ethics and practices which is an entirely different thing altogether, which spells out our attitudes towards doing business and every salesman who deals with a customer and every manager signs that annually on pain that if he breaches it he gets severely disciplined or fired, so it is a three way track that follows with a normal sort of internal audit, external audit and business controls that are applying. All three however are interdependent to achieve the desired result.

Kline - Perhaps I could continue my comments here. Next I would like to look at our Conflict of Interest Policy designed to protect the Company from an employee's action to benefit himself at the risk of harming the Company interests. We have a general policy statement and also a list of specific situations which employees are cautioned to avoid. The general Statement reads:

> 'The Policy of the Company with respect to conflicts of interest requires that Directors and employees avoid any conflict between their own interests and the interests of the Company in dealing with suppliers, customers and all other organisations and individuals doing or seeking to do business with the Company or any affiliate. Moreoever policy requires that all such persons should avoid any conflict between their own interests and interests of the company in the conduct of their personal affairs including transactions in securities of any affiliate or of any unaffiliated corporation having a business relationship with Company interests, performing work for others on the company's time, using Company resources or materials for outside work or doing business for or for the benefit of a competitor'.

Then there are some other specific examples which are considered to be in conflict with the company's interest unless the employee has written consent of management. These include:

(a) An employee or close relative having an interest in any organisation which has business dealings with the Company, when there is an opportunity for preferential treatment unless such an interest comprises securities in widely held corporations.

(b) An employee or close relative buying, selling or leasing any kind of property, facilities or equipment from or to the company;

(c) An employee or close relative acquiring or holding oil, gas or mineral exploration or production Titles or royalty interests;

(d) An employee without proper authority giving data or information of a confiential nature concerning the Company to outsiders: and

(e) An employee or close relative accepting commissions, gifts, loans, services or any advantage of more than a nominal value from any organisation, firm or individual doing or seeking to do business with the Company.

This policy is widely disseminated amongst employees and in addition, all employees in what we believe are sensitive positions are required to affirm in writing once a year that they have complied with this policy.

Finally, I would like to turn to Exxon's Business Ethics Policy which has been adopted by all Exxon's Affiliates to ensure lawful and ethical conduct on the part of employees when acting on behalf of the Company. The Policy statement goes beyond a routine requirement to obey the law. For example, the statement reads in part:

> 'An overly ambitious employee might have the mistaken idea that we do not care how results are obtained as long as he gets results. He might think it

best not to tell higher management all that he is management all that he is doing, not to record all transactions accurately in his books and records, and to deceive the Company's internal and external auditors. He would be wrong on all counts. We do care how we get results. We expect compliance with our standard of integrity throughout the organisation. We will not tolerate an employee who achieves results at the cost of violation of laws or unscrupulous dealing. By the same token, we will support and we expect you to support an employee who passes up an opportunity or advantage which can only be secured at the sacrifice of principle. Equally important, we expect candour from managers at all levels and compliance with accounting rules and controls. It has been and continues to be Esso's policy that all transactions shall be accurately reflected in its books and records. This of course means that falsification of its books and records and any off-the-record bank accounts are strictly prohibited.'

My former boss who was a former controller of Exxon Corporation said if you can't book it right you probably should not be doing it. This policy is distributed annually to all Esso employees. In addition all Exxon affiliates have adopted what we call a Business Ethics Policy Compliance Programme. The Compliance Programme in brief includes provisions for -

Brimacombe - Could I interrupt - when you said all employees then, you do not mean that -

Kline - Literally all employees. In the case of management employees it would be mailed to their home. In the case of say truck drivers at the terminal, it would be on the bulletin board and in some cases it would go to their home too, but for all employees once a year this is put up either on bulletin boards and literally sent to the homes.

Duprey - We send them individually to every employee.

Brimacombe - Similarly.

Kline - The purpose of that is that there is no employee who could shrug his shoulders afterwards and say, 'I did not really know you didn't want me to do that.' To continue, Exxon's Compliance Program includes provisions for:

1. Identification and reporting to Exxon Headquarters in New York all violations and probable violations of the Business Ethics Policy.

2. Conducting periodic reviews of all business practices to assure compliance with the policy.

3. Attempting to persuade Companies in which Exxon has a minority interest to adopt similar policies and similar compliance programs.

And I must say that we have had virtually no trouble in this area, certainly in my experience, and we operate in a lot of countries with a lot of different companies;

4. Informing individuals and firms providing services under contract to Exxon affiliates in contract provisions or otherwise, that all final settlements and billings rendered to Exxon affiliates properly reflect the facts about all transactions handled for the account of the affiliate. In addition these contractors are informed formally that they are not authorised to take any action on behalf of Exxon affiliates which would violate applicable laws.

Just an aside here, you see running through here perhaps what you might consider to be an overemphasis on book-keeping. The reason for that is in our judgement (and the SEC in the United States has found this) that the things that are done improperly almost always

invariably will be book improperly. If you can emphasise and speak particularly to the people who do the controllers work in the book-keeping and also make it clear to all employees we are going to book everything right and book everything for exactly what it is, then that in itself is tremendous evidence that the company means exactly what it says.

5. Preparation by the Chief Executive of each affiliate of an annual statement evaluating the effectiveness of the compliance program and confirming that all violations in his organisation which came to light in the past year, if any, have been recorded. And finally, the compliance program includes a statement which says that the controllers department will provide staff assistance to management regarding this compliance program but implementation of the programme is the responsibility of line management.

In summary then, Esso is a large world-wide organisation which operates essentially under a decentralised system of management. However policy making is centralised and there is a large body of formal policies relating to the systems of management control. Specific internal control procedures are described in a formal internal control Manual which is used as a guide by all affiliates. A professional world-wide internal audit staff appraises controls including compliance with the internal control Manual and also checks on conformity with company policies. Of particular interest is the Company's policy on Business Ethics, violations of which must be reported to the Corporation's Audit Committee in New York.

A final word on this last item. Ethical conduct and high credibility with government and with those with whom we do business is in our own interest you might say, and that would certainly be correct. A large multinational oil company most assuredly is subjected to more than the usual amount of criticism for even the smallest transgressions and Esso Australia has too

much to lose to try unethical actions or actions against the interests of Australia. But just as important is the fact for us, as I am sure with you, such conduct is the way we want to behave, and it makes coming to work in the morning a lot more fun.

Clifford - Thank you very much.

Hall - I have concern which stems from the fact that you, like we, are an American multinational. Therefore the mores and ethics tend to be those based on essentially what the Americans believe. Our parent is registered there, but the laws in many countries are quite different. There is a lot of room for manoeuvre. Now your company can establish its own ethics and stay that way but your competitors who are on the local track, may be quite satisfied that their ethics are in line with the ethics of that particular country and that they are behaving quite properly in accordance with local customs, and yet they may be carrying out things that are to your disadvantage. I spent a number of years with the International Chamber of Commerce as National Chairman and I worked hard on many of the guidelines for transnational corporations. That is a thankless task, because you compromise in the end. You come down to something that is not definitive and not workable and not specific because of the variety and totality of interests you must recognise. Whereas within a company, you can self-regulate specifically, but Esso must run into some problems - not as many as others because most of its competitors happen to come from the same place as you come from. Therefore essentially, you are dealing with competitors who have come from the same environment of law and morals and ethics etc. But where you are dealing with competitors who are based in different places, who have different cultures and different ethics and different approaches then you have a problem, at least, I see a problem and I do not know how you can be expected to self-regulate yourself out of existence.

Clifford - Would that be only a problem for the transnationals?

General agreement - yes.

Adam - That would not be a problem for you operating in Australia though would it?

Hall - Yes, it can be a problem. We compete not only with American-based companies but with local companies and companies based in Europe and Japan, in countries where customs and attitudes vary considerably on what we consider fundamental issues like taxation, employee personnel policies, political involvement, etc. We see it right now when our key employees are being approached with employment offers based on contract services and other packages having significant taxation implications which we feel we cannot live with but which appear to be within the law here.

Kline - I agree it's a problem. I think it has some very frustrating aspects, but I also think it has some optimistic aspects. There are employees that I have personally talked with, old hands in the company who have said in the past 'there is no way you can operate in .....' and they will name some country. But by God we have done it. I guess one example I can talk about because it has been widely publicised. Our Company had a really terrible experience in Italy. We fired the Manager out there and there was a great deal of difficulty. We fired him long before any of the SEC or Congressional investigations in the U.S. and cleaned up the mess ourselves but it was still dragged out years later for political purposes. But people who had lived in Italy, done business in Italy, said there is no way any major company or even a minor company could do business without making political contributions. We made our last one in 1971 and we have not given a penny since then and we have done business and are in about the same situation as we were in before that time. The fact is that it has been very difficult for those who have been on the spot, but they have done it.

Duprey - We withdrew from Italy as did BP but our Chairman went on record, as saying, its not bribery, its extortion.

Hall - But you can get into trouble. I understand what you are saying and we had a very similar situation. Our Chairman got up and said - we are not making political donations to anyone in the world - I have got to tell you, we subsequently found a case where we had. And then he had to confess; and it so happened that in Canada it is legal to give money to a party and perfectly acceptable under the law and Canadian management thought they were abiding by it. There was nothing remarkable about it locally so it just slipped through the cracks. Canadian management was acting within the law and the custom of Canada, but again that is a prize example of that sort of thing. I think what we are trying to do or talk about today is essentially what we all would like to see in an ideal world, but it is getting to it which is the problem.

Clifford - But is it true then that, as a result of what we have just heard, as you move out of the countries where you can not operate the problems of that country become known and a moral climate of opinion develops? Is there in fact a climate of ethical behaviour beginning to develop slowly across the world, fostered by transnationals which whilst operating on one kind of pattern which comes from one country, they are beginning to apply this to other countries? Is an international ethic being developed even where the cultures are different, so that even in Japan they are now beginning to worry about previously accepted traditional behaviour - about how many gifts are being given and how much the business parties cost and so on? Is it true that what we are getting here is an international climate and to what extent does the U.N. Centre on Transnational Corporations contribute to that? Do you know what they are doing? As I understand it they are trying to get some kind of ethical level of business behaviour across the world. Of course it is difficult to distinguish between payments which are corrupt and traditional. Even in the new American law against corrupt hand-outs I think the hand-out to get freight off the docks is still permitted. I think that is one

of the things they make a distinction about.

Clifford - There are some things. I remember going through this when it was enacted and there are somethings that are legal and some things that are not. They do acknowledge that there are certain things which are necessary to get the wheels moving and so on.

Kline - With our Company it is strictly 'If a reputable lawyer will not say that it is lawful, forget it.' You are not going to be able to do it in a given country.

Hall - Well there are problems here for the fellows to install your phones here in Australia. If you want your phones installed, they will install them at the week-end on overtime. We can not do it so we do not get our phones installed. That is a Government instrumentality.

Cotterill - I can not get in and out of Nigeria without paying the man at the desk some money. But you would withdraw from any country where the clerks at the airport were going to be a damned nuisance and steal your clothes if you did not dash them something?

Hall - No, I do not think that is quite the issue. The issue is that you may do it and declare it openly and describe it, but that immediately gets you into trouble. If you want to go into Nigeria, that is the way you get in but you can decide - I do not think that a major multinational who was operating there would get out for that reason, but it would say to the Government 'This is what I am paying'. It would declare its hand. It would do nothing underhand and allow it to continue. We had that situation in another country and we declared. It did not do us any good either with the people or with the national Government so in the end we withdrew; but we were open and honest about it. I think that is the thing. The problem is that if you do not do this, if you do not do what we are talking about here, you are going to get into the state you are in the United States of America. The compliance with the Equal Rights Act in the United States is costing an incredible amount of money, an incredible

amount of manpower within all companies. We have hundreds of Compliance Officers, that is what they are called within the Company, who are keeping the records of which members of minority groups are employed, what they are doing. Whether they are promoted? How are they paid relative to the rest? They are re-audited and inspected every three months. Now if you want to get to that stage, because if you are a good company and you are doing everything that is right and you are encouraging and engaging in the spirit of the thing, you will quickly get caught up in the net if someone does not (do the right thing). If you go to compulsory compliance, I do not think that business can afford it. There was a roundtable conference in the United States, and I know that Exxon was involved and our Chairman was involved and the cost for four government agencies was investigated; it was in the billions of dollars just to comply with the regulations. This was brought upon them because they did not have self-regulation, ethics in sufficient strength to avoid overregulation.

Clifford - To confirm that there has been an estimate of decreasing productivity in the United States which has come up with the idea that a certain proportion of the reduction in productivity can be traced to the resources diverted to satisfy regulation. They are spending so much time on the compliance regulations and trying to make sure that they have good protective internal systems to cover this that bureaucracies grow on both sides unproductively. The companies and the government are deeply involved. But is there anything in what we are now saying which does not apply to any of the companies that we have round the table? Does anything seem foreign to anybody?

Cotterill - I do not know off hand any country in which we do not do business apart from Israel.

Adam - The whole formalising of self regulation is very very new as far as we are concerned and I am sure it has only been adopted

because of recent history in the United States and the feeling that spread abroad, to some extent by new employees, that it is desirable to do this sort of thing so that you can show that its part of your company policy if you get attacked. Therefore it is written down and spelt out in great detail. The fact that you do adopt it as company policy and you do adopt fairly precise regulations is not a great change other than writing it down, what any good company has been practising all along. Our company has a history of looking far enough ahead to realise that they have to live with the world and they have to be allowed to live by the world and therefore they have to act in a way which would be considered to be acceptable to the community as a whole, so that as far as we are concerned our writing down of our standards of ethics, rules and regulations is a very recent thing and I suppose that one of the reasons for this is that we have operated almost entirely in Australia. We have never operated in America. We have not got caught up with the people who accuse you of all sorts of irritating things so to that extent it is all new and I wonder really whether it - how necessary it is, or where it gets you in the Australian climate. It is a response to regulations in a way rather than an alternative to regulations.

Duprey - No. I would not agree with that. Though I think that what you say is obviously partly right.

Cotterill - When did you start doing it?

Kline - When you say it is a response to regulation, I do not know whether you are talking about what has historically happened or what is desirable. I will give you my opinion, and that is, although I am extremely critical of many of the regulations in the United States because governments always overreact and overregulate, there were enough incidents that came to light in the United States that business ethics became a political issue. If I were in a country where it was not a political issue and I worked for a large company I would do my best to see that it did not become a political issue and that is why I

think self-regulation would be a very healthy thing in terms of keeping a major scandal or a political issue from arising.

Adam - I am not suggesting that a big company that looks to the long-term and accepts high moral standards is merely responding to regulation. What I am suggesting, rather, is that the detailed writing of it down and the detailed steps through which you go in order to make certain that you both are, and are seen to be, complying with your internal regulations is to some extent an unnecessary formulation of principles already accepted for the sake of avoiding criticism or charges.

Kline - I think our formalized procedures grew along with the regulation probably.

Hall - Would you agree that the sheer discipline of saying what you will or will not do, how you will or will not operate, is a useful exercise in itself, in that, in doing so, you bring in the question of examining everything that you practice. These things are good in themselves in that once you decide on a self-regulatory practice then you have examined it as a company wanting to stay in business and decided, that's the way you want to operate, and having put it down, there is a discipline there that says - if you want to deviate from that, you have to go back to ours again.

Duprey - I agree with that, there are a number of other factors that come into it too. There is a simple administrative factor with any organisation. Taking ours, we have 5000 employees roughly in Australia, and you get a turnover factor that is perhaps 20 per cent per year. Now it is impossible to indoctrinate those people without having some documentary statement of what the company's philosophies and aims are. Therefore it serves a purpose from the point of view of inducting new employees and giving them something that they can fall back on and helping comparatively new supervisors because it is possible for people to grow up through the organisation and become supervisors without ever really having thought about this type of

control before they become supervisors: yet it is part of their duty to care as supervisors. Equally in our case, our statement of philosophies and aims in Australia was prepared by the staff as a co-operative venture and it is reviewed by a whole series of sub-groups in the staff, from various levels on a two yearly basis where everyone looks at it, subscribes to it, decides whether it needs to be changed because the environment has changed, needs to be added to or detracted from, so it gains acceptance because of the way in which it was put together.

Adam - I must say that our experience is somewhat different. When we did introduce this, I am not certain when it was, last year sometime, it was something of a yawn. I do not think it made any difference or was considered terribly significant by anybody when it occurred.

Duprey - I do not want to leave the impression that the Shell staff went out and threw parties. The thing is that you have to try to bring it to their attention.

Cotterill - Our experience would be different again in that we have not done that. It sounds terribly pretentious, but I just would not expect anybody who reports to me to do anything that is illegal, and I would expect that with those who direct their reports to him, for him not to allow them to do it, and straight on down the organisation. I have never sent a letter out to anybody which said, 'I expect you to act in accordance with the law.' They just do.

Adam - We took the same view when we were introducing it. We were hesitant as to whether we would insult the staff by introducing a policy statement which implied that they might have acted otherwise .....

Cotterill - Say to one of my Divisional Managing Directors: 'Do not bribe'. I just would not do it. Say to one of them, 'Do not infringe the Trade Practices Act, and sign every twelve months.'

Duprey - I have news for you chum. You are vulnerable!

Hall - Do your fellows know what is in the Trade Practices Act?

Cotterill - Well his terms and conditions that he signs on appointment certainly under a great list say that.

Adam - You certainly circulate them with what the implications of the Trade Practices Act are, but to go to the next stage and say: 'And you are not intended to breach it.'

Cotterill - And annually you will sign a piece of paper that says, 'I have not breached it.'

Hall - The piece of paper we have says: 'I understand what the general purposes and directions and guidance is and I understand that if I knowingly go out and do something stupid that I can get fired.' - just to bring it to his attention. Let us take one that we have - purchasing. We have very strong rules about purchasing. You can not go out and buy from your brother. You cannot keep the same supplier year in and year out without ocasionally going out to tender and seeing whether you have been done in the eye. There are certain rules. Without those rules, some of those practices will go on year in and year out, just by virtue of the fact that the quality of the goods is fine and so I pay a little extra. This sort of forces the employee to examine whether he is doing the right thing by the company, and again, is he doing the right thing in terms of other people in the market place who have a similar product and want to sell it?

Cotterill - I would expect the man above him to periodically say: 'Have we checked on the competitive position for cars or some other product?'

Hall - I understand that, but if you are in a delegatory .....

Duprey - Do not get the impression that just because these statements go out that they are a substitute for supervisory action. But the reality is that the number of people that you have working for

you in a large organisation inevitably represent a cross-section of the community and in any cross-section there are good people and bad people. There are misguided people and well guided people. There are people who will do things believing that it is in your best interests when in fact it is not. It is to protect yourself from that sort of thing that you take the trouble of making certain that they fully understand what your policies are.

Adam - Well purchasing procedures of course are standard things that would always be set down in a way that you would automatically not act wrongly if you comply with the procedures.

Kline - In terms of ethics, when we first put the policy out and publicised it, we had had it for years but it had been there as an unspoken rule, or it was taken for granted, and I am sure a lot of people said, 'What is this? What is going on?' So our Chairman put a covering letter on it saying that this had been our policy for years and we wanted to make sure that we reiterated it and assured people world wide that this was our policy because of recent events and so on and now it is an accepted thing: people accept it. In fact I think, if anything, they are pleased about it. The same thing happened with contractors or people we were in business with. We would go in where we owned 20 per cent of a company and our representative there was perhaps a little embarrassed the first time he walked in and said: 'Our Company has a policy like this and can I interest you in taking a look at it? See if you want to adopt it.' When it has been well handled, we have had no problems at all that I know of. Now if he walked in and said, 'From now on we are going to need to have an Ethics Policy' in an accusatory tone, that would be an inappropriate way to handle anything like that.

Hall - That is a curly one if you have a 50-50 venture with another company .....

Cotterill - We do not find that particularly difficult; we do not find anything curly in that at all. We have a simple rule which everybody knows

and understands that says, if it is a company in which our own organisation has a substantial interest, then if the product that is offered is not meeting specifications or the delivery is competitive then go where you like. If it meets the specification and if it is competitive from the delivery point of view, then you should give that company which is within our own organisation a chance to meet the price. I can not see any problem on that. I can not see that any immorality or any illegality will come from that.

Hall - I agree with that. I am not suggesting otherwise - I am saying that I think that while we can be self-regulatory in whatever style we like, whether it is your free style that says, 'I behave well and I expect that everyone is going to follow my example, and that is the way it is in our company,' that is fine, but I worry about the fact that there will be bad apples and unfortunately where there is a bad apple or something breached its a knee-jerk reaction for people to say - let us regulate. I have seen it in my company, someone does something stupid, so what do they do, they take away the authority from all the managers to do that and bring it back about two levels - absolutely stupid.

Cotterill - That is exactly what happens.

Clifford - We have been talking about self-regulation in what amounts to one organisation. But you Fred raised the question of other companies and the competition would be there. How does one deal with this within an industry? It seems to me thatthere could be in fact the possibility of self-regulation within very large transnational corporations or larger corporations that have a fair share of the market and probably do not worry about this. But if such standards are to be applied, what about the small company just coming in at the margin and trying to operate? That is the company I think that you have in mind that would possibly cut the corners and do various other questionable things. Now, how do you make sure that sufficient regulation of the industry prevents that happening?

Hall - I do not quite know. I do know that in the advertising industry they have been successful in my view by a process of sanctions in establishing a reasonable framework of discipline and ethics. They certainly have had an approach which I think has been accepted and agencies that breach it or people who do things wrong know about it, and know what they risk. They risk disclosure and publicity which they would perhaps prefer not to have and that is a sort of a self discipline that is implied. I do not know how you would do it for an industry and yet I suppose it is possible.

Duprey - I have just had experience as President of the Australian Chemical Industry Council which is made up as you well know of a number of very large chemical companies in an industry which includes a multiplicity of small back-yarders, pots and pans type manufacturers. It is extraordinarily difficult to have any of those people accept any of the standards which the large companies take as a matter of course. There are no sanctions that you can impose on them.

Clifford - In that case, we are probably in an area where you might need Government help.

Duprey - There are always these renegades in any industry, even in the oil industry itself. There are a lot of small operators who may cut corners and if they do that then disaster happens. Imagine an LPG tanker with some lack of safety standards because it was operated by a back-yarder and it blows up in a populated area and causes a disaster. What will happen will be that the whole industry will have very rigid regulations on the use of LPG tankers, perhaps no LPG tankers, or something totally inappropriate to the real need of the industry as a whole. But the large companies are hard pressed to do anything about that other than to show a lead.

Braithwaite - Surely they can be thrown out of the association?

Duprey - Then you go right to the top if you like to the Confederation of Australian Industry. As a Board they have put out general policy statements to industry as a whole but you cannot police these things

down the line. You can not invoke any sanctions against individual companies or organisations that do not follow the lead you put out. That does not mean that it is not worthwhile putting it out, of course and one would hope that an awful lot of people take a great deal of interest. But the fellow who is predisposed to cut the corners will do it anyway. Probably feels he has to.

Clifford - And that I think is where we come to the junction between the official regulation and self-regulation because there can be a certain amount of self-regulation but it probably will never get to the person who is just barely in the market and sees himself as needing to get a bigger share and believes he can do it only by cheaper practices or whatever it may be. Probably in that case you have to have some form of regulation; but again government regulations could be easily ineffective unless you have a fairly large enforcement mechanism, and you are back to a questionable bureaucracy which we are really here to avoid. But if in fact there were some other ways in which, through the industry, access to materials and things of that sort could be controlled, then there might be an easier way to do it.

Kline - I do not know how you would do it. I think in furtherance of what Ron is saying that the small guy has two aspects that we do not have. The first is: that contract to him may mean the difference between staying in business or having a good year or a bad year, while we are in a situation where are not goingto live or die on one contract. The second is, even if there were a law, he will probably never get investigated or caught. It is extraordinarily difficult to police small businesses and politically there is no real gain to be obtained by exposing some small businessman respected in the community and competing with the so-called oil giants or with the so-called computer giants. Whereas anybody that can expose something as to what Shell does, BP, Esso; there is some real political gain in that. Many people seem anxious to believe the worst about multinational companies.

Adam - What you said in the paper about the cost-effectiveness of regulations seemed to me important. I guess nobody tends to object too much to regulations which only lay down the standards that should be complied with anyhow. The problem is twofold there.

1. The regulation which you may not comply with, but if you are acting reasonably and sensibly it won't matter whether you do or not, and

2. Where you are burdened with a whole lot of work of collecting information or data in order to establish to some dubious credit with somebody that in all respects and at all times you have complied with something that you would have complied with anyhow.

This big build up of bureaucratic nonsense goes on in order to insure that some members of the industry with different sorts of standards are in fact complying with something that sensible people will believe in, and balancing the danger of their non-compliance with the cost to everybody else and forcing everybody else to comply seems to me to be the difficult problem. You look at this new Companies Bill that you mentioned. One little section which I was looking at the other day, which tightens up the provision for payment of dividends, which is not a very important thing, it means that you have to see in your accounts a profit out of which you can pay the dividends indebted without getting into trouble. The old Act said that you could not pay dividends except out of profit and the old regulation was quite sensible and I do not think there would be many problems arising out of it. But now it means that a company has to play safe. Its got to have its accounts completed and audited and it can not pay a dividend until probably four months after the end of the period in which the profit was made, which is alright for the big companies that have stores of undistributed profits, but not so good for the new fellow who is getting on the way. It screws people up unnecessarily, probably in most cases, 99 per cent of cases, for the sake of covering some possible breach which might get somebody into trouble in .1 per cent of cases. This is the important thing.

Hall - The very nature of the spread to cover all possible loopholes, the definition of 'Executive' in there carries through to the guy down in the store who actually receives something for the company. It is a scary document when you look at it and I am glad it is only an exposure draft.

Clifford - You have all commented on the New Companies Bill - This is the model draft which will be repeated in each State: and everything in that Bill is probably derived from some past sharp practice by one company at one time or another which the Corporate Affairs people have had to chase. Not surprisingly, that Bill happens to be very largely the construct of the Corporate Affairs Commissions, and it has been worked out with accountants. They are very concerned about the way in which accountants have been operating in the past. But I think you will probably find that, as you said, it is somebody right at the periphery of the market or somebody who has just been trying this on - or somebody who has been operating a fly-by-night company coming into operation and going out of operation after amassing funds. Now, the difficulty here of course is that the Corporate Affairs Commissions have always had to act in retrospect. They can not get in. Even though a company may have been set up purely to take money fraudulently from the public. Even though they may know that, Corporate Affairs Commissions can not move until something has happened that gives them the authority to move. In other words they are set up in the normal police, law enforcement manner, and in my view, that has always been wrong, because if you have a Corporate Affairs Commission it should in fact be in a position to see what is going on if they are afraid that there is in fact some fraudulent practice. So now they have drafted this Bill and I think it is an important document which needs all your experience being brought to bear upon it - because, as you say, to simply prevent one infringement by a small organisation, they could in fact make a regulation which would tie up a great deal of business time .....

Adam - This is what the SEC has been doing in the United States in the 'Blue Sky Law' throughout all the States of America, an enormous quantity of work for the sake of the odd little defalcation -

Kline - In fact we were talking before about this so called Foreign Corrupt Practices Act. This is an unbelievable Act. It goes far beyond corruption: In fact only a small piece has to do with foreign bribery. It goes into control systems of the company, foreign and domestic.

Brimacombe - Which in a transnational company goes right down the line. We are affected here as a subsidiary of a British company because it is operating in the United States. So a great new ball game is created with a lot of data that has to be submitted to conform .....

Braithwaite - What other control systems mandated by that Act are irrational?

Kline - There are four criteria and, for example, one is that with reasonable regularity you need to inventory your assets to check them against the books. It is a criminal act if you do not. We had a look and thought: How often do we take physical inventory? I am not against physical inventorys, but I am sorry to say that the U.S. has made it a criminal act for somebody to decide it is not worthwhile to do more than, say, ten every seven years when maybe a jury might decide that he should have done it every five years.

Brimacombe - If I could just use this as an example of our industry. The 44 gallon drum is treated in your accounts as an asset and that is scattered over the whole of Australia, in a multitude of customers hands at any given point of time. It is impossible to ever take a total inventory. Try farm storage tanks. It ends up as being an asset on your balance sheet.

Cotterill - Well you can write them off .....

Kline - Anyway, its called the Foreign Corrupt Practices Act, and nobody wants to be against foreign corrupt practices but the Act went far, far beyond what anybody could construe as a foreign corrupt practice. Nobody really knows what is going to come out of it. It seems very unlikely that anybody is really going to go to gaol because he decided to take inventory every eight years and the jury said they should have taken it every five years. That does not sound like a very criminal act, but no-one really knows.

Braithwaite - I was interested in Mr Adam's comments earlier. Mr Clifford and myself have spoken to a number of Australian companies and we have an impression that the most widespread attitude among indigenous Australian companies is that the very detailed kind of internal compliance system that Mr Kline has described in relation to Esso is not really appropriate for the Australian environment. Self-regulation is said to impose severe costs, just like government regulations. I am trying to represent their views. These are not my views. They say that you really can not write down rules to cover all the circumstances that business confronts. Every situation is different and has unique circumstances and really can not be covered by rules. There are a number of objections that seem to me to be pretty widespread in the Australian business community. Mr Adam was saying that BHP is moving in the direction of the American model in a sense and I thought that there was an implication in what you were saying that this was because BHP was in a sense becoming a multinational itself.

Adam - There is more and more being written about this sort of thing. Practices tend to grow world-wide and when you find yourself involved with other companies that do this sort of thing, you think perhaps shouldn't we too. As far as we are concerned, all we have done is produce this statement of policy which you saw. We have not done anything in the way of setting up a mechanism to deal with breaches as

they come through. Maybe we have not had to. Perhaps there are ways of dealing with it, like the fellow gets sacked. But it is not written down anywhere. When the Trade Practices legislation came in there were a number of lawyers around the countryside in Australia who were saying, well, in America it is customary for companies to issue statements of policy in relation to Trade Practices and Antitrust matters and say thou shalt not do this and thou shalt not do that and thou shalt comply with all the regulations. We advise you to do that because if the Directors are ever charged with breaches of the Trade Practices Act, they can produce this as something that they issue to all senior employees, and therefore the monkey is off their back. I think some of this happened after the GE case in the United States but it has been happening over a time. If you put it cynically, its to get the monkey off the senior fellows back, in many other cases to protect the company itself from the problems and make it certain that everyone does know. These things tend to become worldwide.

Braithwaite - But has BHP's attitude changed since you are important in Indonesia now? Has that attitude changed?

Adam - No. Certainly any areas of concern as to improper payments would be in what little contact we have with those countries, not in Australia.

Hall - I have a question for Ted. You mentioned your Audit Committee and the Directors' audit of non-executive Directors. Do you do that in your subsidiaries? Do you have a Board, and if so, do you have non-executive members, and if so, do they do the job of an Audit Committee?

Kline - We have a local Board, but no, we do not have any outside Directors. We happen to have an Ethics Committee where any incident comes up is reviewed by the Committee, but the answer is no.

Hall - I wondered because we have a local Board and we have non-executive Directors and they have formed themselves into an Audit Committee and they have access to our local Auditors and our Internal Auditors separate from the Board and .....

Kline - Just one comment on that. I do not think that would assist in compliance in our company because our policy is clear and our shareholder has his own Auditors and so I do not think outside Directors would add very much. It may be a good idea but I do not think it would assist in the compliance in our particular case.

Cotterill - My boss is inclined to appoint local Directors in Australia or any other country in the world who keep an eye on my behaviour, the behaviour of other executives, and gives them a useful focal point to discuss what I should be paid or all sorts of other things. I think the outside non-executive Director has a very real role to play in that respect and I think that that is one of the very few checks that we have as a multinational on our subsidiaries elsewhere. Certainly we would not appoint anybody to an overseas Board who we did not believe to be an extremely ethical, moral and usually eminent person in the community. I would think that was a very good method of checking, because he would be far too embarrassed to see anything bad going on anyway. I do not think there would be much chance of putting him in gaol, although if they bring in the new regulations perhaps there will. I am not too sure that it would be wise.

Duprey - We have one external Director and he does sit as a member of our Audit Committee with other members of the Board and direct access to Audit Reports and the Chief Auditors at all times. We do not have the system that you have, reporting any breaches up the line to London, but there are certain specific things that it is mandatory to report. We have enough visits from the Chief Auditor for the world, who comes out here frequently and reviews our audit programme and discusses things with us. Also various other senior executives come in from London so that if anything was going wrong or I suspected the Chairman of fiddling the petty cash the opportunity is there to discuss our problem.

Brimacombe - We haven't had it but we are on the verge of it and while I think we had enough controls prior to it we acted responsibly from the top down. I am almost convinced that it has been brought about by the Foreign Corrupt Practices Act and the SEC regulations as a result of us now being listed on the New York stock exchange.

Hall - The reason I raised the issue is that I have both positions - Executive Director of IBM and I am not on the Audit Committee and non-Executive Director of other companies in which I am on the Audit Committee ..... carefully under the Australian Companies Act, ... the Australian Companies Act because of some experiences in recent years if you are a Director on that then you understand what is going to happen to you, if you do not ask, if you do not get involved and if you do not act in a self-regulatory way because you are the first person exposed and as you say we may not go to gaol, but we know of some who did go to gaol .....

Clifford - It was at one seminar in Sydney a few years ago on Corporate Crime, that one of the judges made the point that as time went on it would be impossible to get outside Directors to serve because of the risk of their being prosecuted for company practices they knew nothing about.

Cotterill - We have a rule from London which says that the auditors themselves must, should conduct an audit that internal instructions are being carried out. This is a useful one as well. Our auditors have picked me up on a couple of quite idiotic things in recent times. But perhaps they did it just to let me know that they did in fact check the memos and the instructions that came out from Sir Arnold that were being followed. I think that auditors could be used in this role rather than just making sure that the books of account were right. There was a little one on credit cards. The Company rule was that it won't pay for membership fees of credit cards. So the $20 per year for American Express can not go through, and I signed somebody's expenses with it on and they did in fact manage to pick it up, which surprised me and certainly made me think about the number of

rules and regulations and whether I was being careful or not in seeing that they were followed. There could be a useful role for auditors there, perhaps more useful than they often perform.

Clifford - Could I get your views on the significance in all this of the accountants. Really behind that Companies Bill and everything else is the problem of accountancy which has become less and less responsive to what is required over time. In other words, the idea of what is a 'true and fair' account, this changed from the time when we could simply say that this was a statement of what the company was doing to a position in which in some cases even the law has said it was sufficient for an accountant simply to say, this is a true and fair statement of the figures that I am looking at - and not to worry about their relationship to company facts. Court decisions have sometimes permitted accountants to certify accounts that were internally consistent as accounts but which may have borne no relation at all to the reality of the operations in the company. You probably know that in the first draft of the Companies Bill they even had a statement about principal company accountants being honest, even now I think they have something about people being honest. They do not define honesty but they have it that people must be honest. How do we see the auditors, not the operations auditors so much as the financial auditors, the accountants. How do we expect their work to be a fair check on what is happening? Is it a system in which you have confidence or have you found over a time that this financial certification is a routine which really does not give much information as to what is happening within the company?

Brimacombe - I think we rely on them a fair bit. We still have auditors but we do not have auditors of the auditors. They reach the end of the line somewhere where you relax.

Clifford - But your auditors would in fact be expected to ensure that any statement of accounts was a fair reflection of what was

happening in the company?

Adam - But they are relying on the systems that are there and the systems being followed. They do not sit over the shoulder of everybody .....

Brimacombe - You are talking about external auditors as distinct from internal auditors. We rely more on the external auditor. He has a statutory role to perform. They have to certify the accounts.

Duprey - We seem to spend most of our time educating the external auditors, with a new team every year to educate. What you have to appreciate I think is that in dealing with companies like ours, because we are a multinational company, because our results are consolidated at London on a quarterly basis and they have to mean the same wherever in the world they come from, we have a highly sophisticated and highly standardised set of accounting rules, regulations, codes and things of this nature. Nevertheless, within all that, there is obviously room for discretion and room for error and we rely on the controller to monitor this and to watch that error does not creep in. He is the final arbiter in the company, I suppose subject to my overruling it if need be on how expenditure will be coded. I am sure that is the same for all the companies around the table.

Kline - I would like to add to that. The way we are organised is that each function - marketing, producing, controllers and so on has his kind of functional counterpart in the United States with which he has a liaison relationship. By far the strongest of these relationships is the Controller. The Controller really has two bosses - his boss here but also the Region Controller and, as Ron said, he is made very much aware of that in any affiliate. He has a dual responsibility and I guess I would differ with you in one respect and that is, I could not override the Controller. He would have the final say. I might call his boss. We might be in Houston, and question him on it. But I could not tell him to book something different than what he feels should be booked.

Duprey - Let us be very clear on this. I must admit that I have never yet overriden him and said, 'We will do this despite your opinion to the contrary'. But there have been numerous occasions when because of the peculiarities of the Shell system of accounting or some new type of transaction has come up, we have differed in our view as to how it should be recorded within the company's instructions, or we simply refer the situation to the controller in London and we say, 'This is what happened. This is the way we think we should handle it, but there is an alternative -which would you like us to take'.

Brimacombe - But to publish your accounts here you would have to at least get your own local external and internal auditors to agree with your reason or accept theirs, otherwise they .....

Kline - No doubt about it, the auditors have a role, but the Controller has a stronger role than auditors have. Auditors are backup but Controllers are part of the main line organisation and that is why, if you recall in our Compliance Program, we say that any questions of interpretation or any staff interpretation for assistance, is the role of the Controller even though line management has primary responsibility for implementation. Notice we say the Controller and not the Law Department, even though this is in part compliance with the law, because the Controller has such a close relationship with the parent company and also because, frankly, he has the responsibility for the way that things are booked. If anybody is going to do anything, sooner or later they are going to have to get it booked, whether they are going to spend any money or receive any money or whatever.

Hall - I see him as being very strong but I see also the design of the system in which he operates as being as big a check as him. The system has sufficient controls and checks and balances across a divisional structure, or however you are structured. We for example, would overrule, may overrule the Controller. In fact that is one of

the things, management line always wins, as strong as the staff is, line always wins but he has a staff man too, and the staff man can then go the VP to whom my chairman reports and say, 'Well, you have overruled the Controller in Australia. That is your perogative. Now I am overruling you because my staff is telling me.' So you have that contention system built right through our management system. The same applies to that. I was delighted to hear that you do not have a series of auditors. We have auditors on auditors on auditors. You have internal, you have local, external, corporate, and corporate external. Now before you can say anything, five auditors have had a look at it. It has got to be clean after that.

Cotterill - It is less likely to be clean.

Duprey - Despite my facetious comments earlier about educating external auditors, which is a fact, because we have to educate our own staff anyway, you probably have just as much staff turnover as we do, we have a very detailed external audit and a very detailed internal audit. But the responsibility for accuracy is not with the auditor, and the systems establishment is not with the auditor. He is the guy who tells you if you are going off the rails.

Cotterill - But you assume you employ auditors who will go through and see that the methods you are using and the systems are sensible and will do statistical checks to see that your records are right. If you do not you should not be paying them their money.

Braithwaite - Why do you say there is a greater chance of there being problems if you have multiple auditors?

Cotterill - Because I think that there will automatically be differences and disagreements between them on methods and interpretation and they will start arguing about those things rather than getting down to the actual meat of it, to the truth. I was particularly interested in the comment you made on 3. Can compliance with codes of conduct be made one of the criteria on which promotion is assessed? I would have thought that anybody

who does not follow your code of conduct is going to go anyway. He is just not going to be there, and that is the most important criterion for the code of conduct surely.

Clifford - Can I tie that up with something else that we have been talking about - the financial controls and so on. One of the very first interviews that we had was with the chief executive of a large Australian company and the stress there was on the person in charge of the operation rather than any outside body. You simply gave the man responsibility to do what he had to do and if he did not do it he was in trouble and it has always seemed to me that you could have two lines of control in any organisation with the government or company or so on. That is, you get the man who is appointed to do the job and there are two ways of handling this; you can either give him the money to get on with what he has to do and then he has to produce the results you want and you keep him responsible the whole time. You know therefore whose head should fall if something goes wrong. On the other hand you have the system that many governments use and that is, to have the man with the responsibility but he does not handle the money and there is the financial controller who has responsibility for the money as it goes down the line. Now if anything does go wrong there is likely to be a conflict between who should be held responsible, the man who handled the money or the person who had to make the decision on the operation? Do we get a dichotomy of liability? We do in government, I know that, but whether this happens in companies I am not sure.

Cotterill - Yes, Ministerial responsibility, the sensible principle to run there - its never happened to me yet -

Kline - I do not see any dichotomy but each has his own responsibility. If the line has responsibility for a budget project of twenty million dollars for example, and know that we are going to overrun by a certain amount, they have to come back and get approval

to spend this overrun amount.

Clifford - This is the point. Suppose he comes back and says: 'I did not have enough money, I want or need some more to do this', and the answer is: 'I am sorry, you were given the cash and you were expected to do it': When something goes wrong, he then says, 'I did say that I did not have enough money to do it properly'. In other words - I did make the point -

Hall - He should not have gone ahead on the basis that he did not have enough money.

Duprey - We all have to go back to our Boards if we do not have enough money.

Kline - My point is not that he would not get the money, but my point is that he could not have continued to draw on money without control because the controller would have to draw him up short and say: 'You have to go back now and have more funds authorised.'

Clifford - I think what my real question was whether he had enough money in the beginning, whether in fact the money that was given to him was appropriate for the job.

Brimacombe - Well, if he was responsible for drawing up the budget, that is up to him. That is his job. If the guy who has to raise the money does not produce it in enough time for him to get on with it, then obviously he can not be held accountable. There is a dual responsibility, but it is easily identifiable. There is no real problem.

Duprey - But equally there can be another problem. If you are talking of the sort of expenditure that we talk of - it can be fifty million dollars for a new plant - then you have an engineering group who would do the estimates for that plant. They may not be under the line manager who is going to run the plant or the line manager who in fact is going to build it. He is entitled to rely on the accuracy of their estimates if that is

the system of the organisation which it happens to be within ours. Now if the overrun in terms of cost was due to lousy performance by the estimators who were not under the line control of the fellow who is suddenly finding that he is over budget then legitimately he has a complaint. He would have to go back to the board to get another allocation of funds. His answer is simple: 'The estimate was so and so. The reality is this.' And then it is the engineering manager who has to get in there and support him or explain why he was wrong in his estimates.

Clifford - Yes, that is the kind of dichotomy I was getting at.

Kline - That is part of what I was talking about when I mentioned segregation of duties too. There is no one group and no one person who has complete knowledge and control over any transaction. It is split up. That does not take away any of line management'sauthority in terms of the directions they want to go, budgets they want to draw up and plans and new businesses, old businesses. But it does mean that when they decide what they are going to do and they get the right authority to do it, that is what they do. They do not go out and do something else.

Clifford - Is there anything we have not covered?

Braithwaite - One thing that I meant to mention in relation to the paper that was sent out to you. Obviously the people who we have here are extraordinarily busy and we would not expect you to have the time to sit down and write detailed criticisms of the paper. But if there were anyone else in your organisation who would be interested or be able to do that, any comments or criticisms on the paper would be appreciated. I just wanted to come back as my last question to Mr Kline, what your reply would be to the comment that we have had from some Australian companies that detailed rules for self-regulation within the corporation are not a sensible innovation in the Australian context, that you cannot write rules for ever changing business

circumstances, because that seems to me to be the most essential issue, the bone of contention.

Kline - Well our Company has worked successfully under that kind of a set-up so I know for us and I believe for others that it can be workable. Whether it is applicable or not, whether it is necessary or not, is a local judgement. I would saythis. I am not foolish enough to think that everything that happens in the United States is going to happen in Australia. But a lot of things that happen in the United States happen before they happen in other places, for reasons that I do not fully understand. But that is the way it seems to be and I would advise people to take a careful look at what has happened to regulation of American business because to the extent that they can learn and avoid some of the pitfalls that American companies have experienced they may be able to avoid the - I won't say disastrous - but certainly very troublesome over-regulation we have there. I would think it would be very much in the interest of Australian business to self-regulate and probably it is not necessary that you get all the little companies involved - I would suspect even getting the major companies to agree on some kind of self-regulatory apparatus would probably be to their own benefit and to the benefit of all business in Australia. The reason I say that is that I think it could go a long way towards avoiding the kind of difficulty that some American companies have encountered. Now I have no reason to believe that the Australian companies are necessarily involved in some of the same things that some American companies were. But on the other hand, I did not think other American companies were either. So, the worst you can say is that if it does not cost you too much, you might do something a little unnecessarily.

Adam - Harking back to what you said, I did not really think it was a great detailed set of regulations you have I mean, you do not set out the 150 commandments. You are talking in fairly general terms about what is good and honest and true and what is not.

Kline - Although the Ethics Policy itself is a one page statement we do have a Compliance Policy which is formalized and somewhat detailed. Although it is not outrageously detailed, it is probably more detailed than a typical company in Australia would think about doing.

Clifford - Well it seems to me that we come back to this real problem that within large companies which have a large share of the market, there is not much difficulty about self-regulation because they are probably doing a large amount of it already and this is part and parcel of the normal operations. There is self-regulation and if not formalised it can be formalised relatively easily. But within an industry we are faced with the fact that we are not going to get too easily the kind of self-regulation which will flow right through all the companies so it is the ones right at the bottom that are really the Government's greatest concern. Of course large companies have been involved in politics and have been accused of large pay-offs in other countries: but if we are concerned with self-regulation here it is the marginal operators who do things that should not be done. That is one problem, how we move from the big companies' internal regulation to industry self-regulation, and that seems to be related to the point you made Fred about the transnational situation that you can do it within an area where there is an understanding of compliance but may have problems in other cultures. It can be a problem when you have to compete with others who will not follow that rule and will take competitive advantage of all the things that you will do to conform. They have an advantage either because they do not need to conform, or because they have no intention of conforming. Then you are in real difficulty. What you are saying about a transnational corporation's problems in different cultures seems to be similar in principle to what can happen in trying to regulate an industry. Whilst it is true that in the one case specific cultural differences would be there, it is also true that the same kind of corner cutting and

sharp practice that there might be at the lower ends of an industry could be equated to some extent to the kind of way in which one would have to compete within different cultures. We therefore have this big problem now both that within the industry and within a transnational's global operations. How do we get to the root of that problem.?

Hall - I think that industries, (where there is an industry association, formed for whatever reasons) will have difficulty, but they can be stimulated in the face of the threat of severe regulation to establish within themselves codes of conduct. Not the force of compliance that a large company would provide, but they can establish some basics that the industry accepts - if you want to belong to the association and you are outside the association you obviously lose some benefits. I do not know what they would be. If you want to belong, then there ought to be some minimum codes of conduct that may not be able to be policed effectively, but are there and that is the first step. But the agonies of getting to that may be considerable. But I do not think you can go from the sophisticated systems that Esso has to assuming that there will be one across an industry without a lot of time and a lot pressures.

Duprey - You can do it by example. You can do it by exhortation. You can do it by education, but you can not do it by compulsion. The guy who wants to cut the corners for what he sees to be good and proper reasons, no matter what you have said in an association circular that sets out standards, he will ignore it.

Brimacombe - You have to do it with the knowledge that you are going to accept something well short of Utopia. The classic example in the oil industry would be the industrial relations, but we keep trying. We keep meeting, we keep talking. Australian Computer Equipment Suppliers expressly left out industrial relations from one of its charters.

Deletion .....

Brimacombe - A lot of them take the alternative of saying 'Yes there are two political parties we give them both so much.'

Clifford - If we can get to a stage where we can bring in the government at the regulatory level lower down where it is going to be more needed that might be the answer. But there would have to be some industrial organisation in each case that would in fact be laying down standards or in fact ensuring as you say that people who did not conform to this kind of standard would have to consider sanctions imposed by the industry and possibly some governmental disadvantages too.

Duprey - Its terribly difficult isn't it. You can have an over-regulation. Where you have the health department or the council saying what is needed before premises are licensed to operate as a restaurant and that is a sanction that is there and it has teeth. But how do you impose a sanction that says that the guy who is buying the bread rolls for that restaurant can not take a bottle of scotch from the bread roll supplier at Christmas time?

Cotterill - You can always have governments who say: 'I won't give you any more orders if you close your plant down.' How about that for a regulation?

Clifford - You could not even give a New York policeman a cup of coffee after the Knapp Commission. He would not accept it because he was so afraid of this act being misinterpreted as corruption. Anyway our time is up and some of you have planes to catch. Thank you very much indeed. It may seem that we are going round in circles but I think each time we meet we ge a little nearer to our objectives - and t we on our side are certainly getting a tremendous amount out of this. We will now share with you whatever we have obtained from this discussion and we will then decide with you what the next step should be.

Braithwaite - Any feed-back would be useful.