Preface

The present volume represents the most recent contribution of the Australian Institute of Criminology to the understanding and control of white-collar crime in Australia. Institute involvement in the study of complex commercial fraud, and of white-collar crime in general, date to its founding nearly two decades ago. Dr Andrew Hopkins, an early Institute staff member currently on the faculty of the Australian National University, wrote landmark studies on what was then the new *Trade Practices Act 1974* (Cwlth) (Hopkins 1978a; 1978b).

Dr Hopkins was followed by Dr John Braithwaite, now also of the Australian National University, who has been instrumental in establishing Australia as one of the world centres for the study of white-collar and corporate crime. Among his contributions while on the staff of the Institute which have received international critical acclaim are *Corporate Crime in the Pharmaceutical Industry* (Braithwaite 1984), *The Impact of Publicity on Corporate Offenders* (Fisse and Braithwaite 1983) and a seminal article on enforced self-regulation published in the *Michigan Law Review* (Braithwaite 1982).

After leaving the Institute, Dr Braithwaite continued to collaborate with our researchers in the study of white-collar crime. Indeed, one of these projects sets the stage for the present volume.

In 1984, Dr Braithwaite and I collaborated in a study of enforcement strategies of Australian business regulatory agencies. Together, we visited every Australian capital city and met with executives of ninety-six different regulatory agencies from the Reserve Bank of Australia to the Chief Inspector of Explosives in Queensland. Our book, *Of Manners Gentle* (Grabosky and Braithwaite 1986) was published jointly by the Institute and Oxford University Press in 1986. My commitment to principles of truth in advertising compel me to disclose that much of the book is now dated. For reasons which will soon become apparent, this is just as well.

Included in our project were those agencies then participating in the cooperative scheme for companies and securities regulation - the state and territory corporate affairs commissions and the National Companies and Securities Commission. Corporate affairs regulation is discussed in Chapter Two of our book.

The picture which we painted of corporate affairs regulation at the time of our fieldwork in 1984 was not one to inspire confidence. Agencies were

hopelessly under-resourced. The backlog of cases awaiting investigation for possible fraud was apparently endless. Responsible ministers resisted requests for additional investigative resources. Political interference was pervasive; ministers were able to quash prosecutions quite readily, and did so. Corporate affairs regulators were told, 'Don't rock the boat'. In the most unusual event that an offender was brought to justice, penalties imposed were tepid, if not derisory. It is no wonder that the sorry state of Australian enterprise which marked the latter years of the 'Decade of Greed' were able to develop.

Fortunately, governments, in their wisdom (if perhaps belatedly) saw fit to replace the inadequate regime of companies and securities regulation which enabled fraud to flourish.

The essays in this volume were originally presented at a conference convened by the Institute in August 1991. One of the objectives of this conference was to describe the new countermeasures which have been mobilised to combat complex commercial fraud in Australia. Representatives of agencies which have been created since Braithwaite and I undertook our research (The Australian Securities Commission, the National Crime Authority, the Commonwealth Director of Public Prosecutions) discuss the directions which they are taking to combat complex commercial fraud. Other papers address such timely topics as penalties appropriate to fraud offenders, and the responsibility of professional advisers for the prevention, detection and rectification of client fraud.

A prominent theme in this collection is the very significant risk that the proliferation of investigative and enforcement agencies across the Australian federal system today might contribute to inefficient and ineffective fraud control.

As the decade of the 1990s began, the image of Australian business in the eyes of international financial institutions and markets was tainted. Australia had become the butt of jokes in international financial circles. The challenge of Australia's economic recovery depends to a significant extent on the ability to dispel that image. I hope that the Australian Institute of Criminology, by publishing this collection of essays, can make a small contribution to this effort.

P N Grabosky
Canberra
December 1991

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Keynote Address*

The Honourable Dean Wells
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* The Attorney-General wishes to acknowledge the very considerable assistance rendered to him in the preparation of this speech by his Private Secretary, Ms Susan Moriarty.

Thank you for the compliment of inviting me to give the keynote address for this conference. It is a sad fact that conferences dealing with complex commercial fraud and other corporate misdemeanours are going to be a fairly regular occurrence for at least the next decade.

Ultimately, however, Australian society will demand that business and political leaders attempt to grapple with the impact of what we now know is a phenomenon unparalleled - fraud on a scale which we have never experienced before; fraud that is both widespread and endemic.

Ironically, given the enormity of our task, solutions and strategies aimed at inhibiting its upsurge cannot be simplistic. Jingoistic rhetoric too, will not suffice. This is not the kind of criminal activity which responds to a call for more police on the beat, or greater police powers.

Unfortunately, the very groups on which we might rely to assist us in our endeavours are themselves caught up in a neat paradox - professional lawyers and accountants are oftentimes, it turns out, the white-collar criminal's fellow collaborator. Without their knowledge of important first principles of law and accounting, furtive criminal enterprise would, to a significant extent, remain merely wishful thinking.

Professional assistance to clients has, in more recent times, passed beyond the mere provision of disinterested advice to an inquiring client and literally become, in many instances, the 'aiding and abetting' of a criminal offence. The formulation of commercially fraudulent schemes predicated on the advice of eminent legal and accounting practitioners is now subject to the uncomfortable scrutiny of the courts. As Justice McHugh, before his elevation to the High Court, observed, there is 'a public perception that lawyers and accountants are indispensable to the success of many criminal enterprises' (McHugh 1988, p. 2).

Professional involvement has given complex commercial fraud a dimension previously unencountered. It is not millions of dollars we are talking about - it is literally billions. According to the Australian Government's draft white paper on taxation reform published in 1985, annual revenue losses from tax evasion exceeded $3,000 million each year with an even greater loss through tax avoidance schemes (Grabosky and Sutton 1989, p. xi).

More recently, the *McCusker Report* (1990) uncovered the concealment of

hundreds of millions of dollars which had vanished in the interests of entrepreneurship. Criminal charges are pending. In reporting on the inquiry findings, the *Australian Financial Review*, a respectable business daily, pondered the larger question of precisely how misappropriation of this magnitude had occurred. Somewhat expectedly, the auditors concerned, a large national accounting firm, were called before the Commission, and whilst professing complete ignorance of the impugned transactions, certainly have been embarrassed by these events. They are not alone. Many of our most respected accounting firms now find themselves, too, in the ambiguous position of being both the victim of and co-accused in complex commercial crime disclosures.

No doubt there are other equally spectacular instances of fraud. Indeed, it is only an impression, but it does appear that each day in every daily newspaper and every weekly magazine there is some story disclosing further fraudulent malpractice by companies and their controllers. I make this point because at one stage it became a widespread belief that welfare fraud was the most serious fraud afflicting our community. This is not to suggest that welfare fraud is not a serious matter. Indeed, all fraud, whatever its stylistic manifestation must be detected and prosecuted. My remarks are simply directed to making the point that corporate fraud is a new genre which has crucial ramifications for not only the corporations which are plundered and their hapless shareholders but for the economy at large.

The misappropriation of vast quantities of property and assets have macro-economic effects which are no less harmful because their causes are imperceptible. The amount of funds available for investment - both private and public - seriously influences employment opportunities and other quality of life indicators. The rate of investment is ultimately the principal determinant of Australian living standards. It is the lifeblood of any modern democratic nation. Massive misallocation of financial resources away from productive enterprise and misused for questionable and fraudulent purposes impinges upon the proper management of our national economic performance. As the Taxation Commissioner asked:

> Wouldn't it be great if legal brains could turn to something more productive than dubious wealth protection activities? A continuing source of concern to me is the proportion of time, effort and top brainpower some of Australia's large corporations and wealth holders devote to the protection of wealth from the claims of society - taxation - compared with what they devote to the creation of wealth. How much greater a nation we might become if this time and talent were devoted to creating more wealth rather than squirreling away what the rest of the community is entitled to share through taxation (Boucher 1988, p. 36).

Echoing the Tax Commissioner's concerns, it is for that reason that I want to address critically commercial fraud in its corporate context. In so doing, of course, I am mindful that this area of law is probably the most controversial in terms of contemporary legal developments.

In discussing this particular theme, it is impossible to overestimate the role played by our courts. Judges do not operate in a sterile vacuum. Like us, judges

read newspapers, academic articles and other publications. Like the rest of the community they could be expected to be alarmed at what can only be described as an inexplicable and almost exponential increase in the rate of corporate commercial fraud.

Judges are in fact supplementary law makers - the judgments which they hand down in this area not only affect the rights of both parties to the action, they are also a valuable source of precedent. Judgments no more and no less declare the law - judicial interpretation of company law statutes will constitute the primary basis upon which professional advisers respond to their corporate clients' legal uncertainties. In this sense, judges define not only what is unlawful corporate behaviour: they define lawful behaviour as well and with it the proper ethical standards for corporations and their controllers.

The growth area in terms of company law is undoubtedly directors' duties. As controllers of the corporation, they are in a unique position to influence directly the capital accumulation, risk-taking, and profit-making strategies of that corporation. It becomes a timely question to ask: what then, constitutes proper and lawful behaviour on the part of directors?

It is a well-known principle of the common law, now statutorily enhanced, that directors owe certain duties to the company whose financial destiny they control. In the last five years that duty to the company has been extensively liberalised. The courts are ruling that mere formal adoption of the corporate form will not prevent a finding that directors as controllers of the corporation are personally liable for misuse of company funds or calculated abuse of the 'separate legal entity' doctrine.

Parliaments have assisted the judiciary in this regard. The new Corporations Law administered by the Australian Securities Commission is at the forefront of a federal crusade to effect social change in this sector.

But it also remains true to say that the judiciary as a body, in initiating any fresh impetus, will have regard to a social consensus that previously acceptable corporate behaviour can, in the 1990s, be viewed as criminal conduct. There is, as the investigative journalist, Chris Masters has said, 'a new mandate to bring the corporate criminals to book' (Grabosky and Sutton 1989, p. ix).

Peak business organisations express similar sentiments. The Business Council of Australia, joined by seven other high-profile business organisations, released their working paper in December 1990 entitled 'Corporate Practices and Conduct'. The paper addressed community concerns surrounding extravagant and reckless corporate behaviour and ultimately endorsed a new code of operational and administrative ethics for all businesses (Bosch 1990). Similarly, the Australian Stock Exchange has significantly strengthened its monitoring rules for listed companies but these amendments do not automatically guarantee utopia. 'It is impossible to regulate for honesty', the Managing Director of the Australian

Stock Exchange, Gavin Campbell, warns (Campbell 1991, p. 8).

I do not want to dwell too long on these aspects. It seems to me, both as a citizen and as a politician, that the courts and companies are cognisant of the community's expectations and concerns. As a whole, they have collectively internalised the need for a new set of ethical guidelines. Recent developments in broadbanding directors' duties in relation to their shareholders, their creditors and even their employees are apposite evidence of this necessary trend.

For me as Attorney-General and as a member of a social democratic government, my agenda is more wide-ranging. Judicial scrutiny is important but, along with many others in our community, I want to know precisely how and why this phenomenon of complex commercial crime gained its momentum.

I am interested in these questions because of two reasons - firstly, I suspect that despite the introduction of innovative, and sophisticated strategies to combat complex commercial fraud, unless we understand the social and cultural assumptions which underpin its existence, those strategies may well end up technically perfect but purely gestural. For instance, we might ask, why is it that the current armoury of statutory remedies and detection apparatus remain underutilised? The empirical studies seem to suggest that our institutional regulators carried out their statutory duties with a great reluctance. Why? Budget constraints and legal complexity are partial explanations but they are not the complete answer (Grabosky and Braithwaite 1986, pp. 2-3).

Secondly, I also agree with the observation made by others that if we cannot contain it, then 'ultimately the image and the legitimacy of the entire system of Australian enterprise will be tarnished by corporate crime' (Grabosky and Sutton 1989, p. xi). The downgrading in our international business reputation which results from an institutional failure to confront and control fraudulent business practices, is a self-evident and unpleasant fact. The Australian Securities Commission has no illusions about its role - employees' coffee mugs are boldly emblazoned with the motto 'our mission is to achieve maximum credibility of Australian corporations and securities markets'.

Historically, successful prosecutions of corporate or commercial fraud, have attracted very light penalties. I have yet to hear of a tax evader or fraudulent company director receiving life which is the statutory maximum under s 411 of the Queensland Criminal Code for armed robbery. And what is fraud other than a sophisticated form of robbery? No doubt factors of victim/offender proximity and the degree of violence influence sentencing considerations but that is not a complete explanation.

Certainly too, the new Corporations Law is not kidding around - this time the sanctions are much harsher. For instance, monetary penalties have been increased five-fold in the area of 'insider trading'. But that is only part of the equation. The litmus test is really in what case will the statutory maximum be applied? I say

that because I am aware that there is a prevailing community perception that commercial fraud is less serious than other forms of robbery. Unarguably, the potential for serious personal injury to the victim is much more discernible in the case of an armed robbery or robbery with violence but is it any more culpable than the creative pilfering of the company trust funds and the subsequent misery of thousands upon thousands of financially bereft investors? I am certainly not advocating that we leave the question of sentencing to the discretion of the injured victim but it might be instructive to ask the investors caught up in the several unit trust mismanagement nightmares if it is time for some law reform in this area. I am sure they would welcome the invitation.

Complex commercial fraud has beset our community. Let us explore the popular assumptions which underpin its continued existence and its contemporary prominence. We are all familiar with the Costigan Royal Commission (Royal Commission on the Activities of the Federated Ship Painters and Dockers Union 1982) which ostensibly started its life as an inquiry into one of our most powerful waterfront trade unions and ended with just as large an investigation into a massive and fraudulent taxation avoidance industry.

The tax avoidance industry burgeoned in the context of a deplorable community perception that the rich could and did treat their taxation obligations as purely voluntary. For a while there the *Income Tax Assessment Act 1936* (Cwlth) lost almost every element of compulsion it legislatively possessed.

In this regard too, I think important tax law decisions by the High Court in the 1970s also persuaded the rich, corporate citizens and individuals alike, that they could not only choose whether to pay income tax at all, they could, by various artificial highly formalistic schemes, choose what rate of tax they thought appropriate in the circumstances. We all know what 'bottom of the harbour' means. More recently, of course, the High Court has reversed a number of those key decisions but I think more out of a sense that the floodgates had become a tidal wave rather than any philosophical rethink about the social disutility of unprincipled tax avoidance. In sanctioning income splitting, the High Court had quite a deal to say about the theoretical niceties of the law of equity but only one High Court judge cared to discuss the implications for taxation revenue (*see* Murphy J in *FCT v. Everett* 143 CLR 440).

Tax avoidance is only one example. What are we to make of the Estate Mortgage affair, the Adelaide Steamship affair, the Regal and Occidental Life Office affair and countless examples of corporate mismanagement tainted by allegations of criminal and fraudulent intent - if we do not attempt to locate these discrete and seemingly random instances of complex commercial fraud into some kind of overall context and pattern, then our strategies for detection and prevention, no matter how superlative, will risk being underutilised. I am not alone in this belief. The eminent sociologist, Hugh Stretton (1990), wrote in an article aptly titled 'Laughing All The Way to the Bank' in which he traced the meteoric rise of directors' incomes:

> It has become fashionable to call for improved corporate supervision and even for changes to our business culture, but the roots of the problem are far more profound than we realise.

That statement is my analytical starting point. To go back to my earlier remarks concerning the tax avoidance industry, it seems to me that the fundamental justification for the rise and rise of this collective preoccupation amongst the Australian community - the sanitised version of which is now called tax minimisation - rested upon a basic though flawed assumption that Australia was not only a high tax country, the tax rates were too high. A logical consequence of those mistaken assumptions is that tax avoidance is not really a crime. It may be illegal but then again so is 'two-up'. One fiction led to another. If tax rates were 'too high' then tax avoidance merely invited recitation of the 11th commandment 'don't get caught'. This assumption also gave rise to an equally untrue though popular mythology that the so-called 'tax revolt' was a legitimate response to this unsatisfactory state of affairs.

The truth is actually the reverse - Australia is a low tax country. Of the twenty-three member nations which constitute the Organisation for Economic Development (OECD), only Turkey and the USA have lower tax receipts as a percentage of their GDP (*see* OECD 1990a). The evidence unequivocally indicates that Sweden and Denmark are high tax countries. Despite that fact, there was no incidence of 'tax revolt' in those countries. I do not want to take this point too far but I do want to expose the myths - the evidence does not support an assumption that tax revolts are associated with high tax countries. Indeed, they are associated with low tax countries. You may recall that the 'tax revolt' scenario was rehearsed in California prior to taking off in this country as a popular journalistic pursuit. Assumptions then that taxes are too high in this country and that a little tax minimisation indulgence by our companies and their controllers is just the antics of Ned Kelly and Robin Hood revisited are simply unsupportable.

I want to destroy another popular fiction which is one of the subtle influences at work in the field of complex commercial fraud. There is an equally pervasive assumption throughout the Australian community that Australian workers are relatively overpaid, relative that is to our Asian neighbours - certainly not in relation to our European counterparts - and that any increase in their money wages is accompanied by a corresponding decline in corporate profitability.

In fact, the profit share of the overall business sector has been on an upward trajectory since 1982. Profit share as a percentage of GDP has risen in those intervening years from a point of just under 30 per cent to nearly 40 per cent in 1989. On the other hand, the collective share of the national cake going to wages has declined in the same period (OECD 1990b).

Not all incomes have fallen, however. Whilst wage-earners have exercised fiscal restraint, the same cannot be said of their managerial counterparts. Payments to senior executives have been growing at nearly twice the rate as male average

weekly earnings since 1984. By 1990 executives have received an effective 25 per cent increase in pay relative to other employees (ABS 1990).

Not only have these incomes increased exponentially and in so doing, destroyed traditional wage/salary relativities, this quest for limitless incomes has spawned a pattern of income distribution in this country which is now the second most unequal in the western world. The top 20 per cent of all income earners now take 42.2 per cent of total income and the bottom 20 per cent now take 4.4 per cent. Sadly, the poor are now poorer - since 1988 their collective share has fallen from 5.4 per cent to 4.4 per cent. The source of this statistical data is the respected World Development Report (1980, 1989, 1990) published in Washington, USA. Our distribution of wealth is equally asymmetrical - the top 20 per cent own 72 per cent of all property. Worse still, the bottom 50 per cent own just 1.6 per cent of all property (Dilnot 1990, p. 14).

When we look at directors' remuneration, the growth has been even more outstanding. Looking at the twenty-three largest Australian companies as our sample, a comparison between their Annual Reports for the year ending 1988 and 1989 showed that of those twenty-three, four companies increased their average directors' remuneration by more than 50 per cent while 12 gave rises in excess of 20 per cent. In one case, the remuneration for its directors increased by just under 125 per cent in the one year - in monetary terms that meant an increase from $3,944,000 to $8,864,000. These increases are nothing short of staggering whichever way you look at it.

These statistics invite the question - why are we still beset by the mythology that egalitarianism is the defining characteristic of Australian society? And more pointedly, why, in the midst of plenty, is there such an unjustifiable propensity among some people to help themselves to even more by illegal means?

It is perhaps a little hollow that our proudest boast is that the butcher and barrister may socialise without impunity, when the reality is that it is economic relationships which impact upon quality of life opportunities. You may like to shout your local economic high flyer a beer in the pub after work, but I think that most Australian workers would draw the line at shouting him or her free use of the roads, hospitals and other public services simply because he or she is lucky enough to have hit upon a highly fraudulent though undetected tax avoidance scheme.

At this point, I want to come back to my central theme. Without understanding how and why complex commercial fraud became such a popular corporate and white-collar pastime, any combat strategies will remain largely symbolic. The thing we learn from income distribution patterns in this country is that if society assumes as one of its fundamental economic doctrines that the pursuit of limitless incomes is a perfectly valid endeavour, then the temptation to engage in complex commercial fraud to outdo competitors becomes almost irresistible. In short, if you cannot see a role for public policy in income control, then you will always

have the material basis for an incessant search, engaged in by corporations and their controllers, aided and abetted by the professions, to find more creative and legally effective ways in which to increase income and wealth.

You will also, as a consequence, lock our courts into a reactive modus operandi - yesterday's black-letter law is today's criminal activity. In one sense these retrospective judgments are somewhat undesirable. While we all appreciate that 'the criminal law is not immutable - indeed, the history of the criminal law is replete with examples of behaviour once permissible which was subsequently prohibited' (Grabosky and Sutton 1989, p. xiii), it still remains equally valid that companies and their controllers should operate with some ethical certainty and within recognised legitimate institutional restraints.

The question of institutional restraints or the lack thereof naturally raises the problem of regulation. In an era in which deregulation is a bipartisan political inclination, it is an uncomfortable task to investigate, let alone criticise, traditional regulatory regimes for general failure to stem complex commercial fraud.

Deregulation - freeing up the market as it is called by its proponents - makes it more difficult to talk about increasing regulatory powers. If you are going to increase the scope and extent of investigative agencies charged with protecting the public interest, then you are going to become more interventionist not less. Nowadays, partly as an intuitive response, and partly as a realisation that there is something flatly contradictory about deregulation on the one hand and jackpot type funding increases to regulatory bodies leading to greater institutional scrutiny of investment decisions by corporations on the other, we find we cannot talk about financial deregulation but instead have to use its euphemistic substitute - 'greater prudential supervision'.

The fact that there is general support for the new spearhead of greater prudential supervision does not resolve our dilemma. If we are committed to increased supervision, then what are we to do when some rather unpleasant transactions are detected because of it? Traffic flow is necessarily governed by traffic lights. So too is the acceptable velocity of our motor cars - different speeds are acceptable in different demographic locations. Like the next motorist, when I am in a tearing hurry, I do not like stopping at red traffic lights but I am not prepared to risk the potentially tragic consequences on the basis of some self-serving argument that my civil liberties have been unjustifiably stifled by the regulatory functions of traffic lights and traffic rules.

If we are committed to the principle of competition between companies then we must be prepared to regulate the conduct of that competition or be prepared for the unintentional fallout. 'The undisciplined market is one thing, responsible free enterprise quite another' as one commentator has remarked (Kemp 1991, p. 26). Competition may ultimately deliver lower prices for the consumer, but it also has a side-effect. Competition increases the pressure on corporations and their

controllers to overlook or sidestep ethical considerations. When you are fighting for your corporate life as in a takeover, there is the temptation to commit that one isolated criminal act, 'cooking the books', 'price fixing', the illicit and illegal hire of private investigators to uncover your competitor's financial Achilles heel, ignoring health and safety legislation, releasing defective products into the marketplace with the accompanying mens rea, avoidance of customs duties on imports - these are also instances of complex commercial fraud - the consequences of which are self-evident.

Regulation exists, then, to distinguish between lawful and unlawful corporate behaviour. The function and duty of regulatory agencies is to enforce lawful behaviour and prosecute its unlawful counterpart. Speaking philosophically, the content of regulation is derived from public policy debate - public policy itself is largely driven by the community's preference for one political agenda over another. Business and industry regulation by definition restrict the otherwise free choice of corporations and their controllers. There is a lot of profit to be made in pharmaceuticals but there are regulations governing their production, distribution and use. It would be ludicrous to suggest the recision of these cautionary regulations. Other equally important investment decisions, resource allocation and wage determination principles are all subject to some extent to public scrutiny and institutional restraint. To the extent that we do regulate business and industry behaviour, declaring some forms of behaviour tortious or criminal, we do so at the behest of broader community interests. Regulation of the commercial marketplace by legislation or statute reflects a basically democratic initiative precisely because it reflects and incorporates widespread public concern.

If regulation per se then is under ideological attack we must reply that there exists another quite different set of priorities. There is an equally distinguished body of intellectual thought which seeks deregulation in the interests of 'freeing up the marketplace'. This achievement is posited as the natural consequence of deregulation. These theorists argue that politics has unnecessarily usurped the traditional role and responsibilities of markets. If markets remain unfettered, so the argument goes, then the outcomes which markets deliver, will be the most optimally efficient. Public policy considerations 'distort' otherwise rational investment decisions, increase prices and hamper organisational efficiencies.

There is a point, I agree, where some kinds of regulation may produce these deleterious effects. I acknowledge the intrinsic importance of maintaining a dynamic and responsive corporate environment in which our private sector corporations can compete and react to international market trends both quickly and innovatively. However, the point that free market ideology seems to ignore is that most other nations which share our first world status also dilute otherwise undesirable market outcomes by the imposition of public policy measures based on notions of social justice.

Indeed, if the size of government correlates with the extent of regulation, then Australia, relatively speaking, is at the low end of the regulatory scale. The

OECD figures for 1988 demonstrate that only Greece and the United States had a smaller public sector than Australia (OECD 1991).

If Australia is characterised by a small public sector, then, is it not completely legitimate to ask: does the practical implementation of deregulation unintentionally create more opportunistic conditions under which complex commercial crime flourishes? It is not offensive to suggest that corporations and their controllers experience an inherent difficulty in distinguishing between the public interest and their own private interest. Some politicians have had this difficulty too. Some ended up in gaol for it. The difficulty of drawing the line is well understood by the Senate Standing Committee on Legal and Constitutional Affairs (Australia 1989) and their subsequent report on company directors' duties clearly empathises with the directors' predicament (Tolmie 1990, p. 54). The legislative requirement of environmental impact statements, health and safety regulations are simply statutory illustrations of the state's accommodation of the public interest. Before concluding, I would like to quote, somewhat at length, from an article which appeared in *The Weekend Australian* in June 1991. This theorist concluded that:

> the damage wrought by the market doctrine went far beyond its economic effects. The 80s witnessed an alarming decline in business and professional standards and community morality. Once the notion gains ground that all profit, is good, and the larger the profit the more efficient the enterprise, the door is opened to naked greed and widespread corruption. How many of the so-called 'yuppies' who achieved overnight riches through insider trading or other dubious activities really believed they were doing wrong? Most no doubt thought they were just being smart - a jump ahead of the field.
>
> We should now be fully aware of the dangers to our society, and to the integrity of governments, of a system that permits individuals to accumulate in a short time huge personal wealth which cannot in any way be justified by their contributions to our standard of living and the strength of our economy.
>
> Infected by the get-rich-quick mania, many senior business executives awarded themselves salaries and other benefits which, in the Prime Minister's favourite adjective, could not unfairly be described as 'obscene'. At the same time they have had the gall to urge restraint on the ordinary wage and salary earner.
>
> In a few short years, deregulation and the market philosophy have led to a blatantly inequitable distribution of wealth and income entirely foreign to the hitherto strong Australian egalitarian tradition (Kemp 1991).

What is required, concludes this writer, is not only a 'return to decent ethical practices' but also 'business leaders who put their country's welfare at least on a level with their own personal gain'.

The writer is C.D. Kemp, the founder and former Director of the Institute of Public Affairs. This article was also published in Quadrant which is a respected, and not exactly left-wing social policy issues magazine. These are not the ravings of an unreconstructed Marxist. C.D. Kemp is a well-respected and influential conservative social theorist. In the end, his credentials do not matter - what

matters is that whatever your politics, it is time to expose those myths which encourage the ongoing perpetration of complex commercial fraud. It is time to 'get serious' about corporate criminality.

Nothing less than the future prosperity of our country is at stake.

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Fraud and the Liability of Company Directors

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Directors' Liability for Fraud: a Changing Scene

This paper reviews three significant developments concerning directors' liability for fraud-related conduct. They are:

- the broadening of the concept of dishonesty as it applies to corporate officers;
- the extension of liability to cover passive neglect by corporate officers; and
- the application of money-laundering offences under Commonwealth proceeds of crime legislation.

These dimensions of the law are only a small part of the overall framework of controls against corporate fraud and related offences (*see*, for example Dorman and Fong 1986; Senate Committee on Legal and Constitutional Affairs 1989; Black 1991). Moreover, the efficacy of the criminal or civil law in this area depends primarily on the level and quality of the enforcement resources available, a topic addressed by several other speakers at this conference. Nonetheless the developments reviewed in this paper may critically affect the scope of liability for corporate fraud and create a number of problems which our law-makers have yet to resolve.

Corporations Law dictionary: the Bierce additions
'Fraud': the soul of religion, the essence of commerce, and the bait of courtship.

'Corporation': an ingenious device for the maximisation of profit and the minimisation of responsibility.

Dishonesty

The more important offences of dishonesty that apply to corporate officers include the offence of dishonesty in the exercise of a power or the discharge of a duty, as now prescribed by s. 232(2) and (3) of the Corporations Law (formerly s. 229(1) of the *Companies Code*).

Section 232(2) and (3) of the Corporations Law provide as follows:

> 2. An officer of a corporation shall at all times act honestly in the exercise of his powers and the discharge of the duties of his office.
> 3. the penalty applicable to a contravention of subsection (2) is:
>
> . if the contravention was committed with intent to deceive or

defraud the body corporate, members or creditors of the body corporate or creditors of any other person or for any other fraudulent purpose - $20,000 or imprisonment for 5 years, or both; or

b. otherwise - $5,000.

The Basic Offence

In *Marchesi v. Barnes* [1970] VR 434 liability under a previous equivalent of s. 232(2) (s. 124 of the uniform *Companies Act* 1961) was held to require a deliberate disregard of a conscious awareness that what was being done was not in the interests of the company. This restrictive interpretation is consistent with the general principle that criminal liability for serious offences requires a subjectively guilty state of mind. However, in *Australian Growth Resources Corporation Pty Ltd v. Van Reesma* (1988) 13 ACLR 261 the Full Court of the Supreme Court of South Australia seems to have recooked the concept of 'honesty' to the point of evaporation.

In *Australian Growth Resources*, assets of the company had been transferred to a director under an agreement prior to the company being placed in receivership. One central issue was whether the company could recover those assets on the basis of a breach of s. 229 (1) of the *Companies Code* (the precursor to s. 232(2) of the Corporations Law). It was held that there had been a breach of s. 229(1) even if the director had genuinely believed that he was acting in the best interests of the company. The reasoning was as follows:

> The penalty provision distinguishes between acts 'done with intent to deceive or defraud the company, members or creditors of the company or creditors of any other person or for any other fraudulent purpose' and other acts, thereby recognising that an officer may fail to 'act honestly' within the meaning of the section without fraud. The section therefore embodies a concept analogous to constructive fraud, a species of dishonesty which does not involve moral turpitude. . . . a director who exercise his powers for a purpose that the law deems to be improper, infringes this provision notwithstanding that according to his own lights he may be acting honestly (*Australian Growth Resources v. Van Reesma* (1988) 13 ACLR 261 at 272).

The test of honesty adopted in *Australian Growth Resources* is thus objective except that the corporate officer must at least be aware of the conduct and circumstances that are taken to amount to a lack of honesty. (*Compare* Smith (1986) where it is suggested that the test under s. 229(1) (a) is one of honest and reasonable belief as under the *Criminal Code* (Qld), s. 24. The equivalent under s. 232(2) would be the common law defence of reasonable mistake of fact).

The interpretation adopted in *Australian Growth Resources* is questionable. First, it is far from clear that a person fails to acts 'honestly' merely because the conduct is inconsistent with the best interests of the company. Some additional element of moral obloquy is required, at least as a matter of ordinary usage. If the additional element is that the defendant should have realised that the conduct was not in the best interests of the company, then the test amounts to negligence, not dishonesty. Yet negligence is not the concept articulated in s. 232(2). Secondly, it is possible to explain the difference between the basic offence under s. 232(2) and the aggravated offence under s. 232(3) without going to the extreme of

interpreting the basic offence as one that does not require some element of fraud. Lanham, Weinberg, Smith and Ryan have offered this explanation of the provision:

> . . . a concept of fraud limited to intending to cause real economic loss to the company or its creditors as suggested by the decision of the High Court in *Hardie v. Hanson* [(1960) 105 CLR 451] would enable a distinction to be made between the mental elements in the two crimes under s. 229(1)(a) and s. 229(1)(b) and thus would allow some sense to be made of the second offence . . . which carries a markedly increased penalty (Lanham et al. 1987, p. 285).

It may be argued that *Australian Growth Resources* is a civil case and that the *Marchesi v. Barnes* [1970] VR 434 interpretation of the requisite guilty mind required still applies for the purpose of criminal liability under the provision. There is little sense in automatically equating the fault requirement for criminal liability with that appropriate for civil liability: *see Hurst v. Vestcorp Ltd* (1988) 13 ACLR 17, at 26 per Kirby P; *Chugg v. Pacific Dunlop* (1990) 50 A Crim R 85 at 88-89, Deane J; *United States v. United States Gypsum Co* (1978) 438 US 422, at 436-443. However, in *Waugh v. Kippen* (1986) 160 CLR 156, at 165 a case concerning a statutory provision in the field of industrial safety, the High Court of Australia held otherwise on the ground that the legislature could not be taken to have spoken with a forked tongue. The single-mindedness of *Waugh v. Kippen* tends to produce a result that is either unsatisfactory from the standpoint of the accused or, if satisfactory in that respect, is too restrictive for the purpose of civil liability. The civil and criminal components of s. 232(2) need to be unscrambled and redefined. For the purposes of civil liability it may be argued that liability should not turn on lack of 'honesty' but on whether the defendant was careless. If so, the ground is adequately covered by s. 232(4). For the purpose of criminal liability, it may well be sufficient to confine liability to what is now the aggravated offence under s. 232(3).

The Aggravated Offence

The aggravated offence under s. 232(3) requires an intent to defraud or a fraudulent purpose but this requirement has been diluted by the tendency of many courts to equate fraud with a populist notion of 'dishonesty'. The populist approach has been adopted by the English courts in relation to the concept of dishonesty under the Theft Act 1968 (*Ghosh* [1982] QB 341; *see also Feely* [1973] 1 QB 530), and by the New South Wales and Victorian courts in relation to offences of fraudulent dealings with company property (*Glenister* [1980] 2 NSWLR 597; *Smart* [1983] VR 265 at 194-95). By contrast, the Victorian Court of Criminal Appeal has refused to accept the same approach in the context of the offence of dishonestly obtaining property by deception: dishonesty, it has been held, is a legally-defined concept (*Bonollo* [1981] VR 633; *Brow* [1981] VR 783; *Salvo* [1980] VR 401). The leading judicial attempt at definition is that of McGarvie J in *Bonollo* [1981] VR 633 at 656 in the context of the offence of dishonestly obtaining property by deception: 'dishonestly' requires that an accused, when obtaining property by deception, be aware that by obtaining it he will detrimentally affect the interests of the victim in a significant practical way. The reform of the law of theft in the Australian Capital Territory embodied

essentially the approach taken by McGarvie J. Section 96(4)(b) of the *Crimes Act 1970* (NSW) in its application to the Australian Capital Territory provides that an appropriation of property is not to be regarded as dishonest if undertaken in the belief that it will not cause 'any significant practical detriment to the interests of the person to whom the property belongs'. (*Compare* Elliott 1982; *see also* Williams and Weinberg 1986, p. 118; and, at the opposite extreme, *compare* Canada 1977).

On one interpretation (Smith 1986, pp. 159-62), fraud under s. 232(3) is not a legal concept for the trial judge to define but an everyday notion for the trier of fact to determine. If so, the scope of the offence depends on the trier of fact's conceptions of commercial morality (Cecil 1976, pp. 167-8; *see generally* Williams 1983, pp. 722-31; Smith 1984, pp. 182-7). The absence of a clear standard of liability has been criticised as being excessively vague and inconsistent with the fundamental requirement that guilt be proven beyond a reasonable doubt:

> [W]hatever the word 'dishonesty' is finally decided to mean, its meaning must be a question of law and not left to random interpretation by individual juries and magistrates. Any other course would be a hazardous departure from the fundamental principle of common law that each separately identifiable component of an offence must be proved beyond reasonable doubt by P. If the meaning of one such element of an offence is left at large for popular interpretation, the safeguard of proof beyond reasonable doubt is lost, for no-one knows with any precision what it is that P has to prove (Howard 1982).

It may be critical to the outcome of a case whether the concept of 'fraudulent purpose' is taken to be a populist notion for the trier of fact to decide, or is given specific content as a matter of legal definition. For instance, an accused may honestly believe that he or she was legally entitled to the property in question or to act in way in which he or she did. It may be that legal advice has been obtained and that the advice has been followed in good faith without realising that ultimately it would be found to be wrong (*compare O'Donovan v. Vereker* (1987) 29 A Crim R 292). On a legalist interpretation of s. 232(3), fraud is a legal concept which is defined to include the defence of claim of right (*see generally* Williams 1961, pp. 305-45; Williams and Weinberg 1986, pp. 53-4). This defence, which applies to theft and a wide range of offences against property, is significant largely because it provides an exception to the general rule that ignorance or mistake of law is no excuse (*Walden v. Hensler* (1987) 163 CLR 561; *Lopatta* (1983) 35 SASR 101). On the populist interpretation of fraud or dishonesty, however, the defence of claim of right does not apply: the question is whether the accused's conduct was dishonest in all the circumstances of the case. Thus, the fact that an accused acted in good faith on the basis of legal advice would not necessarily mean that his or her conduct would satisfy a jury's homespun conception of what is required to amount to an act of fraud or dishonesty. The issue is fundamental and requires full consideration by the High Court. The Gibbs Committee (1990), in its review of Commonwealth criminal law, has recommended that the concept of dishonesty be abandoned and replaced by the requirement that the accused act without lawful justification.

Passive Neglect by Corporate Officers

A perennial issue is the extent to which corporate officers are liable for passively neglecting their common law or statutory duties (*see generally* Menzies 1959; Trebilcock 1969; Cox 1989). The recent trend in the context of the obligation to cease trading when insolvent (*see* s. 592 of the Corporations Law) has been to impose a positive obligation on directors to monitor the financial state of their company. A similar trend is likely in the context of the obligation under s. 232(4) of the Corporations Law to exercise a reasonable degree of care and diligence in the prevention of the commission of fraud by or against the company.

Trading when Company is Insolvent

The prohibition against continuing to trade when the company becomes insolvent was once widely regarded as a paper tiger but several recent cases indicate that the section does have teeth (*see further* Burrell and Long 1991). Section 592 provides partly as follows:

1. Where:
    . a company has incurred a debt;
    b. immediately before the time when the debt was incurred:
        i. there were reasonable grounds to expect that the company will not be able to pay all its debts as and when they become due; or
        ii. there were reasonable grounds to expect that, if the company incurs the debt, it will not be able to pay all its debts as and when they become due; and
    c. the company was, at the time when the debt was incurred, or becomes at a later time, a company to which this section applies,

    any person who was a director of the company, or took part in the management of the company, at the time when the debt was incurred contravenes this subsection and the company and that person or, if there are 2 or more such persons, those persons are jointly and severally liable for the payment of the debt.
2. In any proceedings against a person under subsection (1), it is a defence if it is proved:
    . that the debt was incurred without the person's express or implied authority or consent; or
    b. that at the time when the debt was incurred, the person did not have reasonable cause to expect:
        i. that the company would not be able to pay as and when they became due; or
        ii. that, if the company incurred that debt, it would not be able to pay all its debts as and when they became due.

In *Metal Manufacturers Ltd v. Lewis* (1988) 13 NSWLR 315 it was held by a majority of the New South Wales Court of Appeal that Mrs Lewis, a passive director, was not liable under s. 556(1) of the *Companies Code* (the precursor of s. 592(1)) for a debt because she had established under s. 556(2) that the debt was incurred without her express or implied authority or consent. Kirby P dissented

and observed that much more was expected of the modern company director than passive neglect of the company's financial affairs:

> They cannot surround themselves with a shield of immunity from the operation of s. 556 by the simple expedient of washing their hands of the company's affairs and leaving it to a co-director to attend to those affairs and to incur the debts with third parties which it is the very purpose of s. 556 to control (*Metal Manufacturers Ltd v. Lewis* (1988) 13 NSWLR at 321).

Passive neglect was no excuse in *Statewide Tobacco Services Ltd v. Morley* (1990) 8 ACLC 827, decided by Ormiston J of the Supreme Court of Victoria. Mrs Morley was a director and shareholder of a small family company, but had taken no part in the company's dayÄtoÄday management over a long period prior to its collapse. It was held that she could not rely on the defence under s. 556(2)(a): she has given her son a general authority to look after the business of the company and that was sufficient to amount to an authority to incur debts. It was also held that Mrs Morley's failure to monitor the financial progress of the company meant that she lacked reasonable cause to expect that the company would be able to pay its debts when due. Illness and absence could be taken into account, but complete neglect was unreasonable. A director is expected to 'take a diligent and intelligent interest in the information either available to him or which he might with fairness demand from the executives or other employees and agents of the company' (*Statewide Tobacco Services v. Morley* (1990) 8 ACLC 827 at 847). Particular expertise was not essential but reasonable diligence was required on the part of a director. Reasonable diligence included the obligation to try to understand or discover sufficient of the company's financial affairs to enable the director to stop the company's activities when it is no longer able to pay its debts as and when they fall due.

A similar approach was recently taken by Tadgell J in *Commonwealth Bank of Australia v. Eise* (1991) unrep., S. Ct of Vic., No 2263 of 1990, 3 July. Mr Eise, an honorary part-time director of the National Safety Council of Australia, was held liable to repay $96,704,998. The State Bank of Victoria had been duped by John Friedrich, the chief executive officer of The National Safety Council, and had provided finance at a time when the Council was insolvent. The accounts and accounting information provided to the bank had been 'bogus and misleading to an astonishing degree'. It was argued that Mr. Eise was not liable under s. 556(1) of the *Companies Code* because he too had been deceived by Friedrich. Tadgell J held otherwise. Mr Eise had failed to look properly at the accounts and the auditors' reports. Mr. Friedrich's deceit should also have been apparent to him. The defence under s. 556(2) therefore failed. It also held that it was inappropriate to grant Mr Eise relief from liability under s. 535 of the *Companies Code*. Although the Bank may have been careless in providing finance to the Council, it was nonetheless the responsibility of the board of directors to ensure that the company was able to meet its current obligations. It was also stressed that Mr Eise had made a grave mistake in signing a directors' report that the 1987 accounts had been considered when the opposite was the case; he had falsely represented that the Board had complied with its obligations in relation to the accounts. This had been conduct of 'the utmost folly'; without it, Friedrich's fraud

would probably have been discovered. To grant relief in such a case would be 'a serious disservice to the administration of the Code and to the commercial community'. In short, Mr Eise's downfall was attributable to his failure to monitor the Council's financial position.

Prevention of Fraud

Effective monitoring is also expected of corporate officers in the prevention of fraud by or against their company, whether the fraud is committed by other directors or by employees of the firm. Section 232(4) of the Corporations Law has particular significance in this context. Under this provision there is an obligation on corporate officers to exercise reasonable care. There is little doubt today that the obligation extends to ensuring that the company has in place controls that are adequate to guard against fraud-related losses.

Section 232(4) provides that:

> An officer of a corporation shall at all times exercise a reasonable degree of care and diligence in the exercise of his or her powers and the discharge of his or her duties.

Failure to comply with s. 232(4) is an offence punishable by a fine of up to $5000, and attracts a variety of civil remedies. It may be argued that the relevant standard of negligence is gross or criminal negligence, at least where criminal liability is in issue (*see* Smith 1986, p. 163; *compare Newman* [1948] VLR 61 at 67; *Shields* [1981] VR 717; D [1984} 3 NSWLR 29; *see further* Senate Committee on Legal and Constitutional Affairs 1989, para. 13.12). To date, however, the High Court has shown itself unwilling to differentiate between the fault elements required for civil and criminal liability, and a requirement of criminal negligence would be inconsistent with the remedial purpose of the provision (*Waugh v. Kippen* (1986) 160 CLR 156 at 165; *but see Hurst v. Vestcorp Ltd* (1988) 13 ACLR 17, at 26 per Kirby P; *Chugg v. Pacific Dunlop* (1990) 50 A Crim R 85 at 88-89, Deane J; *United States v. United States Gypsum Co* (1978) 438 US 422, at 436-43).

Australian companies enjoy considerable latitude as to the policies and procedures they may adopt for the purpose of complying with legal duties, the prevailing regulatory philosophy being that freedom and efficiency should be maximised by allowing companies to regulate their own internal affairs. There is of course a vast proliferation of rules governing particular facets of company operations (for example, accounting requirements, share issues, conduct of meetings) but the nature and extent of the compliance system devised to prevent fraud is left up to the company concerned. Although the law thus tends to keep out of the 'black box' of organisations (see Stone 1975), it is wrong to suppose that the compliance steps taken or not taken by corporate officers are immune to legal scrutiny. On the contrary, s. 232(4) may well bring them into focus.

Assume that the board of directors of a merchant bank delegates all tasks of fraud prevention to a compliance manager and then exercises no supervisory role over his or her compliance activities. Assume further that the compliance manager

takes an unduly optimistic or casual view of the compliance function delegated and that the company's financial health is jeopardised by a number of middle managers who have engaged in scams such as manipulation of share prices, trading ahead of customers on the futures exchange, and money-laundering. In supposing that the compliance officer would prepare adequate compliance procedures, and in refraining from demanding any assurances of adequacy, have the members of the board violated s. 232(4) by failing to use reasonable care and diligence in exercising their power to manage the business of the company? Should they have insisted on at least quarterly or half-yearly reports by the compliance officer as to the nature and extent of the company's compliance system?

It may be argued that, in the absence of any reason to suspect that the compliance officer would not properly discharge the function delegated, there is no liability. Certainly there is some support in the case law for this position (*Re City and Equitable Fire Insurance Co Ltd* [1925] Ch 407 at 429, Romer J; *Graham v. Allis Chalmers*, 188 A 2d 125 (1963). *See further* Corkery, pp. 137-9; Warnick (1988); also consider Perkins 1986, p. 12). Thus, it was once said that directors would be liable only if 'they were cognisant of circumstances of such a character, so plain, so manifest, and so simple of appreciation, that no men with any degree of prudence, acting on their own behalf, would have entered into such a transaction as they entered into' (*Overend and Gurney Co v. Gibb* (1872) LR 5 HL 480 at 487-8 per Lord Hatherley). On the other hand, it may be argued that prevention of commercial fraud is a matter of such significance for a merchant bank that failure to monitor such compliance by requiring periodic reports and assurances may amount to lack of reasonable care by the directors in exercising their power to manage the business of the company. (*Compare Gould v. Mount Oxide Mines Ltd* (1916) 22 CLR 490 at 530; Perkins 1986). Losses associated with non-compliance may easily be more significant than some of the traditional items of financial business on the agenda of board meetings, for example, review of leases of premises, the financial ramifications of which may pale into insignificance when compared with a major scandal involving fraud. Hence it would be unwise to assume that the duty under s. 232(4) is confined only to the traditional areas of fiscal command expected of directors in the past. Account must also be taken in the change of the law relating to a director's obligation to stop a company from incurring debts when it can no longer meet its current obligations. Passive neglect is no longer an excuse under s. 592 and a comparable interpretation is likely in the setting of s. 232(4).

Another important factor is that much is known today about how organisations can malfunction and what can usefully be done to guard against breakdowns. There is now an extensive literature on preventive law and liability control over a wide variety of fraud-related activities, including embezzlement and computer fraud (*see*, for example Dinnie 1987), companies and securities fraud (*see* Levi 1986; Mann 1976; Mann 1974 and Bell 1987), defence procurement fraud (*see* Schwarz 1987), bribery and corruption (*see*, for example Price Waterhouse and Co 1979), restrictive trade practices (*see*, for example Price 1985), and offences relating to consumer protection (*see*, for example Pengilley 1981).

The likely causes of malfunction can be easy to remedy. Take the precaution of providing an early warning system for alerting top managers to possible illegality lower in the organisation. There are legion instances of compliance problems being concealed at lower or middle levels of management and of companies being taken by surprise when the bad news is aired in public (for example, Exxon in relation to allegations of the payment of bribes by its Italian subsidiary). The solution adopted by many companies (for example, General Electric, Dow Chemical, Exxon, Allied and United Airlines) has been the uncomplicated one of supplementing one-over-one reporting relationships with extra reporting channels to top management (*see further* Coffee 1977; Braithwaite 1985).

Various other developments point toward the individual liability of corporate officers under s. 232(4) for failing to initiate or monitor compliance controls. These pointers include the following:

- the emphasis on internal compliance controls in response to the foreign bribery cases (see, for example Ferrara 1980), and under recent reforms of US insider trading legislation (see US Insider Trading and Securities Fraud Enforcement Act 1988);
- the emerging relevance of probation as a sentence against corporations, and the use of probationary conditions to require the adoption of effective internal controls (see American Bar Association 1975);
- the insistence on adequate anti-fraud controls in plea agreements negotiated by the US Department of Defence with corporations charged with fraud in defence procurement (see Orland and Tyler 1987);
- the compliance controls required under the Cash Transaction Reports Act 1988 (Cwlth), especially ss. 11-12;
- the corporate governance movement (see generally American Law Institute 1982; Hopt and Teubner 1985), one of the planks of which is that company boards of directors should be required by law to oversee compliance efforts, as by means of audit committees.

Money-Laundering Offences

Another major facet of corporate fraud control in Australia is the legislation we now have on money laundering. The *Proceeds of Crime Act 1987* (Cwlth) and other money trail legislation provides an extensive armoury of weapons, including money laundering offences and a suspect transaction reporting requirement. Under the new Corporations Law package, offences under the Corporations Law are subject to the operation of the *Proceeds of Crime Act* and related Commonwealth legislation. This is significant, partly because money laundering offences under the *Proceeds of Crime Act* go further than any equivalent under state legislation, and partly because the obligation to report suspect transactions now applies to offences under the Corporations Law.

Section 81 of the *Proceeds of Crime Act* enacts the serious offence of money-laundering:

1. in this section:
   'transaction' includes the receiving or making of a gift.
2. A person who, after the commencement of this Act, engages in money laundering is guilty of an offence against this section punishable, upon conviction, by:
   . if the offender is a natural person - a fine not exceeding $200,000 or imprisonment for a period not exceeding 20 years, or both; or
   b. if the offender is a body corporate - a fine not exceeding $600,000.
3. A person shall be taken to engage in money laundering if, and only if:
   . the person engages, directly or indirectly, in a transaction that involves money, or other property, that is proceeds of crime; or
   b. the person receives, possesses, conceals, disposes of or brings into Australia any money, or other property, that is proceeds of crime;

   and the person knows, or ought reasonably to know, that the money or other property is derived or realised, directly or indirectly, from some form of unlawful activity.

The money-laundering offence under s. 81 represents a species of the offence of receiving stolen goods but differs in a number of important respects:

- the maximum penalty is much higher (for individuals, $200,000 and/or gaol for up to 20 years; *compare* receiving under *Crimes Act 1900* (NSW), s. 188, which carries a maximum of 10 years);
- the mental element under s. 81 requires that the accused know or o*ught reasonably to know* that the money or other property is derived or realised, directly or indirectly, from some form of unlawful activity; *compare* the requirement of knowledge or belief under for example, *Crimes Act 1900* (NSW), s. 188; *Raad* [1983] 3 NSWLR 344; (*see also Schipanski* (1989) 17 NSWLR 618; *Anderson v. Lynch* (1982) 17 NTR 21; *Fallon* (1981) 28 SASR 394; *Crooks* [1981] NZALR 53);
- the defence of claim of right seems inapplicable and no provision is made for cases where the accused intends to return the money or property to the police or the rightful owner; and
- 'proceeds of crime' may be derived directly or indirectly (it does not matter that the proceeds are not traceable at equity) from a much wider range of offences than theft or offences against property.

Section 82 of the Proceeds of Crime Act creates the offence of receiving or possessing money reasonably suspected to be the proceeds of crime:

1. A person who, after the commencement of this Act, receives, possesses, conceals, disposes of or brings into Australia any money, or other property, that may reasonably be suspected of being proceeds of crime is guilty of an offence against this section punishable, upon conviction, by:
   . if the offender is a natural person - a fine not exceeding $5,000 or imprisonment for a period not exceeding 2 years, or both; or
   b. if the offender is a body corporate - a fine not exceeding $15,000.

2. Where a person is charged with an offence against this section, it is a defence to the charge if the person satisfies the court that he or she had no reasonable grounds for suspecting that the property referred to in the charge was derived or realised, directly or indirectly, from some form of unlawful activity.

The offence of receipt or possession of suspected proceeds of crime under s. 82 is akin to the offence of being in custody of something reasonably suspected to be stolen (*compare Crimes Act* (NSW), s. 527C). However, there are several significant differences:

- the maximum penalty is higher (2 years, as compared with 6 months);
- under s. 82 there need be reasonable suspicion only that the money or property amounts to proceeds of crime whereas under *Crimes Act* (NSW), s. 527C there must be reasonable suspicion that the thing in D's custody is itself stolen (*Grant* (1980) 55 ALJR 490); and
- under s. 82 there is no requirement that the accused be caught red-handed with the property subject to prosecution (*compare Crimes Act* (NSW), s. 527C; *English* (1989) 44 A Crim R 273).

The offence under s. 82, although claimed to be similar to that under s. 527C of the *Crimes Act* (NSW), is much more broadly defined and is inconsistent with the policy concerns expressed in *Grant* (1980) 55 ALJR 490.

The implications of the offences under sections 81 and 82 are far-reaching. Consider for example the fact situation in the Guinness case (*see further* Hobson 1990; Hill 1991). Guinness became involved in a contested takeover bid for the Distillers company. The market value of Guinness shares was critical to the bid because part of the offer consisted of Guinness stock. The market was manipulated by parties acting in cahoots with Guinness and who bought Guinness shares pursuant to a scheme whereby they were indemnified against loss by Guinness. After Guinness succeeded in the bid for Distillers the other parties to the scheme of market manipulation were left with large parcels of Guinness shares. Assuming that the facts took place here today and that the parties were convicted of market manipulation under s. 998(1), then anyone who later bought those shares would commit the offence of money laundering if they had reason to know that the shares were involved in the market manipulation scheme. And if the directors of Guinness later indemnified the other parties against loss then all concerned would be guilty of money laundering in relation to that transaction: the transaction would 'involve' proceeds of crime - the shares - within the meaning of s. 81(3)(a).

The money laundering offence under s. 81 also criminalises the receipt of funds by directors or their companies in the context of deals which, unlike the Guinness scam, are not blatantly illegal and which have hitherto been accepted as within fairly safe bounds. Assume that A, a director of company X, organises and obtains for himself a special consulting fee of $1 million. The payment is in breach of s. 232(3) of the Corporations Law. A later invests the $1 million in company Y under a deal that he arranged with the directors of company Y after he landed the consulting fee from company X. If the directors have reason to

know that the fee has been obtained as a result of conduct by A that was an offence under s. 232(2), s. 232(3) or any other offence anywhere in the world, then they commit the offence of money laundering under s. 81 and are liable to gaol: they have engaged in a transaction that involves the proceeds of an indictable offence under s. 232(3) and the requisite mental element is also present (reason to know that the property is derived from an unlawful activity). The directors may have believed that they were legally entitled to act but claim of right is no defence under s. 81, nor is ignorance of the law. If company Y is a cash dealer as defined in the *Cash Transaction Reports Act 1988* (Cwlth), their best course of action is to report the transaction to the Cash Transaction Reports Agency (CTRA). Under s. 243D(6) of the *Australian Securities Commission Act 1989* (Cwlth), they would then gain immunity from liability under s. 81 or s. 82.

The main criticism is that the mental element required for liability under s. 81 or s. 82 of the *Proceeds of Crime Act* is not confined to intention, knowledge or recklessness (cf. *Confiscation of Proceeds of Crime Act* (NSW), s. 73, where the offence of money laundering requires knowledge). The objective tests of liability imposed are inconsistent with the emphasis traditionally attached to subjective tests of liability for serious offences. Subjective blameworthy states of mind have been insisted upon in a long line of High Court decisions, from *Parker* (1963) 111 CLR 610, to *Crabbe* (1985) 156 CLR 464, to *He Kaw Teh* (1985) 157 CLR 523 and *Giorgianni* (1985) 156 CLR 473. It should also be realised that ss. 81 and 82 do not adhere to the model provided by the money laundering offences enacted under the US Money Laundering Act 1986; under the corresponding US provisions knowledge is required: 18 USC s. 1956(a)(b) (*see further* Plombeck 1988).

Attention is also drawn to the effect of s. 243D of the *Australian Securities Commission Act*. Under this provision a cash dealer must report suspected Corporations Law and ASC Law offences even where the suspicion relates to an offence that may have been committed by the cash dealer itself. When the *Cash Transaction Reports Act 1988* (Cwlth) first came into effect it was commonly thought that the suspect transaction reporting obligation related to offences suspected on the part of persons with whom a cash dealer engaged in a transaction. The extension of the suspect transaction obligation under s. 243D means that cash dealers are legally obliged to report suspected breaches of the Corporations Law whether or not they are implicated as the victim or as an offender. Assume that the directors of a cash dealer come to learn that dealers in its trading room have been trading ahead of customer orders. Under s. 243D the suspected breach of s. 844(2) of the Corporations Law by the cash dealer and the employees must be reported to the CTRA. Failure to report is a serious offence on the part of the cash dealer and any director knowingly concerned in the failure to report is liable for complicity.

Conclusion

Old assumptions about the nature and extent of criminal liability for corporate fraud have been transformed in various ways. The task of enforcement has thereby been assisted. It may also be the case that the breadth and uncertainty of the law will have a real deterrent effect in the commercial world. The major question, however, is whether the law's change in form can be matched by effective enforcement so as to achieve a change in substance.

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The Australian Securities Commision and the Prevention of Fraud

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Until the 1970s, Australia generally approached a corporate law as essentially a private affair - between the company, its officers, its shareholders and its creditors. The role of government, apart from legislative changes every now and then, was extremely limited. For example, the office of 'special investigator' - now abolished - was premised upon the government not having a strong and continuous investigative system and having to engage outside experts to tell it what happened.

Historically, corporate regulators in Australia have concentrated on the prosecution of corporate offenders. Actions aimed at the preservation or recovery of company property have been left to individual shareholders and creditors, or to receivers and liquidators acting on their collective behalf. The track record of those regulators was not spectacular. By and large, major corporate law investigations were focused solely on the perceived protagonists (usually company controllers). The investigations were often commenced several years after the events in question, by which time evidence was thin on the ground and suspects and/or their assets had left the jurisdiction.

The Australian Securities Commission (ASC) takes the view that the integrity of the Australian commercial markets, and the protection of investors, will be enhanced if it adopts a more comprehensive approach to enforcement. The ASC's law enforcement goal is to develop a 'deterrent net' against contraventions of the Corporations Law, with investigation of all serious breaches. Where appropriate, action will be taken to preserve property, obtain civil remedies, including recovery and other public protection, and prosecute or discipline offenders.

The methodology which the ASC is developing to become an effective securities regulator differs from that of the former corporate affairs commissions in a number of respects. This paper is designed to identify some of the more particular differences in methodology. However, the differences can be summarised by the proposition that the ASC is adopting and adapting the methodology of the Securities Exchange Commission of the United States, to the extent that the ASC is seeking to build an investigative team with the following features:

- professionalism in the conduct of its investigations;
- multi-disciplinary teams which bring together financial, legal forensic and

investigative skills;

- the prompt initiation and completion of major investigation;
- the concentration of expertise on securities and corporate issues.

In order to achieve this structure, it is necessary that the ASC is and is regarded as a specialist agency; its attention must be directed towards the enforcement of the Corporations Law and all matters outside the purview of that law should be referred to other agencies. Secondly, the ASC must not be reactive to corporate failures (acting only upon the receipt of a report from the receiver or liquidator) but pro-active establishing programs under which suspected contravention are promptly investigated, with a greater emphasis upon current transactions and market dealings. Thirdly, to be an effective securities regulator, the ASC must manage its investigative resources much more carefully, allocating priority to those matters which affect market integrity, and ensuring that the investigation is sufficiently resourced to be completed within an investigation plan and within some reasonable period.

The ASC derives it power of investigation and enforcement pursuant to the *Australian Securities Commission Act 1989* (Cwlth) - the ASC Act. Part 3 of the ASC Act establishes the powers of the ASC in relation to investigations and information gathering.

In exercise of those powers, the ASC intends to adopt a program, under which its investigative resources are applied for the following goals:

- investigation of serious offences under the Corporations Law, with the intention of seeking all appropriate prosecutions and civil remedies;
- investigation of takeovers where it is suspected that there occurred unacceptable circumstances which should be referred to the Corporations and Securities Panel, and any possible market manipulation to the courts, for appropriate civil and criminal relief;
- the establishment of a deterrence program, for the purpose of establishing an environment of compliance, through the processes of education, audit, disciplinary action and (if necessary) prosecution.

Investigation of Serious Offences

The ASC will be taking a pro-active role in its approach to corporate regulation. The ASC wishes to play its part in restoring Australia's reputation in the international market and to be seen to be strongly enforcing the law apparently abused with such recklessness over the past few years. The ASC should be seen as the corporate regulator closely involved in normal day-to-day commercial life, litigating perceived breaches of the corporate law.

The statutory scheme of the Law sets out the various courses available to the ASC, where evidence is obtained as a result of an investigation (including

evidence upon the examination of persons pursuant to s. 21 of the Act):

- where it appears to the ASC that a person may have committed an offence, the ASC may cause a prosecution for that offence to begin, pursuant to s. 49 of the Act;
- where it appears to the ASC to be in the public interest for a proceeding to be carried on for civil remedies, the ASC, if the person is a company, may cause such a proceeding to begun, and in other cases may cause such a proceeding with the consent of the person entitled to begin proceedings, pursuant to s. 50 of the Act;
- where civil proceedings are under way, the ASC may intervene in those proceedings pursuant to s. 1330 of the Corporation Law;
- where the ASC elects, it may prepare a report on an investigation under section 17 of the Act, which report will be accompanied by the records of examination prepared in respect of that investigation, or any other relevant records of examination (s. 27); and
- the ASC may provide a copy of the record of examination and related books to various persons (including the lawyer of a person carrying on, or contemplating, civil proceedings), pursuant to s. 25 of the Act.

There are three facets to the ASC's enforcement policy - preservation, recovery and prosecution, in descending order of priority:

Preservation

The prosecution of criminal offences, and civil litigation for compensation, are matters which can generally be determined only in longer term. The ASC intends to take advantage of interim measures for the protection, in the short and medium term, of the interests of shareholders and creditors. The Corporations Law provides the ASC with three main options which it can use to prevent further damage to a company's assets or business. These are:

- Injunctions under section 1324 of the Corporation Law. This 'injunctions' is wider than that which was previously available to corporate regulators under the Companies Codes, and is akin to that available under s. 80 of the *Trade Practices Act 1974* (Cwlth).
- The injunction may be a restraining injunction or a mandatory injunction, and it can be sought not only in the case of a contravention of the Corporations Law but also in circumstances which fall short of direct contravention including attempts to contravene the Law.
- An injunction, if granted by the Court, allows the ASC great flexibility in directing the particular affairs of a corporation without relieving it of its existing management.
- Receivership. It may, in appropriate cases, be essential that the existing management be removed. Section 1323(1)(h) of the Corporations Law allows the ASC to apply to the court for the appointment to a corporation of a receiver or a receiver and manager. The remedy is available where:

- an investigation is being carried out under the Australian Securities Commission Act 1989 (Cwlth) or the Corporations Law into acts or omissions that constitute, or may constitute, a contravention of the Corporations Law;
- a prosecution has begun against a person for a contravention of the Corporations Law; or
- a civil proceeding has been commenced under the Corporations Law.

- Provisional Liquidation. The ASC has powers under certain provisions of the Corporations Law to apply for the winding up of a company. For example, under s. 464 the ASC can apply to the Court to wind up a company which is under investigation. The ASC is required to demonstrate that one of the usual criteria for winding up is present: for example, that the company is unable to pay its debts, or that the affairs of the company are being conducted in the interests of directors rather than in the interests of the members as a whole.

However, the ASC's primary aim will be to preserve the property of the company. The issue of dissolution is one generally best left to creditors and shareholders, with the ASC acting only in exceptional circumstances

Recovery
The Corporations Law contains a broad range of provisions which permit persons to recover civil compensation or damages from those who have contravened the Law.

Some of these provisions permit the ASC to make application to the Court on behalf of parties who have suffered the loss.

The ASC believes the appropriate civil action is more likely to produce effective remedies for the benefit of companies, auditors and creditors, rather than prosecution and proceeds of crime actions.

Property and damages of the company can be recovered following contravention of the directors' duties provisions (s. 232), the loans to directors provisions (s. 234) under the provisions enabling recovery of preferences by a liquidator (s. 565) and where a company has incurred debts while it was insolvent (s. 592).

The Corporations Law gives the ASC additional powers to enable recovery in specific situations:

- where the prospectus provisions are breached or there has been a contravention of the Law, particularly relating to securities, then the ASC is entitled to seek a restitutionary remedy under sub-section 1325(5);
- where a party engages in conduct which constitutes insider trading, the Commission is now empowered pursuant to s. 1013(6) to bring an action in the name of, and for the benefit of the company, the securities of which

were traded, to recover damages for the benefit of that company; and

- the Commission is able to bring an action under s. 598, seeking orders consequent upon by a person connected with a corporation, seeking orders that the person compensate the corporation for the amount of loss or damage suffered by reason of that fault.

In all of the above cases, the onus of proof in the action brought by the Commission is the civil onus: that is, proof on the balance of probabilities, rather than the criminal onus. Although the Commission must consider the comments in *Briginshaw* (1938) 60 CLR 336 in cases where fraud is alleged, the onus is still that of balance of probabilities.

The scope for pursuit of recovery actions is enhanced by s. 50 of the ASC Act. The ASC is entitled, following an investigation or from a record of examination, where it considers it would be in the public interest for a person to take proceedings for recovery of damages or his or her property, to carry on proceedings in the name of that person.

Section 1330 of the Corporations Law also gives the ASC power to intervene in court proceedings arising under the Corporations Law. The ASC had adopted a policy (published in the ASC Digest) that it is not usually appropriate to intervene in proceedings of a purely commercial nature, where the parties are well able to present their case to the Court, or where there is potential a potential plaintiff with sufficient funds to bring proceedings but is not prepared to do so. The ASC is likely to intervene where a case may affect the integrity of financial markets or has a particular financial or commercial significance; where the ASC wishes to make submissions to the Court on the interpretation of the Law; where the ASC considers it would be in the public interest.

Prosecutions
Under s. 49 of the ASC Act and s. 1315 of the Corporations Law, the ASC has the power to initiate and conduct all prosecutions. The ASC will conduct prosecutions of minor offences. However, major offences are prosecuted by the Commonwealth Director of Public Prosecutions (DPP) upon a reference by the ASC, in accordance with a memorandum of understanding between the DPP and the ASC.

Prosecution for criminal breaches of the Corporations Law is an important part of the ASC's overall enforcement strategy. Ideally, however, civil recover actions should be taken first, and disposed of as quickly as possible, for the benefit of the members and creditors of a particular company. Thereafter, the wider public interest should be satisfied and appropriate criminal prosecutions brought.

Section 25 of the Law permits the ASC to give a copy of the written record of an examination, together with a copy of any 'related books', to a person's lawyer, if the lawyer satisfies the ASC that the person is 'carrying on, or is contemplating in good faith, a proceeding in respect of a matter to which the examination related'.

Further, s. 25(3) of the Law permits the ASC to give such information to a person, subject to such conditions (if any) as it imposes.

Section 25 is part of a statutory scheme where, upon the ASC investigating the matter, the results of that investigation can be put before a court, in the course of criminal or civil proceedings, or otherwise released. Unlike s. 24(2)(b), which deals with circumstances where the record of examination is given to the person examined, s. 25 contemplates that the record is given to the lawyer of another person carrying on or contemplating legal proceedings, including proceedings against the examinee, or to any other person.

The ASC will release records of examination under in the context of this statutory scheme and, in the case of requests under s. 25 (1), after an assessment as to the other remedies and causes of action available to the ASC.

Generally, the ASC will not release records of examination under s. 25 unless the investigation to which the examination relates is completed or is sufficiently advanced so that the release of the information would not jeopardise the continuing investigation.

The ASC believes that, except in exceptional circumstances, the potential jeopardy to any examinee through the release of a record of examination is not a relevant consideration. Division 9 of Part 3 of the Act establishes a regime as to when the record of examination is admissible in various proceedings. That regime, and in particular s. 78 and s. 79 of the Act, regulate the use of records of examination in proceedings, and allow objection to be taken to the admission of the statement before a proceeding by any party (including the examinee).

Generally, the ASC will not release information under s. 25(1) unless the ASC is satisfied that it is in the interest of better administration of justice that the information be made available.

The ASC believes that, subject to the provisions of s. 78 and s. 79 of the Act, the records of examination may assist in the expeditious hearing of matters by the courts (recognising that the record of examination of a person is admissible in evidence against the person and is prima facie evidence of the matters to which it relates, pursuant to s. 76(3) of the Act). In many instances the record of examination will assist in identifying the issues in dispute in civil proceedings facilitating orderly litigation. However, the ASC also acknowledges that an examination may extend to matters other than those dealt with in the proceedings to which a request under s. 25 relates and that the unnecessary dissemination of information provided by an examinee is not contemplated by the Act.

Methodology of investigating suspected contraventions

Firstly, the ASC will concentrate on serious breaches of corporate law. As to what constitutes 'serious' is a matter of policy. We would regard a misinformation to the Stock Exchange as serious, because the financial markets require accurate and complete disclosure by corporations if they are to work effectively. We

would also regard any warehousing arrangements of listed securities as serious, again because the integrity of the financial markets rests upon compliance with the Corporations Law. The measure of seriousness not only refers to the nature of the breach, but also to the detriment suffered by shareholders and creditors of the corporation and the breadth of the suffering.

Secondly, the ASC is concentrating on breaches of the Corporations Law. The ASC does not see itself as a general policeman. Where breaches of criminal law are discovered, the matter will be referred to the Australian Federal Police, state police, or (in appropriate cases) the National Crime Authority. The ASC has established liaison with these agencies in order to ensure that all matters are properly investigated. In addition to referring appropriate matters to other agencies, the ASC has a statutory duty pursuant to s. 16(1) to prepare a report to the Attorney-General whenever it forms the opinion that a serious contravention of a Commonwealth or state law has been committed, identifying the evidence on which that opinion was formed. The ASC is not a regulator responsible for the enforcement of other laws, but will report it if it finds evidence of such offences, for example if taxation fraud is disclosed in the context of an ASC investigation. The ASC will only be an expert enforcer of corporate law.

Thirdly, the ASC has announced a policy of 'national investigation'. That policy does not mean that the ASC is only interested in the major investigations. Rather, it indicates that certain investigations require a national focus, either because of the geographic spread of the transactions under examination, or because of the resources required properly to staff the investigation. The fact that an investigation is designated a 'national investigation' ensures that it has an appropriate allocation of resources - although not necessarily a larger allocation than a 'non-national' investigation - it depends on the facts of the matter.

Fourthly, the ASC is establishing a procedure to try to ensure that every complaint is promptly assessed. Upon receipt of any complaint, whether from a shareholder, creditor, auditor, liquidator or an exchange, the ASC will determine whether the complaint warrants investigation. Under s. 13(1), the ASC may only commence an investigation if it has 'reason to suspect a contravention of a national scheme law' or a contravention of another that concerns the management or affairs of a body corporate or involves fraud or dishonesty and relates to a body corporate, securities or futures contracts. Before the Commission commences an investigation under s. 13(1), it must therefore have an objective basis to allege a contravention (as discussed in *Sim v. NCSC* (1988) 13 ACLR 191). Assuming the legal basis exists for an investigation, the decision to investigate will still have to be seen in context of a prioritisation of actions, in order to make effective use of the resources. Many situations will not warrant the use of the resources. In other cases, the complaint may be referred to another agency as described above. A minority will produce serious investigative efforts by the ASC.

Where the complaint suggests a breach of the Corporations Law, an investigation

will be commenced. It is the role of the ASC, in managing its resources, to monitor the progress of every investigation to determine the seriousness of the matters under investigation, the adequacy of resources to complete an investigative plan, and the likelihood that prosecutions or civil action will stem from that investigation. We would hope that every investigation will be completed within a period of one year, even if the investigation is taken to the stage of an initial report, suggesting future areas of inquiry. We would intend that investigations have defined scope, so that the ASC can properly manage its resources.

Investigations and Section 68

For the purpose of an investigation, the ASC may by written notice require a person to appear at a private examination to give evidence on oath (s. 19, ASC Act). Also, the ASC may given certain persons a written notice requiring production of specified documents relating to the affairs of a body corporate (s. 30, ASC Act). The ASC has similar powers to obtain documents in respect of securities and futures contracts (s. 31 and s. 32, ASC Act).

Section 68 of the ASC Act grants an immunity to persons bound by these compulsory processes, from the consequences of being compelled to incriminate themselves. Specifically, s. 68 expressly provides that they must comply with these compulsory processes by giving information, signing a record of the examination or providing documents which may incriminate them. However, in doing so they can, by claiming privilege against self-incrimination, render their oral evidence and the fact that they have signed the record or produced the documents inadmissible in any criminal proceedings (other than for perjury). Additionally, s. 68 provides that any 'information, document or other thing obtained as a direct or indirect consequence' of the person making the statement or signing the record, as the case may be, is admissible in evidence against the person in a criminal proceeding other than for perjury. Sub-section 68(3) extends the application of the use of immunity and the derivative use immunity to other proceedings for the imposition of a penalty.

In fact, when the investigation plan is being prepared, the ASC cannot know whether it will pursue civil remedies or criminal prosecutions or both, nor will it be in a position to know the specific remedies or charges which will arise for consideration or the possible or likely defendants. The strategy which must be adopted, therefore, is that the ASC must have regard to the derivative use immunity so as to minimise any prejudice to the possibility of either civil or criminal proceedings.

As a result, the ASC must, so far as possible, require full compliance with notices for production of documents, and resolve, by negotiation or court order, any challenges to such notices, before conducting any oral examinations. This is because documents which are otherwise available to the ASC pursuant to notices to produce and otherwise admissible in evidence in all proceedings, may become the subject of an argument, raised by the examinee defending criminal

proceedings or civil proceedings for the imposition of a penalty, that the document was only obtained as a direct or indirect result of evidence give at the examination.

In some cases, the prospect of criminal prosecutions will have to be jeopardised so as to pursue appropriate civil remedies. This will especially be the case where examinations must be conducted at short notice, possibly of individuals having a pivotal role in a suspected contravention. This will occur because sufficient evidence must be gathered in order to protect the interests of shareholders and creditors by way of civil proceedings. The prosecution of such an offender would be jeopardised because of the likely inadmissibility, as against that person, of evidence obtained after his or her examination.

Some prospective defendants will (quite sensibly) prefer to give oral evidence under s. 19 of the ASC Act rather than assisting informally, and before producing documents if possible, so as to be in a position to invoke the derivative use immunity to the fullest possible extent.

Another difficulty which arises by virtue of the derivative use immunity in connection with the conduct or oral examinations under s. 19 of the ASC Act is that persons having a less significant role in the conduct under review must be more heavily relied upon examinees. In this way a compromise is struck such that persons who played a lesser role in contravention may be allowed to become immune from civil proceedings for a penalty or a criminal prosecution, in the hope that evidence can be gathered and used against those who had the more significant role in the contraventions. In contrast, if the derivative use immunity were not available, the more significant participants in a contravention could be questioned and their evidence used as a basis for further investigation and the gathering of evidence which would be admissible against them. Also, the investigation (and any prosecution) process could thereby be streamlined and made fairer to those who are the subject of enquiry because the ASC and the DPP would better know the defendant's defences or explanations.

Another difficulty arising out of the derivative use immunity is that, when conducting examinations, the ASC must confine the questions asked of an examinee within a very narrow compass. In this way, the availability of the immunity to that examinee will be confined to the particular matters the subject of the questions and not to any other related or unrelated contraventions of which ASC may or may not be aware. Of course, the difficulty here is that a more thorough and broad-ranging examination is sacrificed in the interest of minimising the adverse impact of the derivative use immunity. There is also the danger of the examinee maximising the benefit of the immunity to himself or herself by giving broad-ranging answers. An inspector's ability to curtail the scope of an answer will of course be very limited because the need to do so will not be apparent until the answer is given.

As will be apparent, all of the above-mentioned difficulties will not only arise for

consideration at the time the particular step is taken in an investigation, but also when the initial investigation plan is prepared. The overall result is that the ASC must at times compromise its ability to pursue civil relief and facilitate prosecutions against all relevant parties, and take risks even as to its ability to pursue those playing the more significant roles in a contravention. Further, the ASC is compelled to take such decisions at times when it cannot possibly be apprised of all the facts.

The practical effect may be that any evidence obtained after the person has given evidence before the ASC, even if not derived indirectly or directly from that evidence, is inadmissible. In such circumstances, the overall prosecution may well fail not because the evidence it has is derived directly or indirectly from the evidence before the ASC, but simply due to the fact that the DPP cannot discharge the onus of proving that it was not so derived. In its present form the provision may have the effect that prosecutions simply cannot proceed. The matter is as serious and as urgent as that.

It should not be assumed that the difficulties we perceive relate only to investigation and criminal prosecutions. There is a need to strike an appropriate balance between the pursuit of civil remedies on the one hand and the preservation of the ability to bring prosecutions on the other (especially in the numerous investigations into apparently very serious contraventions). In doing so, there is a fear that necessary conservatism in the investigatory process (because of s. 68(3) of the ASC Act) may limit or jeopardise the ability of the ASC to pursue civil remedies.

In the light of the above comments, it should not be surprising that the ASC has sought amendments to s. 68, in order to remove the derivative use immunity. Although the ASC respects many of the arguments raised in defence of civil liberties, those arguments must take into account the particular difficulties of investigating corporate criminality and recognise the complexities of a large corporate investigation. The ASC believes that s. 68 does not properly balance two sets of competing private rights: those of shareholders and creditors whose interest in a corporation have been affected, and those of the parties responsible for the management of the corporation (normally the directors), who may rely upon the privilege against self-incrimination.

Investigations under Section 13(2) of the ASC Act

The ASC has power to conduct an investigation where it has reason to suspect the unacceptable circumstances within the meaning of Part 6.9 of the Corporations Law have, or may have occurred. Such an investigation can be for the purposes of determining whether the ASC should make an application to the Corporations and Securities Panel for a declaration of unacceptable acquisition or conduct, or otherwise for the due administration of the Corporations Law.

The important distinction between an investigation pursuant to s. 13(1) and one

pursuant to s. 13(2) is that an investigation under 2.13(2) is not one concerned with a contravention: unacceptable conduct for the purposes of the Law does not require illegality. For this reason, and because the Law only permits the ASC to refer a matter to the Panel within 60 days of the relevant acquisition, the methodology of the investigation will vary from that normally adopted by the ASC.

The differences in methodology between s. 13(1) investigation and a section 13.(2) investigation will include:

- all enquiries will normally proceed by formal examination under s. 22 of the ASC;
- the investigation will not seek to reach final conclusions, but only to permit the ASC to be satisfied that it may properly refer the matter to the Panel under s. 733 (it being recognised that the Panel is intended by the Law to conduct an inquisitorial proceeding to determine whether there was unacceptable conduct); and
- the onus of proof before the Panel is lower (the Panel not being bound by any rules of evidence), so that material which would be regarded as circumstantial or hearsay by a court can properly be compiled for presentation to the Panel.

In these circumstances, the ASC will not be concerned by the risk that examinees will claim a privilege against self-incrimination pursuant to s. 68 of the ASC Act. The ASC believes that, within the scheme of the Law, it is more important that it brings matters promptly to the attention of the Panel, notwithstanding the jeopardy to subsequent criminal prosecutions (if any) posed by s. 68(3).

Deterrence Programs

The ASC recognises that, although its investigative focus is to concentrate on perceived serious offences, it is also necessary to engender an environment where there is compliance with all aspects of the Corporations Law. There is a danger that, in adopting a team structure and concentrating on matters of perceived serious offences, the investigative resources of the ASC will be fully utilised. This should be avoided, if the ASC is also to establish a general climate of compliance.

In addition to the national and regional priority matters, and those investigations being conducted in the ordinary course upon assessment of complaints, it is necessary for the ASC to us its investigative resources to give effect to other policies, in the companies and market regulation areas. The ASC must show its determination to ensure compliance with all provisions of the Law going to the administration of companies and markets.

In various areas affecting the administration of companies, the offences are of a summary nature, and the penalties could be considered insignificant. It would be

a misapplication of resources to seek to prosecute all these offences. Rather, it is appropriate that a policy of selective enforcement be developed under which the ASC's broader policies are given effect to, by specific and publicised efforts to ensure compliance with relevant provisions of the Corporations Law.

Specific areas are proposed for inclusion in a deterrence program, as follows:

- failure by directors and secretary of a company in liquidation to provide a report under s. 475;
- failure by liquidators to report as to affairs of the company pursuant to s. 476;
- failure by receivers to report as to contraventions of the Corporations Law under s. 422;
- failure to notify resignation of auditors under s. 329(5);
- failure to notify resignation or retirement of company officers under s. 242(7);
- failure to lodge annual returns under s. 335;
- failure to maintain registers of directors' interests under s. 235;
- failure to notify substantial shareholders under s. 708, both in the required time and in the prescribed form;

Although these matters may be regarded as minor, they are in fact relevant to the integrity of financial markets and the ability of the ASC to expediently administer the Corporations Law.

An important feature of the deterrence program would be the use of publicity. The impact of the campaign will be maximised by publishing a schedule of target areas and campaign dates in the ASC Digest.

Responsibility of Experts and Advisers

A climate of compliance requires probity and responsibility by advisers and experts. The ASC carefully reviews the work of independent experts, who furnish reports in relation to transactions requiring approval of shareholders, whether under the Corporations Law or the Australian Stock Exchange Listing Rules. Whenever it is suspected that not all relevant material is placed before shareholders, the ASC will commence an investigation and will use its compulsive powers to examine the preparation of the report by the independent expert (including a review of all working papers and instructions).

In addition, the ASC will review the work of auditors, in order to determine whether the auditors properly discharged their duties to the Corporation. In appropriate cases, where negligence is suspected on the part of auditors, the ASC will consider the commencement of civil actions by the Commission on behalf of and in the name of the Corporation, pursuant to s. 50 of the ASC Act. In other cases, the ASC will refer possible breaches of duties to the Companies, Auditors

and Liquidators Disciplinary Licensing Board, by way of disciplinary proceedings.

These programs will be an important part of the ASC's deterrence program and will be conducted both in conjunction with investigations into suspected contraventions, pursuant to s. 13(1) of the Code, and in exercise of the ASC's more general more supervisory role, exercising its powers of enquiry.

Powers of Enquiry

The ASC has a power to require the production of documents pursuant to section 30, 31 and 32 of the ASC Act. These powers may be exercised in the circumstances described in section 28 of the ASC Act which permits production of documents in the case of an alleged or suspected contravention all for the purposes of investigation pursuant to section 13, but also:

. for the purpose of the performance or exercise of any of the Commission's functions and powers under a national scheme law . . . ;

b. for the purpose of ensuring compliance with a national scheme law.

Accordingly, the ASC's power to require production of documents is not limited to its investigative powers. The ASC can properly require the production of documents as part of a general 'audit' of transactions or of a company's affairs, in order to ensure compliance with the Corporations Law.

In addition, the ASC has broad powers to require from licensed brokers and dealers information in relation to their business. Section 788 of the Corporations Law permits the ASC to require a statement as to the particulars of the business including information which the ASC may require to be audited. Again, it is not necessary that the ASC be investigating any alleged or suspected contravention, where it requires information from a licensed person.

The ASC regards these as important powers, which will assist it in the detection of matters requiring investigation.

Conclusion

Any program for the prevention of fraud must start from the assumption that there will always be fraud, but its occurrence can be minimised through twin policies of encouraging a fear of conviction and imprisonment, and establishing an environment of compliance.

The policies of the ASC are being designed to create that environment of compliance. Those policies will need to be reviewed and revised in future years. The ASC accepts that it is a new organisation, and its enforcement culture is in its infancy. The ASC will also be responsive to what is occurring in the securities markets and welcomes criticism and comment about its enforcement priorities and policies.

The range of remedies available to the ASC means that it must be selective and it must manage its resources consistent with its policies. The purpose of this paper is to outline those policies and to permit an informed public debate. It is only through that debate that fraud can be effectively combated by the ASC.

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Auditors and the Reporting of Illegality and Financial Fraud

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Auditors' responsibilities have become the subject of renewed Australian and international interest in the light of the spate of the corporate collapses of recent years. Whilst this has continued to be the subject of debate over the last decade or more, the clarification of the rules in this area has become a matter of particular concern recently. This is especially so in relation to the reporting of financial fraud or illegality. This issue has become the subject of debate in a number of countries apart from Australia.

In the United Kingdom, for example, the enactment of the Banking Act 1987 in England authorised auditors of banks to communicate fraud and other financial concerns confidentially to the Bank of England. Also, s. 109(1) of the Financial Services Act 1986 overrides any duty that an auditor may have to a client not to communicate information, which the auditor has become aware of as an auditor, where the auditor in good faith communicates that information to the Securities Investment Board. In other words, s. 109 'creates a right and a power for the auditor to disclose appropriate information to the appropriate regulator' (Sweeney-Baird 1990, pp. 30-1). The recent decision of the House of Lords in *Caparo Industries plc v. Dickman and Ors* (1989) 1 ACSR 636 has also examined the implications of auditors' reports for potential investors in the company. The House of Lords found that there was a duty of care owed by an auditor to an individual shareholder but not generally to potential investors. This decision has received considerable discussion elsewhere and I will not traverse the same ground here. Suffice it to say that it has clarified the potential obligations of auditors for negligent action. However, it does not greatly assist us in discussing the issue of the responsibility of auditors for detecting financial fraud and illegality.

The United States has seen the publication in 1987 of the report of the Treadway Commission, the National Commission on Fraudulent Financial Reporting (*see* further Goldstein and Dixon 1989, pp. 439-74; *Corporate Crime Reporter 1987*, pp. 1-3). The Commission had been set up by the American Institute of Certified Public Accountants (AICPA) and several other American private accounting organisations. In addition to recommending that corporate management design and implement internal control systems adequate to prevent and detect fraudulent financial reporting, the Treadway Commission concluded that '[a]uditors can and should do a better job of communicating their role and responsibilities [as well as their findings] to those who rely on their work' (quoted in Goldstein and Dixon

1989, p. 471). There has also been an ongoing Congressional debate concerning the responsibilities of auditors to the investing public as reflected in 1990 United States House of Representatives hearings (Wyden sub-committee of the Energy and Commerce Committee) aimed at amending the Securities Exchange Act of 1934 to improve procedures to provide reasonable assurance of detecting illegal acts (see further Neebes 1990 and Congressional Record H8892, 4 October 1990). This legislation has received the support of the accounting profession in the light of criticisms made of auditors of the failed savings and loan institutions and in view of the possibility of even harsher legislation being passed (*see Wall Street Journal*, 14 September and 5 October 1990). It has been suggested that fraud and other criminal conduct played an important role in the collapse of about 40 per cent of the savings and loan institutions which had been taken over by the US government's Resolution Trust Corporation (Crenshaw 1990). This alleged widespread level of illegality had the effect of reviving questions about the independence of auditors in auditing large corporate clients such as the failed Lincoln Savings and Loan Association (Nash 1989). Although more than half of the profits reported by the Lincoln Savings and Loan were the result of sham transactions, its auditors, Ernst and Young, apparently claimed that their role was only to ensure that the firm's accounts complied with generally accepted accounting principles and not to determine the safety and soundness of the firm (see further Thomas 1989; Wayne 1989). The proposed new American legislation would require auditors to notify the Securities Exchange Commission (SEC) of possible illegalities by the company and to evaluate a company's internal control measures periodically.

In the United States the AICPA has recently promulgated a number of new Statements on Auditing Standards which, inter alia, have had the effect of increasing the responsibilities of auditors in detecting material errors and irregularities and in detecting violations of law and regulation which have direct and material effects on financial statements (Neebes 1990). However, the Chairman of the AICPA Auditing Standards Board recently argued that there are significant limits upon the capacities of the auditor to respond to financial fraud. As he put it:

> Two inescapable realities constrain the auditor's ability to assume broader responsibilities than those now contained in the literature to detect and report illegal activities. One, it must be understood that the operations of American businesses are today a broad, almost incomprehensible, array of legal requirements imposed at every level of government. Moreover, in circumstances in which publicly-held companies are engaged in foreign operations, the fabric of legal requirements becomes even more extensive and uncertain. The Auditing Standards Board, which developed the new standards on illegal acts, believed it simply would not be feasible to design an audit to provide positive assurance of detecting all material illegal acts. Two, it should be recognised that auditors, although highly trained and reliably regarded as experts in financial matters, are often ill-equipped or unable to arrive at legal conclusions concerning whether a specific activity or transaction comports with legal requirements. Here the auditor relies on legal counsel and other specialists. Even then, sometimes uncertainty associated with the interpretation of applicable laws or regulations

> or surrounding facts precludes a legal judgment (Neebes 1990, p. 13).

Consequently, Neebes went on to say that the response of the profession has been to reach the following 'solution to this problem' :

> First, it has defined an affirmative obligation to consider laws and regulations that are generally recognised by auditors to have a direct and material effect on the determination of financial statement amounts. Second, it has established auditor responsibilities with respect to audit discoveries of illegal acts which go beyond the concept of direct and material effects on financial statement amounts . . . Lastly, if an auditor concludes that an illegal act has a material effect on the financial statements, and the act has not been properly accounted for or disclosed, the auditor would express a qualified opinion or an adverse opinion on the financial statements. Such a qualified or adverse opinion would, of course, result in notification to the SEC of the illegal act (Neebes 1990, pp. 13-14).

However, the AICPA has strongly resisted proposals which would require an auditor to detect illegal acts which 'could materially affect the issuer's financial statement or operations'. Such a requirement has, not surprisingly, been seen as being impracticable (Neebes 1990, p. 19).

In Australia, concern over the responsibilities of auditors faced with corporate illegality has also been evident in the spate of legal actions brought against auditors and the increasing realisation by auditors and regulators that the current laws imposing liabilities upon auditors to report illegality and financial irregularities are less than adequate. In 1987, the National Companies and Securities Commission (NCSC) announced that it would target auditors in its crackdown on accounting standards (Potter 1987, pp. 1-2). Notable recent cases of apparent audit failure include those involving Rothwells, Tricontinental and the National Safety Council, to mention but a few. At the same time we have seen new legislation in the form of the *Corporations Act 1989* (Cwlth) which has modified the law in this area. Arguably, this legislation still needs to be greatly strengthened if it is to be of more than symbolic value.

However, the view of the auditing profession in Australia is that it is management that has the role of detecting financial fraud and that the detection of fraud by auditors is seen as being secondary to the primary duty of reporting whether the accounts are 'true and fair' (Gay and Pound 1989). For example, paragraph 7 of AUS1 (*see* Parker 1991) provides as follows:

> While the auditor is responsible for forming and expressing an opinion on the financial information, the responsibility for its preparation lies with the management of the entity. Management's responsibilities include the maintenance of adequate accounting records and internal controls, the selection and application of appropriate accounting policies, and the safeguarding of the assets of the entity. The audit of the financial information does not relieve management of its responsibilities (*see* further Godsell 1990, p. 121).

However, it needs to be said that where large accounting firms also provide substantial advice on the preparation of a corporation's accounts, the thrust of the philosophy as expressed in AUS1 (Parker 1991) is much harder to justify, unless

of course auditing is entirely divorced from the remainder of accounting work for a corporation.

Auditors have argued that they should be able to avoid responsibility provided that they put in place an audit plan which provides a reasonable expectation of discovering material mis-statements in the accounts, rather than detecting all material fraud. In this context it is often argued that the public has unrealistic expectations of auditors and it has been left to the courts to seek to bridge the gap between public expectations and the views of auditors concerning their responsibilities.

Almost a century ago, the courts recognised the approach taken by auditors in the conclusion that the auditor was to be seen as a watchdog and not as a bloodhound (per Lopes LJ in *In re Kingston Cotton Mill Co (No 2)* [1896] 2 Ch 279 at 289, 290) . However, the courts have also come to recognise that the standards of care and skill are now more stringent than they were in 1896, when this colourful expression was articulated. As Moffitt J observed in *Pacific Acceptance Corporation v. Forsyth* (1970) 92 WN (NSW) 29 at 65): 'If fraud has taken place and is undetected by the auditor he is blameworthy in the eyes of the law [but] only so far as he has been negligent in determining the scope and character of his examination' (*see further BGJ Holdings Pty Ltd and Anor v. Touche Ross and Co and Ors* (1988) 12 ACLR 481 and *WA Chip and Pulp Co Pty Ltd v. Arthur Young and Co* (1987) 12 ACLR 25).

However, short of a breach of a statutory duty (per Corporations Law s. 332(10)), there is no obligation on the part of the auditor to report fraud if the auditor believes that the financial statements give a 'true and fair' view of the financial health of the company (Gay and Pound 1989, p. 127). Also, the auditor's duty of confidentiality to the client does not prevent the auditor from reporting a matter if he or she knows that a fraud has been committed. However, if developments in the United States are any guide, it may be only a matter of time before it will be seen as insufficient for auditors in Australia to say that they have taken reasonable steps to plan an audit and to leave it at that. As Gay and Pound (1989, p. 128) point out, in the United States the Statement of Auditing Standards SAS 53 issued in 1988 'the auditor is expected to detect material errors and irregularities, not just plan the audit to search for them. This is an important extension of the auditor's role compared to the position in Australia, as expressed in Statements of Auditing Practice AUP16'. As Godsell has noted, AUP16 points out that the failure to detect material fraud or error does not necessarily imply any failing on the part of the auditor (Godsell 1990, pp. 122-3). Paragraphs 6 of AUP16 states:

> Due to inherent limitations of an audit there is a possibility that material mis-statements of the financial information resulting from fraud, and, to a lesser extent, error, may not be detected. The subsequent discovery of material mis-statement of the financial information resulting from fraud or error existing during the period covered by the auditor's report does not, in itself, indicate that the auditor has failed to adhere to the basic principles governing the audit. The

> question of whether the auditor has adhered to the basic principles governing an audit is determined by the adequacy of the procedures undertaken in the circumstances and the suitability of the auditor's report based on the result of these procedures.

Paragraph 8 of AUP16 adds that

> The risk of not detecting material mis-statement resulting from fraud, is greater than the risk of not detecting a material mis-statement resulting from error, because fraud usually involves acts designed to conceal it, such as collusion, forgery, deliberate failure to record transactions, or intentional misrepresentations being made to the auditor.

Accounting Standards have the force of law except in so far as they are inconsistent with the *Corporations Act 1989* (*see further* Parker 1991). The principal provisions of the Corporations Act dealing with the duties of auditors remain largely unchanged from those appearing in the Co-operative Scheme Companies Code. Apart from expressing the section in gender neutral terms, Corporations Law s. 332 is in substantially similar terms to the Code s. 285. However, the ambit of the auditor's duties under s. 332(3)(a) is a little wider than the duties under Companies Code s. 285(3)(a) in that the new provisions require the auditor to reach a conclusion regarding the truth or fairness of all the matters dealt with in Division 4 of Part 3.6 and not merely the matters set out in Companies Code s. 269, which dealt with the profit and loss account, the balance-sheet and group accounts. This section contains the following principal provisions.

- Under s. 332(1) the auditor is required to report to the members on the accounts which are required to be laid before the company at an AGM as well as upon the company's accounting records and other records relating to those accounts. This provision also requires that the auditor report on group accounts if the company is a member of a group. This report is to be furnished to the directors of the company in sufficient time to allow them to comply with their duties under s. 315(2) to forward financial statements to members at least 14 days before the meeting.
- The contents of the auditor's report are spelt out in s. 332(3). The auditor is required to state whether in his or her opinion the accounts of the company are properly drawn up so as to provide a 'true and fair view' of **the matters required by Division 4 of Part 3.6** to be dealt with in the accounts, whether the accounts are in accordance with the Act and whether they are in accordance with applicable accounting standards. Where the accounts are not drawn up in conformity with the applicable accounting standards, the auditor is required to express an opinion as to whether the accounts would have presented a true and fair view if they had been prepared in accordance with such standards. Where the auditor does not believe this to be so, the auditor is required to give reasons for this opinion (per s. 232(3)(ii)). Also, where the auditor is of the opinion that the accounts are not properly drawn up as required or that there has been an unacceptable failure to comply with applicable accounting standards, then the auditor is

required to report the reasons for reaching these conclusions. Where the auditor is not satisfied with compliance with the approved accounting standards he or she is required by s. 332(11) to furnish a copy of the auditor's report to the Australian Accounting Standards Board within 7 days of providing his or her report to the directors.

- The auditor is also required by s. 332(3)(d) to report on any defects or irregularities in the accounts or group accounts or any omission from the accounts which would have the effect of not providing a true and fair view.
- The auditor is also required to form an opinion in regard to various matters set out in s. 332(4) regarding the adequacy of accounting records.
- Section 332(9) requires the auditor to report in writing to the Commission any failure upon the part of the company or the directors to comply with annual general meeting requirements set out in s. 245 or to comply with the financial statements requirements of s. 316.
- Probably the most important provision for our purposes is to be found in s. 332(10). It is worth setting out this section in full. This is in the following terms:

> Except in a case to which subsection (9) applies, if an auditor, in the course of the performance of duties as auditors of a company, is satisfied that:
>
> . there has been a contravention of this Act; and
>
> b. the circumstances are such that in the auditor's opinion the matter has not been or will not be adequately dealt with by comment in the auditor's report on the accounts or group accounts or by bringing the matter to the notice of the directors of the company or, if the company is a subsidiary, of the directors of any body corporate of which the company is a subsidiary;
>
> the auditor shall forthwith report the matter to the Commission by notice in writing.

The general penalty provisions in s. 1311 apply to breaches of the auditors' duties provisions in s. 332. Section 1311(1) provides that:

> A person who:
>
> . . .
> b. does not do an act or thing that the person is required or directed to do by or under a provision of this Law; or
> c. otherwise contravenes a provision of this Law;
>
> is guilty of an offence by virtue of this subsection . . .

As the amount of the penalty for a breach of s. 332(10) is not specified in Schedule 3 of the Corporations Law, or in s. 332 itself, s. 1311(5) provides that the applicable penalty for a breach of s. 332(10) will be a fine of $500. This fine is hardly a great deterrent although application may also be made by the Commission under s. 1292 of the Corporations Law to the Company Auditors and Liquidators Disciplinary Board to cancel or suspend for a specified period the registration of an auditor who has failed to comply with s. 332(10). Were the

latter penalty used it would of course constitute a more significant deterrent than the nominal fine which has been provided for in the legislation.

There have been no reported cases on this section or on its Companies Code predecessor. It seems that concern about the limited nature of this provision tends to arise following blatant failures on the part of auditors to report matters that come to their attention. For example, arising out of Mr Justice Stewart's Royal Commission of Inquiry into the activities of the Nugan Hand Group during the early 1980s, the Commission made various recommendations pertinent to the obligations of auditors. The Royal Commission had found that:

> . . . the key to an understanding of how it was that the Nugan Hand Group was able to be spawned in Australia and rapidly expand overseas, is to be found in the methods used to give the published accounts of Nugan Hand Ltd . . . a grossly false appearance . . . [I]t was the appending of the auditors' certificate to such accounts that thereafter gave them the status which automatically follows from the fact that a duly qualified auditor certified them. In the ordinary course of events the audited accounts of a public company are accepted at face value and no attempt is made to go behind them. Well aware of this Messrs F.J. Nugan and M.J. Hand unscrupulously published and proffered to the world at large the accounts of Nugan Hand Ltd to gain commercial acceptance and credibility for the company, and for themselves, not only in this country but overseas, and, in particular, in Hong Kong (Royal Commission of Inquiry into the Activities of the Nugan Hand Group 1985, p. 763).

The Stewart Commission went on to express concern about the fact that, after reviewing the views of the relevant accounting bodies, there was:

> . . . little or no consensus of opinion in relation to this aspect of the auditor's duty [i.e. to detect fraud], not only among auditors but also among those who rely on published audited company accounts such as those proposing to deal with the company on the strength of its audited accounts . . . Essentially this perceived difference of opinion, on the question of what is the extent of the auditor's duty to detect fraud, stems from two distinct interpretations of the duty which seem to be current. The distinction seems to be whether the auditor is under a duty to detect fraud that is, to specifically search for fraud, or whether, on the other hand, it is enough for the auditor to plan his audit so that he has a reasonable expectation of detecting material mis- statements in the financial statements resulting from irregularities or fraud. The latter view appears to be echoed in this country in the current Statements of Auditing Practice in respect of Fraud or Error (AUP16) issued by the Accounting Standards Board in June 1983 (Royal Commission of Inquiry into the Activities of the Nugan Hand Group 1985, p. 76).

The Royal Commission explained how the audit partner in the firm of accountants which audited the Nugan Hand accounts, and which had earlier prepared these accounts, came to certify the Bank's accounts as being 'true and fair' :

> Mr Pollard [the audit partner] said Mr Brincat [an employee at that time] completed the audit work for the accounts of Nugan Hand Ltd. Mr Pollard signed the annual accounts audit certificate because Mr Brincat was not yet a partner and therefore not entitled to sign. However, Mr Pollard admitted he had not looked at Mr Brincat's working papers and so was in no position to hold the opinion expressed above his signature (which was that the Nugan Hand Ltd

> accounts for 1974 gave a true and fair view of the state of the Group's affairs) because he himself had not done the necessary work. Mr Pollard said that when he signed the accounts he did not know whether they were true or not. He said the documents were probably just put in front of him and he signed them as he relied completely on Mr Brincat (Royal Commission of Inquiry into the Activities of the Nugan Hand Bank 1985, pp. 245-6).

Brincat subsequently became a partner with Pollard and Heuschkel. For five years from 30 June 1975 Brincat prepared the accounts for Nugan Hand Ltd as well as acting as the auditor for the company and its associates. At page 119 of the *Final Report*, Justice Stewart observed that 'In certifying those accounts each year he [Brincat] says he simply accepted Mr F.J. Nugan's version of various transactions'.

Another aspect of the Nugan Hand accounts which had concerned the Royal Commission had been the use of internal bills of exchange to represent inter-company debts. Neither Brincat nor his fellow partners had experience in their use and they therefore sought independent legal advice concerning them. However, as the Royal Commission noted at page 120:

> Mr Nugan intervened at this point and persuaded the partners including Mr Brincat to accept the view of his own solicitor, Mr J.L. Aston, that the use of internal bills was not inappropriate although it should be the subject of a suitable note to the accounts (*see also* the further discussion of this matter at p. 246 of the *Final Report*).

Justice Stewart added:

> The use of internal bills of exchange continued to be the subject of frequent discussions between Mr F.J. Nugan and Mr Brincat until, at a meeting three weeks before Mr Nugan's death, Mr Brincat said that he would qualify the audit report for the year ending 31 January 1980 to the extent of writing off between $4-5 million against the internal bills, thus exposing Nugan Hand Ltd as hopelessly insolvent.

The Royal Commission's recommendations included a call for the codification of the duty of auditors of public companies to detect fraud in a company. As Mr Justice Stewart put it at pp. 766-7 of his *Final Report*:

> To the extent that there does seem to be some uncertainty as to the scope of this duty it is obviously a matter of some concern. It is clearly undesirable for there to be any significant differences between the ambit of the duty as perceived by the auditor and the understanding held by the client and those proposing to deal with the company on the strength of the audited accounts. In the view of the Commission there is a need for the legislature to define precisely the auditor's duty to detect fraud and whether the duty extends to third parties who can be expected to rely on the audited accounts and to provide for penalties for the deliberate and reckless failure to carry out such duty.

The Royal Commission also recommended that the role of auditor and accountant to a public company be separated. After discussing these two recommendations with the accounting profession 'the [National Companies and Securities] Commission determined that it could not support [these] recommendations . . .' These NCSC recommendations were subsequently endorsed by the Ministerial

Council on Companies and Securities (NCSC 1989, p. 30). The NCSC (1989, p. 30) did, however, accept two other recommendations of the Nugan Hand Royal Commission. One of these involved the creation of a criminal offence for an auditor who certifies company accounts which the auditor knows contains false statements or which will create a false impression and the creation of a specific offence for an auditor who deliberately or as a result of reckless indifference fails to comply with the requirements of what is now s. 332 relating to the duties of auditors. To-date no further official action has occurred to create such a criminal offence.

More recently the Tricontinental Royal Commission was told that one of the reasons for the collapse of Tricontinental was that the auditors had been steered away from certain parts of the business. The former managing director of Tricontinental, Ian Johns, reportedly had in 1987 issued a written instruction to the internal auditor from Hungerfords to place more emphasis on the areas of capital markets, corporate funding and cash trusts, rather than the areas of corporate services and project finance (Kaspiew 1991). A number of other current negligence actions against auditors are also well known. For example, AWA Ltd is suing Deloitte Haskins and Sells for damages of between $39 million and $42 million for the loss of over $50 million due to the alleged failure of the auditors to warn the management of AWA of the speculative nature of foreign exchange dealings being conducted upon behalf of AWA by its former foreign exchange dealer Andrew Koval (Lampe 1991, p. 38). As Anne Lampe has reported: 'In its defence, Deloittes is arguing that the AWA board should have known about what was going on in its foreign exchange division, particularly given the magnitude of the transactions. It should have asked how 'millions of dollars of profit' emanated from that division (*see further* Burchill 1990, p. 20). Reference might also be made to similar actions for $264 million which have been commenced against Howarth and Howarth by a Price Waterhouse liquidator for its audit of the National Safety Council accounts (*see further* Burchill 1990, p. 20). Apart from the audit context, it has almost become commonplace to see actions for damages being brought against accountants as advisers in commercial transactions, as they are often the only group involved in a transaction which has any remaining funds (*see The Canberra Times*, 2 March 1990, p. 15; *Sydney Morning Herald*, 2 March 1990, p. 23; Peers 1991, p. 16; *Australian Business*, 23 January 1991, pp. 32-3). It is not surprising therefore that as of April 1990, some 44 per cent of the amount claimed against all accountants should have been made in relation to audit work. The next largest area of insurance claim was in relation to taxation work which accounted for 14 per cent of the total amount claimed against accountants (Blue 1990, pp. 84-5).

It is also of interest to refer to the special investigation report into Rothwells by Mr M.J. McCusker QC (1990). In that report, serious problems with the operation of the duties of auditors' provisions were again identified. The fact that the Rothwells accounts had been audited by KMG Hungerfords, one of the Big Six accounting firms, was used by Rothwells to assure the WA Government and the

public that Rothwells was 'basically sound' (McCusker 1990, p. 29). In many ways the parallels between the internal financial transactions of Nugan Hand Ltd and Rothwells are quite striking. Due to the wide range of Rothwells' financial transactions discussed by Special Investigator McCusker, it is possible here to touch on only a small number of these. As McCusker noted:

> In my opinion, however, the true 'cause' of the failure of Rothwells is to be found in its 'receivables', the debts owing to it which, as in the case of most financial institutions, constituted its major asset . . . compounding [Rothwell's 'woefully inadequate' financial records] was the manner in which the massive indebtedness of L.R. Connell and Partners and Oakhill [Connell's private company] to Rothwells at 31 July 1987, of $324m, was 'removed', and by journal entries purportedly replaced with 'assets' such as debts for millions of dollars owing by companies with $2 paid up capital, with recourse against the directors expressly excluded by the terms of the loan . . . (McCusker 1990, pp. 26-7).

McCusker went on to add that:

> Since 1983, Connell had been a substantial borrower from Rothwells, mainly through his partnership (L.R. Connell and Partners) and his private company, Oakhill Pty Ltd. The borrowings were massive, and for the most part unsecured. Over the years, they had rapidly increased. But no-one reading the published Annual Report and Accounts of Rothwells would have appreciated that to be the case, for at the end of each financial year the 'Connell debt' would be 'removed'. This was done in various ways, amounting to transactions which were entirely shams, or (in 1987) mainly shams.

The effect of these 'sham' transactions was to remove the 'Connell debt' on each balance date and return it by journal entry on the following day with a view to ensuring that the public accounts did not reveal the extent of Connell's borrowings. The reversal of these journal entries received no consideration from the auditors, even though Schedule 7 of the Companies Code and Stock Exchange Listing Rules require the disclosure to the shareholders of any 'material contract', such as the sham assignment of the debts of Connell on balance day (McCusker 1990, pp. 52-3). McCusker referred to the 'perfunctory and tolerant manner in which the audits were carried out' by Carter and his associates (McCusker 1990, p. 54). No efforts were made by Carter to establish that debts existed or that the debtors were aware that their debts had been 'assigned'. Although debtor confirmation letters had been prepared by Carter to determine the amounts supposedly owed, none of these letters were sent to the alleged debtors, thus avoiding further notification of the sham nature of these transactions. As McCusker notes:

> The revelation of the fact that the $35m entry was a sham, which would have flowed from the responses to the confirmation letters, would have obliged the auditors both to qualify their report, stating the true position (as to Connell's debts), and to report the entire matter to the Corporate Affairs Commission, under s. 285(10) of the Companies Code (McCusker 1990, p. 56).

It was clear that 'the audit team was aware of the pattern that had developed, whereby large Connell borrowings were "extinguished" on each balance date' (McCusker 1990, p. 58).

In an analysis for the McCusker inquiry of the KMG Hungerford's audit of Rothwells, Deloittes had concluded that inadequate provision had been made by Rothwells for doubtful debts and that, upon the basis of the receivables, the auditors could not have reached a conclusion that Rothwells had made a proper provision for doubtful debts (McCusker 1990, p. 64). Similarly, a secret 1987 review of receivables by Price Waterhouse commissioned by Connell quickly found that Rothwells was in an extremely serious financial situation. Although the Price Waterhouse team were forbidden by a 'confidentiality agreement' from disclosing the contents of its review to anyone other than Connell, Pope, the Price Waterhouse partner who had led the review, was, as McCusker explained, 'astonished and concerned' when he saw the July 1987 Rothwells accounts as he believed that they were misleading (McCusker 1990, p. 32). Apparently, Pope felt compelled to comply with the terms of the confidentiality agreement as he knew that the WA Government's $150 million overdraft guarantee to Rothwells after the 1987 stock market crash was very vulnerable. Also, he was concerned that his client, Bond Corporation, had to be misled although it was also at risk from Rothwells. Legal advice had led Pope to conclude that he was precluded from disclosing what he knew.

Most of the 'Connell debts' to Rothwells were eventually 'cleared off the slate' by the agreement of the WA government to pay $400 million for a share in a proposed Petrochemical plant project which Connell and Dallas Demster had packaged. As McCusker noted, this effectively amounted to 'a gift of about $300m' to Connell 'enabling him to clear a large part of his direct and indirect indebtedness to Rothwells' (McCusker 1990, p. 39).

Looking further at the role of the auditor in this sorry tale, McCusker noted that:

> The evidence of Carter [the auditor] discloses a quite extraordinary approach to the assessment of what was a proper provision for doubtful debts. Asked . . . whether he sought to make some assessment of the credit worthiness of Rothwells' debtors (bearing in mind that the audit working papers revealed little in the way of such assessment), and whether he called for balance sheets or profit and loss statements in respect of Rothwells' debtors, he said:
>
> > 'Not specifically because they would not have been available for the recent accounting period at that time . . .'
>
> . . . The proposition that Connell 'stood behind the Rothwells' debts', as providing 'comfort' to the auditors, is a recurrent theme in the evidence of Carter (McCusker 1990, pp. 67-9).

McCusker went on to note that:

> No attempt was made by Carter, or by any of the Rothwells directors, to obtain a verified statement of Connell's net assets, so as to determine whether his 'wealth' (financed by extensive borrowings from Rothwells) was sufficient to meet his ever-mounting debt with Rothwells (McCusker 1990, p. 73).

Instead of undertaking any independent assessment of the accounts of Rothwells, Carter admitted that due to unavailable documentation 'to a large extent we were forced to rely on his (Hugall's) [a Director and Secretary of Rothwells] own

assessment of the company's prospects'. He added that: 'We relied more on in depth discussions with the directors . . . rather than looking at files' (McCusker 1990, pp. 70-1). Despite the finding of McCusker that Carter was fully aware that Rothwells was being used by Connell for very extensive borrowings (McCusker 1990, p. 119), no qualifications were made to their report on the Rothwells accounts by the firm of auditors. As McCusker noted:

> . . . Carter relied very heavily upon Lucas and Hugall in his audit of the receivables. They were both directors of Rothwells. That reliance, and lack of any objective evaluation, was not calculated to produce the 'independent audit' which the shareholders and the public are entitled to expect. Lucas was in charge of the loan portfolio. Many of Hugall's companies were in fact substantial borrowers from Rothwells. The audit working papers obtained by the investigation confirm his dependence on the word of Lucas and Hugall, as distinct from an evaluation of the records . . . The picture of the audit that emerges is one of a total failure to take any steps, independently of the executive directors, to determine the true state of the receivables, and an awarenesss that for several years the accounts and records relating to receivables had been and still were quite unsatisfactory (McCusker 1990, pp. 107-9).

In response to a number of 'horror stories' from inquiries such as the Nugan Hand Royal Commission and the McCusker Investigation, the NCSC simply contented itself with issuing a Practice Note (Release Number 356) in September 1990 on the duties of auditors to report to the Commission under the predecessor of s. 332(10). This practice note largely restates the terms of Companies Code s. 285(10) [the equivalent of the present s. 332(10)] and provides a few examples of breaches and how these might be dealt with. For example, the Commission notes:

> 7. Where an auditor believes that the contravention can reasonably and effectively be remedied by the directors, and the directors are subsequently able to ensure that there will be no repetition of the contravention, the auditor is not required to notify the Commission and may simply report the matter to the directors . . .
>
> 10. Once the auditor has decided that the Commission should be notified pursuant to sec 285(10), such notification must be given without delay, i.e. not notifying the Commission until the directors' views can be sought on whether notification should be given to the Commission is not in itself a sufficient reason for delaying notification. In particular, the auditor should not wait until the conclusion of the audit to report a matter that becomes known at a preliminary stage of the audit.
>
> 11. Where the directors have been notified of a contravention of, or failure to comply with, the provisions of the Code and the auditor is not satisfied with the action taken or that timely remedial action will be taken, the Commission should be notified without delay.

In late February 1991, Arthur McHugh, the then Executive Director, Markets, of the ASC had occasion to comment on the ambit of s. 332(10). McHugh revealed that 'The Commission has recently had cause to re-examine this [section] and has reached the conclusion that the duty to report is wider in several respects than had previously been realised'. In particular, he went on to add:

> First, the duty to report arises forthwith and not at some indeterminate future time or at the conclusion of the audit.
>
> Second, the range of possible contraventions covers the whole gamut of the Law and certainly includes difficult but important areas like s. 232 (directors' duties).
>
> Third, and most controversially, the Commission believes that it is sufficient that the auditor form an opinion based on the available facts at the balance of probability degree of satisfaction. It does not require evidence that would persuade to say the degree required for a successful prosecution of the matter identified (Release Number 356; McHugh 1991, pp. 12-13).

The first two of the above points largely re-state matters already covered in the NCSC's September 1990 Practice Note on s. 285(10) of the Code. It will be interesting to see if the third matter raised by McHugh leads auditors to suddenly begin to come forward in greater numbers than has been the case in the past. I somehow doubt it, despite the existence of flagrant cases such as the Nugan Hand and the Rothwells cases referred to above.

Some recent Australian Empirical Data

With colleagues at the Centre for National Corporate Law Research at the University of Canberra, Stephen Bottomley and I undertook a study of the attitudes to corporate law of public company directors in the top 500 Australian companies drawn from the 1990 *Business Review Weekly* (BRW) listing of the top 500 companies. This study involved detailed interviews of over 100 directors from the top 500. A total of almost 150 interviews were conducted, two-thirds being with company directors and the remainder with advisers and observers such as corporate lawyers, auditors, liquidators and regulators. In the course of this study, directors had occasion to remark upon the role of auditors in relation to breaches of directors duties. It is useful to refer to their highly pertinent attitudes.

The auditor as target: As noted earlier, it has become fashionable to sue auditors rather than to seek to recover funds from the directors who may have been responsible for the financial failure. As one Adelaide lawyer interviewed as part of the top 500 study observed:

> A lot of companies never go into liquidation . . . [as] . . . there is no cash to finance an inquiry into what happened. Banks do not throw good money after bad. In addition it is too expensive to run complex corporate claims. Persons will not run it unless they are satisfied that the individual is worth suing as directors can shed assets. **It is more productive to sue auditors.** (emphasis added)

A question which received a wide response asked respondents to offer possible solutions to the situation in which attempts are made to enforce the duties of directors 'after the horse has bolted' or after the assets have been dissipated by directors who have behaved illegally. Respondents were asked whether there were any means of providing an earlier intervention or early warning of this type

of situation. Many respondents pointed to auditors as being the first line of defence in this area, as the following comments show.

One Sydney managing director of a leading public company echoed the views of many senior executives when he observed that 'There needs to be a better use of accounting standards, more stringent reporting and a larger question mark over the auditing profession'. Many directors argued that auditors should be required to assume greater responsibilities in regard to the detection of financial failure. As another Sydney director noted: 'Other than directors, the next best informed people are the auditors. Auditors have a duty to the public. They should assume further legal responsibilities'. Another Sydney director pointed out that it was necessary to impose greater responsibilities upon auditors as 'Auditors are the only ones able to raise the alarm'. As a Brisbane regulatory official also noted: 'the auditors' role could be bolstered as they are effectively the only people who could find anything'. A Brisbane director characteristically echoed this theme when he answered that 'audits have to be more thorough and you have to rely on auditors being more conscious of their duties'.

One solution which is frequently referred to is a greater resort to **audit committees**. The size of the company does, however, affect the enthusiasm that directors have for audit committees. Directors of smaller companies, unlike directors of larger companies, do not believe that audit committees can be justified. However, as a Brisbane director noted: 'you need an audit committee in any reasonably sized public company as a go-between for the board and management'. A chairman of an Adelaide company similarly remarked that 'larger companies have them but smaller companies do not worry about them. In larger companies they are very important and necessary'. An ASX official noted that audit committees are 'totally impractical for little listed companies as they cannot find the numbers'. As one Adelaide Big Six audit partner explained: 'Auditors will say things to audit committees which they would not put into writing. If the audit committee makes inquiries this is a potent thing. The honest director will only applaud these things'. The chief executive of an Adelaide based investment company noted that 'audit committees are a necessary thing to have. The National Safety Council is an example of how the CEO kept an auditor at bay'. As an Adelaide liquidator explained:

> One of the hallmarks of corporate collapses has been the one man rule situation. There is no doubt that the chairman-CEO role, which is common on founder driven companies, tends to be followed for better or worse. The use of audit committees puts a check on the authority of that person. It is a useful role if it works.

An audit partner in a Big Six Brisbane firm of accountants was somewhat more restrained in his support for audit committees when he observed: 'in some ways audit committees are a bit of a party as the auditor may not have total access to the Board as he may have had. I would like to see the best of both worlds. The auditor needs the audit committee and access to the whole Board'. Others were more critical of the capacities of such committees, although the general view of

these committees was a favourable one. As a Perth liquidator cynically observed of audit committees: 'Potentially they can be effective, but no more than the status quo'.

Many respondents did, however, point to **conflict of interest problems** which had the effect of undermining the effectiveness of auditors in responding to corporate financial failures. As one Perth corporate lawyer noted:

> Auditors have a marketing drive rather than a watchdog drive. You audit a company as if you are auditing a kindergarten so you can hang onto the job. Liquidators have more of an incentive as they know they will be paid.

A Sydney managing director of a large mining company similarly noted:

> Auditing is a complete wank. I have no faith in it. The big Six or Eight are concerned only with maximising their fees. No information is given to you in auditing.

An experienced Brisbane liquidator added:

> You cannot rely upon auditors as you rarely see balance sheets that are true and fair. During the 1980s audit firms took business risks in competing for audit work. Auditors also have a strong relationship with the company they are auditing. Ninety-nine per cent go to water if threatened with a loss of business.

This sentiment was confirmed by a Brisbane independent director who remarked: 'A lot of corporate failures are contributed to by auditors. Auditors are lax due to greed and power'. An Adelaide public company chairman explained this when he said that 'Companies always try to keep auditors very much on side. Auditors are paid by the company'. Consequently, as one Australian Securities Commission investigations officer noted: 'Auditors rely on the directors for the correctness of the accounts and the directors say they rely on the auditors for the correctness of the accounts. The buck does not stop anywhere'. A Brisbane mining company chairman pessimistically echoed this theme when he said that 'all the auditors and accountants in the world will not help . . . There is a tremendous amount of buck passing in the community'.

Nevertheless, it is also widely recognised that there were **limits upon the extent to which auditors could be relied upon** to detect possible financial failure and breaches of legal rules by public company directors. As one Big Six audit partner pointed out: 'The ASC seems to think that they ought to push more responsibility upon auditors such as a duty to report breaches of the Code. That would be useful [but] the difficulty is that as auditors you are not lawyers'. As many respondents also pointed out, the requirements of the legal system are such that legal action cannot be commenced against someone until the breach of the law has occurred. As an Adelaide CEO observed: 'It is like with a criminal. You cannot charge him for murder before he has done it'. Similarly, a Perth based liquidator noted that 'There is no solution as the law says you can only commence an action once the damage has occurred'. As a Melbourne respondent put it: 'sin has to be committed before litigation can occur'. An executive director of a Perth company also remarked that 'a crime is never committed until it is committed. The best you can

do is try and educate the directors'. However, some interviewees also saw auditing standards as letting auditors 'off the hook'.

The prevention of financial failure is also seen as being difficult because, as a Perth finance director noted, 'You cannot do anything about bad decisions and bad judgments . . . auditors do not make commercial judgments'. As a Brisbane audit partner in a Big Six firm of accountants added: 'Auditors define their role more narrowly than the courts do. The directors have to manage the company, not the auditors. There must therefore be a meeting of the ways between the courts and public expectations of what an auditor can do'. Ultimately, many would agree with the comment of an Adelaide accountant that 'auditors' responsibilities have to be clarified'. There was also some concern for the 'embattled auditor'. In conclusion, as one liquidator from a Big Six firm warned:

> We will now see a three to five year bayoneting of the wounded. Litigation will only enhance the incomes of lawyers and accountants. Juries will not understand and people will get off.

This prognosis is an all too common and depressing pattern which tend to characterise so many areas of corporate law enforcement.

Theorising about Audit Failure

Dr P.N. Grabosky (1991) has sought to provide a theoretically based social science explanation for the failure of auditors to perform satisfactorily. He offers three sets of explanations for such failure. These explanations fit well with the descriptions of the audit failures of the kinds identified by Mr Justice Stewart and by Mr M.J. McCusker QC. Grabosky's explanations are respectively described as inter-organisational, intra-organisational and individual level explanations. **Inter-organisational explanations** refer to demands within the accounting firm itself resulting from 'the highly competitive nature of the market for many professional services [which] may impose time and resource constraints on the professional adviser which invite or even necessitate the 'cutting of corners' during the course of an audit or an inspection'. Grabosky goes on to add that:

> Commercial imperatives may generate pressures on a professional adviser to attract new clients. Not all businesses are financially healthy or efficiently and honestly managed, although principals would like to portray them as such. In some cases, there may be a need to take on almost any prospective client, no matter how unsavoury they may be.

Intra-organisational explanations cover factors internal to the organisation itself. Grabosky points to a number of such factors. For example, he notes that 'Insufficient attention to the overall organisation and staffing of a project, [such as] the planning and supervision of a financial audit . . . can contribute to professional errors and omissions'. Furthermore, he points to problems arising out of the 'fragmentation of decision making which the servicing of some large corporate clients may entail'. Where a team of persons are at work on the audit no one person may have the complete picture. Specialisation may also have this

effect. As Grabosky (1991) puts it: 'the apportionment of limited tasks to individual members of a professional team can be done in a manner which impedes recognition of patterns of data which may be indicative of some anomaly'. This may therefore have the effect of leading individual practitioners to interpret the financial situation of the corporation as being less serious than it actually is. Where a person has only a partial picture of the audit situation there may be a reluctance to communicate bad news on the grounds that there may possibly be other explanations.

Finally, personal or **individual level explanations** refer to such factors as selectivity of perceptions, the inclination to disregard dissonant information, the interpretation of sensory data consistently with personal preferences and the adoption of a kind of tunnel vision by the professional. As Grabosky adds: 'Experienced professionals are able to place themselves in a state of mind which may be characterised as one of ambivalence or uncertainty, perhaps conditioned by reliance on the assurances and representations of others, which permit an interpretation of professional conduct as within the bounds of permissibility'.

Grabosky concludes his useful analysis by noting that audit failures 'would appear to arise most commonly from commercial pressure, where accountants underprice their services and then tailor their work to fit the fee. When failure occurs, the professional denies responsibility for diagnosing and investigating fraud'. This seems to have been an all too familiar pattern in auditing practice in Australia during the 1980s.

Another explanation which overlaps with Grabosky's intra-organisational and individual level explanations of audit failure is to be found in **the effect of a domineering chief executive**, especially where that person is also the founder of the audited company. An important factor in deterring auditors from taking a forthright stand in the audit process is the existence of a domineering chief executive in the company being audited. This issue has been commented upon time and again in the literature on the duties of auditors. For example, the American Institute of Certified Public Accountants in developing a list of symptoms of financial statement fraud has highlighted the importance of a highly domineering senior management accompanied either by an ineffective board of directors or by compensation tied to reported performance (Raab 1987, p. 527). Similarly, Sorensen, Grove and Sorensen (1980, p. 228) have noted that 'Financial difficulties may force management into acts of questionable integrity, especially if there are a few dominant individuals running the business'. In the Nugan Hand Royal Commission report Mr Justice Stewart observed that Brincat, the Nugan Hand auditor, had 'described Mr Nugan [the founder of the Nugan Hand group] as a strong willed and overbearing person who exerted considerable influence over Brincat' (Royal Commission of Inquiry into the Activities of the Nugan Hand Group 1985, p. 120). Mr M.J. McCusker QC had also noted that the affairs of Rothwells were extremely closely intertwined with those of L.R. Connell and Partners and Connell's private company Oakhill Pty Ltd. The effect

of this was to give Connell considerable leverage over the affairs of Rothwells, as was evident by the 'loans' which he extracted from Rothwells and his capacity to control the flow of financial information, such as occurred in the 1987 review of Rothwells' financial condition which had been undertaken for him by Price Waterhouse.

Conclusion

It is clear that these are not comfortable times for auditors. They have prospered during the boom years of the 1980s when few questions were asked and standards were allowed to slip. However, the time has come to rewrite the Corporations Act provisions dealing with the duties of auditors. It is no longer adequate to allow the auditing profession alone to determine how it should be regulated. There are significant public interest issues at stake and the tax payer has had to meet the substantial costs of the failure of auditors to report matters which have clearly come to their attention, as was particularly well demonstrated by the McCusker investigation. It seems that when auditors did not know exactly what was occurring, they preferred to ignore financial impropriety and illegality rather than risk the wrath of their corporate clients.

Not only is there a significant public interest in greater responsibility being placed upon auditors, corporate management and shareholders are equally perplexed by the actions of auditors. As illustrated in the findings from the study relating to directors of Australia's top 500 public companies discussed above - companies which provide the bread and butter, not to say cream, of audit work - management is less than happy with the role of auditors during the 1980s. Not only do shareholders find the audited accounts of public companies to be less than helpful, management itself questions the value of the contributions which auditors have made.

What is extraordinary with apparent audit failures of the 1980s such as those involving Rothwells, Tricontinental and the National Safety Council is that a similar pattern of audit practice has been occurring for some time and that those who have warned about the consequences of this have generally been ignored. The warnings of Mr Justice Stewart in his Nugan Hand Royal Commission Report illustrate this and show that practices which became an art form in the 1980s existed during the 1970s and perhaps earlier. The complacency of the auditing profession in the face of repeated examples of audit failure over several decades is evidence of the need for firmer legislation. As the courts are unlikely to develop more appropriate rules in this area, it is inevitable that Australia must follow the United States path and seek to introduce more appropriate rules. Such changes will of course be passionately resisted by the accounting profession, but the justification for this cannot be strong. Whilst the audit failures of the 1970s may have tended to occur in smaller accounting firms, the examples of audit failure in the 1980s also come from the pinnacle of the profession, the Big Six or Big Eight accounting firms. If such larger firms are forced to cut corners and take

advantage of the ambiguities which accounts may present, then it is clear that the auditing profession needs to reassess its policies. If auditors are not prepared to do this, then arguably others should do it for them.

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The Responsibility of Lawyers for the Prevention, Detection and Rectification of Client Fraud

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The lawyer trained in an atmosphere of strict ethical constraints and supervised by professional colleagues, does not easily adjust to consumer and executive government pressures to make the lawyer and accountant criminally and tortiously responsible for the actions of the client he advises.

There is no doubt that executive government will continue to be under increasing pressure from the public servants who administer statutes dealing with corporations and financial transactions, who become frustrated at the inability to convict the major perpetrators of corporate fraud and crime and who then turn their attention to the advisers, both legal and otherwise, who have assisted in the perpetration of the fraud or offence.

Legislators tend to see these issues in terms of the consumer and public perceptions. Nice questions of professional obligations and professional legal privilege are not matters that particularly interest the public or legislators and certainly not most public servants.

It is necessary to look at the nature of the duty which a lawyer owes to his client before we can look at the duty he owes to some third party, or the executive government, or the public at large. For us to understand this, it is necessary to look at the public policy behind legal professional privilege in its wider policy context rather than narrowly, in a particular case.

The concept of 'public policy' is a curious one in that the parliament and executive have no real appreciation of what public policy means, and the public certainly do not understand the concept. It is, curiously enough, left to judicial interpretation to spell it out and defend it. It is in the judgments of the courts that particular judges formulate principles of public policy for the benefit of justice and the public at large.

Public policy can perhaps be easily understood in the context of the so-called 'whistleblower' legislation, a subject not unrelated to the suggestion of a lawyer having an overriding duty to the public. The public generally would think it is 'a good thing' that a public servant who perceives an evil in the administration of government, or an employee of a large public corporation exposes evil by referring the matter to a newspaper, a parliamentarian, the police, or some other

anti-corruption organisation.

The problem with whistleblower legislation is that once it becomes law a government will tend to employ only, in 'sensitive' positions, people who are considered personally or politically 'safe'. This goes against the general Australian public policy that the public service should not change when a government changes, since the public servant, being generally apolitical, can be relied on to advise and be involved in policy formulation without the government being concerned that the public servant will see a higher duty and run off to the press.

The public policy involves the obligation of secrecy on the part of the public service and employees generally. It has served this community, and serves this community, much better than wholesale changes in political administrators, the inevitable politicising of the public service and to some extent large corporations - in the latter case using 'politicising in the personal rather than party-political sense.

Similarly, the public policy behind legal professional privilege is that it is in the interests of justice, and therefore in the interests of the community as well as the individual person seeking legal advice, that he should be able to seek it under professional privilege and not place himself in jeopardy by consulting his lawyer.

There are many circumstances involving relationships between the individual and the state, and with other individuals, where a course of action may be contemplated which may involve a breach of a statute or a common law crime, or may involve breach of a contract or lead to other civil litigation. Obviously, some offences are at the same time both civil and criminal. Trespass, in all its manifestations, clearly can be a criminal as well as a civil wrong and it may be that a person is contemplating committing an offence such as civil trespass to land which is, at the same time, an offence under the New South Wales *Inclosed Lands Protection Act 1901*. The duty of a lawyer, barrister or solicitor is clearly to advise a client as to what the law is and to counsel against breaches of both civil and criminal law. If a client wishes to proceed with actions which are fraudulent or criminal it is the duty of the lawyer to advise the client that he can no longer act. The fact that a client may go to another lawyer armed with the knowledge obtained is not a matter of concern to a lawyer who has advised the client since he must assume that another lawyer, when approached, will take the same ethical position. No amount of rationalising that the client will get advice somewhere else and therefore, why not keep the client, will justify a lawyer continuing to act for a client who proposes to commit an offence. Drug pedlars use that logic.

This position applies whether it be in relation to matrimonial matters such as property or custody, whether taxation statues or other regulatory legislation, or in other torts or crimes.

Many years ago, at a time when there were allegations of corruption within the Immigration Department, a solicitor rang me up to say that a foreign national had approached him to find out what he, the foreign national, had to do to obtain entry to Australia, meaning by legal means or otherwise.

The solicitor, after confirming his view with me, told the client that there was nothing that could be done, and the client went back to his foreign land. It would have been quite easy, with a couple of injudicious phone calls, to put him on to someone who could 'arrange' it. That information could have been conveyed to the client, as no doubt some practitioners would on the basis that the practitioner did not want to have anything more to do with achieving an unlawful object personally. Although probably not committing an offence himself, the solicitor would nonetheless, without necessarily committing an offence, have acted unprofessionally.

This example is but one of a myriad of different situations that a lawyer faces.

The Competing Arguments as to the Lawyer's Duty

In the United States of America there has been considerable debate as to the duty of a lawyer to expose his own client's fraud, and the moral obligation of lawyers to third party and to concepts of 'justice' in the abstract. This debate arose at the time of the adoption of a new set of recommended Rules of Professional Conduct by the American Bar Association. The Association had before it the recommendations of the Kutak Commission, the basic recommendation of which was that a lawyer may reveal confidential information to the extent that he believes necessary to prevent the client from committing a criminal or fraudulent act, or that the lawyer reasonably believes is likely to result in substantial injury to the property of another and that the lawyer should rectify the consequences of his client's action. The provision covered proposed prevention of fraud whether or not that lawyer's services had been involved.

This debate occurred in the light of the then existing Code of Professional Responsibility which provided that when a lawyer discovered fraud he should endeavour to rectify it at first by advising his client, and if the client refuses, he should promptly inform the injured person. Thus it required a mandatory obligation to act if the client refused. The rejection of the Kutak Commission's recommendations led to a substantial debate both within the legal profession and outside.

The fact that such a debate should occur underlines the difficulties of trying to draw parallels between what is done in an Australian legal system, or any other legal system deriving its essential form from the legal system of the United Kingdom, as against the American legal tradition. The two systems are substantially different in approach.

The significance, however, of the debate is that it does raise the problem that very

often the only means of protecting the public, or indeed third parties, from an unscrupulous operator is that it is his own lawyer who is the means of carrying out that unscrupulous end, and therefore that lawyer has some moral obligation to prevent himself being used as an instrument of that fraud. The debate is examined at length in an article in the *Emory Law Journal* concerning rectification of client fraud by Geoffrey C. Hazard Jnr (1984), a professor of law at Yale University.

It is further argued by Professor William H. Simon of Stanford University in an article in the *Harvard Law Review*, 'Ethical Discretion in Lawyering' that conventional approaches to legal ethics are too categorical, that rather than operating with a system of formalised ethical rules, lawyers should exercise judgment and discretion in deciding what clients to represent and how to represent them. He said that lawyers should seek to do justice and consider the merits of clients' claims and goals relative to those opposing parties and other potential clients. The competing ideals are firstly the overriding lawyer's duty as an advocate and a duty to his client, as against the lawyer's role as an officer of the court owing loyalty to the public. The first, 'libertarian', approach absolves the lawyer from moral responsibility and he is only constrained in assisting his client by that which is not prohibited by criminal laws, but is otherwise able to use everything within his power to assist his client's end. This can often, and does often, render substantial injustice to litigants and the public generally, and may result in justice being perverted because his client has a deeper pocket than that of his opponent or the other member of the public and a litigant or potential litigant can be defeated in seeking justice to which all are entitled.

There is no doubt that in the Australian context many lawyers do this to the immense frustration of litigants and cost of running the system. The delaying tactics of some defendants who know that a plaintiff is dying of a serious disease are morally responsible but in most cases are permitted to do so by the rules. It is for this reason that many advocate a more interventionist role on the part of the courts rather than take the passive judicial role of allowing matters to take their course before the courts.

The growing tendency towards judicial case management is evidence of judicial and political impatience with the cost of running the system and the injustice caused by those who deliberately delay. There is no doubt that in many cases a lawyer has a duty to advise his client as to the immorality of such a tactic if nothing else. Quite possibly, a very large number of them not only fail to do so, but indeed, adopt the client's strategy as a stratagem of their own.

It probably emphasises the peculiar nature of a professional and client that they do have an influence on each other whether it be in legal matters, accounting matters or otherwise. To take a fairly extreme example, years ago I was taking evidence before a Parliamentary Committee on Prostitution from a prostitute who was a little conservative in matters sexual. She commented to the effect that clients were endeavouring to persuade her to carry on activities that she would not otherwise have countenanced. The prostitute complained that the publication

of certain types of 'girlie' magazines had 'educated' the client, who would endeavour to try to persuade the prostitute to enlarge her range of activities.

Her words were something like 'You have got to watch them, they will try anything'. I have observed lawyers change in their practice when they become a defendant's solicitor particularly acting for a large client such as an insurance company. No doubt the analogy of the lawyer and the prostitute will not go unnoticed by the reader.

The question is therefore raised, as to how far a lawyer should argue with a client as to the way in which litigation or business practices are carried out. It is not to the credit of the legal profession that harsh economic times induce a reluctance to stand out on matters of principle. In that respect they are not necessarily any worse than other professions or trades, but as officers of the court they ought to be different.

The New South Wales Regulatory Approach

In 1987 the then New South Wales Government enacted the *Legal Profession Act* which has since remained substantially in that form following subsequent amendments brought about by the succeeding government. The approach is to set up various regulatory mechanisms but the legislation is based on concepts of 'professional misconduct' and 'unsatisfactory professional conduct'.

The Act uses as criteria for discipline, conduct occurring otherwise than in connection with the practice of law which would justify a finding that the practitioner is not of good fame and not a fit and proper person to remain as a barrister or solicitor.

In effect, the Act sets up objective standards to be determined by practitioners in the field together with the assistance of lay persons in determining professional conduct. A series of rulings on the almost infinite list of circumstances in which a solicitor or barrister may find himself in determining difficult ethical questions including obligations to other parties, obligations to the court and obligations to the public at large will result, cumulatively, in a series of such rulings, many of which will deal with the obligation of the lawyer to third parties and to community standards.

The Australian or the New South Wales ethical approach is, however, predicated on the fact that a lawyer does not have an obligation to disclose all criminality coming within the lawyer's knowledge in the course of obtaining and acing on instructions. However, in some cases the lawyer may have an obligation to cease to act.

An example of this is that if a barrister under the New South Wales Bar Association Rules finds that his client has committed perjury, he is under no obligation to inform the court but must decline to take further part in the

proceedings unless the client gives the barrister authority to inform the court. A barrister who is aware that the court has not been told of a conviction of his client is not under any obligation to advise the court of that matter, and must continue to act for that client (NSW Bar Association Rules 1987).

Dilemma of Duty

My experience of some thirty odd years of legal practice is that the overriding problem for every client is that client. Very often a client will omit to tell a lawyer a salient fact. Very often a client will be scared to make known a fact or conviction which would assist the lawyer in giving the client better advice. However, the duty to the client where it is not in conflict with the duty to the court is that a client must be free to tell the lawyer every relevant fact upon which to get advice. The client cannot be expected to know whether a proposed course of action is necessarily criminal or fraudulent until he asks. A client is entitled to the best legal advice in order either to prevent litigation or pursue litigation, or indeed to take on a course of action. Any system which casts on the lawyer an obligation to disclose material to the court or to a third party interferes with the lawyer-client relationship and makes it an untenable one. There is no way the public can be expected to get proper legal advice if they cannot pose a problem to a lawyer, and there is no way interests of justice are served by people giving inadequate advice.

I reject the approach of those that say the lawyer has an overriding duty to his own view of justice and that he has a duty to inform the public of his client's criminal or fraudulent activities or proposed criminal or fraudulent activities.

It is often difficult when a client suggests a course of action which may involve criminality to work out whether the lawyer has some sort of duty to inform the appropriate authorities. A proposal to kidnap a child in a custody matter, put forward by the client to the lawyer with a clear indication that the client proposes to proceed, obviously casts on the lawyer an obligation to bring it to the attention of the appropriate authorities as this cannot become part of professional privilege. An inquiry as to whether, for instance, in a custody situation, a child can be taken, is not an indication of criminal intent, it will usually just be a reflection of a client's dilemma in trying to deal with something which appears to him or her to be unjust according to that person's standards.

The Lawyer's Overriding Obligation in Relation to Prevention, Detection and Rectification of Client Fraud

Subject to the lawyer's duty not to mislead a court and not to become the party to a fraudulent activity by way of conspiracy or otherwise, it is the lawyer's obligation to use his very powerful position to prevent client fraud which comes to his attention by the use of the following devices:

- The lawyer should use, where necessary, the threat of ceasing to act for a client where a proposed course of criminal or fraudulent conduct comes to his attention. We should not underrate the significant power the lawyer has to use the threat of what may sometimes be embarrassing and sometimes inconvenient in order to deter a client from a criminal or fraudulent course of action. If the client seeks other legal advice the lawyer has nonetheless fulfilled his duty. Some clients will not be deterred from a course of action no matter what circumstances arise.
- The lawyer should use his knowledge of the legal system and wider experience of society and ethical training to try to convince the client as to why a course of action should not be continued. Most people do not realise just how persuasive a lawyer can be with his client where advice is being given in a solicitor/client relationship in relation to a particular transaction. It may be the first time that someone has pointed out to the client ethical obligations and a duty to society. A significant number of clients will be shamed into departing from a proposed course of action by the very fact that the lawyer knows of the action and disapproves of it. People often even want to be thought well of by their lawyers and other people with whom they come into contact for advice or otherwise.
- The lawyer should take considerable care when obtaining original instructions to find out what the ultimate aim of the client is and whether the client is contemplating some course of action that is criminal or fraudulent. The experience of dealing with clients in financial or emotional stress situations can often lead a lawyer to anticipate the problem rather than be placed in the dilemma of withdrawing from proceedings when they have proceeded some way towards completion.

The above proposals as to the way in which a lawyer should discharge his duty in preventing his clients from carrying out a criminal or fraudulent activity will obviously only deter some but not all clients.

The lawyer has to accept the fact that it is the client's privilege, not his, that it is the lawyer's obligation to give the client the best advice that is available, but that he may not substitute his own moral standards for those of his clients. Practitioners will be surprised to see how many clients they can influence into not taking a proposed criminal or fraudulent course of action, and they must live with the fact that the system is designed to enable people to obtain advice. The only way to achieve that is to have the fullest possible disclosure and therefore the best possible advice. This cannot be achieved if there is a soundly held view that the lawyer may disclose confidential information.

There should therefore be no obligation on a lawyer to expose his client unless that client commits a crime or makes it clear that he is going to do so.

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Professional Advisers and White-Collar Illegality: Towards Explaining and Excusing Professional Failure*

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Professional advisers play a pivotal role in the prevention and control of white-collar illegality. They are in a position to exert a significant influence upon the moral climate within which their clients operate (Tomasic and Pentony 1990, p. 2). In some circumstances, the imprimatur of or certification by a professional is a prerequisite of the client's entitlement to do business. Professional guidance is often essential to ensure a client's compliance with regulatory requirements. Given the complexity of regulatory systems, those actors who are subjects of such regulation generally require professional assistance to achieve the most advantageous ordering of their affairs within the limits of the law.

On the other hand, through lack of diligence or by design, a professional adviser can facilitate a client's breach of the law. This may entail failure to dissuade a client from pursuing an illegal course of action, failure to detect such a violation, or, having detected a violation, failure to disclose the illegality to appropriate authorities. In more extreme cases the adviser can become an accessory, a co-conspirator, or an accomplice in the client's illegal activity. In the most extreme case, the adviser is a criminal entrepreneur, the architect of an illegal course of action taken by the client.

The professional advisers in question are a subset of what Kraakman (1986, p. 53) refers to as 'gatekeepers' - private parties who are in a position to disrupt misconduct by withholding their cooperation from a wrongdoer. Misconduct on the part of either the professional or the client need not be intentional; in either case it may flow from varying degrees of negligence or indeed, from incompetence.

The diagram in Figure 1 depicts the relative contributions of professional and client to professional failure. The northeast quadrant reflects a situation wherein failure results from the intentional conduct of both client and adviser. Both intend deception; they are accomplices in fraud. Alternatively, when the professional knowingly imparts wrongful advice in the belief that the client will act upon that advice, the professional is aiding and abetting the client's criminal activity.

Where professional failure arises from deception on the part of a client, questions arise as to the degree of diligence with which the professional reviewed the client's affairs. In the southeast quadrant, the client has deliberately misled the adviser. At point 'A' professional ignorance is least blameworthy, arising not from professional negligence but rather from the client's skill in concealing the deception, or from other factors essentially beyond the adviser's control.

Evidence of a client's intent to deceive, or other illicit purpose, may not be immediately apparent to a professional adviser. It then becomes appropriate to ask just how rigorously an adviser might be expected to scrutinise a client's affairs to discern the presence or absence of such intent. Moving upwards from point 'A', the adviser's ignorance may flow either from his or her own negligence, or at point 'B', from reckless indifference.

In some instances, a professional adviser may wrongly advise a client or make erroneous representations about the legality of a course of action. Such advice, when given in good faith, is represented by point 'C'; when recklessly provided, by point 'D'.

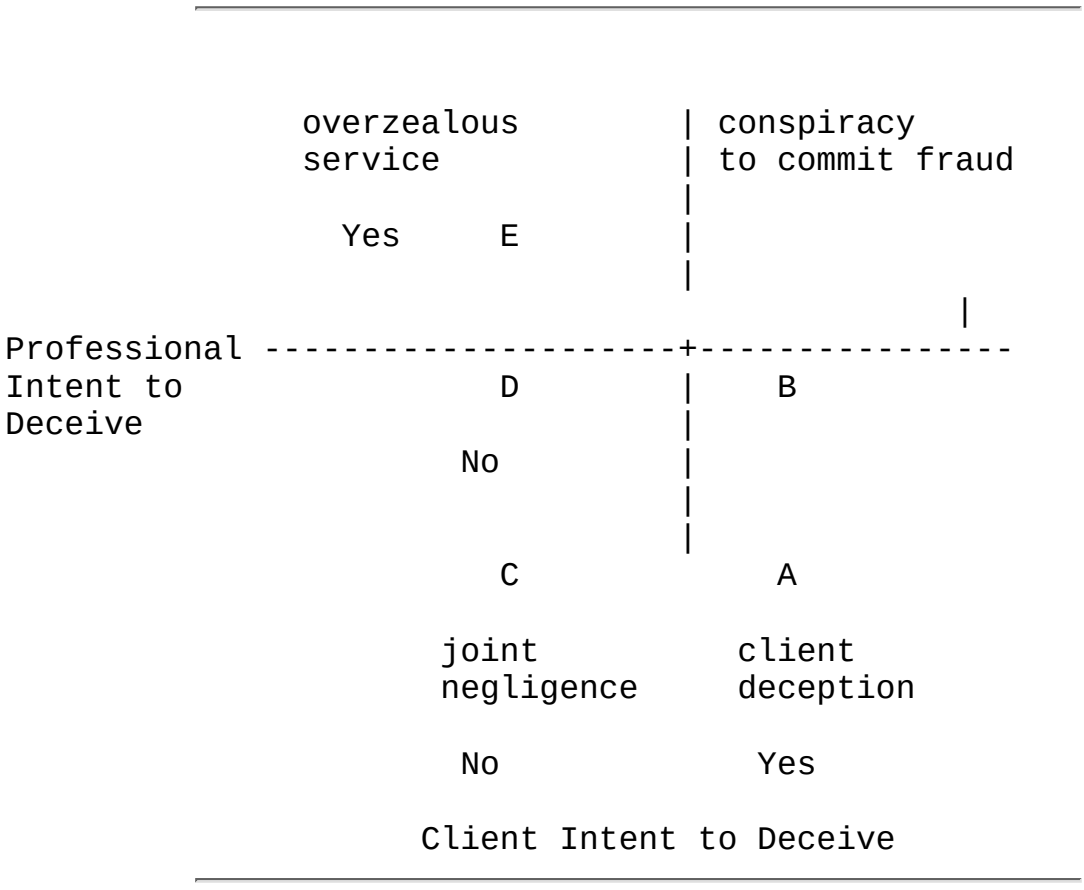
The presumably rare situation where a professional knowingly lies on behalf of an unwitting client is represented by point 'E'. The following pages will be concerned primarily with professional conduct in the southern hemisphere of Figure 1, and to a lesser extent with activity occurring just north of the equator.

Recent examples of failure on the part of professional advisers abound; the consequences of such conduct can be very costly in human and in financial terms. Of the hundreds of savings and loan institutions which failed in the United States over the past decade, many received clean audit opinions only shortly before being identified by regulatory authorities as insolvent (Bowsher 1990; *see also* Raab 1987, p. 514).

Registration statements and other documents filed with corporate affairs authorities by lawyers on behalf of their clients have on occasion contained false or misleading information (Great Britain 1988). This can lead to the erosion of trust which provides the very foundation for modern commerce. Investor reliance on such information can lead to catastrophic financial loss.

The inadequate oversight of construction projects by structural engineers has been followed by collapse of the structures, resulting in death or injury to workers or to members of the general public (Victoria 1971). The engineer's failure to identify shortcomings in the design of a product may contribute to malfunction and to subsequent death or injury to consumers.

Figure 1: The relative Contributions of Professional and Client to Professional Failure



Braithwaite (1984) has documented numerous examples of grossly inadequate record keeping and outright falsification of data in the safety testing of drugs by researchers and testing laboratories under contract to pharmaceutical industry firms. In some instances, these led to the marketing of drugs with dangerous side effects.

In the course of providing services to their clients, professionals may be confronted with moral choices, or with decisions between competing values. At times, these choices may be explicit, and the processes by which they are reached cut-and-dried. Most independent auditors who discover obvious frauds are unlikely to provide their clients with an unqualified bill of financial health. Under some circumstances, however, these moral choices may be less stark, and the means of resolving them less explicit. The following pages propose a framework for the analysis of these issues.

Analysts of white-collar illegality would do well to seek a more complete understanding of such occurrences. How does a professional adviser navigate the limits of legality on behalf of a client, particularly when, because of the discretionary and indeterminate nature of many regulatory rules, these limits may be unclear? What circumstances are conducive to a professional's exceeding these limits, whether intentionally or through negligence?

What circumstances might lead the professional adviser to subordinate his or her professional judgment to other imperatives? How does the professional seek to justify or to rationalise such behaviour? How does he or she frame the issue when a conflict arises between a duty to the client and a duty to the public?

This article will delineate the contours of what promises to be a fruitful area of research in white-collar illegality. As the role of professional advisers in the prevention and detection of white-collar illegality has received only limited attention to date, research should provide important new insight on this subject. The deregulatory trends which characterise many contemporary industrial societies have, ironically, enhanced the importance of the professional adviser's role. Self-regulation or delegated regulatory tasks have emerged as complementary, if not alternatives, to governmental regulatory oversight. The devolution of regulatory control responsibilities to independent professionals appears increasingly common (Halliday and Carruthers 1990). This has the potential to transform the relationship of auditor-auditee from a professional- client relationship into one of an adversary nature, and to transform the profession into an apparatus of the state.

The article takes as its model the phenomenon of audit failure, where a client experiences significant financial problems not long after having received a clean bill of financial health from an independent auditor. The article invites comparison of the accountant's contribution to audit failure with analogous shortcomings in the work of lawyers, consulting engineers, and other professionals independent of and external to their clients' organisations. The article charts a course for research on the contribution of professional advisers to white-collar illegality by identifying some of the social and organisational circumstances which may explain audit failure and its analogues; and the basic moral reasoning or lesser excuse advanced by the professional after the fact to justify or to rationalise his or her questionable conduct.

Explaining Professional Failure

A number of factors may contribute to the professional's failure satisfactorily to perform an appropriate control function. Some of the more significant of these are noted here. For illustrative purposes they may be grouped into three categories, each representing a distinct level of analysis. Inter-organisational explanations embrace those factors of the environment within which the professional operates, including other organisations and institutions which interact with the provider of professional services. Intra-organisational considerations refer to

those of the collectivity within which the adviser performs his or her professional work. Individual factors refer to the processes of perception and cognition on the part of the individual professional. Rarely may a given professional failure be explained by a single circumstance operating in isolation. Failures are more likely to arise from the interacting and compounding influence of factors discussed below (Petroski 1985, p. 220).

Inter-organisational explanations

Competitive pressures

Most professional advisers work within large organisations which operate on a commercial basis. The highly competitive nature of the market for many professional services may impose time and resource constraints on the professional adviser which invite or even necessitate the 'cutting of corners' during the course of an audit or an inspection. In engineering, the elimination of error is a direct function of cost (Florman 1985, p. 33). The accounting firm which aggressively underbids its competition for an audit engagement and negotiates an inadequate fee can devote only so much staff time and can afford only so much partner involvement before it begins losing money. Underpricing one's professional services and then tailoring one's work to the anticipated remuneration can lead to neglect. Time constraints may invite the acceptance of inadequate audit evidence or may lead one to omit essential auditing procedures (*see further* Stevens 1981; National Commission on Fraudulent Financial Reporting 1987; Bosch 1990).

Commercial imperatives may generate pressures on a professional adviser to attract new clients. Not all businesses are financially healthy or efficiently and honestly managed, although principals would like to portray them as such. In some cases, there may be a need to take on almost any prospective client, no matter how unsavoury they may be. This can require a degree of deference to a client's wishes which may lead the professional organisation, or the individual professional adviser, to engage in conduct of questionable propriety.

Prospective clients experiencing financial distress may seek to reduce audit costs. Ironically, the very state of financial distress may require more intensive auditing. A company in poor financial health may thus engage professional services inadequate to the task at hand (Schwartz and Menon 1985, pp. 248, 252).

In highly competitive circumstances which constitute a buyer's market for professional advisory services, the prevailing view may be one that if a professional organisation or an individual professional adviser is unwilling to conform to the ethically questionable requirements of a client, a willing replacement can easily be found.

There are, for example, those companies whose principals 'shop around' for an auditor, basing their 'purchasing' decision on the accounting firm's acceptance or rejection of a particular accounting standard or on their willingness to interpret accounts favourably. Pressures to accommodate client preferences may be reinforced in a competitive market situation (Schwartz and Menon 1985; Stevens 1985, p. 228; *see also* National Commission on Fraudulent Financial Reporting 1987, p. 112; Bosch 1990, p. 133; Nash 1989).

The marketplace for legal services may also be conducive to a certain lack of scrutiny of clients' affairs. Lawyers with a reputation for intrusiveness tend not to be favoured by clients, and may well be less successful than their more discreet counterparts (Mann 1985, p. 120). Nelson refers to the increasingly competitive market for corporate law clients, suggesting that lawyers are less likely to resist clients' illegitimate demands in order not to discourage future business (Nelson 1985, pp. 503, 544; *see also* Kraakman 1986; Bosch 1990, p. 77).

Competitive pressures may also influence engineering decisions. Concern surrounding the

ultimate profitability of a product may lead a contractor to shave costs through design modifications. Design flaws may result. Price competition among consulting engineers may lead to the provision of inadequate services and ultimately to physical failure (Stanley 1982).

Time pressures and deadlines can be particularly important to the engineering profession. The adage 'time is money' applies to an equal if not greater extent to engineers than to their counterparts in other professions. Delay in completion of a construction project, or in bringing a new product to market, can entail enormous financial cost to a client. Client pressure for prompt and favourable certification may at times reach an intensity sufficient to impair the independent, objective judgment of some professional advisers.

Tight reporting deadlines may also contribute to accounting failure. Time pressures may discourage auditors from pursuing anomalies (*Re Thomas Gerard and Son Ltd* [1968] Ch. 455; National Commission on Fraudulent Financial Reporting 1987, p. 56).

Normative ambiguity

Situations in which the boundaries of legality are obscure may invite a professional's transgression. The ambiguity of accounting standards can encourage a client to seek to influence an auditor's interpretation (National Commission on Fraudulent Financial Reporting 1987, p. 116). Lawyers, too, may perceive vagueness as an invitation to test the limits of the law.

Models of the professional-client relationship

Another explanation for professional failure may reside in circumstances of the professional-client relationship. The model of a neutral, disinterested, independent professional operating at arm's length from the client is more of a caricature than a representation of reality. Ellin (1982, p. 75) distinguishes between various models of the professional-client relationship. Under the 'agency' model, the professional carries out the wishes of the client, as if the client were acting for him or herself. The professional is, in other words, a mere instrument of the client's will. Under the 'cooperative' model, professional services are produced in an atmosphere of equality, partnership, and mutual trust. Under the 'adversary' model, professional and client engage in arm's length bargaining in an atmosphere of mutual wariness.

One might envisage circumstances wherein relations between professional and client become so close that the professional internalises the client's values to the extent that the professional is no longer able to make an independent judgment. This process of internalisation may flow from social or cultural similarity of professional and client, from the duration of their professional relationship, or from mutuality of economic interest, as noted below.

Nelson suggests that the strength of corporate lawyers' identification with their clients' interests is such that it is unrealistic to regard them as neutral professionals (Nelson 1985, p. 526). Heinz and Laumann (1982), in their study of the Chicago Bar, found that corporate lawyers were significantly constrained by and dependent upon their clients.

Other lawyers may interpret the professional-client relationship as one of agency, and regard themselves as essentially having been 'bought' by the client or as mere 'letter carriers' with no responsibility for the letter's contents (Fried 1976, pp. 1060, 1085-7).

Mann (1985, p. 110), in his study of defence attorneys specialising in white- collar cases, notes the widespread view within the white-collar defence bar that it is not the attorney's responsibility to enforce his or her client's compliance with the law. The professional, on the other hand, is obliged to refrain from knowingly participating in violations of the law or in actively facilitating such violations.

A professional may be financially dependent on a client's account. Contract laboratories with

responsibilities for independent testing of pharmaceuticals or pesticides may be dependent on manufacturer clients for continued growth if not economic survival (Braithwaite 1984, p. 103; *see also* Kraakman 1986, pp. 71-2). A more direct interest in the client's financial affairs, although discouraged by some professional codes of ethics, may blunt a professional's critical faculties.

The diversification of some professions can lead to a greater involvement of professional advisers in a client's affairs. Many large accounting firms today are highly diversified, providing a wide range of management consulting services, in addition to traditional audit services. While some would argue that the wider knowledge of a client's affairs which can be obtained in the course of providing non-audit services may improve the effectiveness of an audit (*see* Sorensen et al. 1980), critics would contend this may constitute a conflict of interest and thereby threaten the objectivity of the audit function (Briloff 1981, p. 161; *see also* National Commission on Fraudulent Financial Reporting 1987, p. 44; Cooke 1985, pp. 13, 14).

Most professionals place at least a modicum of trust in their clients; they will vary in the lengths to which they will go in order to discern whether this trust may have been breached. Precisely how energetically a professional should search initially for errors or irregularities in his or her client's affairs is a matter for judgment. Professionals who forego independent verification and who depend uncritically on management representation of significant information face some risk of failure (Briloff 1981, p. 34; *see also* Great Britain 1988, Ch. 22 and 23). What degree of unsavoury aroma should suffice in order to invite further scrutiny is also problematic. Indeed, olfactory sensitivities may themselves vary widely. Accountants often elect to define their responsibilities quite narrowly, taking great pains to explain that they are not fraud investigators.

Professionals also differ widely in the premium which they place on client satisfaction. The accountant who deems a company's accounts to be unauditable and declines an engagement, or who refuses to subscribe to a client's preferred interpretation of inventory valuation, may be contrasted with his or her colleague who, bending over backward to please the client, favourably twists an interpretation of his or her client's financial position.

Some clients may use threats, harassment and intimidation in order to influence professional judgment. Doctors who, in the course of testing pharmaceutical products reported adverse side effects, have elicited hostile communications from pharmaceutical manufacturers (Braithwaite 1984, pp. 65-9). Engineers and other professionals who may be disinclined to interpret fact or law to their client's satisfaction may become the subject of physical threats, or more commonly, economic pressure.

The adviser's professional ideology and perception of role can be of great importance in explaining his or her behaviour as an agent of social control. Consider the lawyer who internalises the aggressively adversarial posture of the criminal defence attorney and applies it in settings, such as the provision of advice relating to tax or securities, where it is arguably inappropriate (Lorne 1978, pp. 425, 426; compare Freedman 1974). This model of the professional as champion for the client may be contrasted with his or her counterpart who offers neutral, objective advice from a standpoint of disinterested independence.

Institutions of control

Other institutions may serve to enhance or to detract from the rigour with which an adviser performs his or her function. Reputational capital can be a significant asset, and market incentives to maintain these resources can be strong. Those professionals who command such assets are less likely to engage in conduct which might place their reputations in jeopardy. Association with a disreputable client or identification with an unsavoury venture may stain a professional image. Conversely, those professionals without significant reputational assets have

less to lose by adopting risky practices or by engaging risky clients (Raab 1987, p. 525).

Paradoxically, highly reputable professionals have an additional incentive for maintaining vigilance, in that they are particularly attractive to perpetrators of fraud. Prestigious accounting and law firms may thus be sought after as 'bait' to attract gullible investors to a fraudulent enterprise (Kraakman 1986, p. 68).

Liability to the client or to third parties for losses occasioned by professional negligence can serve to heighten professional vigilance (for discussion *see also* Baxt 1990, p. 249; Godsell 1990; *see also* Rennie 1985, p. 49). Alternatively, immunity from legal action may invite nonchalance. In some instances, however, the exercise of vigilance may enhance liability. Engineers have been advised that to point out construction deficiencies on one occasion may obligate them to do likewise on subsequent occasions lest they be held liable for damages arising from unreported deficiencies (Martin and Schinzinger 1989, p. 325).

The risk of liability can cut both ways. Excessive deference to a client's wishes may render the professional liable to third parties in the event of subsequent failure. Alternatively, strict adherence to norms of professionalism may arouse a client's resentment. Accountants whose audit reports cast an unfavourable light on a client's financial affairs can find themselves the targets of libel action. Whatever the case, the availability of professional indemnity insurance may influence the adviser's inclination to nonchalance on a client's behalf, or to candid assessment of a client's circumstances.

The organisation of one's profession may also provide incentives or disincentives to rigorous professional comportment. Professional associations vary with regard to their goals and with regard to the functions which they perform. Most are concerned to a considerable degree with the financial health of the profession and its members. Most seek to reduce or eliminate external threats to whatever autonomy the profession and its members may enjoy.

Beyond this, professional associations may play a role in defining and in reinforcing standards of professional practice. Many publish canons or codes of professional ethics to guide their members with regard to the relative emphasis they should place on duties to the client and responsibilities to the public interest. In some cases, these may be clear cut; most codes of engineering ethics contain the declaration that engineers in the performance of their professional duties 'hold paramount the safety, health and welfare of the public' (Lichter 1989, pp. 211, 213). In other professions, however, codes of ethics may be ambiguous or contradictory (Chalk et al. 1980, p. 102).

Actions in the form of professional sanctions, in the event that professional standards are transgressed, may be firm or non-existent. Mechanisms of professional discipline can be toothless, or may constitute a real deterrent to malpractice.

Professional associations also vary significantly in the support which they are willing or able to provide their more principled members. Such support could include official statements of commendation for ethical conduct, or assistance with legal defence and awards to professionals who uphold ethical principles (Unger 1987, p. 17; 1989, p. 223).

The regulatory environment within which the client's affairs take place may be expected to influence the provision of professional services. For reasons ranging from relative size of their resource base to variation in philosophy of compliance, regulatory agencies differ substantially in their enforcement strategies (Grabosky and Braithwaite 1986). An apparently permissive regulatory regime may invite risk-taking on the part of both the client and the professional adviser. Alternatively, a regulatory environment with a reputation for rigorous oversight and strict enforcement is more likely to encourage professional diligence.

Relations between different advisers may at times provide occasions for professional failure. When one professional relies on the assurance of another that a client's circumstances are in order, and neglects to verify the situation personally, errors can be compounded. A chain of unverified assurances can thus trip up otherwise careful professionals who would normally exercise greater care when dealing directly with the client (for examples, *see* Traub 1990; Great Britain 1988, p. 473). Similarly, communications blockages between successive professional advisers can enhance the risk of failure (Kraakman 1986, p. 71).

Other authorities may provide professionals with guidance relating to the resolution of value dilemmas. Consider, for example, how the United States Supreme Court regards the accounting profession:

> By certifying the public reports that collectively depict a corporation's financial status, the independent auditor assumes a public responsibility transcending any employment relationship with the client. The independent public accountant performing this special function owes ultimate allegiance to the corporation's creditors and stockholders, as well as to the investing public. This 'public watchdog' function demands that the accountant maintain total independence from the client at all times and requires complete fidelity to the public trust (US v. Arthur Young and Co. (1984) 465 US 805, 817).

Intra-organisational explanations

Although professional services may be provided by sole practitioners, they are often provided by members of an organised collectivity. In the factory-like environment of some professional organisations, the professional is less of an independent moral agent than an employee who must contend with the various constraints and pressures of organisational life, which tend not to encourage moral reflection (Rhode 1985, pp. 589, 590, 636). These factors, and the process of adaptation to the perceived expectations of one's organisation, can impede the individual's ability to make informed ethical judgments (Nelson 1985, p. 504; *see also* Jackall 1988, pp. 109-10).

When such services are rendered by a team, the structure of the team itself can be crucial to the performance of the professional function. Insufficient attention to the overall organisation and staffing of a project, whether the planning and supervision of a financial audit or the development of testing protocols for a complex engineering design, can contribute to professional errors and omissions (*see* National Commission on Fraudulent Financial Reporting 1987, pp. 153-64).

Rapid expansion of an organisation, such as that pursuant to a merger or takeover, may lead to malfunction. Mismanagement of rapid organisational growth may entail the deployment of inexperienced or otherwise unqualified personnel.

Other aspects of organisational life which bear upon the question of professional failure include the division of labour and fragmentation of decision making which the servicing of some large corporate clients may entail. The assignment of discrete tasks to team members and the supervision of members in the performance of these tasks may be accomplished in such a way as to minimise the risk of professional failure. Alternatively, the apportionment of limited tasks to individual members of a professional team can be done in a manner which impedes recognition of patterns of data which may be indicative of some anomaly. Deciding the scope of a financial audit - selecting those categories and subcategories of transactions to be scrutinised - and assigning responsibilities to individual members of an audit team, can be crucial to the success of an audit. In engineering, lack of attention to system design may result in individual components of a system being over-engineered, at the same time that the system as a whole is under-engineered. The Japanese, by contrast, are celebrated for their concern over achieving a consensus in the planning and execution of projects (Pascale and Athos 1982, pp. 111, 127).

Fragmentation of professional tasks and remoteness from the consequence of a professional project may also be conducive to the diffusion of responsibility amongst members of the collectivity, and can thus militate against disclosure (Shapiro 1990, pp. 346, 349). Darley and Latane refer to 'pluralistic ignorance' wherein observers, led by the apparent lack of concern by others in the face of an anomalous situation, interpret the situation as less serious than they would if acting alone. Safeguards may be built in by a professional organisation. Kraakman (1986, p. 72) discusses how legal opinions may be subject to review by a disinterested partner or by a law firm's review committee; similar provisions for peer or partner review may apply to audit engagements (National Commission on Fraudulent Financial Reporting, pp. 54-5).

Specialisation has become a characteristic of much professional activity. The tendency of a professional to focus specifically and precisely on a technical matter, rather than take a holistic perspective on a client's affairs, may at times be an efficient approach to the provision of professional services. It does, however, have its liabilities. Underlying, predisposing factors and problems of a systemic nature may go undetected (Konner 1987; *see also* Lifton 1986; Nelson 1985, pp. 531, 544; Wasserstrom 1975, p. 1; Australia 1985, para. 761). Self-identification as a technician rather than as a moral actor will facilitate ignorance of wider normative consideration (Postema 1980, p. 80). This becomes even more significant when, as Katz observes, white-collar illegality is rarely 'situationally specific', tending instead to entail acts dispersed over time and place (Katz 1979, p. 431, 435-6).

The risks posed by such fragmentation of assignment can be compounded by the absence of opportunities for communication between team members or by implicit pressures not to 'rock the boat'. The very structure of an organisation can condition passive compliance in subordinate members (Katz 1979b, pp. 295, 296).

Impediments to the flow of information into and through an organisation may be substantial. Withholding and filtering of information may occur informally or may be explicitly mandated procedure. Information may be withheld from supervisors in order to limit their potential responsibility, and to accord them 'plausible deniability'.

The reluctance to communicate bad news is a well documented principle of organisational communication (*see* Stohl and Redding 1987; *see also* Tesser and Rosen 1975, p. 193; O'Reilly and Roberts 19 , p. 253). Organisational constraints on individual disclosure need not be subtle. Subordinates in hierarchical organisations who might be inclined to question the propriety or prudence of their superiors may be inhibited by the formal or informal sanctions which could follow such a course of action. Individuals within organisations who may be inclined to 'blow the whistle' on impending professional failure may face harassment or loss of employment (Holden 1980, p. 749; *see also* Glazer and Glazer 1989).

Where the adviser's function entails an element of risk assessment, and where the relevant decision is reached collectively, there may be a greater inclination on the part of individual participants to be less risk averse (Bem et al. 1965, p. 453).

Individual-level explanations

Selectivity of perception and the inclination to disregard dissonant information are familiar human characteristics. There are those individuals who will go to great lengths to interpret sensory data in a manner consistent with their preferences (Festinger 1957). Conversely, there are those professional advisers who may be exposed to information about which they would rather not know. Alternatively, they may encounter ambiguous data indicative of a problem which they subconsciously do not wish to understand. In the professions, as in life, both knowledge and ignorance can be selective.

As noted above, white-collar illegality is rarely detected in the manner of a 'smoking gun'. Rather, there occurs a gradual accretion of suspicion, a slow emergence of doubt, in the eye of

the beholder. One tends to pay greater attention to those stimuli which confirm rather than contradict one's presuppositions. A professional adviser who enters an engagement with trust in his or her client, who subsequently encounters something slightly irregular, may be disinclined to probe further.

The failure to perceive indicia of client wrongdoing may result simply from sensory overload in the face of time pressures. Alternatively, it may occur as a result of the professional's predisposition. The tendency to perceive stimuli which are congruent with one's expectations or preferences and the tendency not to perceive dissonant information is a common one. There may well be a temptation to resolve factual or normative ambiguity in the client's favour Rhode 1985, p. 629; *see also* Traub 1990, p. 112; Mann 1985, p. 120). This can be explicitly reinforced by codes of professional ethics (Mann 1985, p. 247).

Experienced professionals are able to place themselves in a state of mind which may be characterised as one of ambivalence or uncertainty, perhaps conditioned by reliance on the assurances and representations of others, which permit an interpretation of professional conduct as within the bounds of permissibility (Traub 1990, p. 114).

Individuals also differ widely in their estimation of risk. Those professionals who underestimate risk of failure are by definition less likely to engage in precautionary measures (Heimer 1988, pp. 491-519). While no profession has a monopoly on arrogant overconfidence, it is tempting to speculate whether the role demands of the legal professional as advocate, and the relative optimism of the design engineer, are accompanied by different approaches to uncertainty than those manifested by accountants.

As noted above, the role differentiation and technical specialisation characteristic of many professions contributes to the development of professional tunnel vision. Similarly, the degree to which a professional internalises the values embraced by his or her client may also introduce bias in perception and cognition.

There are those who are inclined to introspection, and those who are not. When a lack of self-awareness is combined with a certainty that one is right (or righteous) one may fail to perceive that one's own conduct may be questionable (Martin 1985; *see also* Martin 1986, p. 15; Bok 1982, ch 5).

In some cases, concerted ignorance may be explicit. Mann describes how some white-collar defence attorneys carefully probe their clients for information helpful to a defence, but discourage disclosure of information which might be counterproductive, or which, if known, could place the lawyer in an ethically questionable position (Mann 1985, pp. 103-5; *see also* Traub 1990, pp. 120, 257).

Excusing Professional Failure

In confronting their failure to prevent or to detect illegality by a client, some professionals may acknowledge moral agency, and will undertake an attempt at genuine justification. This entails an admission of responsibility, accompanied by the argument that one's course of action was appropriate under the circumstances (Austin 1956, p. 1). These moral claims will, of course, vary in persuasiveness, and may be subject to evaluation. One model for the evaluation of moral judgment has been suggested by Bok (1978, p. 121) in her discussion of the ethics of lying. In order to claim exoneration, the professional must first have acknowledged the existence of a moral dilemma, evaluated the relative merits of available courses of action, and ensured that no morally preferable alternatives were available to the path eventually taken.

In real life, of course, the professional may not engage in conscious moral choice in the first place. The activity later coming into question may have been experienced as 'business as usual'

rather than perceived as entailing a moral judgment. He or she may concede a degree of thoughtlessness - an absence of moral reflection altogether. While one might argue that professionals should know better, the ambiguous nature of many regulatory regimes is such that some clients, and their advisers, may be unaware of the ethical or legal implications of their conduct.

Alternatively, professionals may seek to portray themselves as amoral calculators, having engaged in what they regarded as a rational choice based on careful assessment of the likely (material) costs and benefits of available courses of action (Kagan and Scholz 1984, p. 67). The most cynical of these will perceive illegality as an indispensible part of the ordinary way of doing business (Passas 1990, p. 167; Jackall 1988, p. 167).

Otherwise, a professional's response may be based on a simple explanation of his or her questionable behaviour. Bok (1978, p. 74) distinguishes between a true explanation - a mere statement of empirical fact, and an excuse - a proposal advanced to remove blame by denying responsibility altogether or by claiming that one's responsibility was dilute or limited.

The extent to which the 'vocabulary of evasions' (Macaulay 1985, pp. 553, 562) differs across professions, in scope and emphasis, and in its ability to stand up to analysis, is an inviting subject. Given the emerging responsibilities for social control which members of many professions may be expected, if not required, to undertake, the results of such an enterprise may be useful to those who would adjust professional codes of ethics to reflect these new roles.

Attempts at genuine moral justification

Those attempting a genuine moral justification for professional failure may present a variety of arguments. Where the professional failure is undeniable, and entailed some element of intent, one may portray one's transgressions as essential to prevent the occurrence of a greater harm, such as the collapse of a financial institution with attending losses for small investors, or the failure of a business enterprise, with resulting unemployment. Thus, one may seek to justify one's actions in concealing or in understating adverse financial information in order to prevent a self-fulfilling prophecy (Wells 1985, p. 71; *see also* Paul 1984, p. 44).

Alternatively, the professional may try to justify a course of action by appealing to what he or she perceives as a 'higher good' or wider public interest. The professional may contend that his or her questionable actions were instrumental in achieving a greater benefit. An engineer may seek to justify a relaxation of vigilance in testing by contending that the likely benefit of a product would outweigh the product's possible risks.

Otherwise, the professional may seek to construct a moral justification attuned to the defence of necessity in criminal law. There are those professionals who disclaim responsibility with the excuse that if they personally had not engaged in the questionable conduct, someone else would have. Thompson (1987, p. 50) refers to this as 'excuse from alternative cause'. An extension of this argument entails the contention that were one to withdraw from a professional engagement, a successor would effect an even greater degree of questionable conduct (Rhode 1985, p. 626). In a sense, then, by remaining in an engagement, the professional claims to be acting to minimise harm. Such attempts at justification are not very compelling, as they have the tendency to reduce the behaviour of all to that of the worst.

A further strategy of justification may entail something resembling a defence of duress based upon fear of client retaliation. Liability of professional advisers for disclosures reflecting adversely upon their clients was noted above (see p. 80) . Professional advisers may seek to excuse failure by arguing that their action or inaction was conditioned by a potential legal threat (for example, see Vise 1988; see also Lulan 1985, p. 67).

Of course, the quality of moral justification is a function of its wider acceptance. The wayward

professional, vulnerable to self-deception, may attach grossly inappropriate weight to a certain outcome, an attribution unlikely to be shared by professional colleagues or laypeople. Publicity and a degree of consensus is thus essential to the justification of moral choice (Bok 1978, p. 92).

The construction of lesser excuses

Those professionals who may not be up to sophisticated moral reasoning but who still seek the mitigation of blame can be expected to advance lesser *post hoc* rationalisations of professional failure. In the absence of reasoned moral justification, the adviser's response to professional failure is likely to take one of two forms (Bok 1978, p. 74). The professional's first resort will tend to involve denial of any wrongdoing altogether. In such instances, the professional will either deny that a failure occurred in the first place, or will contend that he or she took all reasonable precautions and adhered strictly to all professional standards in providing service to the client. A securities lawyer who fails to disclose the existence of client negotiations with a 'white knight' in response to a hostile takeover offer might, for example, argue that the discussions in question were only preliminary; their lack of sufficient substance and the remoteness of any agreement were such as not to warrant disclosure (in the matter of George C. Kern, Jnr, (Allied Stores Corporation) US Securities and Exchange Commission, Initial Decision, Administrative Proceeding, 14 November 1988; Memorandum of Law of the Division of Enforcement, 6 March 1989; Reply Memorandum of Law of the Division of Enforcement, 21 April 1989, File No. 3-6869). For example, legitimate differences of opinion may exist regarding what constitutes information which may be material to the financial well-being of a company. The professional may simply embrace his or her own interpretation of the facts, and contend that the authoritative judgment which underpins the allegation of ethical impropriety was simply incorrect.

Where professional failure and its consequences are undeniable, it may still be possible to deny wrongdoing. This can, for example, entail the argument that one's best professional efforts were in fact applied to the problem at hand, that no anomalies were apparent at the time, and that the adverse consequences were simply not foreseeable. Such an argument could, for example, be advanced by an accountant whose client's skill at concealing a fraud was such that no 'red flags' became apparent in the course of a reasonably thorough audit.

The professional adviser's vocabulary of extenuation can also be conditioned by the organisational and environmental considerations discussed above. Perhaps the most obvious of these occurs when the professional anticipates becoming the target of legal action. In these circumstances, his or her excuse may be framed in anticipation of a particular legal defence.

Alternatively, the adviser may argue that he was making an attempt in good faith to probe the limits of legality on behalf of his client. Where these limits are uncertain or ambiguous, a certain testing of the law may be appropriate to see what enforcement authorities are willing to tolerate (Lorne 1978, p. 467). Such circumstances of ambiguity invite both misadventures and their subsequent rationalisation (Passas 1990, p. 166).

In their classic discussion of how delinquents mobilise justifications for deviance, Sykes and Matza (1957, p. 644) use the term 'neutralisation' to refer to efforts to extenuate moral agency. They identify five basic techniques of neutralisation, including denial of responsibility; denial of harm or injury; denial or derogation of victim; condemnation of condemners; and appeal to higher loyalties. Although the intentional acts of delinquents differ substantially from the reckless or negligent conduct of professional advisers, techniques of neutralisation are occasionally shared.

Auditors often disavow responsibility for fraud detection, contending that their obligations were limited to adherence to conventional auditing standards. Some might contend, for

example, that they are not in a position to pass judgment on the health of an organisation or on the morality of its executive, and are required simply to determine if financial statements conform to generally accepted accounting principles. Others will go further and contend that the detection of fraud is a 'mission impossible', that events are beyond the auditor's control (Clarke 1985, p. 66). In the terminology of Sykes and Matza (1957), this would entail denial of responsibility.

There are those situations in which a professional might argue that his or her own alleged wrongs were themselves causally unrelated to, or at least causally remote from, the eventual impact. Thompson (1987, p. 62) discusses how, in the public sector, specialisation facilitates the division of moral agency. The adviser will thus contend that other factors, or other actors, intervened to dilute his or her own responsibility. Such an argument is commonly coupled with an attempt to shift blame to another party. Attempts to 'pass the buck' often arise from failures occurring in the context of complex processes involving a number of different participants. Failures occurring in large scale engineering projects are especially conducive to such forms of excuse. Structural engineers, in the aftermath of a mid-construction accident, are inclined to blame the contractor. Failures occurring after completion of a project may be attributed to improper maintenance (Florman 1976, p. 94). Indeed, it has been argued that the legal system provides plaintiffs with incentives to maximise the number of defendants in such cases (Landes and Posner 1980, p. 517). Here again one sees what Sykes and Matza (1957) would refer to as denial of responsibility.

Where the professional acknowledges some transgression, he or she may seek to minimise their culpability by arguing that the misconduct was itself trivial, 'a minor technicality' (Briloff 1981, p. 16). Regardless of the severity of the professional lapse, an adviser may argue that the consequences were victimless, or that the ultimate impact of the transgression was negligible (Thompson 1987, p. 82) Consulting engineers who fabricate 'satisfactory' test results and who are fortunate enough to be able to point to the absence of subsequent malfunction or system failure will argue that their actions were 'harmless'. Sykes and Matza (1957) would describe this as denial of injury.

Professionals may be inclined to blame the victim, holding him or her largely responsible for his or her own misfortune. Consider, for example, the person who is injured in the course of using a rotary lawnmower to trim a hedge. The designer of the lawnmower in question would disclaim responsibility, arguing that it was not a shortcoming of design, but rather the egregiously improper use of the device, which led to the injury. Sykes and Matza (1957) would refer to this as denial of the victim.

In some circumstances, the professional will suspend personal moral judgment, instead invoking that of an authority figure. Such 'moral modelling' may be regarded as volitional, as distinct from that which is imposed coercively by members of an organisation's hierarchy. 'Respectable' people may appear to condone practices which might otherwise be regarded as questionable. Impressionable subordinates thus internalise the values of those senior to them.

Elsewhere, the professional may seek justification in professional ideology or in terms of the professional-client relationship. The internalisation by some lawyers of the criminal defence model of zealous advocacy was noted above; in some instances, the professional will invoke the principle of loyalty to his or her client to outweigh other considerations. Luban (1983, p. 83; 1988) terms this the 'adversary systems excuse' (*see also* Daley and Karmel 1975, p. 747; Rhode 1985, p. 594; Freedman 1988, p. 1939; Noonan 1966, p. 1485). Thompson (1988, p. 50) observes the paradox that a professional may seek to rely upon a code of ethics in order to excuse unethical conduct. Sykes and Matza (1957) would refer to this technique as an appeal to higher loyalty.

The antithesis of the paternalistic model of professional-client relations is that which Rhode (1985, p. 624) describes as governed by 'restraints of role.' Here the professional embraces the principle that it is inappropriate to override or second-guess a client's policy decisions. Mann provides an illustration from an interview with one white-collar defence counsel, who described it as his obligation to defend the client, not to sit in ethical judgment of him, nor to initiate law enforcement actions. Professional responsibility is seen as limited to informing the client of the significance and consequences of an illegal course of action (Mann 1985, p. 121). Thus, professional advisers can provide implicit advice and assistance in illegal conduct, but ultimately concede that 'what the client does is the client's business'.

Others may engage in what Rhode (1985, p. 620) refers to as an 'appeal to agnosticism' contending that the concept of public interest is too nebulous to define, much less to invoke, in order to override the interests of one's client. Problems which may arise from this posture can be significant. As Rhode (1985, p. 625) claims, 'Clients can justify asocial action on the ground that counsel have pronounced it not unlawful, while counsel can rationalise their participation by deferring to client autonomy' (*see also* Simon 1988, p. 1083; Gordon 1988, p. 1; Traub 1990, p. 114).

A similar justification derives from the professional's perception that the regulatory requirements or procedures in question were themselves inappropriate, unworkable, or at an extreme, illegitimate, to be regarded as more the product of self-serving bureaucracies than as serving any useful social function. Nelson, in his survey of lawyers practising in large firms, reported antipathy to regulatory agencies (Nelson 1985, p. 1081). Sykes and Matza (1957) would describe this as condemning the condemners.

In circumstances of unquestionable failure, the professional may base his or her attempt at extenuation on prevailing informal norms. One may, for example, contend that the practices in question had long been implicitly condoned by regulatory authorities. The discretionary enforcement which characterises most regulatory regimes may produce a situation where sanctions are eventually imposed for a particular course of action which had been taken on one or more previous occasions with impunity. Under these circumstances, unless the impending change in enforcement strategy was made explicit, the professional may argue that the conduct in question was tolerated by regulatory authorities.

The invocation of informal norms may extend to those prevailing in one's own industry or in one's own professional organisation. Scriven (1989, pp. 222, 223) refers to this as the 'defence of common practice' (*see also* Bok 1978, p. 163; Rhode 1985, p. 637). For example, professionals retained by companies doing business in certain cultures traditionally regarded bribery as an accepted and essential business practice.

At an extreme, standards can be perceived as so constraining that it is simply impossible to adhere to them and still conduct one's business. Alternatively, they can be perceived as symbolic or aspirational rather than as strictly binding; departure from the standards may thus be interpreted as excusable.

Conclusion

One may at this stage begin to speculate about the antecedent circumstances and *post factum* rationalisations of professional failures. It would appear that within the legal profession, the internalisation of the criminal defence model of zealous advocacy may not only underlie failure to prevent, detect and disclose client illegality, it may also serve as the main theme of excuse advanced by the wayward professional. The lawyer sees him or herself as serving the public interest **through** the adversary system, rather than more directly, as is the case with members of other professions.

Audit failure, by contrast, would appear to arise most commonly from commercial pressure, where accountants underprice their services and then tailor their work to fit the fee. When failure occurs, the professional denies responsibility for diagnosing and investigating fraud.

Engineering failures, on the other hand, also appear to arise from time and budget pressures. The vocabulary of neutralisation advanced in the aftermath of engineering failure tends to attempt to fix moral responsibility on other actors.

A more detailed review and analysis of professional moral reasoning would be of some utility. It would appear that many, if not most, attempts at extenuation in the aftermath of professional failure tend not to entail systematic moral reasoning, but rather more feeble attempts at excuse. Given the new and expanding social control responsibilities which members of many professions may expect to face, a systematic exposition of various forms of moral reasoning (and lesser forms of excuse) across professions may be useful to those who would adjust professional codes of ethics to confront these new responsibilities.

The responsibilities of professionals are not fixed and immutable, but rather tend to evolve, either spontaneously or in response to external demands. Accountants, in their capacities as independent auditors, are under increasing pressure to be alert for possible client illegalities, and to disclose those which come to their attention. The accounting profession in the United States, having reversed a previous position, recently expressed support for proposed legislation requiring auditors to notify regulatory authorities of possible illegal acts by clients (Blumenthal 1990, A2). The US legal profession, by contrast, rejected proposals to widen duties of disclosure of client illegality (Schneyer 1989, p. 677; Rhode 1985, p. 612).

Wolfe describes morality as a 'negotiated process, through which individuals, by reflecting periodically on what they have done in the past, try to ascertain what they ought to do next' (Wolfe 1989, p. 216). It may be time for such reflection.

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The Investigation of Fraud

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The difference between success and failure in a fraud investigation is good management. A fraud investigation project has to be planned and managed, just like a mining project or a construction project or any other kind of project. Perhaps an even better analogy is a military campaign, because investigating major fraud is a bit like fighting a war. The trouble is, you are not sure at the beginning who is the enemy, who is an ally and who is neutral. Finding that out is part of the job.

The point is that a fraud investigation must be approached as a management exercise. You make a plan, and then you make sure the plan is carried out. You will almost certainly have to change the plan as you go along. That is part of the management exercise - as in war, success goes to the side which adapts best when circumstances change or things go wrong. But having a plan and being prepared to change it is very different from simply reacting to every new demand or development, with no overall plan at all. That is management by reaction, and it is one of the main reasons why companies fail. Reactive management kills companies. Reactive generalship loses wars. But nowhere is there greater scope for reactive management to create an embarrassing and wasteful comedy of bungling ineptitude than in the investigation of fraud.

To get onto a practical level, how should a fraud investigation be managed?

Let us assume that we have been told in general terms what the job is. It might be to investigate a major collapse, like Rothwells or Ariadne. It might be to investigate the affairs of a particular company or group, like the Bond Group or Independent Resources. Or it might be a case where an individual has allegedly made off with corporate funds, like the John Friedrich or Robin Greenburg cases.

Whatever the nature of the fraud investigation you are given to do, there are four key questions you have to ask yourself:

- what do you want to achieve?
- what resources do you need?
- how are you going to get the evidence?
- are you going to make sure you can use the evidence?

Setting the Priorities

When you answer the first question, 'What do I want to achieve?', you are **setting the priorities** for the investigation. It is not enough to say 'I want to find out what happened'. The objective of a fraud investigation is not just to **obtain** information, but to **do something** with the information.

The first and most obvious objective is to punish the perpetrators of the fraud, and anyone else who helped them along the way. But it is not quite as simple as this. Sometimes the most urgent priority is to get an injunction to prevent further damage being done, or to freeze assets so the proceeds of fraud are not spirited away. This will usually involve using section 1323 and/or section 1324 of the Corporations Law (Cwlth) or perhaps Part 6.10 of the Corporations Law if shares are involved. In setting priorities for a fraud investigation, the first step should always be to identify whether there is anything that needs to be done urgently to prevent further damage, or stop the escalation of loss.

Assuming you have identified and dealt with the urgent priorities of preserving property or preventing the escalation of loss, or identified that you are not facing any of those problems in your investigation, you can get back to thinking about your overall objectives. But it is still not as simple as just punishing the perpetrators of fraud. What do you want to do? Do you want to recover profits made by the perpetrators of fraud? Do you want to recover losses suffered by the company that collapsed? And if you do want to recover money or assets, who do you want to recover them for - the Crown, or creditors and shareholders of the collapsed company? Remember, too, that there is not much point driving your investigation in the direction of asset recovery unless there are some assets to recover. If you decide to go down the asset recovery track, you are likely to have to devote a substantial part of the resources of your investigation to finding the assets. If you are dealing with a sophisticated fraud, the majority of the proceeds are likely to have been taken offshore to the Channel Islands or some other tax haven, and finding them will not be easy.

There is no doubt about asset recovery - it is the way to go if you can do it successfully. It hits the perpetrators of fraud right where it hurts: in the hip pocket, thereby achieving the policy objective of discouraging others from doing the same. Even better, it pays part or all of the cost of the investigation and the resulting court action. Asset recovery therefore is the first thing you should look at. But it is not easy.

There are four main avenues of asset recovery:

- The *Proceeds of Crime Act 1987* (Cwlth): This Act applies to offences under the Corporations Law by force of section 29 of each state's Corporations Act 1990. It enables the Director of Public Prosecutions to apply for a forfeiture order or a pecuniary penalty order. In fraud cases, the pecuniary penalty order is more likely to be relevant. It amounts to an

order by the court that a convicted offender should pay a penalty equal to the amount of any benefit he gained from the offence. To use the Proceeds of Crime Act, you need to identify an **indictable offence** giving rise to a **profit**. The recovery order can be made as **part of the criminal proceedings** by the court which convicts the offender. The amount recovered goes to the Crown.

- The specific sections in the Corporations Law which permit the recovery of losses from convicted offenders, as part of the criminal proceedings: examples are
    - section 232(7) (formerly Companies Code section 229(6), dealing with breach of directors' duties);
    - section 205(6) (the old section 129(6), which applies where a company has given financial assistance for the purchase of its own shares).

  Under these sections, the benefit of the recovery goes to the **company**.
- The sections in the Corporations Law which permit **civil** action to be taken by or on behalf of the company, to recover either profits or losses. Examples are:
    - Corporations Law section 232(8) (formerly Companies Code section 229(7), dealing with civil recovery of profits or losses flowing from breaches of duty by directors and officers);
    - Corporations Law section 234(7) (formerly Companies Code section 230(5), dealing with indemnity against losses caused by loans to directors and related entities);
    - Corporations Law section 598 (formerly Companies Code section 542, dealing with compensation for losses caused by fraud, negligence, default, breach of trust or breach of duty);
    - Corporations Law section 593 (formerly Companies Code section 557, imposing civil liability for all or part of the debts of a company or a person convicted of incurring debts without a reasonable expectation that they could be paid, or being knowingly concerned in fraudulent conduct by the company).

  In these cases, any amount recovered goes to the **company or its creditors**. The Australian Securities Commission (ASC) can take action on behalf of the company or its creditors, either because standing is conferred on it under the relevant sections (for example sections 593 and 598) or in the exercise of the Commission's general power to take representative action under section 50 of the ASC Law.
- The sections in the Corporations Law dealing with prohibited share acquisitions which permit the court to order vesting of shares in the ASC - *see* Part 6.10.

There are therefore a number of options to choose between if you want to recover

assets. The choice will be governed partly by what you want to achieve, partly by your preliminary assessment of the evidence the investigation will turn up, and partly by what you know about what assets can be recovered. The option that often looks best is the Proceeds of Crime Act, because it confers wide powers to locate and freeze assets, it gives access to property that is effectively controlled by the offender as well as property that is directly owned, and the proceeds go to the Crown. However, it has two drawbacks. First, it is only available if the offender made a **profit**, and in a lot of corporate collapses all you can find are losses. Secondly, you can only get a pecuniary penalty order if you can first obtain a conviction for an indictable offence, then convince the court that an order is an appropriate exercise of its discretion. For reasons like these, the ASC is likely to find itself using civil proceedings to obtain recovery, using its general investigative powers under Part 3, Division 1 of the ASC Law to locate the assets and seeking orders under section 1323 of the Corporations Law to freeze them. However, this presents problems when the assets are overseas.

Whether or not you are trying to recover assets, you will certainly be trying to achieve a **prophylactic effect** - in other words, to **discourage others** from engaging in similar fraudulent conduct. Again, there are choices to make. What is the best way to set an example to an offender's peer group - by taking his assets away in a civil action, or by having him convicted on a criminal charge and gaoled or fined? That is a difficult question to answer. When you have to make the choice in relation to a particular fraud investigation, you are more likely to be influenced by pragmatic considerations. If your evidence is not strong enough to prove the case beyond reasonable doubt, you will lean towards civil action. A related factor in favour of civil action is that statements made at an examination under claim of privilege against self-incrimination are admissible against the maker in certain civil proceedings, but not in criminal proceedings - see sections 68 and 76 of the ASC Law. On the other hand, if the defendant has no assets you may think you will achieve more by putting him in gaol.

Then there is another kind of decision to make. In many major corporate collapse situations there are multiple instances of criminal conduct by the main player or players, plus a whole host of ancillary offences committed by the small players who did their bidding, or acted as compliant directors of their companies, or carried out their share transactions, or gave them professional advice. Is it better to target the main players only, or to widen the prophylactic effect of the exercise by catching as many as possible of the accomplices? In my opinion, the answer to this question is clear. You must take effective and convincing action against the main players; but you must also maximise the prophylactic value of the investigation by making an example of any subordinate officers, professional advisers, brokers and others who helped to make the fraud happen. If people in these groups see their peers going to gaol or being made bankrupt because they have allowed themselves to get involved in fraud, they will think at least twice before doing it themselves.

These are the sorts of priority decisions that should be addressed right at the beginning of an investigation: are you aiming to take civil or criminal action, are you looking at asset recovery and if so what kind, and who are your targets? You cannot make final decisions on all of these issues at the beginning. Priorities will almost certainly change as you go along, as the evidence comes in.

But you must start setting priorities right from day one. The most important thing in setting priorities for an investigation is **what resources you have**. With a small budget and a small staff, you must either think small or think very, very smart. There is just no point in trying to take civil and/or criminal action against thirty or forty different defendants if you have not got the resources to get the evidence or run the cases. In this situation, your strategy must be to concentrate on a small number of clear-cut cases which will achieve maximum prophylactic effect at minimum cost. As you go through the investigation you must ruthlessly weed out targets, however attractive, if they look too hard. It has been said before of other activities, but it was never truer of anything than of running a fraud investigation: it is the art of the possible. That is what setting priorities is all about - identifying the possible.

Resources

The first key question is what you want to achieve, the second is what resources you need to achieve it, and the answers to these two questions are interdependent.

Resource issues will be different in every case, depending on the scope of the job, the money and people available and so on. But there are at least three key issues that come up every time:

- the team leader;
- the team structure; and
- information technology.

Team structure governs the choice of team leader. Experience suggests that the inverted pyramid structure is preferred to the pyramid. In the pyramid structure, there are a large number of investigators gathering raw data, a small number of analysts (legal or financial) analysing it, and one person at the top making decisions on it. This structure is inefficient. Suppose we have a team of ten people: six investigators and one clerical assistant, two financial analysts and one lawyer. My suggestion would be : 'Cut the team to eight, but let us change the structure to one clerical assistant, three investigators and four analysts - one financial analyst and three lawyers.' Then the team leader can brief the lawyers on the priorities of the investigation; the lawyers translate the overall priorities into an action plan for the part of the investigation delegated to them, and each lawyer works with an investigator to gather the evidence he needs. Then the lawyers analyse the evidence collected and report to the team leader. The financial analyst provides expert advice on financial matters when and where

needed.

Different people have different views on who should be the team leader. Certainly, the team leader has to understand how commerce works, to understand how fraud works. And he or she has to have some management ability, because a fraud investigation is an exercise in management. I would choose a lawyer, because the chances of success in the investigation are better if the team leader understands not only the substantive law governing fraud and the way business works, but also the rules of evidence and the relevant principles of administrative law. Investigation these days is a legal minefield, and the chances of negotiating it successfully are better if a lawyer leads the team. I do not rule out an experienced policeman, investigator or insolvency practitioner as team leader, but using a non-lawyer inevitably means much greater dependence on legal resources from outside the team - whether from the DPP's office, from elsewhere in the ASC or from a private firm. A non-lawyer leading an investigation under today's conditions needs strong legal backup.

Many routine administrative tasks have to be dealt with. These administrative tasks must be delegated to a member of the team other than the leader, if the leader is to have any time to lead. One of the most valuable members of an investigation team is a good administrator. This role can be combined effectively with responsibility for computer registration of documents and computer litigation support.

That brings us to the last resources issue: information technology. No-one should even contemplate doing a major fraud investigation these days without sophisticated computer support, in place from day one. Every document collected in the course of the investigation must be summarised under a number of key headings - author, recipient, date, brief description, other parties named, when seized, how seized, location and so on. The summaries are then fed into the computer so that you know right from the start what information you have, and where you obtained it, and you can find it again when you want it.

It is a serious mistake in a major fraud investigation to delay introducing the computer classification of documents until the investigation has been running for some time. Trying to classify a backlog of several hundred thousand documents in a hurry and still carry on an investigation is a frustrating exercise. What is worse is that it can only ever be partly successful, because you will have to call in emergency classification staff who are at best unfamiliar with the documents, and at worst unfamiliar with the English language. The old computer adage applies here to the full: garbage in, garbage out. It is essential to have the computer classification of documents in place from the very beginning, and to make sure every member of the team takes document classification seriously.

Finally, computers can also be a big help in recording the transcripts of examination of witnesses, witness statements and any other relevant material, such as related civil cases or examinations by liquidators. The big advantage here

is that you can call up any of this material quickly and search it for reference to any particular subject you may be investigating.

The leading edge of information technology at the moment is document imaging - a system which enables documents to be copied onto a computer disk and reproduced on screen. This has potentially valuable applications in the presentation of complex fraud cases in court, but it may not be a viable tool at the investigation stage yet. The cost and work involved in imaging are such that it is only worthwhile when applied to a selected group of key documents, such as the exhibits in a particular prosecution.

Getting the Evidence

Once you have set the priorities for the investigation and chosen the resources for the investigation team, you come to the question: how do you get the evidence? But it is not enough just to get the evidence - you must be able to use it in court. It is no good finding out what happened, if the evidence cannot be used in court.

The beginning of a major fraud investigation is always the hardest part. When do you start? One thing is clear: before you hold hearings or interview witnesses, you must do your homework. Read and assimilate whatever information you can find on the subject matter of the investigation. Often, there is a liquidator's report, or a shareholder's letter of complaint or some other document which can at least get you to first base in terms of understanding.

The principal weapons at the investigator's disposal for collection of evidence are statutory notices to produce documents, search warrants, statutory powers to examine witnesses, and the conventional procedures of interviewing witnesses and taking statements. These weapons will all need to be used, but initially let us consider the practical aspects of a controversial subject: granting indemnities to witnesses.

It can be very difficult in a fraud investigation to gain an 'inside view' of what really happened. Key documents may have been destroyed. The main players are uncooperative and claim total memory loss. Lesser figures are also afraid of prosecution, but almost equally afraid of being called as witnesses to testify against their former bosses or clients. No-one will talk. Faced with this kind of problem, one can easily sympathise with US regulatory authorities in their use of indemnities and plea bargains. (As to the legal status of these practices in Australia, *see* Temby 1985; Clark 1986).

Decisions on granting indemnities will be taken by the DPP or other prosecuting authorities rather than by investigators, but investigators may need to decide whether to recommend them and if they are granted, how to handle indemnified witnesses. The indemnity is a valuable tool, if used sparingly. The ideal case for an indemnity is where there is one intelligent, articulate 'insider' whose role has been aiding and abetting rather than perpetrating the criminal conduct. By

granting indemnity to a person in this position, the investigation gains a valuable witness without losing its primary prosecution target. A cooperative insider can have enormous value in identifying investigation targets, as well as actually providing evidence. But there are some pitfalls in the use of indemnities.

Before a decision can be made on whether an indemnity should be granted, you need to know whether the evidence the witness can give will be worthwhile. The only effective way of assessing this is to obtain a 'broad brush' statement. This will give an idea of what the witness can say; but it may well come back to haunt you as a prior inconsistent statement when the prosecutions are finally in court, just because the witness (or more accurately, his lawyers) in preparing it will have taken a broad brush approach and not attempted to prepare a detailed and strictly accurate account of every incident covered. Another point of some importance is that if the indemnified person is to be used as a key witness in court, it is a waste of time indemnifying him unless he is mentally tough. A weak witness will not retain credibility in the face of the harrowing cross-examination he will inevitably receive in a major fraud trial. A weak person may have value in telling you what happened and directing you to other evidence, but it is a mistake to rely on him to provide any worthwhile evidence himself - indemnity or no indemnity. It is also useful to remember that even if it stands up under cross-examination, the testimony of an indemnified person is likely to be given reduced weight. Wherever possible, other evidence should be obtained to corroborate his story.

Notices to produce documents

Whether or not the inside story is obtained from an indemnified witness, at some stage you need to start collecting evidence. It is useful to collect documents and read them before talking to witnesses, either in investigative hearings or in interviews. This means that the first substantive step in the investigation is to issue **selective** notices to produce documents. There is great skill in knowing what documents to look for, and where to find them. How well an investigation team does this depends on the ability and experience of the people in the team. Different investigative agencies have different powers to require the production of documents. In the case of ASC investigations, the relevant powers are in Part 3, Division 1 of the ASC Law. Most notices requiring production of documents are issued under section 30 or section 33, but there are also 'special case' powers to issue notices under section 31 (where securities transactions are concerned) and section 32 (notices relating to futures contracts).

The ASC can only issue notices to produce documents for a limited range of purposes. These purposes are set out in section 28 of the ASC Law.

There has been a tendency in the past for corporate investigators to be fairly casual about the issue of notices. This casual attitude is one that investigators can no longer afford. If a notice is not properly drafted and issued for a proper purpose, the recipient does not have to comply with it. It is a waste of resources of an investigation to spend time in court fighting over a notice that is poorly

drafted, or does not have a proper foundation in one of the purposes referred to in section 28. A notice to produce documents should not be issued unless it has first been looked at carefully and approved by a lawyer who is familiar with the relevant statutory provisions. A major investigation is likely to have to issue a lot of notices, so there should be a well-established and quick procedure for legal review of notices before they go out.

ASC notices to produce documents have to follow a prescribed form. This form is set out in Form 2 in Schedule 1 to the ASC Regulations. In completing the form, there are two principal items to be filled in. The first is the purpose for which the notice is issued: this should be within the range of purposes set out in +section 28. In most cases the notice will say it is issued for the purposes of a particular investigation being conducted under Part 3 Division I. The investigation should be described in words quoted directly from the instrument constituting the investigation. The second item which has to be filled in is a description of the books to be produced. This is where some legal drafting skill is required, to make sure the description is wide enough to catch everything you want but precise enough to avoid being oppressive or confusing to the recipient. For example, if you want books relating to particular banking transactions or share transactions, name the parties involved and give as many details as possible about the transactions. In particular, the **period** during which the transactions took place - for example, 'between 1 January and 31 December 1988'.

ASC notices to produce can only be signed by a member or staff member authorised under section 34 of the ASC Law, or by a person delegated under section 102 of the ASC Law. If the recipient of the notice asks for evidence of authority to issue the notice, it has to be produced to the extent required by section 86 of the ASC Law. There is provision in ASC Regulation 6 for the ASC to issue a document certifying a person's authority under section 34.

The notice can only require the documents to be produced to a 'staff member' of the ASC. 'Staff member' is a defined term (*see* section 60 of each state's Corporations Act 1990), and includes consultants engaged under written agreements (ASC Law section 121). It also includes seconded Federal Police (ASC Law section 122). But it is difficult to work out whether it applies to seconded state police, because they are referred to in section 122 of the ASC Law by reference to section 249 and section 249 has been repealed. The answer may be in section 77 of each state's Corporations Act 1990, but it is far from clear.

A couple of definitions are worth noting. 'Books' is very widely defined for the purposes of the ASC Law, in section 60 of each state's Corporations Act 1990. Effectively, it means any document or other record of information, so it extends to computer tapes and disks. The other important definition is 'possession', as used in section 33. Note that 'possession' in section 33 does not just mean 'possession'; it means 'possession, custody or control'. This surprising result is reached via section 60(2) of each state's Corporations Act 1990, and section 86 of the Corporations Law. This shows why a lawyer's advice is necessary on issuing

notices.

It is very common for people to respond to notices by producing photocopy documents. This is not satisfactory, for two reasons. Firstly, it is possible to learn more from an original than from a copy. For example, there may be parts which are obscured by a stick-on slip, or comments written on the back of the document. Secondly, the purpose of the investigation is to provide a foundation for legal action and original documents are needed for use as evidence in court. The ASC is permitted by section 37 of the ASC Law to retain documents for as long as is necessary to finish the investigation, decide whether legal proceedings are appropriate, and carry on the legal proceedings. In other words, the ASC can keep original documents until all related actions are finished.

Companies that are required to produce documents usually respond to notices through their solicitors. The standard procedure is for the documents to be sent to the solicitors who will sift through them, remove the documents they say are subject to legal professional privilege, copy the rest and send the copies to the ASC in an order which is not necessarily anything like the order in which they came from the company. This is not a practice which investigators should accept. It is generally preferable to get original documents; but it is also important to get them in the exact condition in which the company kept them. It is one thing to get a vast pile of documents in no particular order, but it is much more useful to get Mr. Smith's file, Mr. Jones' file, the correspondence running file and so on. This is an area where the police procedure of going to premises with a search warrant and taking documents has a lot to recommend it. The ASC does have search warrant powers under sections 35 and 36 of the ASC Law, but they can only be used where a notice to produce documents has been served but not complied with.

The importance of computer classification of documents is worth noting again at this point. Whenever any documents are produced to an investigation, the originals must be classified to record **exactly** where they came from, how and when they were produced, and by whom. The contents of each document must also be summarised so a search of the classification index will find it again. Then, the original document should be put in safe storage. If the document is needed for working purposes, copies should be taken.

Sometimes there will be a pile of documents produced in answer to a notice, which simply does not make sense. Section 37(9) of the ASC Law deals with this situation : either the staff member who issued the notice or the one who received the books can require either the person who produced the books or any person who was party to compiling them to explain any matter about the books or the way they were compiled. This power can also be used where documents are produced in an undifferentiated mass and it is important to find out which particular files they came from.

Both in drafting notices to produce documents and assessing whether notices

have been properly complied with, it is essential to have some appreciation of commercial practice. In other words, it is important to know what to look for. Some examples:

- Many companies keep running files of incoming and outgoing correspondence and facsimile transmissions. Documents, particularly faxes, which may have been 'purged' from personal or subject files, can sometimes be found on these running files.
- Computer disks and tapes are a valuable source of material. If a document or letter has been shredded, it may still be possible to find a copy on the word processing system - particularly on a backup tape.
- If it is relevant to establish the whereabouts of a particular executive at a particular time, a great deal can be learnt from a company's travel and expense account records.
- Business diaries are an obvious source of information. Many executives keep both a desk diary and a pocket diary.
- In a major fraud investigation involving a public company, one of the key sources of information is the audit working papers.
- The importance of Board minutes as a source of information is obvious. But even more informative can be the papers circulated to directors before Board meetings. Most public companies keep these papers in some semblance of order, but it is surprising how often they are overlooked by investigators who are not familiar with the way a company's Board works.

On-market share transactions are a special case. It takes some inside knowledge of the broking industry to identify the documents which track a transaction from the buy or sell order through to the screen or floor trade, and back to the contract note. The assistance of an expert may be needed to tell you what to look for. Brokers generally will not produce the entire paper trail unless forced to do so. It is best to take a two-step approach with brokers. Early in the investigation, it is enough to collect the main documents that explain what happened; but if the transaction becomes important for a possible court action, you need to go back and get everything.

If a company's initial response to a notice falls short of producing all documents which may be relevant, what should the investigator do? If there are reasonable grounds to suspect that relevant documents exist and have not been produced, a search warrant can be sought under section 35 of the ASC Law. In most cases, however, the investigator will only have a general suspicion that particular documents like fax running files, expense account records or executives' business diaries may exist and may not have been produced. In these cases, it is probably preferable - and certainly less inflammatory - to write to the company specifying the particular category of documents and asking if any such documents exist, and if so why they have not been produced.

Under section 68 of the ASC law, people who receive notices cannot refuse to

produce documents in answer to the notice on the ground that production might tend to incriminate them or make them liable to a penalty. The documents must be produced; but if the person producing them claims privilege against self-incrimination, the fact that the documents were produced cannot be used as evidence in criminal proceedings or proceedings for the imposition of a penalty. It is important to understand the relatively narrow scope of the protection resulting from a claim of privilege in this context. It is only the fact of production that cannot be used; the documents themselves can still be used as evidence in proceedings against the person producing them, if some other way of getting them into evidence can be found. For example, they can be admitted under the business record provisions or by someone identifying a signature on them.

Much more important in this context is the claim for legal professional privilege. This is a highly controversial subject, since the High Court delivered its decision in *CAC (NSW) v. Yuill* (1991) 9 ACLC 843. To briefly summarise the situation:

- Where documents are held by solicitors, a notice to produce may be served on the solicitors. The solicitors may resist the demand for production on the ground of legal professional privilege - ASC Law section 69. If they do, they must answer the notice by providing the name and address of the client, and sufficient particulars to identify the documents.
- Faced with this situation, one option for the investigator is to contest the claim for privilege on the grounds that the documents described are not privileged at all. This means going to court to have the matter resolved. The normal principles governing the ambit of legal professional privilege will apply. These are not set out here; they can be found in texts such as *Cross On Evidence* (Cross 1991). Solicitors' claims for legal professional privilege often are too wide; the criterion seems to be 'Is the document potentially embarrassing to the client' rather than 'Is the document produced for the purpose of taking legal advice or in contemplation of litigation'. Claims like this should be challenged if the documents are potentially important to the investigation. The ASC should try to work out some rules for dealing with documents which are the subject of contested privilege claims, along the lines of the rules worked out between the Law Society and the police in relation to search warrants. Pending the establishment of any formal rules, most solicitors will agree to a procedure under which the documents are delivered to a magistrate or judge until the case can be heard.
- Following the *Yuill* case, the investigator has another option. He can issue a notice directly to the client, demanding production of all documents in his possession, custody or control (remembering that 'possession' as used in section 33 of the ASC Law extends to custody or control). The High Court in *Yuill* decided that under the special investigations provisions of the Companies Code - which include section 308, very similar to section 69 of the ASC Law - the client's right to claim privilege had been abolished. If the same reasoning applies under the ASC Law, the client

> will have no choice but to get the documents from his solicitor and produce them.

At this stage, it is not clear whether the High Court's reasoning in *Yuill* applies to the ASC Law. My view is that it does because section 69 of the ASC Law, like section 308 of the Companies Code 'positively indicates . . . an intention not to extend the full protection of legal professional privilege beyond a legal practitioner' (*Yuill* per Dawson J, (1991) 9 ACLC 843, 855). However, this may not be generally accepted by the legal profession, until the matter is resolved by a court. This will happen fairly soon; but in the meantime investigators must expect demands for production of potentially privileged documents to be resisted.

This raises the question: what should the investigator do if documents are not produced in response to a notice? One option is to obtain a search warrant. This may well be the appropriate course to take where the investigator suspects that a person or company holds documents and is simply refusing to produce them. More commonly, production will be resisted on the ground that the documents are not caught by the notice, that the notice has not been properly issued, or that the documents are protected by a claim for legal professional privilege. In these circumstances it will usually be more appropriate for the ASC to seek an order under section 70 of the ASC Law. Section 70 allows the ASC to go to the court, produce a certificate saying that a person has failed to comply with a notice without reasonable excuse and ask the court to order compliance.

What constitutes a 'reasonable excuse' is, unfortunately, far from clear. In the view of Dawson and Toohey JJ in the *Yuill* case, it refers to 'physical or practical difficulties in complying with' the notice (9 ACLC 855). Gaudron and McHugh JJ, on the other hand, thought 'reasonable excuse' extended to any legal basis for resisting compulsory production (9 ACLC 857 and 862 respectively). A similar view appears to have been taken by Jenkinson J of the Federal court in *ASC v. Graco* (1991) 9 ACLC 828.

On a practical level, whenever a person served with a notice makes some excuse for not complying with it and the ASC is not prepared to accept the excuse as reasonable, the matter should be referred to the court under section 70. It is then up to the court to decide whether the excuse is reasonable or not. Evidence on this issue may be obtained from *MF1 v. National Crime Authority*, a judgment of Herey J in the Federal Court(1991) 5 ACSR 353.

A word of caution, though, is necessary about referring too many matters to the court in the course of an investigation. Court fights are expensive and distracting sideshows. It is best to avoid them if you can. It is surprising how often a fight can be avoided by talking to the people on the other side, explaining to them what you are doing and why you are doing it. Even if you cannot talk them into complying, you need to think carefully about whether the expense, delay and distraction of an application to the court is worthwhile.

If a notice is challenged, the first thing you should do is take a critical look at the notice and assess the validity of the objection to it. If there is any reasonable basis for the objection at all, do not be drawn into a court battle that could be lost. Withdraw the notice, and if possible issue a new one free from the defect that was objected to. Provided the new notice is within power and issued for proper reasons, there is no reason why it should be infected by whatever might have been wrong with the earlier notice.

The penalties for concealing documents from an ASC investigation are severe. Section 67 of the ASC Law provides for a maximum penalty of $20,000 or 5 years gaol, or both. If it is shown that a person has concealed, altered or destroyed books, he can escape liability only if he proves that he did not intend to delay or obstruct the investigation or defeat the purposes of a national scheme law - section 67(2).

There is one final point on notices: from time to time people who are asked to produce large numbers of documents, particularly old documents or printouts from superseded computer systems, ask for compensation for the time they have to spend getting the documents together. Under the ASC Law there is no right to compensation, and in most cases that is the only answer that should be given. Very rarely, there may be a special case where an ex gratia compensation payment is justified. Out-of-pocket expenses are a different matter - these should generally be borne by the investigating agency, provided they are reasonable and properly documented.

Search warrants

Under the ASC Law, search warrants are a second-line weapon. They can only be obtained where there has been a failure to produce books as required by a notice. Contrast the position in police investigations where search warrants are very much a first-line weapon.

Can Federal police seconded to an ASC investigation use their powers under section 10 of the *Crimes Act 1914* (Cwlth) to obtain search warrants? The trigger for section 10 is an offence or suspected offence against a law of the Commonwealth. Section 29 of the Corporations Act 1990 of each state says that an offence against a state's Corporations Law is to be treated as an offence against the laws of the Commonwealth, so it seems the Commonwealth Crimes Act (including the search warrant provisions) does apply to Corporations Law offences.

Can state police seconded to an ASC investigation use their search warrant powers under the state equivalents of section 10 of the Commonwealth Crimes Act, such as section 711 of the WA Criminal Code? It follows from sections 29 and 33 of each state's Corporations Law that state search warrant powers are not available where the matter being investigated is a suspected breach of the Corporations Law. However, the position is different where the conduct being

investigated is or includes a breach of some state law other than the Corporations Law, such as the Criminal Code in WA - then a search warrant can be obtained by state police under the state provisions. But in my own view, it is preferable for ASC investigations wherever possible to use powers conferred by the national scheme laws, or the Commonwealth Crimes Act which is incorporated by reference into the national scheme.

Another area where powers of search and seizure can be relevant to a major fraud investigation is in the exercise of information-gathering powers under Part 4 of the Proceeds of Crime Act.

There are well-established principles relating to the execution of search warrants. Police officers usually have a working-level knowledge of them, and lawyers who want to find them can look in books like *The Law of Criminal Investigation* (Gillies 1982).

The execution of a search warrant, like every other part of an investigation, is an exercise in management. If a major seizure exercise is to be carried out, it has to be carefully planned and coordinated. Every person involved in the exercise must be clearly told what he is looking for, and how to decide what he can and cannot take. There must be a responsible person in charge of every location, fully briefed to enable him to deal with objections from the occupants of the premises and answer questions from his own team. There is little margin for error with a search warrant: if you miss documents you are unlikely to get another chance to collect them, but if you take too much you will be dragged off to court.

Investigative hearings

The power to hold investigative hearings is an important weapon for the ASC investigator, but it is a tricky one to use and is, in my opinion, often used clumsily with results that vary from useless to counter-productive. To conduct a hearing properly you need three things: a clear understanding of the hearing procedure; an effective questioning technique; and a great deal of preparation.

The ASC has power under section 19 of the ASC Law to require a person to appear before a staff member for examination, if it believes on reasonable grounds the person has information about a matter it is investigating. The procedure for these examination is set out in sections 20 to 27. There is also a power to hold hearings under section 51 and the procedure for those hearings is set out in sections 52 to 62. I will concentrate on examinations under section 19 because they are more likely to be used in the course of an investigation.

To summon a witness for examination, the Commission has to give a notice in the prescribed form, which is Form 1 in Schedule 1 to the ASC Regulations. The notice has to be signed by a person who has the requisite delegated power under section 102 of the ASC Law. The notice has to state the general nature of the matter being investigated. This requirement was considered by Jenkinson J of the Federal court in *ASC v. Graco* (1991) 9 ACLC 828. His Honour held that

'investigation of the affairs of Titan Hills Australia Limited' would have been a sufficient description, provided the notice had specified the period covered by the investigation; but because there was no reference to a period in the notice, it was deficient and Mr. Graco had a 'reasonable excuse' for not complying with it in terms of section 70 of the ASC Law.

The person conducting the examination must be a staff member. There is a certain amount of expertise involved in conducting these hearings effectively, and the questions should be asked by a lawyer with courtroom experience. If there is no suitable lawyer in the investigating team or available from elsewhere in the ASC, an outside lawyer can be retained as a consultant for the purpose. Provided the retainer is by written agreement, he or she will come within the definition of 'staff member' in section 60 of each state's Corporations Act 1990.

The person conducting the hearing must always make sure the rights of the person examined - to claim privilege, to have legal representation and so on - are fully explained to him so that the explanation appears in the recorded transcript. This is so even though these rights have to be set out in the notice convening the hearing. It is also essential for members of the investigation team attending the hearing, other than the person actually conducting it, to have their attendance authorised: otherwise, they are committing an offence under section 22(2) of the ASC Law. It is good practice for the person conducting the hearing to have all of this introductory material written or typed out, and to follow the script closely to make sure nothing is left out. This saves a lot of trouble if it later becomes necessary to use the transcript as evidence in court.

Some transcripts of examination have consisted mainly of apologies to the witness for calling him in before the people conducting the hearings knew enough about the subject to ask him questions. Other transcripts show that key questions went unasked, or half-complete answers were not pursued, because the people conducting the hearings did not know enough about the subject to recognise the issues. This highlights the need to do homework - to find out as much as possible about the subject before holding an examination hearing. Of course, it is not always possible to gain a full understanding of a subject before examining witnesses about it. It may be necessary to call witnesses back for further examination. But generally speaking, examinations, particularly of major players, should be left until other investigative weapons have been used to find out as much information as possible. In this connection the subject of privilege against self-incrimination needs to be discussed.

Section 68 of the ASC Law says that is not a reasonable excuse for failing to answer a question at an examination, that the answer might tend to incriminate the examinee or make him liable to a penalty. But although the examinee does have to answer every question, he can claim in relation to any question that the answer might incriminate him. If he does, the answer cannot be used in any criminal proceedings **against that examinee**, or any proceedings against him for the imposition of a penalty. **And it is not only the answer itself that cannot be**

used - no information, document or other thing obtained as a direct or indirect result of the answer can be used in a criminal or penalty action against the examinee - *see* section 68(3) of the ASC Law.

This has some very significant practical consequences for the investigator:

- It makes it highly undesirable to examine any key player at an early stage of the investigation, because anything his evidence leads you to even indirectly cannot be used against him if he claims privilege. All possible evidence must be obtained from other sources before any potential defendant is examined.
- When you do examine a potential defendant you must be able to prove what evidence you had before you saw him, to forestall any claim by him that you cannot use any particular item of evidence because you were led to it, either directly or indirectly, by an answer he gave at the examination under privilege. Again, this brings us back to the importance of an efficient, computerised document recording system. It must be possible to prove, using the information recorded in relation to each piece of evidence obtained, how and by whom it was obtained. Even so, it is not going to be easy to prove that any item of evidence obtained after the examination of a key player was not obtained as a result of privileged evidence he gave.

Section 69(3) places an unreasonable burden on the conduct of an investigation and needs to be limited in scope. But unless and until the section is amended, investigators will have to come to terms with the practical problems it raises.

The principles which govern claims for **legal professional privilege** at examinations are broadly the same as for notices to produce. Section 69 of the ASC Law makes it clear that lawyers can claim privilege in appropriate circumstances; the question is whether that impliedly repeals the right of the client to claim privilege. The answer depends on whether the High Court's decision in *Yuill* applies to section 69. Until that issue is settled, whether non-lawyers can claim privilege against giving evidence about communications with their lawyers is unclear.

Is the same lawyer entitled to represent more than one witness before an examination? This question may have particular importance where the person conducting the examinations requires examinees to keep their transcripts confidential, under section 24(2) of the ASC Law. There is a danger that the confidentiality condition may be circumvented if the same lawyer represents more than one witness. In *Wood v. NCSC* (1990) 8 ACLC 474, Wallwork J of the Western Australian Supreme Court upheld a direction by the chairman of an NCSC hearing that the same solicitor could not appear for more than one witness; but he struck down as beyond power a further direction that extended the prohibition to other solicitors from the same firm. On this authority, it is possible to stop the same lawyer from acting for more than one witness; but it is not possible to stop different witnesses from being represented by different solicitors

from the same firm.

It is usually desirable to protect the privacy of an ASC hearing by making an order that the witness should not discuss his evidence or disclose the transcript to anyone other than his own legal advisers. The decision of the full Federal court in *NCSC v. Bankers Trust Australia Ltd* (1990) 8 ACLC 1 is authority for the proposition that such an order is within power, provided it is limited in terms of time. In other words, disclosure can be prohibited for a period of six months, twelve months or whatever other period is reasonable in the circumstances. What determines reasonableness is not altogether clear - presumably it is the expected duration of the investigation of which the examination forms part.

The importance of preparation for hearings cannot be underestimated. Wherever possible, documents should be put to a witness to focus his mind. It is all too easy to deny knowledge of a subject when questioned in general terms. It is harder to deny all knowledge when confronted with a document bearing your signature - but it is surprising how many witnesses will still try it. Anyway, the preparation process is all about finding all relevant documents, putting them in a sensible order, and preparing questions about them. With a prepared list of questions, or least subject headings, nothing is missed. You must be prepared to jump about in your list or depart from it entirely, following the flow of the answers you receive; but it is essential to go back to the list before you finish, to make sure everything has been dealt with.

The physical process of paper-shuffling at an examination is a very important part of making the examination process work effectively. There should be complete sets of the documents for the witness, his lawyer, the inspector and anyone else who is present. Some people adopt a court-style system of tendering only those documents which can be identified by the witness. This is inappropriate for an investigation hearing; every document in the set should be numbered. In this way you have a record of everything put to the witness, and you know what he cannot identify as well as what he can. For example, there may be 50 documents to put to Mr. Alan Brown and they should be numbered AB1 to AB50. Of course, all sets must be numbered the same way! It is important, though, to describe a document when it is put to a witness, as well as referring to its number; this makes the transcript easier to follow. Needless to say, a full numbered set of the documents must be kept with the transcript of the examination.

A very important practical question is: should you let the witness examine the documents that will be put to him at the hearing, before the hearing starts? If you do show the witness the documents, you lose the element of surprise and give him a chance to think up a story to explain any embarrassing or incriminating document. On the other hand, showing the witness the documents beforehand helps jog his memory and may make the hearing more productive. Neither method is totally satisfactory. Much depends on the attitude of the witness: a cooperative witness will often be even more cooperative if he has examined the

documents in advance, whereas an uncooperative witness may use the preview of the documents to come up with new ways to frustrate you. Unfortunately you do not always know in advance whether a person will cooperate or not.

One should not expect too much from hearings. All too often, witnesses are untruthful or forgetful. You will not always get what you want; but with a lot of preparation and a lot of patience, you might just get what you need.

Interviews and statements

Some witnesses say they are prepared, or even prefer, to talk to investigators at an informal interview rather than an examination. Now there is no doubt that interviews do have their place in an investigator's repertoire, but they need to be used with care. As every experienced policeman knows, witnesses who start out friendly often turn nasty when they find out they are in the target zone, and try to deny what they have previously been happy to say. The witness must of course be warned if an intention has been formed to charge him, and it is not always easy to say when the need for a warning first arises. For these reasons, if there are seconded policemen (or investigators with police experience) in an investigation team, they are the best ones for the job of interviewing because of the training they have had in interview techniques. It is always good practice to have two people conduct an interview, and good results can be obtained by using one person with police experience and one with expertise on the legal and commercial side.

Although it is a cumbersome procedure at first and it makes some witnesses suspicious, most, if not all interviews should be tape-recorded. Then there can be no argument about what was said, and it makes the process of preparing statements easier.

Great care should be taken in preparing statements, whether from tape-recordings, from the transcripts of examinations or from written interview notes. At the risk of stating the obvious, it is essential to use witnesses' own words, however colloquial, and not put investigators' words in witnesses' mouths. It is surprising how hard it is for inexperienced investigators to grasp this.

Lawyers who work in an investigation team sometimes try to 'improve' statements by cutting out hearsay. This is a mistake. The statement should record (in logical order) everything the witness said that is remotely relevant. The prosecution counsel can worry about what is hearsay.

Other sources of information

There are other potential sources of information which should not be overlooked, such as the transcript of related civil cases or examinations conducted by liquidators under section 597 of the Corporations Law or its predecessor, section 541 of the Companies Code. And of course, one must not forget the enormous contribution to the common stock of public knowledge being made at present by the Royal Commission industry.

Evidence may also come in under the *Cash Transaction Reports Act 1988* (Cwlth) - *see* section 243D of the ASC Law.

There is an intriguing power under the ASC Law to require people to give 'all reasonable assistance'. Section 19(2) brings this power to bear at the investigation stage, and it springs up again at the prosecution stage under section 49(3). It is not clear what 'reasonable assistance' a person can give, apart from giving evidence or producing documents - but the power is drawn to your attention in case you ever find it useful.

Natural justice

There have been a number of court battles over the requirement to give 'natural justice' to people being investigated under NCSC powers or in special investigations under the Companies Code. The authorities are reviewed in the two most recent cases, *Clements v. Bower* (1990) 8 ACLC 801 and *Bond v. Sulan* (1990) 8 ACLC 1273.

The first step towards understanding natural justice at a practical level is to stop calling it natural justice and adopt the description used by Deane J in *Australian Broadcasting Tribunal v. Bond* (1990) 64 ALJR 462, 482 and Gummow J in *Bond v. Sulan* (1990) 8 ACLC 1273, 1275. These judges called the concept 'procedural fairness'. What the investigator has to do is adopt a **fair procedure**. This will vary from case to case; but the essence of it is that people about whom the investigation proposes to make adverse findings should have those proposed findings put to them, so that they get a fair chance to explain or justify their conduct.

In an ASC investigation, a practical way of ensuring procedural fairness is to call all potential defendants in for examination towards the end of the investigation, and question them about their suspected criminal conduct. The evidence should be clearly put to them. They should be told that an inference of criminal conduct (specifying the suspected offence) appears to be open on the evidence, and asked to give reasons why this inference should not be drawn. This removes any ground for complaint that a defendant has been deprived of a fair chance to put forward his own side of the case at the investigation stage.

Confidentiality and subpoenas for production of seized documents

The ASC is required by section 127(1) of the ASC Law to 'take all reasonable measures to protect from unauthorised use or disclosure information given to it in confidence in connection with the performance of its functions or the exercise of its powers'. The rest of section 127 deals with various exceptions.

One contentious issue is the obligation of the ASC to comply with subpoenas requiring it to produce seized documents for use in civil cases. In some cases this is fair enough, but in other cases one party may be able to use the procedure to 'piggyback' on the ASC's powers of compulsion, to get access to documents it could not have obtained directly from the original owner.

It has recently been held in an English case (*Marcel v. Commissioner of Police* [1991] 1 All ER 845) that the police cannot be forced to produce, in answer to a subpoena, documents seized under a search warrant. The same principles should be applied to the ASC by Australian courts, and no doubt they will.

Using the Evidence

Effective investigations will nearly always turn into prosecutions, or civil recovery action. Investigators should always keep this in mind. It is no use getting evidence if you cannot use it in the litigation that follows. Having referred already to a number of practices that should be adopted in gathering evidence, to make sure it can be used, some specific comments about the investigator's role after the investigation turns into litigation are relevant.

Coordination between investigation and litigation teams
Potentially the weakest link in the whole chain of investigation leading into litigation, is the coordination between the investigators and the litigators. It does not matter what sort of litigation flows from the investigation: it might be a prosecution through the DPP's office, or it might be a civil action using in-house ASC lawyers or outside solicitors and counsel. In any of these situations, the managers of the investigation team and the litigation team share a common problem : ensuring their teams get the best out of each other, and out of the case.

It is a good idea for the litigation team to have some input to the investigation at an early stage; certainly before the decision is taken to lay charges or commence civil proceedings. Their advice should be sought, by means of a properly-prepared brief, on whether a prima facie case exists. The decision to lay a charge, or even to start a civil action, is one that has grave consequences for the defendant. No such action should be taken without very careful consideration of both evidence and law. In a major fraud investigation, the investigation team becomes too immersed in its work to make these decisions objectively. That is why the litigation team needs to be involved in - in fact to make - the decision to litigate.

But the lawyers who make decisions on litigation following an investigation must be prepared to take a reasonably robust approach. Nothing demotivates an investigation team more effectively than to see its good work wasted because a lawyer is afraid to go to court unless he is absolutely sure of winning. You cannot win them all - it is not an original comment, but if you are not losing some cases you are not bringing enough. **Nothing will destroy corporate law enforcement more effectively than an excessively timid and negative approach to bringing prosecutions or civil recovery actions**.

Once the decision to litigate has been made, the investigation team turns into a litigation support team. The litigation team should now take the running, and tell the investigators what they want. From this point on, the whole exercise is all about one thing: **making sure the person who presents the case in court does**

the job properly. It does not matter how well anyone else knows the case: if the barrister does not, the case will be lost.

It is always hard to get barristers to think about cases until the day before they start. This should be acknowledged and treated as yet another management problem. Maybe rapes and murders can be run properly after one night's work on the brief; but that is not so with fraud. Consequently, between the manager of the investigation team and the manager of the litigation team, some way must be found of deciding well in advance which barrister is going to run the trial, and persuading that barrister to set aside enough time to:

- understand the facts;
- identify the legal issues;
- write a detailed advice on evidence;
- decide whether charts or other aids to presentation should be prepared;
- prepare particulars; and
- draft an opening address.

Depending on the complexity of the trial, this can take anything from a few days to some months. It is essential for the investigation team to have a role in this process; they are, after all, the ones who know most about the case. What is more, **it must happen at least a couple of months before the committal proceedings or the trial**, so that if any shortcomings in the evidence are identified the investigation team will have time to try and rectify them.

There is a special problem in complex fraud prosecutions run by barristers whose experience is predominantly in criminal rather than commercial law. In those cases the manager of the investigation team must be constantly on guard, both during the preparation phase and **especially at the trial**, to make sure that counsel does not overlook any point of commercial law or commercial procedure.

ASC interim reporting requirements

Anyone running an ASC investigation needs to be aware of section 16(1) of the ASC Law. This deals with interim reports. It says that an interim report must be prepared where, in the course of an investigation, the ASC forms the opinion that a 'serious contravention' of Commonwealth or state law has been committed.

As a matter of practice, the appropriate time for an interim report would seem to be when a brief has been prepared for the litigation team, and the litigation team has responded saying a prima facie case exists. It should be fairly easy to compile an interim report out of the brief and the litigation team's opinion.

The interim report is only needed in the case of a 'serious contravention'. There is no guide to what this means, other than the ASC's own opinion. It seems safest to assume that a serious contravention is any contravention resulting in an indictable offence.

Transcripts
The use of transcripts of examination is dealt with in sections 76 and 77 of the ASC Law. Section 76 is concerned with the use of statements in a record of examination against the person who made them, section 77 with their use against others.

Under section 76, statements from a person's own transcript are admissible against him:

- in any civil or criminal proceedings, if he did not claim privilege; but only in civil recovery proceedings (that is proceedings which are not criminal, or for the imposition of a penalty) if he did claim privilege.

In either case a statement can only be used if it is relevant, any qualifying or explaining statement in the transcript is also tendered and the contents of the statement are not subject to a claim for legal professional privilege.

Under section 77, statements from the transcript of a witness can be used in proceedings against another person:

- if the witness is dead or unfit, is overseas or interstate and cannot be brought back, or cannot be found;
- or in any other case, provided the witness is called to give evidence if the other party requires it.

However, the court may decide to give less weight to a transcript than to oral evidence (section 78).

To make sure transcripts can be used as evidence if necessary, each witness should be asked to sign his transcript - *see* ASC Law sections 24(2) and 76(3). If he refuses to sign, the transcript can be authenticated 'in any other prescribed manner'. The special investigation provisions of the Companies Code said the same thing, and they were backed up by regulation 61 of the Companies Regulations 'prescribing' that either the person who prepared (or supervised the Preparation of) the transcript, or any person who was present at the examination, could authenticate the transcript. There does not seem to be any similar provision in the ASC Regulations.

Multiple requirements for the same document
A complex fraud investigation will usually result in more than one court case. Sometimes the same document is needed as an exhibit in more than one case. There may be other ways of dealing with this, but one which recommends itself is to use section 80 of the ASC Law. This section makes certified copies admissible as if they were originals.

Further investigations after charges laid
Once a charge has been laid, can the investigation be continued with a view to obtaining more evidence for the existing charges, or laying other charges? This really breaks into two questions. First, can the ASC use compulsive investigation

powers **against persons other than the defendant charged**? The answer to this must be yes, because section 49(3) of the ASC Law specifically empowers the ASC to demand assistance from persons other than the defendant after a prosecution has been commenced.

Secondly, can the ASC use its compulsive powers **against the defendant** after he has been charged? The answer to this is less clear. The position seems to be that compulsory investigative powers can be used against the defendant for the purpose of investigating other potential offences, but their use against him to get more evidence for the existing charge may be an abuse of process. A valuable examination of this question and the relevant authorities may be found in Kluver (1990, p. 266).

Administrative Law

In the past, corporate investigators have not had to worry much about administrative law. Now, the situation is different. Commonwealth administrative laws apply with full force to investigations under the Corporations Law and the ASC Law - *see* sections 34 and following of each state's Corporations Act 1990.

A review of Commonwealth administrative law is beyond the scope of this paper, but there is a recent review of the subject in Brien (1991, p. 235). On a practical level, the availability of administrative law remedies highlights the need for careful thought to be given to every decision taken in the course of an investigation: from the decision to constitute the investigation, down to every decision to issue a notice and back up to the decision to lay charges or bring civil proceedings. Every decision must be firmly based on the relevant statutory power, and be taken for valid and relevant reasons by a person with the necessary delegated power. It might be a good idea to develop a form to be filled out whenever an administrative decision is taken, just to focus people's minds on what they are deciding. The form should say who made the decision, what the statutory basis for it was, what the reasons were and who carried out the legal review.

Probably the most important source of Commonwealth administrative law as it applies to investigations will be the *Administrative Decisions (Judicial Review) Act 1977*. Section 13 of that Act allows a person aggrieved by a decision to require the decision-maker to give him written reasons for the decision. There is an exception in paragraph (e) of Schedule 2, concerning decisions relating to the administration of criminal justice (specifically including decisions requiring production of documents, giving of information or appearance as a witness). There is also an exception in paragraph (f) of Schedule 2 which covers decisions about civil proceedings.

Conclusion

To conclude: running a fraud investigation is a classic exercise in management. There are many specific issues to deal with; some of them are identified in this paper. All the decisions on all the specific issues have to be taken in a coordinated way, always driven by the overall objectives of the investigation. The success of a fraud investigation depends on the calibre of the management and the calibre of the people in the team. But no matter how good the people in the team are, a fraud investigation will fall short of its targets if it is not managed properly.

There are two other aspects to be borne in mind, and the first is speed. An important part of managing a fraud investigation is to make sure it happens quickly. Trails go cold, documents are lost or destroyed, witnesses forget, people die. The books are full of cases lost because they were brought too late.

Last of all, the hidden danger: investigator's disease. Some call it paranoia, some call it a predisposition toward conspiracy theories. Really, it is just a tendency to believe that everyone you are investigating is guilty. It is not to be confused with enthusiasm or even a measure of obsessiveness; controlled, these are good qualities in an investigator. But investigators do have to be told over and over again that there are two sides to every story, and until they have heard and investigated both sides, they must keep an open mind. However rarely it happens in practice, it must always be possible for a fraud investigation to conclude that there has been no fraud at all.

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The National Crime Authority and the Investigation of Fraud

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The National Crime Authority is an investigative agency established by Commonwealth and underpinning state legislation. The Authority is constituted by a Chairman and Members of the Authority. A Member of the Authority is responsible for the operation of one or more of the Authority's offices. The Authority has offices in Melbourne, Sydney, Adelaide and Perth and in 1992 will open an office in Brisbane.

Functions of the NCA

The Authority's functions are set out in the *National Crime Authority Act 1984* (the Act). Amongst those functions is the obligation to investigate certain defined types of criminal activity. The establishment of the NCA in 1984 was prompted by concern within the community about the level and impact of organised crime - a term which is frequently used, but which is rarely defined to everyone's satisfaction. The Act makes no reference to organised crime. Instead, the Act states that the NCA may conduct investigations and inquiries into relevant criminal activity. A relevant offence is defined in Section 4 of the Act as having the characteristics set out below.

The Authority may conduct such investigations by way of general investigation or by means of a special investigation. The powers it may exercise in the course of conducting its investigations vary accordingly.

The Authority's statutory functions envisage and include the power to establish, participate in and coordinate state and federal joint task force investigations in appropriate cases. This aspect will be referred to later in this paper, as it is considered to be a most important function when considering the role of various law enforcement agencies in investigating serious fraud matters.

It should be noted that the Authority is purely an investigative agency and has no prosecutorial function. Under the Act the Authority has the responsibility to furnish admissible evidence assembled by it to appropriate prosecutorial agencies.

The Authority also has a statutory function in the area of criminal intelligence and law reform. In that regard the Act states that the Authority is to obtain, analyse and disseminate intelligence and information to relevant law enforcement agencies and to make recommendations where considered appropriate to the

relevant Minister regarding reform of law and/or administrative practice.

Powers of the NCA

Because of the state and federal legislation establishing and defining the powers and functions of the Authority, the Authority is free of jurisdictional restrictions on its activities in Australia. The powers available to the Authority in the conduct of a general investigation are those powers which may be used by the police investigators taking part in the investigation.

It is in relation to a special investigation that the Authority's coercive statutory powers come into play. These powers include:

- the power to conduct hearings and summon witnesses to appear before the Authority and give evidence on oath and produce documents;
- the power to, by way of notice compel the attendance of a person before a member of staff of the Authority to produce documents specified in the notice;
- the power to compel the production of documents and information from some federal and state agencies and officers of those agencies;
- the power to appoint specialist consultants to assist in particular investigations;
- the power and obligation to cooperate with similar international agencies.

When a person is summoned to appear before the Authority, the person can refuse to answer a question or produce a document on the grounds of self-incrimination. The person does not have that right if the relevant Director of Public Prosecutions (or equivalent prosecutorial agency) provides the person with an undertaking that the answers given or documents produced by the person will not be used in criminal proceedings against them, other than for a charge of perjury under the National Crime Authority Act. A person may also decline to answer questions where legal professional privilege attaches.

In other circumstances the Authority can compel a person to answer questions unless the person has a 'reasonable excuse' to refuse to answer.

The term 'reasonable excuse' has not been subject to judicial consideration as it appears in the NCA Act, but there may well be circumstances other than those referred to above where a person can refuse to answer questions or produce documents.

In addition to the above statutory powers under the National Crime Authority Act, the Authority has telephone interception capacity and a sophisticated physical and technical surveillance capacity.

References and Special Investigations

The special investigative powers of the National Crime Authority may only be exercised after a notice of referral (reference) under the Act is obtained from the Commonwealth and/or relevant states. Although the procedure varies slightly in relation to the obtaining of a Reference from the Commonwealth, as compared to the states, the process basically involves the matter that is sought to be investigated by the Authority being approved by the Inter-Governmental Committee (IGC). The IGC comprises relevant state ministers and is chaired by the Commonwealth Attorney General. The appropriate state and/or federal Ministers then sign a notice, referring the matter the subject of the investigation to the National Crime Authority. A matter may be referred to the Authority by the Commonwealth, all or any of the states or any state or states and not the Commonwealth. A cost sharing formula is applied to matters in accordance with the jurisdictions that have referred the matter.

A copy of this notice of referral is required under the Act to be annexed to each and every summons served on a person to attend and give evidence before the Authority in relation to the particular investigation.

Criteria applied to NCA References

The National Crime Authority Act lays down criteria governing the jurisdiction of the Authority to investigate certain types of criminal activity. The statutory definition requires that an offence subject to investigation by the Authority:

- must involve two or more offenders and substantial planning and organisation;
- must be of a kind that ordinarily involves the use of sophisticated methods and techniques;
- is an offence that is committed or is of a kind that is ordinarily committed in conjunction with offences of a like kind;
- and is an offence that involves, inter alia 'theft, fraud, tax evasion, currency violations . . . obtaining financial benefit by vices engaged in by others, corruption, bankruptcy and company violations or matters of the same general nature as one or more of the foregoing.

Further, the definition does not include an offence committed in the course of a genuine dispute as to matters pertaining to relations of employees, or an offence, the time limit on the commencement of the prosecution of which, has expired. It also does not include an offence that is not punishable by imprisonment or is punishable by imprisonment for a period of less than three years.

The Authority applies additional criteria to matters under consideration for its investigation. The most important of these are:

- that the conduct the subject of the proposed investigation involves criminal

behaviour crossing jurisdictional boundaries;

- that the matter under consideration could not be properly investigated by normal police means and exercising normal police powers;

These criteria are most important, in that by their application the Authority attempts to focus upon the investigation of complex and serious matters not suited to investigation by other law enforcement agencies. Further, they avoid the Authority being put in the position of competing with other law enforcement agencies.

The Multi-Disciplinary Investigative Team Approach

The key to conducting a thorough professional and successful investigation starts with assembling together a team of individuals with the appropriate motivation and expertise to conduct the particular investigation. In the case of serious fraud investigations, the importance of assembling such a team will determine whether the investigation is an effective one or not.

The Authority conducts its investigations by way of multi-disciplinary investigative teams. When the Authority commences an investigation, a team is formed containing the appropriate mix of disciplines and skills to carry out the investigation. The team may be led by a lawyer, police investigator or accountant, depending upon the nature of the investigation. On occasions the Authority will also appoint at the outset, specialist consultants such as merchant bankers or accountants from the private sector to assist the investigation. The Authority has flexibility within its settled structure to assemble a team with the expertise necessary to investigate a particular matter, from within the Authority, or by drawing on the expertise of other agencies in carrying out its joint task force function.

All members of the team are co-located, rather than being located at various points of the building set aside for disciplines. This co-location helps to engender a team spirit and encourages the informal transfer of information between team members.

It goes without saying that the multi-disciplinary team model used by the Authority places it in an advantageous position to investigate serious fraud offences. The Authority's statutory functions and powers and its multi-disciplinary approach make it uniquely suited amongst law enforcement agencies in Australia to coordinate and participate in serious fraud investigations.

Drug/Fraud Investigations

Since its creation, the Authority has conducted numerous investigations including major drug and fraud investigations. In matters other than the fraud related matters, the expertise of the multi-disciplinary team has also been used.

In the past, partly due to the expertise of the former Chairman of the Authority, The Honourable Mr Justice Stewart, the Authority's resources were slanted more heavily towards complex drug investigations. This reflected community concerns prevailing at that time.

The Authority found that its multi-disciplinary team approach was well suited to complex drug investigations, which were often document intensive and involved significant legal and accounting expertise, particularly in the area of tracing assets acquired from the proceeds of crime and more generally, following the money trail. The expertise developed by the Authority in the management of long- term, complex and document based drug investigations can be applied in the conduct of serious fraud investigations. The importance of documents in potential drug prosecutions cannot be over-emphasised.

Even with the increased interest and emphasis on white-collar criminal activity, the law enforcement community continues to allocate far more resources to the investigation of drug related activity than to fraud matters. In recent times, the enormity of the damage caused to Australia by fraudulent conduct, particularly involving public companies, has been clearly acknowledged. Apart from the devastation caused to defrauded individual investors, Australia continues to suffer as a whole because of the lack of confidence and trust in Australian enterprises by Australian and international investors alike.

It should be noted that under Mr Justice Stewart's chairmanship the Authority was involved in investigations involving taxation fraud, customs fraud, companies and securities, fraud, corruption, payment and receipt of secret commissions, fraud offences against state revenue agencies, social security fraud. The Authority has also assisted various agencies in the recovery of funds due to them and has successfully instituted action under Proceeds of Crime legislation.

Looking back at the 1980s it has become abundantly clear to law enforcement agencies that no single agency has the capacity, resources or expertise to properly undertake investigations and assemble evidence to prosecute offenders in serious fraud cases. Serious fraud investigations may involve a combination of all or any of, taxation fraud, state or federal revenue fraud, customs fraud, social security fraud, companies and securities industry fraud or other organised fraudulent schemes.

The Authority has recognised and intends to respond to the enormous damage done to Australia by corporate and securities industry defalcation during the 1980s. Reputable leaders of the business community are of the opinion that it is necessary for those responsible for fraudulent behaviour to be brought to justice. The successful investigation and prosecution of fraudulent 'high flyers' will facilitate the restoration of confidence in bona fide companies within Australia and in the Australian capital markets generally. The Authority sees that it has a role in assisting the Australian Securities Commission and other regulatory and law enforcement agencies to convince the international investment community

that Australia is a safe, secure place to invest where laws will be properly enforced, and that business within Australia will be properly regulated and policed, and that those who transgress the criminal law will be brought to account.

Information Management

An efficient and 'user friendly' information management system is central to the conduct of any serious fraud investigation. Information management has therefore been an area of some moment to the Authority since its inception.

One of the major difficulties in handling the complex cases fitting the criteria for the involvement of the Authority is the volume of documentary information generated by a single case. This statement is particularly applicable to the investigation of serious fraud matters. The task of properly storing, sorting, indexing, analysing and retrieving is an enormous one. The Authority has been involved in the development of sophisticated computerised document registration systems and computerised information storage, sorting, collating and retrieval systems.

The Authority's document management system is designed to preserve the integrity and source of each and every document acquired by the Authority in the course of an investigation. The initial registration function gives each document (or group of documents) a unique number, which will enable the origin of the document to be examined at any time during the investigation or litigation. For example, the computer registration system will record if a particular document was seized pursuant to a particular (identified) warrant and was seized from a particular draw of a particular desk on a documented date and time by an identified officer.

Much more information than this 'basic registration' is needed for any information management system to be productively used as an investigative tool. The development of the Authority's computer systems has been regarded as a matter of some moment since its inception. This was the case even when the Authority's workload was slanted more heavily towards drug related investigations. As stated earlier, these were generally document and information intensive investigations which required as a matter of pure practicability that the Authority develop systems and mechanisms to properly manage larger volumes of information and documentation.

The Authority continues to be involved in the development of its computer systems. It is currently in the process of upgrading not only its document registration system, but also, with a particular view to serious fraud matters, to improve its investigative database.

The Authority has led the way in the area of the tracing of assets and the investigation and following of the money trail by the development of its 'money

tracker' financial analysis computer system.

The Authority has recently developed a new system which is being effectively utilised in the conduct of its major fraud investigations. The system is currently a 'two tiered' system which is the process of being integrated into one. The first stage is the basic registration system referred to briefly above, which records the date, source, type, general description and other details regarding documents and the manner, date and time when the document was acquired by the Authority. Certain other 'links' concerning names of organisations and persons and general references to relevant transactions can also be included at this stage.

The 'second tier' of the system approaches the most difficult problem encountered with any investigative computer support system. That is, to extract all relevant information from an enormous amount of material and have that information entered, sourced and available on the database to be interrogated, analysed, sorted and retrieved in an appropriate format. There is little doubt that in the future a system will be developed involving 'imaging' of documents onto a database with the capacity to search in all relevant fields to enable the user to retrieve all relevant information. The Authority is working towards this goal at the present time. Current systems rely largely upon the keying in of data into designated fields identified as relevant to the investigation and which can be searched on. The Authority has tried a variety of forms to enable this initial keying in of relevant information to take place in an accurate and timely manner. The form currently being used with success in some fraud investigations is simple and fast, and allows police investigators, lawyers, accountants and analysts involved in the investigation to enter relevant data onto the system at the time they are making a general assessment of the worth of a document. Previously, the Authority and numerous Royal Commissions and Commissions of Inquiry have left this most important task, of the initial evaluation of a document and the extracting from the document of its key and important features for entry on the computer system, to junior collators with little or no knowledge of the investigation and often without the expertise to properly understand the complex nature of the document before them.

By the development of a 'user friendly' system and the appropriate training of professional officers with an appropriate knowledge of the case, the Authority has been able to establish a system where the people who enter the all important data onto the system, are the people who will be the users of the data entered and the people with a knowledge of the investigation sufficient to ensure a database of high integrity.

The information thus entered can be sorted, searched for and retrieved in a variety of forms including a chronological sort relating to the involvement of particular individuals or entities, occurrences on or between particular dates, a chronological printout of all events concerning a particular transaction or group of transactions, or a variety of all the above.

By having investigators, accountants, analysts and lawyers with a knowledge of the case entering this data it may be argued that valuable time of those professional officers is being wasted. This is not so. It is imperative for someone with a proper knowledge of the investigation to peruse every single document that is acquired in the course of the investigation to make an assessment of the relevance and importance of the document to the investigation. This initial assessment stage is the ideal opportunity for the officer, either by dictaphone for later entry by keyboard staff, or directly on the computer terminal, to enter relevant information regarding the document so from that point on all other team members will be able to search and retrieve that piece of information and know where the information is sourced. In fact enormous time savings are made by this system, because the database can be relied upon as being of a high integrity, and 'double handling' of a document is largely eliminated. If one is searching for particular information and the details of a particular document or file have been entered logically and properly by a person with a knowledge of the matter then the editing of the collation and entry of information is cut to a minimum. One can to a large extent, eliminate the fear, that relevant material obtained from a particular source may have been eliminated as irrelevant or otherwise misplaced and not entered into the system by inexperienced officers. Previous systems where inexperienced collators were employed to carry out this function required complex systems for review which were generally unsatisfactory and required the handling of one document on numerous occasions by a variety of team members, to check that all relevant material had been accurately entered on the database.

Transcripts of evidence given before the Authority are all entered on the computer system by disk and can be searched on a text retrieval basis as can various reports and analyses prepared by investigators assigned to the case. When the Authority acquires documents from outside sources, it seeks to obtain the material on computer disk to enable ease of search and retrieval.

The Need for Coordination of Serious Fraud Investigations

Following the report and recommendations of the Fraud Trials Committee chaired by Lord Roskill in the United Kingdom, the report of which was released in December 1985, comments and recommendations were made in relation to the various stages of the investigation and prosecution of fraud matters.

The report stressed the need for the coordination of investigations of serious fraud matters, noting that in Britain they were fragmented amongst different agencies. It proposed the establishment of a centralised agency with the appointment of a 'case controller' to direct the investigation process at an early stage and to utilise appropriately experienced accountants and lawyers to improve the prospects of a properly conducted investigation and successful prosecution. Many recommendations of the reports were subsequently implemented in the Criminal Justice Act 1987 (UK) which established the Serious Fraud Office for the United Kingdom, which office has similar powers to the Authority, to

investigate serious or complex fraud and to carry through the conduct of any proceedings which result.

Although the Authority is not an agency established for the single purpose of investigating serious fraud matters and its jurisdiction to investigate matters goes beyond complex and serious fraud matters, it is submitted that similar observations, to those referred to above particularly regarding the need for coordination could be applied to the investigation of serious and complex fraud matters in Australia.

It may be argued that the need for an agency to coordinate the investigation of serious fraud matters is probably even more important in Australia than the United Kingdom not only because of the proliferation of agencies concerned with serious fraud matters, but particularly because of the jurisdictional problems between state and the federal laws in Australia.

There are a variety of state and federal regulatory and law enforcement agencies charged with administering and/or enforcing legislation from which a serious fraud investigation may emerge.

There has been a demonstrable lack of coordination of the activities of the various agencies in complex fraud matters involving the crossing of jurisdictional boundaries (national and international) and involving conduct more serious than a mere regulatory violation. Some of this may involve conduct so organised and complex in nature that the agency felt it had neither the responsibility nor the powers or expertise to effectively investigate the matter. Many of these cases have either not been investigated at all or have not been adequately investigated.

The Authority's confirmation as a permanent law enforcement agency, together with its statutory coordinating and joint task force establishment function, its multi-disciplinary team approach and special powers occupy the role of a coordinator of investigations into serious fraud matters.

The permanent presence of the National Crime Authority in conducting and coordinating serious and complex fraud investigations will assist in the development and maintenance of an intelligence and methodology database regarding this sort of criminal activity. Previously, where such matters were either not properly investigated or investigated by way of the appointment of a special investigator under the Companies Cooperative Scheme Legislation, investigative methods and techniques and useful intelligence that could be utilised in future investigations was lost upon the cessation of the Special Investigation or Commission of Inquiry established to conduct the investigation.

The Authority sees an important part of its function in the area not only to coordinate the conduct of appropriate investigations but also to ensure the dissemination of relevant information to appropriate agencies. The development of an intelligence database will enable the Authority to gain greater expertise in the conduct of these investigations and also to analyse intelligence with a view to

taking action in relation to potential fraud matters. It is recognised that the Authority will of course not be acting alone in the conduct of this intelligence function and that the ASC and other agencies will play a significant role in partnership with the Authority.

NCA/ASC Relationship

As noted earlier, serious and complex fraud investigations do not all originate in one agency. The Taxation Office, Customs, Cash Transaction Reports Agency, state and federal police fraud squads, Royal Commissions and other Commissions of Inquiry, state and federal revenue agencies along with the ASC are just some of the sources of serious fraud investigations which may fit the criteria for investigation by the National Crime Authority. In relation to companies and securities fraud, the ASC, as the regulator and the agency responsible for the application of the Corporations Law is the most likely agency to identify criminal conduct appropriate for the Authority to investigate.

There will be a clearly recognisable category of cases in which the ASC may target various forms of civil recovery action. This conduct may also demonstrate breaches of state and federal law going beyond the provisions of the Corporations Law and cases of a complex and substantial nature which entail the crossing of national and international jurisdictional boundaries and otherwise satisfying the criteria for the Authority's involvement which will necessitate joint task force operations between the Authority and the ASC and other law enforcement agencies. The Authority sees itself playing a continuing and coordinating role in relation to the investigation of such matters.

Law and Administrative Practice Reform

The Authority also sees itself as having a role in making appropriate recommendations for the reform of law and administrative practices and procedures and to participate actively in research studies, commissions and committees charged with the examination of regulatory matters.

The Authority reports to government on the results of investigations on matters of the law and administrative reform that affect the environment which may be conducive to or even encourage the commission of serious fraud offences. In this regard once again the Authority will not be acting alone but will be working in partnership and consultation with relevant law enforcement and regulatory agencies in the making of recommendations for law and administrative reform in appropriate areas.

The Authority's current investigation into the methods of money laundering is an area which will soon result in a report to government on the methods and environmental factors which affect money laundering. The Authority either has or is in the process of consulting all law enforcement and regulatory agencies and

relevant industry groups in an effort to identify methods employed by criminals in laundering the proceeds of crime. Any particular cases requiring investigation by the Authority during the course of this twelve-month project will be referred to the relevant law enforcement agency for investigation.

The Authority has recently convened a conference concerning the presentation of complex cases to juries which will result in the establishment of a working party to examine a number of critical national and international issues affecting the criminal justice system, particularly the law of criminal procedure as it relates to the conduct of complex prosecutions.

New Directions of the NCA

The current chairman of the National Crime Authority the Hon. Mr Justice Phillips, after due consultation with other law enforcement agencies, released a paper outlining the new direction of the National Crime Authority.

The fundamental principle underlying this new direction is the determination of the Authority to act in consultation, cooperation and partnership with other law enforcement agencies. The Authority is determined to prove itself as not being in competition with other agencies but as being capable of supplying complementary services to other agencies in the conduct of investigations into complex matters which cross state jurisdictional boundaries and are matters which can only be effectively exercised by the use of the National Crime Authority's special investigative powers.

In this regard the Authority intends to place optimum effort on attacking the profit motive in crime and in particular to target serious fraud offenders whose criminal conduct is based solely upon greed and the accumulation of wealth.

The Authority will seek to cooperate with other agencies in the investigation of fraud matters by the establishment of white-collar crime liaison committees in each of the states of Australia. These committees will comprise representatives of relevant law enforcement agencies in the state and will be charged with identifying appropriate matters for the Authority to consider becoming involved in investigating in partnership with other relevant agencies.

Appropriate matters identified by other law enforcement agencies or by the Authority itself are to be referred to a Consultative Committee comprising Commissioners of Police and the Chairmen of the Cash Transaction Reports Agency and the Australian Securities Commission and representatives of other relevant agencies. They will advise the Inter-Governmental Committee regarding matters appropriate for the Authority to investigate using its special powers.

This Consultative Committee will be serviced by a Secretariat comprised of generally the Assistant Commissioner (Crime) of each state police force. Other agencies may become permanent members of the Secretariat or invited to attend

meetings of particular concern to the agency. It is expected that via the White-Collar Crime Liaison Committees, the Secretariat and the Consultative Committee process, that the Authority will be raised and the Authority will be able to offer its expertise in the management and conduct of complex fraud investigative powers.

Summary of NCA's Role in Serious Fraud Investigations

The statutory powers and functions of the National Crime Authority, along with its multi-disciplinary team approach to investigation, are well suited to the conduct of serious fraud investigations.

The Authority's national focus and cross jurisdictional powers are essential to the conduct of coordination of national serious fraud investigations in a complex environment.

All those involved in law enforcement recognise that there is a gaping hole in the law enforcement area relating to serious fraud investigations and their coordination. This has become particularly apparent in relation to some highly complex corporate matters which demonstrate criminality beyond the area of sole responsibility of the regulator.

The gap seems to occur where alleged criminal conduct goes beyond the sphere of the legislation being administered by the regulatory/law enforcement agency and involves conduct which not only breaches the legislation of the regulatory agency but also arguably state or a number of states criminal laws and Commonwealth Criminal Laws.

It is matters such as these, which are complex, cross jurisdictional boundaries and which require the special powers of the Authority, that the Authority is determined to identify. In such matters the Authority will assemble investigative teams and task forces with the resources and expertise required to conduct a thorough and successful investigation.

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International Aspects of Investigating Complex Commercial Frauds

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The facility for Australian investigators of fraud and other offences to have major investigatory work carried out in foreign countries is progressively becoming available pursuant to the framework provided by the *Mutual Assistance in Criminal Matters Act 1987* (Cwlth) - the MA Act.

The framework provided by the MA Act enables Australia to make treaties or other arrangements with foreign countries whereby assistance can be requested and provided, on a reciprocal basis, in a range of areas both at the prosecution and investigation stages.

Prior to the passage of the MA Act, assistance between Australia and other countries was rendered informally through Interpol and other informal agreements (Customs Cooperation Council) and was limited to investigations. The major exception to that limitation was that Australia's pre-existing extradition legislation already enabled it to take evidence on behalf of foreign countries for their use in criminal proceedings; however, this could be done unilaterally and carried no obligation of reciprocity.

This paper will briefly describe the legislative and treaty mechanism by which such international assistance in criminal matters is becoming available and will then discuss some of the practicalities in making requests to other countries for such assistance. The paper will conclude with references to some of Australia's experience with particular countries.

Organised Crime Legislative Package

The development of legislation in this area and our involvement in development of the Scheme for Mutual Assistance in Criminal Matters between Commonwealth Countries (the Commonwealth Scheme) grew out of increased Australian awareness in the early 1980s of the need for this type of weapon to be employed in the fight against organised crime.

This increased Australian awareness came out of a series of Royal Commissions and public enquiries which in turn led to the development of political will to

adopt a package of measures to counter organised crime.

The package consists of the following;

- the *Mutual Assistance in Criminal Matters Act 1987*;
- the *Proceeds of Crime Act 1987* which enables, inter alia, a judge to make orders for the production of documents or monitoring orders requiring provision by financial institutions of information which will enable investigators to follow the money trail; it also enables freezing and confiscation of proceeds of crime. The facility to be able to request a treaty partner to employ its equivalent legislation for Australia, for example enforcement of restraining orders or forfeiture orders made by Australian courts against property in the foreign country, is a major advance in the investigation of complex criminal cases including complex commercial fraud cases;
- the *Cash Transactions Reports Act 1988* which requires large cash transactions to be reported to, and monitored by, a Cash Transactions Reports Agency, and makes it an offence to open or operate an account in a false name;
- the *Extradition Act 1988* which enables Australia to enter extradition treaties on a wider basis and reduces technical impediments (this Act replaced the two earlier Acts - the *Extradition (Commonwealth Countries) Act 1966* and the *Extradition (Foreign States) Act 1966*;
- the *Telecommunications (Interception) Amendment Act 1987* amended the earlier legislation to enable telecommunication interception in relation to a wider area of criminal activities.

Mutual Assistance Legislation

The Mutual Assistance in Criminal Matters Act 1987 (MA Act - Act no. 85 of 1987 and reprinted with amendments in April 1990) came into force on 1 August 1988. The MA Act is administered by the Commonwealth Attorney-General's Department on behalf of the Attorney-General. The particular functional area of the Department is the International Branch.

The types of assistance available to investigators and prosecutors (pursuant to mutual assistance arrangements between Australia and other countries) include:

- the obtaining of evidence, documents or other articles;
- the provision of documents and other records;
- the location and identification of witnesses or suspects;
- the execution of requests for search and seizure;
- the making of arrangements for persons to give evidence or assist investigations;
- the forfeiture or confiscation of property in respect of offences;

- the recovery of pecuniary penalties in respect of offences;
- the restraining of dealings in property, or the freezing of assets, that may be forfeited or confiscated, or that may be needed to satisfy pecuniary penalties imposed, in respect of offences;
- the location of property that may be forfeited, or that may be needed to satisfy pecuniary penalties imposed, in respect of offences; and
- the service of documents.

It is anticipated that the assistance available in the proceeds of crime area will become of increasing use in complex commercial fraud investigations. The particular types of assistance which eventually the Department hopes to have access to in other countries include various types of information gathering orders (such as production orders, search and seizure orders in relation to tainted property/and monitoring orders), and enforcement in a foreign country of Australian court orders (such as interim restraining orders, forfeiture orders and pecuniary penalty orders).

Subject to some exceptions the various types of assistance will only be available if there is a mutual assistance treaty or arrangement in force with the particular country concerned. It is therefore pertinent to dwell briefly on the treaty negotiation program.

Arrangements with Foreign Countries

Australia is in the process of a major comprehensive treaty negotiation program with numerous countries. When the treaties are in force, those particular countries, together with Commonwealth countries to which the MA Act has been applied, will provide a network of countries from which investigative and prosecutorial assistance will be available.

As at August 1991 treaties are in force with Austria, Canada, Hong Kong (limited to drugs offences), Japan (non-treaty based), Netherlands, Spain, Switzerland (non-treaty based) and the United Kingdom (limited to drugs offences).

There are limited arrangements with the United States of America, Vanuatu and with Papua New Guinea. These limited form regulations were made to enable transfer of foreign prisoners to Australia to give evidence and assist investigations. The availability of this particular form of assistance is itself a graphic illustration of mutual assistance in action whereby evidence which may be crucial to an Australian prosecution or investigation being successful can be made available. This form of assistance is dependent on the consent of the foreign prisoner as well as on the consent of the foreign government.

As at August 1991 treaties have been signed with a further six countries. Those treaties will come into force when the other country concerned completes its constitutional requirements to enable it to bring the treaty into force. Treaties

with a further eleven countries are in various stages of negotiation.

Commonwealth Mutual Assistance Scheme

The MA Act also provides the statutory basis for Australia to be able to give effect to the Scheme for Mutual Assistance in Criminal Matters between Commonwealth countries. The Scheme was approved by Commonwealth Law Ministers in Harare, Zimbabwe, in August 1986.

The Commonwealth Secretariat prefers the use of cooperative 'schemes' to multilateral conventions or treaties or bilateral treaties between member countries. Such schemes, if approved by consensus by the Law Ministers of member countries, operate on the basis that member countries will each introduce their own domestic legislation to enable all member countries to be able to provide assistance to each other in accord with the principles set out in the particular scheme.

Australia is actively involved in the meetings of Senior Officials of Commonwealth Nations and takes all appropriate opportunities to encourage other Commonwealth countries to pass appropriate legislation to support the Commonwealth Mutual Assistance Scheme.

Non-treaty regulations applying the MA Act to other Commonwealth countries will be progressively made as other Commonwealth countries pass mutual assistance legislation and would therefore be able to give Australia reciprocal assistance.

Constraints on Usefulness of Domestic Legislation

It is strategically important for Australia to conclude mutual assistance in criminal matters arrangements with certain countries. The availability of our own domestic laws only enables us to consider approaching another country to suggest negotiation of a treaty or arrangement. However our success in approaching a particular country will depend very much on whether that country has, or is likely to have in the near future, its own domestic legislation whereby it would be able to provide reciprocal assistance to Australia.

We therefore remain very reliant on the pace at which other countries are prepared to legislate domestically. Even when other countries do legislate, the nature of their legislation must be evaluated. The spirit behind mutual assistance is reciprocity and if another country is not prepared, or able, to provide such reciprocity then provision of such assistance by Australia on a unilateral basis may remove any incentive that country may otherwise have had to develop its own appropriate legislative base.

Preservation by Australian Investigatory Agencies of Material received from Foreign Countries

Prior to the development of the current international climate for conclusion of mutual assistance in criminal matters arrangements, the traditional type of mutual assistance that had been available between countries was evidence that has been taken in one country for use in criminal proceedings in the requesting country (section 13 MA Act enables Australia to give this type of assistance on a unilateral basis).

When mutual assistance arrangements are in place material will be available pursuant to a much wider range of requests for assistance. Potentially the volume of material made available by foreign countries could be very large in particular matters, especially in complex commercial matters.

Investigators and prosecutors will need to apply the same technology systems for preservation and recall of information received from foreign countries as they need to apply to material obtained within the jurisdiction.

Our experience thus far in obtaining documents from foreign countries pursuant to the proceeds of crime treaty provisions is still embryonic. However, the use of these treaty provisions may well mushroom in future years as more treaties come into force with countries which have fully developed domestic proceeds of crime law. Investigators will need to have appropriate technology in place to enable the maximum benefit to be obtained from such material.

Information Gathering Orders

One of the areas of assistance where the flow of material received from foreign countries is likely to increase dramatically is in response to Australian requests for information gathering orders. Information gathering orders available in Australia under the Proceeds of Crime Act include orders for the production of documents identifying, locating or quantifying property, or which identify or locate documents necessary for the transfer of such property, proceeds or instrumentalities.

Such orders can include search and seizure warrants authorising seizure of property including seizure of documents in the nature of property tracking documents. It may be more practical for an agency to ask the foreign country to search and seize because it may not be able to identify the documentation with sufficient particularity to enable a production order to be sought.

One of the information gathering powers which generates a lot of interest in the treaty negotiations is the monitoring order. This is one of the most novel features of the Proceeds legislation and enables the investigatory agency to obtain access to a 'window' showing the pattern of movements of funds. Its availability may enable more precise focusing of investigatory resources.

There are limitations on the availability of such orders under our domestic legislation; they are only available in relation to drug trafficking offences involving not less than a trafficable quantity of drugs, organised fraud, or money laundering of the proceeds of either drug trafficking or organised fraud.

There are also limitations on the availability of such orders for international investigations; one of the greatest limitations may simply be that funds are moved to a country where such orders are not available under the domestic law of that country.

Channels to be Used when Making Mutual Assistance Requests

An important feature to be borne in mind by investigators when they are considering pursuing inquiries at an international level is the channel of communication which should be used. The basic distinction which must be made is whether to use 'informal' channels (such as Interpol) or formal channels (government to government requests).

Section 6 of the MA Act specifically preserves existing channels such as Interpol or the Customs Cooperation Council. Requests can continue to be made through such channels without the requirement that the procedures of the MA Act be utilised.

However the threshold question is whether a particular type of assistance can be properly sought through informal channels. Requests that would need the foreign country to exercise compulsory powers on our behalf require a formal request to be made through the diplomatic channel or other channel as established by a mutual assistance arrangement. If the request would not require exercise of compulsory powers in the other country then it can possibly be made through informal channels.

However, there are some borderline situations where it is advisable for agencies to contact International Branch in advance of making an informal request. The role played by the International Branch in performing the 'Central Office' function will now be discussed.

Mutual Assistance Central Office for Australia

In all mutual assistance treaty negotiations it has been necessary to nominate a Central Office for Australia. The Commonwealth Mutual Assistance Scheme likewise also requires each Commonwealth country to nominate a Central Authority. At the initial stages of a request, other countries only wish to be required to deal with one authority in the other country.

The International Branch of the Attorney-General's Department, Canberra, performs the role of Central Office for Australia in relation to all incoming and

outgoing formal mutual assistance requests.

To facilitate Australia providing an appropriate level of service to foreign countries seeking assistance from us, Administrative Arrangements have been made under section 39 of the MA Act with all the states (except Western Australia) and with the Northern Territory. These Arrangements, which are between the Governor-General and the Governor of the states and which are required to be published in the Commonwealth Gazette, provide a framework for execution within Australia of incoming mutual assistance requests.

In the course of performing its Central Office role International Branch will be able to provide preliminary advice on proposed requests and in particular on borderline situations where it may be unclear whether a formal request is required.

If there is no treaty in force with a particular country it is important to know whether there is any domestic law of that country which would require a particular channel to be used. International Branch should be contacted in this regard.

Japan is an example of a country whose specific domestic law (Law for International Assistance in Investigation - Law No 69 of 1980) requires all requests for mutual assistance to be formal government to government requests made through the diplomatic channel. Requests that are routinely regarded as being appropriately made through Interpol if made to other countries must be made by a formal diplomatic channel request if made to Japan.

It is important that preliminary enquiries be made as to the domestic law of a country which is a civil law country. Powers of police in civil law countries are more circumscribed than the powers of their counterparts in common law countries.

Certain assistance can be readily provided by police in a common law country pursuant to informal Interpol requests. The provision of equivalent assistance by a civil law country may require an investigating magistrate to be appointed.

An investigating magistrate would only be appointed to carry out enquiries on behalf of a foreign country if a formal request was received through the diplomatic channel or other channel as agreed in a mutual assistance treaty or arrangement. The local police may only be able to carry out the particular function if so directed by the investigating magistrate.

It may be necessary to seek information or material from a country with which we do not have a treaty. Enquiries to ascertain if Australia has a draft treaty may be useful. It is possible that the existence of the draft treaty may facilitate the granting of assistance by that country.

Another occasion where preliminary Central Office inquiries may be advisable is

where the country concerned is a party to the European Convention on Mutual Assistance.

It is possible that a form of assistance which could be made available under that Convention to other Convention parties (Australia is not a party) may be made available if a form of request is sent that followed the format and other requirements of the Convention.

Other Practical Considerations when making Requests

Sometimes the anticipated response to a proposed informal mutual assistance request can confidently be expected to lead to a subsequent formal mutual assistance request requiring exercise of compulsory powers. In these circumstances it is desirable that only one request be made asking for both types of assistance; the second type being expressed to be contingent on a certain outcome of the grant of the first type of assistance. The appropriate form of request in these circumstances would be a formal government to government request.

The need for such streamlining of requests should be seen against the volume of incoming requests processed by many countries. Australian authorities are very much on a learning curve in the mutual assistance area and the volume of requests is still quite low particularly when measured against the many thousands of requests per year regularly dealt with by European countries.

With these sort of statistics in mind it is incumbent on requesting Australian agencies to be sensitive to the need to make requests in the most efficient form possible. This will no doubt require investigators to talk at an early stage with their prosecutor with a view to not only planning a course of action but also to planning it within a timeframe which, if necessary, can allow a reasonable period for a foreign country to execute a request. Even if there is a treaty in place with the foreign country concerned it is not reasonable to expect other countries to be able to meet very short deadlines.

The corollary of making an urgent request to a foreign country is that we should be prepared and able to provide equivalent assistance ourselves in response to a similar request to us by that country.

Australian Experience with some Particular Countries

Central Office does not purport to be expert on the domestic law of foreign countries but is becoming a repository of available knowledge and information. In conclusion brief reference will be made to the relevant domestic law and practice of several countries with which we have had mutual assistance traffic.

An important country for mutual assistance purposes generally and one which is especially important in relation to the obtaining of banking information is

Switzerland.

Australia has applied its MA Act to Switzerland (Mutual Assistance in Criminal Matters (Swiss Confederation) Regulations - Statutory Rules 1988 No. 385). Switzerland can offer reciprocity pursuant to its 1981 Federal Act on International Mutual Assistance in Criminal Matters (IMAC). Australia has had good cooperation from Swiss authorities but such cooperation can only be given by the Swiss within the terms of IMAC.

Article 3(3) of IMAC provides that a request will be refused if it relates to 'an offence which appears to be aimed at reducing fiscal duties or taxes . . ' . However, Article 3(3) also provides that assistance '. . . may be granted if the subject of the proceeding is a duty or tax fraud'.

It is therefore important for investigators to be aware of the distinction drawn under Swiss law between a fiscal offence and fiscal fraud (for which mutual assistance may be given subject to the condition that the material provided not be used for other purposes).

Swiss domestic law in this area is highly technical. People should be aware of this and should direct enquiries to Central Office on a case by case basis.

However, it is comforting to note that Swiss authorities have, on multiple occasions, provided Australia with information concerning particular Swiss bank accounts. The information was sought in connection with prosecution of criminal offences such as fraud. The information has been provided on the strict condition that it only be used for the specific purposes for which it was requested. Swiss authorities on occasion have arranged for production of bank documents by Swiss bank officers on a date which has been notified sufficiently in advance to enable Australian representatives to be present. This course of action has enabled admissibility requirements to be met in the particular proceedings.

Investigatory authorities contemplating requests to Switzerland should be aware that Swiss Interpol and the Swiss Mutual Assistance Central Office both come within the same Division in the Swiss Federal Department of Justice and Police (Division of International Legal Assistance and Police Matters).

This has the practical result that a previous informal request made via Interpol will be known to the International Legal Assistance section (that is the mutual assistance Central Office for Switzerland) of the Division. Therefore when International Branch, in its capacity as the Central Office for Australia, receives instructions from an Australian agency asking it to make a particular request it should also be given a history of any earlier informal requests and the responses to those requests.

We have recently made Australia's first request under the Mutual Assistance Treaty with The Netherlands (the treaty came into force on 1 June 1991 - Mutual Assistance in Criminal Matters (Kingdom of the Netherlands) Regulations -

Statutory Rules 1991 No. 69). The purpose of the request was to obtain details of a certain person's criminal convictions in the Netherlands. Before the treaty came into force we had unsuccessfully tried to obtain such details; the Dutch had then advised that their domestic law prohibited them from providing these details unless there was a mutual assistance treaty in force.

The important practical issue for me to stress here is the time that we should allow for Dutch authorities to execute such a request. Dutch authorities advise that even in straightforward cases (for example those which can be handled by the public prosecutor without reference to a magistrate) it will be approximately 3 months before the relevant material is available. For more complex cases a delay of approximately five months should be expected. There is provision for responses to be provided more quickly in urgent cases but compelling reasons need to be given.

We understand there are nineteen public prosecutors offices in the Netherlands. These offices handle most of the court cases and in addition they also handle the thousands of mutual assistance requests the Netherlands receives annually from other countries. Material would normally be provided to us in Dutch. If we request the Dutch authorities to translate the material into English before the material is provided to us allowance should be made for lapse of a further 6 to 7 weeks.

As already noted, there is now a drugs limited mutual assistance treaty in force with Hong Kong (Mutual Assistance in Criminal Matters (Hong Kong) Regulations - Statutory Rules 1991 No. 95). This treaty enables assistance to be provided in investigations and proceedings in respect of drug trafficking including the tracing, restraining and confiscation of the proceeds of drug trafficking. Section 20 of Hong Kong's Drug Trafficking (Recovery of Proceeds) Ordinance enables authorities there to apply for production orders from the appropriate Hong Kong court. Such an order can be made even if the matter in Australia is still at the investigative stage. Hong Kong Attorney-General's Chambers and International Branch have been in contact to streamline procedures for requests of this nature.

This facility for production orders to be made in Hong Kong, whilst a matter is still at investigation stage in the requesting country, does not yet extend beyond drug matters. Section 77B of the Hong Kong Evidence Ordinance does enable 'court to court' applications to be made in matters other than drug matters. However such applications are subject to the limitation that criminal proceedings have been instituted, or are likely to be instituted, in the requesting country.

Conclusion

The references in this paper to domestic law and practice of particular countries gives only a fragmented and partial picture of the developing international climate for the conclusion of mutual assistance arrangements. Australia is in the

forefront of countries interested in developing such arrangements.

The degree and nature of assistance potentially available to investigators and prosecutors is progressively expanding. The International Branch of the Attorney-General's Department, Canberra, is keen to maximise the available benefits by working together with Australian law enforcement and prosecution agencies.

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Prosecuting Complex Commercial Fraud

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The Office of the Commonwealth Director of Public Prosecutions (DPP) was set up partly as the result of fraud on the Australian Taxation Office. The Queensland regional office of the DPP was opened late in 1984 and since then it has prosecuted many types of fraud on Commonwealth Government departments.

Some Current Trends

Various issues have arisen in prosecutions conducted by the DPP in the last seven years. In this paper reference will be made to some of those issues which show some current trends in the prosecution of fraud.

Review of decisions in the course of proceedings
One current trend in prosecuting fraud has been the fragmenting of the criminal process. Various decisions during the course of the prosecution are open to review, including the decision to prosecute. In *Newby v. Moodie and Another* 83 ALR 523, a judge of the Federal Court heard an application under the *Administrative Decisions (Judicial Review) Act 1977* (Cwlth) - AD(JR) Act - seeking review of the decision to prosecute. The Full Court of the Federal Court subsequently heard an appeal from the single judge's decision. The appellant had acted as a solicitor for clients who were engaged in asset stripping income tax minimisation schemes. He had been charged with offences against the *Crimes (Taxation Offences) Act 1980* (Cwlth). The grounds upon which judicial review was sought were that the decision to institute and maintain the proceedings against Mr Newby was contrary to law because the prosecution was oppressive and an abuse of process, and that the decision was an improper exercise of the power to prosecute, either because the police officer and the DPP failed to take relevant considerations into account or because the decision was oppressive and an abuse of power.

The Court noted that Section 6 of the *Director of Public Prosecutions Act 1983* (Cwlth) provided that the DPP could institute a prosecution for an indictable offence against the laws of the Commonwealth and that the decision to institute a prosecution was a decision to which the AD(JR) Act applied, being a decision of an administrative character.

In dismissing the appeal the court stated that its power to make an order of review in respect of the decision to prosecute should be exercised only in the

most exceptional cases and referred again to the undesirability of fragmenting the criminal process. The Court also said that once criminal proceedings have been commenced they should be allowed to follow their ordinary course except in exceptional circumstances.

There have been several complex fraud prosecutions during the 1980s where the criminal proceedings have not been allowed to follow their ordinary course. Two examples are *Vereker v. O'Donovan* (argued in the High Court on 18 March 1988) being an application for special leave; the decision reviewed being that of a magistrate in committal proceedings. The magistrate after a seven-month committal hearing in Melbourne had determined that there was a prima facie case against Mr Vereker and others on charges of conspiracy to defraud the Commonwealth in relation to an agreement to implement a taxation minimisation scheme. In *Yates v. Wilson* 168 CLR at 338, being an application for special leave, the decision reviewed being that of a magistrate in committal proceedings. Mr Yates had been committed for trial in Sydney on sixty-five charges for offences against s. 29A(2) of the *Crimes Act 1914* (Cwlth). The charges related to the evasion of sales tax.

Presently in Queensland there is a part heard committal which commenced in March 1990 and is due to recommence in November 1991. Some charges are for conspiring to defraud the Commonwealth. The Supreme Court of Queensland, in its civil jurisdiction, in March 1990, entertained an application for injunctive and declaratory orders and after appeal to the Full Court of the Supreme Court the High Court in June 1991 refused an application for special leave and stated:

> The chief, if not the only purpose of this litigation, is to preclude the admission of evidence in committal proceedings pending in the Magistrates Court in Brisbane, in which the applicant stands charged with eleven offences against the laws of the Commonwealth. Those proceedings stand adjourned and, as Mr Justice Ryan observed in the Full Court of the Supreme Court of Queensland:
>
> > The effect of the orders made in the present case is that the committal proceedings were delayed for five months in the first instance, and they have been delayed for a further eight months as a consequence of the appeal to this Court.
>
> This Court has frequently stated that the fragmenting of the criminal process is a powerful consideration militating against a grant of special leave to appeal against an order which has the effect of fragmenting the criminal process. *See*, for example, *Yates v. Wilson*. There is nothing which makes this case exceptional so as to exclude the application of the general principle. Accordingly, special leave will be refused.

It is interesting to note that various lines of authority have recently developed in the criminal law in England relying on different strands of the judicial review principles (*see* Spencer 1991, p. 260). Spencer (1991) gives as examples of those different strands the principle of a breach of natural justice, the reversal of a conclusion which no reasonable court could have reached and the reversal of a decision reached because the court was misled by what was akin to fraud,

collusion or perjury. Spencer (1991) concludes that:

> It is clear that the application of judicial review which has already expanded rapidly in the civil field is now expanding rapidly in a similar fashion in the criminal field also.

All the examples given in the article are after, not prior to conviction.

Obfuscation

It is not uncommon in the prosecution of complex fraud cases for the defence to attempt to introduce before the jury, normally in cross-examination of a prosecution witness, facts and circumstances different from the facts and circumstances of the prosecution case.

There have been several examples in complex fraud trials prosecuted by the DPP in Brisbane.

Example 1
In a Supreme Court trial which ran for about 5 months in 1985, the thrust of the prosecution case was that the accused, either themselves or through companies controlled by them, acquired companies with current year profits which therefore had a liability to pay income tax. Thereupon, either immediately or within a short period of time, but in the same financial year - usually shortly prior to 30 June in that year - they disposed of the company or companies to persons who were procured and paid to act as purchasers of those companies. It was alleged that these individuals were persons with little or no financial substance and with little or no commercial or financial experience or knowledge or capacity to become directors and/or shareholders of the companies. It was further alleged that they had neither the capacity nor the intention to pay any income tax which might have become payable by the company in question.

Cross-examination of a prosecution witness was designed to establish that the Australian Taxation Office, the victim of the fraud, had the power to recover the lost income tax from the taxpayers and that the accused held that belief.

In his ruling against the proposed cross-examination the trial judge said:

> The fundamental question for the jury is whether on the totality of the facts before it the jury is satisfied beyond reasonable doubt that the accused, or one or other of them, was a participant in an alleged conspiracy to defraud the Commonwealth . . .
>
> The elements of the offences with which the accused are charged are that they conspired together and with others to defraud. . . . It is with reference to the element of defrauding or to the nature of the alleged agreement or conspiracy that the questions arise. Since *Scott v. Metropolitan Police Commissioner* (1975) AC 819 it has been held that in conspiracy to defraud it is for the Crown to establish an agreement by two or more persons to dishonestly deprive a person of something which is his or to which he would be or might be entitled but for the perpetration of the fraud. This formulation seems to have been

accepted as correct by superior courts in this country (*see* for example *R v. Walsh and Harvey* [1984] VR at 474) and it is my present intention to direct the jury in accordance with that formulation.

That being so, the fundamental question for the jury becomes one wherein the jury, before they can convict, have to be satisfied beyond reasonable doubt that on the whole of the facts before it, the accused conspired or agreed to deprive dishonestly the Commonwealth of something to which it was or would be or might be entitled but for the fraud . . .

The concept of 'dishonestly' in this and a related context has excited considerable judicial and other comment.

I propose to direct the jury in this regard, unless I am in the meantime persuaded otherwise, in accordance with the formulation to be found in the decision of the Court of Appeal in *R v. Ghosh* [1982] 1 QB at 1053. It has been consistently held that in determining whether the conduct of an accused is honest or dishonest the standard of honesty is the standard of ordinary, reasonable and honest persons in the community, and in that sense, it is essentially a question for the jury to determine whether, in its view, the conduct in question was dishonest by reference to that standard, and further, that the relevant standard is not the standard of the individual accused. The latter, often referred to in the literature as the Robin Hood test, has consistently been rejected by the Courts. However, the Court of Appeal in Ghosh, so it seems to me, went further than some earlier cases had, in defining the so called subjective element in the test. Not only must the jury be satisfied beyond reasonable doubt that the conduct in question was dishonest, by reference to the standards of ordinary, reasonable and honest men, but the accused must, by reference to those standards, have realised that what he was doing was dishonest . . .

In view of the decision in *Ghosh* and like cases, it seems to me to be irrelevant to the fundamental question for the jury whether the Commissioner might or could have taken action between 1972 and 1980, or indeed at any other time, to challenge the transactions on the basis of s. 260, and to have thereby sought to recover, from the vendor shareholders or their so called associated entities, the lost revenue, or whether the Commissioner failed in his duty under the Statute in not so acting, or whether the accused believed that the Commissioner might have been entitled to have so acted. According to the submissions, the thrust of the intended cross-examination would also be that because the Commissioner was empowered to act, but for whatever reasons, took no action to recover the lost revenue, this was also relevant to the state of mind of the accused as to whether the conspiracy was one to defraud, that is one to deprive dishonestly the Commissioner of that to which he was, or would have been, or might have been entitled, because the Commissioner could have taken action under s. 260 to strike down the transactions and recover the lost revenue . . .

However, by reference to the basic enquiry, that is, whether the accused agreed to deprive dishonestly the Commonwealth of the income tax to which it was or might have been entitled to receive from a company, it is in my view beside the point, in addressing that question, that the Commissioner might have been entitled to recover the lost income in some other way from some other person. This is so, in my view, in any case which involves even a specific intent to defraud and here I refer to the right of the victim of the fraud to recover. The fact that the victim of the fraud might later recover in civil litigation or otherwise that which was lost does not, so it seems to me, affect the question whether a criminal offence was committed in the first place. For the purposes of

> the latter question, the question of criminal liability is determined by examining the conduct of the accused which is relied upon by the Crown by reference to the elements of the offence in question . . .
>
> Finally and in any event I should add that there does not appear to me to be any evidence or any sufficient evidence to support the view that the Commissioner knew the totality of the facts now before this jury. For the point taken to have substance, one would think it necessary for the alleged offender and the proposed victim, at the very least, to both know all of the relevant facts at the relevant time. However, and in any event, there is in my view no evidence or no sufficient evidence that the Commissioner knew the whole of those facts . . . (*see The Queen v. B.J. Maher and J.P. Donnelly*, Supreme Court of Queensland, 5th September, 1985 - 68th day - transcript, pp. 4493-4498. *See also R v. Maher* [1987] 1 QdR at 171).

Example 2

In the same trial referred to in the first example a further attempt was made by defence counsel to introduce irrelevant material. During the cross-examination of another prosecution witness it was sought to establish before the jury the form and details of tax minimisation schemes promoted by the accused, all of which schemes were based on facts and circumstances different from the facts before the jury.

It was argued by defence counsel that there were some features of tax minimisation schemes which were the same as or which were similar to some of the facts before the jury and that some of those schemes had been considered by courts, including the High Court, and others had not been considered at all, nor indeed challenged by the Australian Taxation Office.

During his ruling the trial judge said:

> There is a fundamental objection in a criminal trial based, as it is, on a particular fabric of factual matter for the jury to have to explore in the course of that trial another set or other sets of factual details, some of which may be the same as those in the case in question, but others of which are, admittedly, quite different.

The trial judge also observed that the fundamental question for the jury in a criminal trial:

> is whether, a particular set of facts having been proved, a jury can be satisfied beyond reasonable doubt that an accused person participated in a particular criminal offence.

It was further submitted by defence counsel that it was relevant for the jury, when inquiring whether the individual accused must, by reference to the standards of ordinary, reasonable and honest men, have realised that his conduct was dishonest, to know that there were available in the so-called marketplace similar but different schemes and proposals, some of which may have been regarded as 'legal' and others which had not been challenged in a court by the Commissioner and which were said to have been 'accepted'.

The trial judge stated that:

> it is for the jury to say whether that conduct based on that set of facts which is

> proved, was dishonest according to the standards of ordinary, reasonable and honest men, and to say whether the accused must have realised that that conduct, based on those facts, was by those standards dishonest.

The trial judge also stated that:

> The ordinary, reasonable and honest men referred to are assumed to be the jury. It is they, according to the authorities, who must say whether what is put before them is dishonest conduct according to the current standards, beyond reasonable doubt, and to say whether any person in the community 'of sufficient intelligence and experience' (it is for the jury to say whether the individual accused is such a person) realised what he was doing was dishonest according to the standards of right-minded people. . . . that question has to be addressed by reference to the particular facts relied on as evidencing the alleged conspiracy to defraud.

The trial judge ruled that the matters sought to be raised with reference to other so-called tax avoidance schemes were not relevant, and cross-examination which was designed to elicit details of them was objectionable (*see The Queen v. B.J. Maher and J.P. Donnelly*, Supreme Court of Queensland, 10 September 1985 - 71st day - transcript pp. 4646-4651.

Example 3

The legislation being administered by some Commonwealth departments is often highly complex. During a fraud trial in the District Court in Brisbane in 1988 the complexity of the Sales Tax Acts was raised in the following way by defence counsel when cross-examining an accountant for the accused who had been called as a prosecution witness.

The following is taken from the transcript:

> **Q.** Have a look at the provision of the (No. 6) Act. I will put it up on the projector so the jury can follow what we are talking about. I can read it out to the jury but it is difficult for them to follow? --- (document projected.)
>
> 'SEC.3 Sales tax
>
> Subject to, and in accordance with, the provisions of this Act, the sales tax imposed by the Sales Tax Act (No. 6) 1930 shall be levied and paid upon the sale value of goods imported into Australia by a taxpayer and sold by him or applied by him to his own use.
>
> SEC.4. Sale value of goods
>
> (1) Subject to sub-section (3) of this section, to section 4A and to sub- sections (5B) and (5C) of section 18 of the Sales Tax Assessment Act (No.1) 1930 in their application in accordance with section 12 of this Act, for the purposes of this Act, the sale value of goods shall be the amount for which those goods are sold by a registered person, or a person required to be registered, who imported those goods, to an unregistered person or to a registered person who has not quoted his certificate in respect of the purchase of those goods:
>
> Provided that where goods are sold by retail by a registered person who has quoted his certificate when importing the goods the sale value of the goods shall be the amount which would be the fair market value of those goods if sold by

him by wholesale, but if the Commissioner is of the opinion that the amount set forth in any return by the registered person as the sale value of any such goods is less than the amount which would be their fair market value if sold by wholesale, the Commissioner may alter the amount set forth in the return to the amount which, in his opinion, would be the fair market value of the goods if sold by wholesale, and the amount as so altered shall be the sale value of the goods for the purposes of this Act.'

Q. Now, there are in the second proviso to s. 4 ss. 1, two limbs. The first limb speaks of an amount which would be the fair market value of the goods if sold by wholesale. The second limb speaks of, if the Commissioner is of the opinion - shorten it to say if he is dissatisfied he can alter it to the amount he thinks is applicable. There are two limbs, first one is fair market value and second one is Commissioner's opinion. Right?

A. Yes.

Q. If we just leave that for a moment and come to the goods here and you can look at your schedule if you need to, we see that in most cases we know what the sale price is - the term Purchase Price in the heading of the column. I will call it sale price but not to be confused with sale value. The sale price in Australia, so we understand what I mean, the sale price in Australia is generally apparent in this schedule?

A. It is generally?

Q. Apparent. We know how much the goods sold for in Australia?

A. This is correct.

Q. Let's assume they are retail sales. The amounts that are there are then the retail sale prices?

A. Yes.

Q. Can I suggest that when you make a comparison of that figure, the sale price for which the goods sold in Australia, and then compare that with the sale value as shown in the sales tax returns - when you do that comparison in relation to all of those items, the interesting fact emerges that there appears to be no consistency at all when comparing the sale value declared in the return as a proportion or percentage of the sale price for which the goods sold in Australia . . .

Q. These figures that were selected can and could at that time appear to you to have borne no reasonable resemblance to the fair market value if sold by wholesale - were?

A. I think it is fair to say they weren't and in an attempt to work out what the market value of each individual item was, if the item had not been sold by wholesale. It is what is commonly referred to as an arbitrary sale value. A sale value worked out by a formula acceptable to both parties.

Q. Is that an expression that is actually used in the Tax Office?

A. Yes, that is an expression which is used.

Q. Pretend you were in the Taxation Office, if you can take yourself back to that situation. How would you go about finding out, if you really wanted to, what the

fair market value of the goods was if sold wholesale?

A. The situation often arises because we have a wholesale sales tax and sometimes the goods that are being taxed aren't the subject of a wholesale sale such as this case when you had an importation and sale by retail or manufacture in Australia you would have to work out what the fair market value of the goods would have been if they were sold by wholesale. In the Taxation Office what you tend to do is what is called an industry survey to work out in that industry what would be the fair market value of the goods if sold wholesale. You won't go out and say, 'Here is a particular item. What is the fair market value if sold by wholesale?' What you would tend to is look at the industry and say, 'What would a retailer in that industry want as a retail margin?' Then perhaps you should say, 'OK, retailers want 10 per cent as a margin on those items.' You would say - the Taxation Office would say, 'I will accept for such items manufactured or imported and sold by retail, I will accept a sale value of actual retail selling price less 10 per cent.

In that case it was alleged that the Commonwealth was deprived of the knowledge of the true sales tax payable and thereby of the opportunity to take steps to recover the true sales tax which was payable because the true sale values as disclosed by a second set of invoices were not made known to the Commonwealth.

If it was for the jury to say whether the conduct of the accused based on the facts proved, was dishonest according to the standard of ordinary, reasonable and honest people, and to say whether the accused must have realised that that conduct, based on those facts, was by those standards dishonest then it is difficult to see how the practices adopted by the Australian Taxation Office, which were not known to the accused, were relevant. It is also difficult to see the relevance of the complexity of the legislation upon which a calculation of sales tax was made.

The question of criminal liability is determined by examining the conduct of the accused which is relied upon by the prosecution by reference to the elements of the offence in question. The conduct of the accused in this example which was relied upon by the prosecution was arranging for two sets of invoices, concealing the set showing higher prices and only making available to the Australian Taxation Office the set of invoices containing the lower prices. The raising of the issue of the complexity of the assessing process was merely a device to attempt to obscure the fundamental question for the jury.

There are many other current trends and issues, some of which are listed below. Each could be the subject of a separate paper.

- The influence, if any, on a member of the jury by pre-trial media coverage.
- To what extent should legal aid be available in long and complex trials for fraud offences.
- To what extent, if any, should any seized funds/resources be made available to fund the defence of someone charged with fraud offences.
- Whether the Federal Court should have criminal jurisdiction to hear complex Commonwealth fraud trials.

Some Future Directions

If Commonwealth departments could predict the future with any degree of precision then perhaps the Commonwealth could be saved some of the resources now being devoted to the prevention, investigation and prosecution of fraud. From past experience it is clear that it has not been possible to predict the frauds of the future. Following are a few examples.

An amendment in 1915 to the Crimes Act is a significant example of retrospective legislation.

On 6 May 1915 in the same Debate at page 2949 the Attorney-General advised Parliament as follows:

> The House must accept my assurance that the matter is one of urgency, that the Bill does not alter the substantive law, that it does not create an offence in respect to an act done which would not have been, and which was not, an offence when the act was done, but merely creates a Commonwealth Court before which the offence can be tried. It takes away from no man a right that he now enjoys so far as creating a new offence is concerned. It does give to the Commonwealth the right to take the matter before another tribunal namely, the High Court, instead of, but not to the exclusion of, a State Court. I give the House that assurance, and make the positive statement that the retrospective action of the measure does not create an offence where no offence punishable by State law existed.
>
> Whether proceedings will be taken is not certain, but it is most important that the measure should pass without delay.

On 7 May 1915 the Bill passed through its remaining stages in the Senate without amendment, and became Act No. 6 of 1915.

> CRIMES
>
> No. 6 of 1915
>
> An Act to amend the Crimes Act 1915
>
> [Assented to 7th May, 1915.]
>
> Be it enacted by the King's Most Excellent Majesty, the Senate, and the House of Representatives of the Commonwealth of Australia, as follows: -
>
> 1.(1.) This Act may be cited as the Crimes Act 1915.
>
> (2.) The Crimes Act 1914, as amended by this Act, may be cited as the Crimes Act 1914-1915.
>
> (3.) This Act shall continue in force during the continuance of the war and for six months thereafter, and no longer.
>
> 2. Section eighty-six of the Crimes Act 1914 is amended by inserting after paragraph (d) the following words: -

'or
(e) to defraud the Commonwealth.'

3. This Act shall be deemed to have been in force from the date of the commencement of the Crimes Act 1914.

Section 86(e) then provided:

Any person who conspires with any other person to defraud the Commonwealth shall be guilty of an indictable offence. Penalty: Imprisonment for three years.

On 13 May 1915 an indictment was filed in the High Court by the Attorney-General. The indictment was as follows:

The Attorney-General of the Commonwealth of Australia, who prosecutes for His Majesty in his behalf, informs the Court and charges that the said Arthur Kidman, Frederick William Page, Arthur George O'Donnell and Edward Leslie did at Sydney in the State of New South Wales between 29th October, 1914 and 8th May, 1915 conspire among themselves and with divers other persons to defraud the Commonwealth of Australia of divers and large sums of money by procuring that the Commonwealth of Australia should pay excessive prices for the supply of goods for the use of His Majesty's armed forces raised by the Commonwealth of Australia.

On 16 September 1915 the High Court held the retrospective legislation to be valid in *R v. Kidman and Others* 20 CLR 425 and at page 457 Powers J said:

The substantial question raised in this case is an exceedingly important one, namely, whether the Parliament of the Commonwealth has power to pass what is generally called an ex post facto law - that is to say, a law by which, after an act has been committed which was not punishable by any Commonwealth Statute at the time it was committed, the person who committed it is declared to have been guilty of a crime and to be held liable to punishment.

Following their appointment in November, 1978 Messrs Patrick McCabe and David Lafranchi reported to the Attorney-General for Victoria in November, 1981 as investigators pursuant to Part VIA of the Companies Act 1961. The Report in part stated:

In our opinion it is apparent the investigation sections, in particular those of the Western Australian, Queensland, New South Wales and Victorian Offices, were aware throughout the relevant time period that companies were being dumped. That being so, the question must be asked why no action was taken against those responsible. No doubt decisions as to whether a prosecution be instituted are not the responsibility of the investigation sections nor of the State Offices alone. Whatever the position, in our opinion those responsible for the decision not to prosecute ought to be regarded as at least partly answerable for the revenue losses that flowed from failure to act and for continuation of the abuse of the notification provisions of the Companies Act.

On 9 April 1978, Mr Howard (Federal Treasurer at that time), indicated legislation would be introduced to stop the trafficking in current year profit companies. That legislation was introduced in June. The same had no effect in curbing the sale-on of companies as a means of tax avoidance.

On 11 January 1980 the *Australian Financial Review* reported the comments of a

senior investigator at the Sydney Taxation Office that the Office was frightened by the size of the problem and could only guess at its scope. It was reported that the tax schemes were jokingly referred to as 'Bottom of the Harbour Pty Ltd' by members of the Sydney tax avoidance fraternity.

On 26 November 1980, The Honourable the Federal Treasurer, introduced the Crimes (Taxation Offences) Bill. In the course of introducing the Bill the Treasurer indicated one promoter had stripped 2,086 companies during a recent period using the 'Bottom of the Harbour Pty Ltd' evasion scheme. In 733 of those cases the result had been that the Commissioner of Taxation had been unable to collect on incomes aggregating more than $128,000,000. In part the philosophy behind introduction of the Bill was the alleged inability of the Taxation Office to prosecute in respect of the use of sham directors. In our opinion prosecutions could have been instituted (*see* McCabe and Lafranchi 1982, p. 26-28).

Following his appointment as Special Prosecutor on 22 September 1982 Mr R.V. Gyles QC in his first report to 30 June 1983 stated:

> The only appropriate charge in cases occurring prior to December, 1980 is breach of s. 86 Crimes Act 1914 (Commonwealth), which enacts several statutory conspiracy charges principally in this connection conspiracy to defraud the revenue. It is anomalous that there is no charge of defrauding the revenue simpliciter. Thus, conspiracy trials, with all attendant problems for both prosecution and defence, are mandatory. This requires legislative attention (*see* Gyles 1983, p. 5.).

A year later in his second Report, Mr Gyles stated:

> Notwithstanding the remarks in my last Report it is still not a statutory offence for an individual to defraud the Commonwealth alone rather than in combination with others. I have also drawn attention to the hopelessly inadequate maximum sentence of imprisonment for three years which may be imposed for breach of s. 86 of the Crimes Act. I understand that this is to be taken into account during the proposed general review of the Crimes Act (*see* Gyles 1984, p. 5).

The first Special Prosecutor appointed in Australia to prosecute fraud, Mr Roger Gyles QC recently wrote:

> In my view, if the fraud is such as to make it appropriate to bring criminal proceedings, there should be no difficulty in a skilled and experienced prosecutor explaining the nature of the fraud to a jury, and then presenting evidence to establish it. Even if the evidence takes weeks or months in a complex case, criminal fraud at its heart is always explicable by those who properly understand it. This is not to suggest that obtaining convictions in corporate fraud matters is easy. The investigation which is necessary to properly understand and expose the fraud will often be complex and difficult, bearing in mind that the fraudster may leave all manner of false trails. In addition, we must never lose sight of the fact that the criminal law is only appropriate for those cases where guilt might be found beyond reasonable doubt. We do not have a different standard of proof in dealing with fraud offences than with other offences (*see* Gyles 1991, p. 20).

It has been the experience, since 1982, of the Special Prosecutor's Office and the

DPP that there is no substitute for the experienced, well resourced, hard working, smart investigator. Any prosecution must be based on a well prepared brief of evidence. After the media interest has blown away and the latest flood of legislation has been absorbed there is no way of avoiding the hard slog of the investigation.

The only prediction to be made therefore, with any confidence, is that in the future there will be a lot of hard and interesting work for both investigators and prosecutors in fraud matters.

There has been a fair amount of talk over the last few years about pre-trial conferences or preparatory hearings. The idea, as reported by Prue Innes at page 13 of *The Age* newspaper of 29th July, 1991 in an article entitled, 'Can a Judge Cut the Drudge for the Jury?', will involve the trial judge ordering both the prosecution and the defence to disclose their cases and the trial judge making orders designed to get the case reduced to its essentials and into court with a minimum of delay. It will be interesting to see if and how such procedures develop in the near future.

The next chapter in this volume is by Mr Michael Rozenes QC and his topic is, 'Issues in the Defence of Charges Relating to Fraud'. In the spirit of disclosure a draft copy of this paper was given to him several weeks before the conference at which these papers were first presented.

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Issues in the Defence of Charges relating to Fraud

Michael Rozenes QC
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The topic, 'Issues in the Defence of Charges Relating to Fraud', falls within the stream entitled 'Investigating and Prosecuting Complex Commercial Frauds'.

It is noted that none of the stated aims of this conference really appear to be concerned with the plight of the accused. It is obvious that amongst the persons here gathered there will be little sympathy for the accused faced with defending a complex commercial fraud trial. This aspect will be addressed in this paper.

When Horace Rumpole described with glee the prospects of an upcoming fraud trial as 'a good little earner down at the Bailey with five hundred on the brief and eight refreshers' he was speaking of a form of fraud trial that we are unlikely to see again. The investigator would most likely have been a run of the mill detective and Claude Erskine-Brown would have held the Crown brief.

Over the last twenty years or so the trial of the fraudster has dramatically changed. The type of fraudulent conduct has probably not changed as much as has the detection of the more sophisticated examples of it. That which would have slipped past the inadequate investigative agencies of the past is now more likely identified by modern police and other regulatory agencies equipped with sophisticated investigators and investigative techniques. Most importantly, governments have begun to recognise that white-collar crime is by far the most serious fiscal threat to society and substantial resources are being committed to the battle.

A Question of Cost

Whilst there is justifiably a great and growing concern about the incidence of fraud and the impact it has on particular victims and the community as a whole, care should be taken to ensure that the critical balance of the criminal justice system is not disturbed in a single-minded effort to convict the corporate wrongdoer.

It is clear that the investigation and ultimate prosecution of complex fraud is both a necessary and an expensive operation. The corollary, however, is that the defence of such charges is equally necessary and expensive and our system must recognise that if the presumption of innocence is to be accorded its full weight, then proper funding of the accused cannot be denied.

The presumption of innocence and a verdict of not guilty is of little comfort to

the accused who survives a complex fraud trial. Unlike ordinary criminal trials, it is not uncommon for the complex fraud trial to run for several months and to cost vast sums. Equally, the conduct of the accused's business or professional affairs suffers mightily during the preparation and trial. There is no compensation upon acquittal and although the accused walks away from the courtroom a free person he has most likely been rendered destitute.

The cost of conducting such trials can be financially crippling even for those who can in purely monetary terms afford them. For those defendants who cannot afford the costs associated with the proper preparation and defence of the charges the choices are hopeless.

There is a very real danger that the person with a genuine defence may choose to plead guilty or remain unrepresented to avoid what may be perceived by some to be a greater penalty - financial ruin. Discounts for early pleas of guilty in such cases become a real temptation.

Legal aid is of little comfort. Most legal aid agencies are hopelessly under-funded. In the case of Victoria, the Legal Aid Commission has introduced a $200,000 cap for any particular case. This limitation is applied irrespective of the number of accused charged.

In the case of a single accused, $200,000 ordinarily will pay for junior counsel, an instructing solicitor and perhaps some limited expert accounting or financial assistance and precious little preparation. By comparison the prosecution will invariably be conducted by a Queens Counsel with one or two juniors, supported by at least one if not more solicitors and a handful of various experts in accounting and financial matters. The prosecution will have had the advantage of months if not years of preparation whilst during that period the accused has generally been deprived of access to his documents. If the case has to do with revenue fraud there will also be specialist taxation advisers available to the prosecution.

The effect of proceeds of crime legislation on the question of legal representation should be noted. Described as an 'extensive web of controls' it presents a threat to the right to representation of choice as the same organisation responsible for the prosecution of the offender is responsible for the control of the offender's assets with a view as to how much should be released for his defence. On one view there is some justification in ensuring that ill gotten gains are not squandered away on frivolous litigation, but there is something quite incongruous about the prosecutor determining the amount of money to be spent on the defence whilst at the same time having access to seemingly unlimited resources itself.

A further dimension to the cost of the defence may be added by the involvement of investigative agencies such as the NCA, the ASC, ICAC or one of any number of Royal Commissions and inquiries. These agencies also conduct extensive investigations ranging over many months and in some cases years in which the

evidentiary material ultimately led against the accused is minutely examined and selected. These proceedings often engage the defendant and his advisers in lengthy and costly attendances.

For the sake of this paper it will be assumed that adequate funding exists, and what needs to be done to defend properly an accused charged with a complex fraud will be addressed.

Arrest, Interview and Bail

The prosecution commences proceedings either by way of summons or arrest. In most cases the defendant is offered an opportunity to hear and to answer allegations before he is formally charged. Although, strictly speaking the mind of the informant is said to be open until the time he has allowed the defendant the opportunity to answer the allegations, the reality is that the decision to prosecute is made well and truly before that opportunity is offered.

There is much debate amongst criminal lawyers as to whether it is in the best interests of their clients to allow them to be interviewed by the police. Many professional and business people believe that if given the chance they can 'talk their way out of it', but sadly, this is not the case. The decision to participate in a record of interview cannot be based upon a prospect of persuading the prosecution either to give up altogether or even to reassess the prosecution theory which is usually, at that stage, set in concrete. The only basis for advising a client to submit to an interview is if it is thought that there may be some ultimate and significant advantage to the presentation of his defence. In my view such an occasion would be most rare. An adviser would have to be aware of all that the prosecution has at its disposal and be satisfied that the client was able to deal with each matter. In a relatively simple criminal case where the answer to the prosecution case is short and straightforward a chance might be taken. Where, as in the case of commercial fraud there are literally hundreds, if not thousands of documents, the chances of the client being able to fairly acquit himself are slim. This is especially the case given the investigator's favourite tactic of revealing the documentation on a selective and piecemeal basis. On the other hand, the damage he could do to his defence is enormous since any mistake or omission will be seized upon by the prosecution to illustrate either consciousness of guilt or false denials or both! The conservative, correct view is to say nothing.

Following this course, in Victoria at least, is not without its risks. The Full Court in *Bruce* [1988] VR 579 held that an accused's failure to answer questions when first interviewed could be used by the jury in considering the weight to be attached to his explanation given in court or to the weight to be given to the evidence of prosecution witnesses.

The court had the opportunity to further consider this proposition in *McConville* (1989) 44 A Crim R 455 where it approved of the principle stated in Bruce. The result seems to be that in Victoria the failure to offer an explanation at the earliest

opportunity may be of some disadvantage to the accused in the trial. There is contrary authority in other states, and this matter may well be the subject in the near future of a High Court adjudication.

Choice of Representation

More so than in any other area of criminal law there is a real advantage to be gained from briefing specialist Counsel. It is not that most Counsel cannot master complex commercial issues, but that given the cost of such matters a person skilled in commercial law will more efficiently be able to separate the chaff from the hay. Skilled commercial lawyers will quickly be able to ascertain whether a particular commercial transaction is standard fare or something else, whether a thirty-page indemnity is usual in the circumstances of the particular case or not. I have, on previous occasions, in the course of preparing for trial, obtained special advice about particular aspects of the case from barristers specialising in that particular field. We all think that we can master anything that a jury will have to understand, and that is probably correct, but there is no substitute for expert advice that is both quick and accurate to put defence counsel on the right track and to enable him or her to understand where an expert witness can be attacked and where not.

Choice of counsel is critical. Sight must not be lost of the fact that ultimately the proceedings are a criminal trial, rather than a commercial cause. The ideal combination is a criminal silk with a most experienced commercial junior.

Preparation

Preparation is at the heart of any successful defence. One day spent preparing may save two days wasted in court. Proper preparation will enable the issues in dispute to be crystallised and permit sensible decisions to be made about shortening the trial process. Properly prepared counsel, possessing goodwill, should, by concentrating on the issues, be able to make a seemingly untriable case eminently triable.

The investigating authority will have spent thousands of man-hours in the investigative process. The defence must be able to master the material at least as well as the prosecution. Here the question of resources becomes paramount.

Discovery

The first step in preparation is to ensure that proper discovery has been made of all prosecution exhibits and other materials. The extent of discovery of materials other than exhibits and witness statements sometimes raises questions of legal entitlement which considerations are outside the ambit of this paper.

The Defendant's Paper

It is highly likely that pursuant to search warrant the investigators have seized most, if not all, of the defendant's paper. If copies were made available to the 'searchee' at the time of seizure, the best possible result has been achieved. Failing this, the defendant must secure copies of his or her own paper.

Third Party Paper

Bankers, solicitors, accountants and financial advisers would have surrendered (voluntarily or otherwise) paper which the defendant may or may not know about. The defence must obtain access to this material as soon as possible. In the event that legal professional privilege attaches to any of the documents sought to be seized by the investigative agency, that privilege should be maintained at all times. That is so notwithstanding that it is thought at that stage that certain documents might ultimately assist the accused in his defence. The tactical advantage of keeping such material from the prosecution should not lightly be given away.

Control of Documents

The defence cannot rely on the prosecutor for total discovery. It is not because the prosecutor will wilfully conceal material from the defence but rather because the prosecutor may not be briefed with the totality of the materials. For example, it is highly unlikely that the prosecutor would have been briefed with preliminary and draft witness statements. There are many occasions when such preliminary or draft statements are valuable aids to the cross-examination of the witness. Similarly, many documents may not be perceived to be relevant to the prosecution case but may, nevertheless be essential to the defence case or may become relevant to the prosecution case against the accused once the trial is underway and defence issues become crystallised. It is too late, in my view, to learn of the existence of such documents half-way through the prosecution case when the defence may be locked into a course that has become untenable.

It does not necessarily follow that those instructing the prosecution - the DPP - have any better knowledge than the prosecutor does concerning the existence of any such particular documents. It is often the case that the investigators, be they police or other institutions, select documents for the brief based on their understanding of what is or is not relevant to the prosecution case and what may or may not be relevant for the defence. Obviously, such investigators' perception of what is relevant to the defence will necessarily be constrained by their incomplete understanding of the defence.

Although the prosecution is under a duty to be fair and to produce all relevant documents, prior inconsistent statements of any witnesses it proposes to call, and details of witnesses it has statements from that it does not propose to call, the investigating police or other investigative agency is under no such constraint.

Generally speaking the investigator would not go out of the way to conceal information from the prosecution and ultimately from the defence, but there have been many cases where this result has in fact occurred. Suffice to say that the

investigator is partisan and it should not be left to the investigator's sense of fairness to dictate what is to be produced.

The prosecution ordinarily selects documents which it asserts are relevant to the prosecution case from files and the like seized from the defendant or his advisers. It is essential that in the course of preparation all files are inspected. It is often the case that a document assumes a different significance when its context by reference to other documents is appreciated.

Document Integrity
An investigative agency, doing its job properly, will maintain the integrity of the filing system when seizing documents. There is a temptation, on the part of the investigator, to re-organise the documents so as to assist in the understanding of the transactions. Whilst this may be of assistance both to the prosecution and to the court it may seriously disadvantage the defence which relies on the sequence of certain documents to explain the transactions. An investigation would not deliberately re-organise documents seized, but it is important for the defence to be able to access the documents in the state in which they were located. The collation of documents by the prosecution may be of no harm to the defence but this is a decision that must be made by the defence.

Different methods for obtaining discovery are as follows:

- **By request** A request of the prosecutor or the Director of Public Prosecutions should generally result in the production of all documents sought in the possession of that office. Of course it will not produce any document held by the police or other investigative agency that has not been provided to the DPP.
- **FOI** This procedure is also effective against the DPP but will usually not apply to police and other investigative agencies.
- **Subpoena/notice to produce** This is a most effective tool against the police and the investigator but its utility is circumscribed by the fact that the production of documents either under subpoena or a notice to produce is to the court rather than to the defendant or his legal practitioners. It is highly unlikely that production so late in the piece will be of any real assistance to the defence in a trial situation. The subpoena and the notice to produce are most effective when used in conjunction with committal proceedings.
- **The pre-trial conference** The pre-trial conference is a most useful means by which meaningful discussions can take place between the parties with a view to resolving issues prior to trial. This paper will not deal with the pre-trial conference other than to note that it is an occasion for complaining about what has not been delivered but generally too late to search for relevant material.
- **The committal** The cross-examination of police and other investigators subpoenaed to produce all documents will in most cases identify, if not

actually bring forth all relevant documentation.

It is not possible here to detail all aspects of discovery in committal proceedings, save to say that a number of procedures and techniques are available and should be pursued. At the conclusion of the committal proceedings and well before the commencement of the trial the accused should know all the evidence capable of being called against him. He should know the extent to which any witness is able to affect him. His counsel at the trial should be able to cross-examine without risk.

Committal Proceedings

Much under attack in many jurisdictions, the committal proceeding, if properly conducted, is the most effective means of obtaining pre-trial discovery. This is not the occasion to argue for the retention of the committal process. It suffices to say that most Directors of Public Prosecution in Australia, including the Commonwealth Director of Public Prosecutions, are much in favour of the retention of the committal system. The recent study by the Australian Institute of Judicial Administrators, *The Committal in Australia* (Brereton 1990) recommended the retention of the committal hearing and found that the empirical evidence available disclosed, inter alia, that the committal proceeding provided a reasonably effective mechanism for disclosing the Crown's case to the accused and that particularly in large and complicated cases the committal proceeding can perform a useful management function by clarifying and refining issues.

There is no doubt that committal proceedings can be seriously abused thus rendering them both expensive and time-consuming, but the remedy, in my view, is to control and improve the committal proceeding rather than abolish it. The committal has particular significance in fraud cases because of the complexity of the issues and the volume of the material. A tactical question needs to be determined as to where the battle will be joined. The decision is whether an attempt is to be made to win the case at committal, bearing in mind that notwithstanding such a victory the prosecution have always the right to proceed by way of ex-officio indictment, or to reserve the fight for the trial.

Many advocates are of the view that commercial criminal trials are most difficult in front of juries and that the optimum opportunity is at the committal. There is a concern that juries have great difficulty in coming to grips with cases where large amounts of money have been lost, particularly so when the victim is the Commissioner for Taxation.

Whatever view is taken as to the chances of victory at committal, the opportunity to test the prosecution case and to discover all documents cannot be passed over.

Although it is proper to reserve to the prosecution the right to present directly for trial notwithstanding that an accused has been discharged at committal, such a right ought not be capable of exercise without some risk to the prosecution. If the

prosecution is dissatisfied with the order of the magistrate, then the decision should be reviewed in a superior court. If the review is successful then the trial can proceed in the usual form. In the absence of a successful review, the prosecution can only proceed to trial on the basis that it pays costs if the accused is acquitted. It is bad enough that the accused has to bear the cost of winning once, it is intolerable that he should have to bear the cost of winning twice.

Interviewing Prosecution Witnesses

In some cases it may be necessary to interview prosecution witnesses prior to the hearing. There is no property in witnesses and nothing wrong in interviewing them. A number of precautions ought to be followed when interviewing prosecution witnesses. The prosecution ought, as a matter of courtesy, be advised. As a matter of caution, the defendant ought not be present, but if he is he should not explain his case. I make it a practice to advise such a witness that there is no objection to him informing the prosecution of the contents of the interview. Accordingly it is not to the advantage of the defendant to be foreshadowing his defence to the witness. It is important to discover the means by which the witness has been interviewed by the investigators and in particular whether there are in existence any tape- recordings or other statements. These should be requested and will usually be produced by the prosecution.

Special Problems in Complex Fraud Cases

In complex fraud and revenue fraud trials it is extremely difficult to explain to the jury that which has taken the lawyer a long time to comprehend.

Criminal lawyers place great faith in the jury system. Many have never expressed a moment's concern about the ability of the jury to arrive at a just result. In the area of complex commercial crime, however, it may be difficult for the jury to come to grips with what may be perceived to be a fine line between a sharp business practice on the one hand and dishonest conduct on the other.

Experience has demonstrated that complex commercial fraud trials present significant problems for the jury system. Courts are not constructed to accommodate vast quantities of paper or alternatively sophisticated computer technology. Trials tend to be very long. The issues raised are usually highly specialised. The concept of dishonesty, which lies at the heart of all fraud, is simple enough to deal with when it is concerned with everyday issues, but it is naive to suggest that it can easily be applied to the sorts of cases with which we are here concerned.

The real fear for the defence is that once a jury has appreciated the magnitude of the prosecution effort in bringing the case to trial, and the amount of money involved, they might come to the conclusion that 'there must be something in it'. A cynical view might be that in a commercial fraud trial the onus of proof is

really one of proving innocence and rests squarely on the shoulders of the accused.

A major concern for the defence is the perception that the prosecution case 'swamps' the defence. An effort must be made to try to equalise the impact of the respective cases. The defence must be in a position to make admissions of fact and to facilitate the tender of documents in an attempt to shorten the prosecution case whilst preserving issues that the defence can call evidence upon in the course of its case.

The prosecution must clearly and concisely identify and explain the central issue for the consideration of the jury. If it fails to do this its case will fail.

There is a real danger in permitting the prosecution to range far and wide with what in fact are collateral issues said to demonstrate dishonesty. The trial judge must be persuaded that in the interests of justice and in fairness to the accused the issues to be tried by the jury should be strictly defined and manageable. To do otherwise is to ensure that the trial will extend into seemingly endless forays into marginally relevant considerations which the jury will simply have no hope of contending with. A trial permitted to proceed in this way quickly becomes an intolerable ordeal for all concerned and our system of justice, it is submitted, cannot afford litigation such as this. The selection of a strong and experienced judge is called for in these trials.

The defence must be seen to be participating in the trial. It cannot permit the prosecution to have the whole running of the case. The jury may be overborne by the sheer size of the prosecution effort. Accordingly the defence cannot consist of a mere denial at the end of the crown case. It must call witnesses to prove all manner of marginally relevant things if only to give the impression that there is substance to the defence case and to overcome the apparent sheer weight of the prosecution case.

Modern Courtroom Techniques

The prosecution has developed special techniques in the complex fraud trial to present the facts and issues upon which it relies in such a way that the jury can understand them and come to a conclusion about the accused's guilt.

Jury Aids
In the absence of agreement, the question of the legal admissibility of charts, graphs and other computer assisted aids is not settled. If we are to move the criminal trial into the twentieth century, this question must be resolved in favour of admissibility. The trial of a complex fraud case already raises serious questions about triability in view of costs and complexity. We must pursue all reasonable avenues directed at ensuring that the complex fraud trial can be conducted fairly and expeditiously.

Seeing is believing. There is no doubt that we retain more of what we see than what we hear. More so when what we are required to observe is novel. In addition to relying upon electronically stored source material, the prosecution will, in the course of presenting its case, have created a number of aids in an effort to explain dramatically the prosecution case. Although there appears to be a general resistance to the use of sophisticated visual aids in jury trials, it must be recognised that as a community we are exposed to them as teaching aids in almost every aspect of education. To be satisfied that the use of such aids is ideally suited to explaining complex transactions, one only has to watch any reasonable current affairs program to appreciate what can be done in a relatively short period of time to explain complex transactions.

Financial Spreadsheets

Thousands of financial transactions can be produced in spreadsheet form and then translated into coloured bar charts and other graphs. I am currently defending an alleged sales tax fraud case where the prosecution has delivered 30 arch- lever folders of source documentation concerning several hundred transactions. An analyst has entered each transaction into a computer spreadsheet program and produced a number of spreadsheets. If we are satisfied that the spreadsheet database accurately represents the source material, we will make an admission which will permit the prosecution to rely on the spreadsheets in lieu of the source material. Thereafter all references to transactions will be by way of the spreadsheets. The prosecution will no doubt have the spreadsheet program produce bar graphs and other charts in support of its case. We will do the same. Of course there may be occasions when one party or the other will seek to make some point by reference to the source documentation but on the whole, the proceeding will be significantly expedited.

Graphics

Case graphics utilise computer aided drafting to produce charts and graphs. Such graphics can be used to trace a complicated money trail or an intricate company structure. A complex graphic may not be much easier to comprehend than viva voce evidence but moving or layered graphics can take a jury step by step through the transactions so that in the end the jury is left with a graphic that has been created in its presence, which it understands and which hopefully it can take into the jury room. This form of graphic utilises the computer-aided drafting system (CAD) and can either be operated in the courtroom or presented to the jury in preprinted colour graphics.

The use by the prosecution of modern court techniques such as these put the defence under a great disadvantage unless it has equal access to them prior to and during the trial. It is simply unacceptable for the prosecution to make extensive use of sophisticated and expensive courtroom techniques without making these facilities available to the defence. Not only should the hardware necessary to produce the various graphics and the like be made available but the software and if necessary the technical expertise as well. The defence must have the use of

prosecution storage systems and not just the ultimate product. The cost must be borne by the prosecution.

Judicial Review and Abuse of Process

It is not proposed here to deal with questions of the sufficiency of evidence to support a committal for trial or the courses which may be open to challenging such a committal. It is sufficient to point out that the review process available has only rarely been successfully used. It must be remembered that the remedy is discretionary and courts are loathe to interfere with the committal process unless it can be demonstrated that the magistrate proceeded upon a clearly erroneous principle of law and that correction of the matter will permanently dispose of the prosecution. The courts will not embark upon a weighing of the evidence, nor will they interfere where interlocutory type relief is sought. In any event my experience has been that applications for judicial review invariably assist the prosecution by showing up weaknesses in the prosecution case which can then be remedied - a considerable disservice to the defence cause.

Save to say that separate considerations must be given to attacks on search warrants and listening devices, an analysis of which is outside the parameters of this paper.

Another procedure which has found popularity in recent years and which it is not proposed to deal with in detail, is applications to stay an indictment on the grounds that to proceed would amount to an abuse of the process of the court. This procedure has met with varied success in New South Wales and to a lesser extent in Victoria and South Australia.

At first blush, complex commercial frauds appear to lend themselves to such applications until it is appreciated that the more sophisticated the fraud the more time may elapse before it comes to the attention of the authorities, and the more complex it is, the longer it may take to have it properly investigated.

'At whatever point the matter is raised, it will invariably require exceptional circumstances to make out abuse of process': *R v. Clarkson* [1987] VR 962 at 972- 3. Put another way, '. . . it is a power which is exercisable sparingly and with the utmost caution . . .': Mason CJ in *A-G(NSW) v. Watson and Anor* (unreported, High Court, 16 October 1987).

Conclusion

In the zest to convict the corporate criminal it must always be borne in mind that under the law he or she is to be treated in no different way than any other person charged with any other criminal conduct. The criminal justice system must provide in the trial of the person charged with corporate crime as much of a chance at an acquittal as any other person charged with a serious criminal offence has. At the present time it appears that an accused who relies upon legal aid is

clearly disadvantaged. If the accused is able to properly fund his or her own defence then the cost will be astronomical. There have been a number of trials in the last few years which have exceeded six months duration where the accused have been acquitted and have been left impoverished by the experience. No person should have his defence compromised by a shortage of funds to properly conduct it. If the community is prepared, as it should be, to fund the prosecution of 'super trials' it must find the resources to adequately fund the defence and ensure that justice is done.

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Penalties for White-Collar Crime

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This paper will comment on some general things about the state of penalties not just for fraud in particular, but for white-collar crime in general. There are two simple reasons for this. First, the problem of unsatisfactory penalties for fraud is part of a more general problem of limp or inappropriate penalties for white-collar crime. Second, fraud is a serious part of the problem in almost every area of white-collar crime. In environmental regulation, there are problems with providing false effluent data to regulators; with pharmaceuticals regulation, there have been very serious problems of health authorities being provided with fraudulent data on the safety and efficacy of drugs. Fraud is a major issue in the regulation of companies and securities, prudential regulation (banking, insurance), occupational health and safety and consumer protection. Too often we forget that not only does fraud cost us millions of dollars, fraud also kills. In Australia, we have been woefully neglectful of frauds that put lives at risk.

The most serious frauds, particularly of the latter life-threatening sort, are perpetrated by corporations. For this reason, this paper will concentrate on penalties for corporate offences. There is another reason for giving this priority, however, that has to do with the parlous international reputation of Australian regulatory institutions. For example, so far this year, I have attended three conferences in the Northern hemisphere that have addressed the topic of white-collar crime, and it is noticeable that jokes about Australian business have become common at such events. Queensland's own Joh Bjelke- Petersen features in cautionary tales that are told in the Northern hemisphere about the shocking state of our business and political institutions. It is a mystery why so many English people have heard of the alleged antics of Joh Bjelke-Petersen, but they do not know the name of a single governor of an American state who has been under a cloud for corruption. Perhaps we are just more colourful than the Americans. The fact which we have to deal with as a nation, however, is that our business regulatory institutions are 'on the nose' internationally. For the moment, the pressure has been lifted somewhat because the Japanese are even more 'on the nose'. But the Bjelke-Peterson trial and other media 'spectaculars' coming down the track will shift the spotlight back onto Australia.

It is no use complaining that it is unfair picking on Australia; because it is not unfair. We have deluded ourselves for too long about the integrity of our business and political institutions. A public relations campaign to counter the collapse in international confidence in Australia will not wash because the allegation that we are soft on corporate crime is demonstrably true. To restore confidence in

Australian business institutions, our political leaders must do something dramatic. That something should be to put some teeth into corporate criminal law.

It is vital to do this because our dismal international reputation is a major threat to our economy and a significant cause of the sorry economic predicament we already have. Australian business leaders who give 'presentations' to the New York investment community hear the jibes. Investment confidence in Australia is haemorrhaging because of our reputation for rigged, corrupt markets where the competition is done by foul means rather than fair.

If you look at almost any area of law enforcement directed against business - as Peter Grabosky and I did in our book, *Of Manners Gentle: Enforcement Strategies of Australian Business Regulatory Agencies* - we find agencies with a dismal enforcement record by international standards. We find them under-resourced, operating with statutes which provide for wrist-slapping financial penalties. This is true in companies and securities regulation (as we still breathlessly await our first-ever conviction of an insider trader)[1], environmental enforcement, occupational health and safety, consumer protection, regulation of the media or banking and insurance regulation.

It is even true of the organisation that Grabosky and I concluded was the Australian regulatory agency during the 1980s that imposed the toughest enforcement - the Trade Practices Commission. The Trade Practices Commission is responsible for enforcement concerning misleading representations to consumers, price-fixing rip offs, abuse of market power and a range of other forms of anti- competitive conduct.

But even here, where our enforcement has been most credible, compare what we are doing today with what our major trading partners are doing. Japan and the United States provide for tough prison sentences for senior executives of companies that breach their trade practices laws. Actual use of these severe prison terms has been rare in Japan, but common in the US. The original Murphy *Trade Practices Act 1974* (Cwlth) provided for imprisonment as a sanction. The provision was removed in the 1977 amendments to the Act.

Notwithstanding the rhetoric of deregulation, the facts are that under both the Reagan and Bush Administrations the punitiveness of corporate crime enforcement increased. The percentage of individual antitrust offenders sentenced to gaol increased from 38 per cent under Carter to 54 per cent under Reagan and the time served in gaol jumped markedly.

Restoring imprisonment as a sanction under the Trade Practices Act is not being advocated here. However, we must understand the reasons why our major trading partners are right to perceive us as timid compared to themselves in our approach to business regulatory enforcement. In fact, we are so timid that the financial press never refers to Trade Practices offences as corporate crimes or their

perpetrators as corporate criminals. Indeed as a matter of law only breaches of Part V of the act are criminal.

In response to recent criticism of our Trade Practices penalties, the Attorney-General has stated publicly that he is seeking to persuade his Cabinet colleagues to increase the maximum penalties from the present $250,000 to $10 million. But let us compare this to what is happening in the rest of the OECD. The US Sentencing Commission this year sent its long-awaited recommendations to Congress to increase penalties for corporate crime. Its recommendations will probably become US law in November 1991. For the most serious type of corporate crime possible, the guidelines provide for a maximum criminal fine of US$290 million. Yet for antitrust offences, even higher fines are conceivable because a firm can be fined up to 80 per cent of the value of the commerce affected by an antitrust offence. Hence, if an oil company engaged in price fixing with a competitor on all of its oil sales and those sales amount to a billion dollars, it could be fined up to $800 million if it is a repeat offender which is maximally culpable for the offence.

Already in the US today we are seeing corporate penalties with this number of digits. The judge in the Exxon Valdez oil pollution case recently rejected a US$100 criminal penalty consent agreement as too lenient (even though this was on top of a $900 million civil settlement and over a billion in voluntary clean-up). In the Drexel Burnham Lambert insider trading case we saw consent agreements for civil penalties in excess of US$600 million (including a US$78 million criminal fine) and a ten-year prison sentence for Michael Milkin (Stewart 1991).

The US is not the only country where antitrust financial penalties, like other sanctions against business offenders, are rising sharply. Total anti-cartel penalties imposed by the Japanese Fair Trade Commission (FTC) rose from 147 million Yen in 1987 to 419 million in 1988 to 803 million in 1989 to 12,560 million in 1990. This will rise further if the FTC gets approval for maximum fines to rise from 2 per cent to 6 per cent of the sales of cartel offenders. In Europe the maximum penalties that can be imposed are higher than in the US or Japan. Way back in 1980 the Commission of the European Economic Community (EEC) recommended that the EEC fine IBM US$2.3ÿbillion for alleged restriction of competition in the European computer market. This fine was never imposed. But such extraordinary fines are possible because of the EEC power to impose fines up to a maximum 10 per cent of a firm's worldwide sales. Last month the Swedish company, Tetra-Pak was fined A$114 million by the EEC for discriminatory and predatory pricing.

In this international environment of governments flexing their muscles to secure clean competitive markets where both consumers and investors get fair treatment, Australia has missed the boat. In fact we have missed the boat so badly that gestures such as increasing penalties under the Trade Practices Act to $10 million go nowhere near far enough. We surely do need dramatic increases in the

financial penalties available under all our business regulatory statutes. But to be politically realistic, there is no prospect that we could increase financial penalties to such a degree that Northern hemisphere cynics about the corruptness of Australian business will be convinced that we are being as tough on business crime enforcement as they are.

This seems politically unrealistic because the gap between the level of our maximum penalties and theirs is now so wide. Anything we do now will be better than nothing, but it will still be seen as a limp gesture of catch-up with the rest of the world. We need a dramatic innovation in corporate crime enforcement to make the world sit up and take notice of an Australia that is taking extraordinary measures to clean up its act.

Senator Gareth Evans showed how this could be done in speeches he gave in 1982 and 1983 on the idea of an equity fine as a sanction against corporate offenders. Evans was howled down for proposing something that was seen at the time as horrendously unsympathetic to business. Similarly, when the Australian Law Reform Commission floated the equity fine proposal in a discussion paper a few years later, there were no political supporters to be found. Ironically, the very radicalism and innovativeness of the equity fine that fomented such business and political rejection makes it the ideal instrument for signalling to the world a new Australian determination to get serious about corporate crime.

What is the equity fine idea? It stems from an appreciation of the fact that the cash fine can put us in what Professor Coffee of Columbia University called a deterrence trap. If the chances of getting caught for say, insider trading, are only one in a hundred and if the average returns to insider trading were say $1 million, then the penalty for insider trading would have to be set at over $100 million to make it rational to desist from the practice. The fine has to be so high that it is likely to bankrupt many corporate offenders, putting innocent workers out of jobs.

The equity fine gets us out of the deterrence trap by fining the firm in equity instead of cash. A 1 per cent equity fine means the firm must issue one new share for every 100 shares owned by shareholders. The new shares might be issued to a victim compensation fund or to the state. This should cause an instantaneous 1 per cent drop in the market value of all shareholdings. Unlike the cash fine, the equity fine does not deplete the capital available for investment. Instead of depleting the firm's liquid assets, it simply reallocates ownership of both fixed and liquid assets. And it gets shareholders upset with their management!

There are other reform options beyond becoming just another country which increases the level of cash fines or prison sentences for corporate criminals. Corporate probation, adverse publicity orders and community service orders are examples. These ideas were well developed by the South Australian Criminal Law and Penal Methods Reform Committee (1978) - (the Mitchell Committee). Again these recommendations advanced by the now Governor of South Australia

were ignored at the time. Professor Brent Fisse of the University of Sydney Law School is the world's leading expert in innovative corporate sanctions (Fisse 1981). His ideas have been influential in the United States and parts of them have been adopted there, but they have been ignored by Australian governments.

In our new international predicament as a pariah nation of business shysters, such ideas would bear careful re-examination by a political leadership interested in making a decisive move to scotch that image. But then perhaps our foreign critics are right and the real reasons why Australian politicians refuse to get tough on corporate crooks are to be found in the evidence before the Fitzgerald, Tasmanian bribery and WA Inc Royal Commissions?

In some areas the debate about white-collar crime penalties is, as Professor Tomasic has said in the past, purely academic. What does it matter what the penalties are for insider trading when we never convict anyone? Trade Practices penalties seems a priority area for reform precisely because that is one of the few business regulatory domains where convictions of major businesses do occur on a regular basis. I can see no reason for prioritising increases in gaol terms for common fraud. The effect of that will be to increase sentences for social security cheats and other minor fraudsters who account for most of our fraud convictions. And as research at the Australian National University is showing, criminal enforcement is not the most effective way to tackle the considerable fiscal loss caused by overpayments to social security clients.

In addition to the rethinking of corporate sanctions mentioned in this address, seizure of assets is also an important area of reform if we are to concentrate our energies on sanctions that target (and that can hurt) the biggest sharks of Australian business. However, Professor Freiberg will provide us with a more comprehensive treatment of the problems and advantages associated with that approach (see the next chapter in this volume).

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[1] A former employee of the National Companies and Securities Commission was convicted of insider trading in 1991.

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Confiscating the Proceeds of White-Collar Crime

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[1] This research has been sponsored by the Attorney-General's Department of Victoria and partly by the Australian Research Council. Some portions of this paper are drawn from Freiberg, A. (Forthcoming), 'Crime, profit and Liberty', *ANZ Journal of Criminology*.

The recent downturn in the economic cycle has left a trail of financial devastation. The difficulties created by the spate of corporate collapses are neither new nor confined to Australia. In the United States, the cost of banking, savings and loans, and insurance failures is measured in hundreds of billions of dollars and continues to rise (Calavita and Pontell 1990). These collapses have been accompanied by allegations of fraud and mismanagement by company directors, of improper movement of funds between associated companies and entities and of financially disadvantageous transactions outside the contemplation of shareholders (Watson 1990). Corporate failures leave in their wake competing monetary claims both between creditors and between creditors and shareholders. Where criminal charges are proved, the state also becomes a claimant if pecuniary penalties are imposed.

Beyond the financial cost, however, these failures affect confidence in social institutions and may undermine the strength of the economy, the financial system and ultimately governments. In relation to losses occasioned by major frauds, it is apparent that a substantial portion of assets will never be recovered. Many assets are irrecoverable. Others are of less worth, or even worthless, having been bought at grossly inflated prices.

In many cases litigation against miscreant directors, companies or third parties proves fruitless, their wealth being intimately bound up with the fortunes of the company. Legal proceedings in such cases require an expenditure of time and resources far beyond that of the average investor. Not all claims, however, are pointless. In the United States, risk arbitrageur Ivan Boesky paid the United States government US$100m as part of a negotiated settlement to charges of insider trading, $50m of which represented the disgorgement of profits obtained from insider trading and $50m of which were civil penalties. Boesky also pleaded guilty to a felony and was sentenced to imprisonment. The stockbroking firm of Drexel Burnham Lambert Inc. agreed to plead guilty to six counts of mail, wire and securities fraud and to pay US$650m in fines and penalties. $300m was allocated to criminal fines and civil penalties and $350m was allocated to an

escrow account to pay private claims (Dennis 1988).

In Australia, where an offence has been committed, one of the means by which the proceeds of crime may be disgorged and by which offenders may be disabled from future wrongdoing is the recently enacted legislation which permits the confiscation of the proceeds of crime. This paper will briefly explain the nature of the confiscation legislation, explore its application to white-collar offences and examine some of the problems which may occur through its use in the commercial context.

Terminology

There is no discrete group of offences which can be identified as 'white-collar crime'. The term has been used to describe crimes committed in the course of their work by persons of high status and social repute in the course of their occupation (Sutherland 1940). It refers to such matters as misrepresentation in the financial statements of corporations, manipulation of the stock exchange, commercial bribery, bribery of public officials, misrepresentation in advertising, embezzlement and misapplication of funds, tax frauds and the like. The phrase has been extended from Sutherland's definition to cover any occupational deviance, whether by people of high status or not, and violation of professional ethics. To some it has come to refer to almost any form of illegal behaviour other than conventional street crimes. The broadest definition is one which sees white-collar crime as illegal acts committed by non-physical means and by concealment or guile to obtain money or property, to avoid the payment or loss of money or property or to obtain business or personal advantage.

Other terms have also been invented or used. For example, the term 'insider abuse' has been coined to refer to a wide range of misconduct by officers, directors and insiders of financial institutions committed with the intent to enrich themselves without regard for the safety and soundness of the institutions they control, including violation of civil banking laws and regulations and perhaps also violation of criminal banking laws (Stevens 1989, p. 222).

Corporate crime is another relevant term. Criminal acts committed by corporations or officers of corporations acting on behalf of corporations fall within the broader province of white-collar crime. Offences may be committed by the corporations or employees either to serve the purpose of the organisation or the purpose of the director or employee (Grabosky 1984). It is not necessary for present purposes finally to determine the precise scope of these concepts other than to note that in this paper they will be used in their broader, rather than narrower senses.

The Confiscation Legislation

Legislation to confiscate the proceeds of crime has now been enacted in all jurisdictions in Australia except for Tasmania. Its remote foundations lie in the common law doctrines of attainder and deodand, in the development of statutory forfeitures from the mid-nineteenth century and in the long and ignoble history of customs laws. Its immediate origins, however, lie in the Racketeer Influenced and Corrupt Organisations Act 1970 of the United States (RICO) which was specifically designed to attack organised crime by attempting to dislodge it from legitimate fields of endeavour (Spaulding 1989; Fraser 1990). The legislation was modelled on antitrust laws and provided a wide range of criminal and civil sanctions. In contrast, the Australian legislation, although ostensibly aimed at organised crime, does not have the same organisational focus. However, it is noteworthy that the legislation in neither jurisdiction is limited to traditional or 'blue-collar' crimes.

The core of the legislation is the confiscation order which can be made following a conviction and before or after the imposition of sentence. A confiscation order is the generic description for two discrete orders - a forfeiture order and a pecuniary penalty order.

In general terms, a forfeiture order is an order permitting a court to order the forfeiture of 'tainted property'. Tainted property is broadly defined as property used in, or in connection with, the commission of the offence, or that was the proceeds of the offence, that is, property that was derived or realised, directly or indirectly, from the commission of the offence.

A pecuniary penalty order is an order of a court against the person in respect of the benefits derived by the person from the commission of the offence. It is a financial sanction calculated by reference to the profits or gains made from criminal behaviour and rests on the principle of restitution by forcing the convicted person to disgorge the 'proceeds' or 'profits' of his or her crime (*Fagher* (1989) 16 NSWLR 67 (CCA NSW) per Roden J).

The legislation also creates a number of powerful ancillary orders: a restraining order, which prevents the unauthorised disposition or dealing with property pending the making of a confiscation order, a production order, which requires a person to produce a document which may assist the authorities in identifying tainted property and a monitoring order, which requires financial institutions to provide information concerning financial dealings to the authorities. Extensive powers of search and seizure are also provided and new offences such as money-laundering and organised fraud are created, carrying maximum penalties of over 20 years gaol and fines of up to $600,000 for corporations.

Purposes and Justifications

The legislative and judicial justifications for forfeiture or confiscation are similar to the rationales for conventional sentences: incapacitation, deterrence, retribution, community protection and the like, although the emphasis differs. The confiscation legislation aims to incapacitate, by depriving a person of the physical or financial ability, power, or opportunity to continue to engage in proscribed conduct, to prevent offenders from unjustly enriching themselves, by eliminating the advantages and benefits which the offender has gained through his or her illegality, to deter the offender and others from crime by undermining the ultimate profitability of the venture and to protect the community by curbing the circulation of prohibited items. The legislation may enhance government revenues where confiscated funds are used to fund law enforcement agencies and may be used to compensate the victims of crime if the funds are channelled back to them rather than being maintained by the state (no jurisdiction currently embraces this as an aim, although it is understood that this is under consideration).

Application of the Legislation

Relevant offences

Although ostensibly directed at crimes such as drug trafficking, the confiscation legislation is not restricted to such offences. For the sake of simplicity, examples will be drawn primarily from Commonwealth legislation. This legislation requires that a person be 'convicted' of an offence before a confiscation order can be made. It is primarily intended to apply to serious offences (Commonwealth legislation refers directly to indictable offences), although this is a flexible concept and has been deliberately kept so. The range of relevant offences has been defined, directly or indirectly, to include indictable offences, prescribed offences (usually by regulation), and nominated offences that is, those specifically set out in the legislation. The legislation is, or can be made, applicable to offences under the *Corporations Act 1989* (Cwlth), affecting both shareholders (*see*, for example, ss. 232(2); 232(4)-(6); 234; 590(1)(c)(i); 590(1)(g)), and creditors (*see*, for example, ss. 590(1)(c)(v); 592(1); 592(5); 596(a)-(c)) to insider trading, taxation offences, consumer protection offences, counterfeiting of trade marks, criminal copyright violations, pollution, bribery and corrupt practices and to general offences under state law such as theft, obtaining property or financial advantage by deception, false accounting, falsification of documents, secret commissions and the like.

Relevant Persons

It is implicit in the confiscation legislation that the person convicted of an offence be a natural person, but the word 'person' is undefined. There is no reason, however, why the 'person' charged should not be a corporation and why a

confiscation order could not be made against a corporation. There are a number of matters to be considered in determining whether an individual or a corporation should be charged. These include the cost of prosecution, problems in establishing liability, the securing of an effective remedy, problems in obtaining admissions of guilt and the nature of the sanction (Australia, Senate 1989, pp. 179-89).

It has been argued that for reasons of future corporate compliance it may be preferable to charge organisations rather than the individuals. If recovery is the dominant purpose, the appropriate defendant will be the one best able to satisfy the claims against it. In many cases, the corporation may be an empty shell, or may be in liquidation, but if the corporation does have assets, competition may arise between creditors, shareholders and the state.

The conviction of corporations is facilitated by numerous statutory provisions which provide that where it is necessary to establish the state of mind of a corporation in respect of its conduct, it is enough to show that a director, servant or agent had the state of mind, being a director, servant or agent by whom the conduct was engaged in within the scope of his or her actual or apparent authority. Alternatively, if it is considered that recovery against an individual would be more fruitful, some penal legislation now provides that where a corporation contravenes the legislation, every director is deemed also to have contravened it and to be liable to a penalty unless the director proves that the contravention occurred without his or her knowledge and that he or she used due diligence to prevent its occurrence. From the viewpoint of obtaining a confiscation order, if a decision is made to seek convictions against both the organisation and its officers, it is also clear that the Crown can rely on acts of the director as establishing an offence committed by the company as principal and also as proof against the director of aiding and abetting that offence (*Hamilton v. Whitehead* (1988) 63 ALJR 80).

In the United States, the forfeitability of corporate assets has caused concern following the conviction of a number of banks on counts of money laundering. If a bank were involved in money laundering and if the officers of the corporation, acting in the 'corporate form', were involved, the assets of the bank, not including the depositors' accounts held in a fiduciary capacity, could be forfeited. It has been suggested that such actions may serve to encourage shareholders to take more interest in the actions of the board of directors (Spaulding 1989, p. 226).

Pecuniary penalty orders

Of the two forms of confiscation order, the pecuniary penalty order will be the more appropriate to corporate criminality. This order enables the court to deprive an offender of the monetary value of any benefit gained from an offence which cannot be traced into specific property and thus be subject to a forfeiture order. The method of assessment of the pecuniary penalty is therefore of critical importance (unless otherwise stated, note that legislative references related to the *Proceeds of Crime Act 1987 (Cwlth)* - also referred to as POCA).

Benefit The concept of 'benefit' is central to the confiscation legislation. In the absence of specific legislative direction, courts will have regard to the ordinary meaning of the word by determining how much the defendant has gained from the transaction (*see Commissioner of Australian Federal Police v. Cornwell and Bull* (1990) 94 ALR 495, 506, Wilcox J: 'The function of the court is to make a sound discretionary judgment about the amount of benefit taken by the defendant). A 'benefit' may include a gain, profit, reward or advance, but is not synonymous with 'profit' (*DPP v. Nieves, Italia and Athanasiadis* ([1991] 51 A Crim R 350). The receipt of a sum of money is the benefit which a convicted person derives from the commission of the offence of which he or she has been convicted. The value of the benefit is the amount of money the convicted person has so received). It is further defined in the Commonwealth confiscation legislation as including a 'service or advantage' (POCA 1987, s. 4(1)) presumably to indicate that a benefit can be a non-corporeal gain, so long as it is measurable in pecuniary terms. The term 'benefit derived' is also further defined to include (a) a benefit derived, directly or indirectly, by the person or (b) a benefit derived, directly or indirectly, by another person at the request or direction of the first person (s. 4(3). *See also Commissioner of Australian Federal Police v. Cornwell and Bull* (1990) 94 ALR 495, 506).

Gross or net benefits The confiscation legislation aims to strip from an offender the total benefits from the offence, either by removing any property that is derived from the offence by means of a forfeiture order or by imposing a pecuniary penalty order to disgorge an equivalent amount where the property no longer exists or is not in the possession of the defendant or where the benefit was not in a monetary form. The penalty amount may be reduced by the value of any property already forfeited and by the amount of tax which has been paid which is attributable in whole or in part to the benefits received. As well, if a court considers it appropriate to do so, it may reduce the amount payable by an amount equal to the amount payable by the person by way of fine, restitution, compensation or damages in relation to the offence (s. 26(5)). This provision will be of increasing importance in those cases where independent action is successfully undertaken by creditors, shareholders or the Australian Securities Commission (ASC) and compensation or damages are awarded.

Benefits disregarded: expenses and outgoings The provisions which accentuate the fact that the legislation is concerned with confiscating the proceeds, and not the profits, of crime, are those which require a court to disregard the value of any expenses and outgoings in connection with the commission of the offence in calculating the pecuniary penalty order (POCA 1987 s. 27(8)). Expenses and outgoings include the cost of obtaining a drug which is subsequently sold (*see Fagher* (1989) 16 NSWLR 67; *Commissioner of Australian Federal Police v. Cornwell and Bull* (1990) 94 ALR 495, 505 per Wilcox J), monies paid to corrupt police to ensure that a planned importation would go through Customs (*Commissioner of AFP v. Lahood* 23 May 1988 Federal Court, Sweeney J) and money paid a courier to ferry the drugs (*Commissioner of Australia Federal*

Police v. Razzi (1990) 97 ALR 349).

The matter of the non-deduction of out-goings is especially problematic in respect of white-collar offences, where the distinction between legal and illegal activities is finer. For example, if a defendant person or company is engaged in legitimate construction activities, but obtains a contract by bribery or corruption, would the defendant be able to deduct the direct and indirect costs incurred on the project? In U*S v. Lizza Industries Inc* 775 F 2d 492 (1985) the defendants had been found guilty of charges under the RICO legislation in respect of a bid-rigging conspiracy. It was held that the defendants could deduct direct costs (which would have included purchase of material to build the road as well as wages and equipment rental fees) incurred on each project for which they had been indicted, but could not deduct general overhead and business expenses that otherwise would have been incurred in the operation of their business.

Assessing value

The task confronting the court is to assess the value of the benefit derived by the defendant from the offence. The concept of 'benefit' is a broad one and includes any property, service or advantage directly or indirectly derived by the offender or on the offender's behalf. The court may take into account any money or the value of property other than money that came into the 'possession or control' of the defendant or another person at the request or direction of the defendant by reason of commission of offence or offences, any money or the value of property other than money that came into the 'possession or control' of the defendant or another person at the request or direction of the defendant by reason of commission of offence or offences and the defendant's income and expenditure before and after the commission of the offence or offences. The effect of inflation upon money and assets is taken into account in provisions which allow a court to have regard, in quantifying the value of a benefit, to any decline in the purchasing power of money between the time when the benefit was derived and the time when the valuation is being made. To make the task of establishing the causal link between the offence and the benefit easier, the confiscation legislation creates a rebuttable presumption that any increase in the value of property after the commission of the offence or offences is attributable to the commission of the offence ((s. 27(4)(a) (5)(a). Note that in relation to the Commonwealth, these provisions apply to 'ordinary indictable offences' which are indictable offences other than 'serious offences' (POCA 1987 s. 4 (1)). Although it may be easier for a white-collar offender to demonstrate the legitimate origins of his or her property that it would be for a drug- trafficker, the difficulties and magnitude of a such a task should not be underestimated, particularly when a considerable period of time between the commission of the offence and the trial has elapsed.

Effective Control of Property

Complex frauds are unlikely to be executed through simple commercial vehicles such as partnerships or by easily identifiable individuals. More likely there will be an elaborate network of companies and trusts which will be found to have been in possession of property at the relevant times. The confiscation legislation of the Commonwealth empowers courts to lift the corporate veil, so that in assessing the value of benefits derived by the defendant, it may treat as the property of that person any property that is, in the opinion of the court, subject to the effective control of the defendant (s. 28 (1)).

The crucial term, 'effective control' is the subject of elaborate definition. One of the problems in relation to companies concerns group companies or holding companies. There may be common or overlapping directorships and shareholdings, but in law, the property of a company belongs to that company and not to the directors or to the holding company. A person may be regarded as having 'effective control' of property or an interest in property whether or not the person has any legal right or equitable estate or interest in the property (s. 9A(1)(a)) or any right, power, or privilege in connection with the property (*see DPP v. Walsh and Ors* (1989) 43 A Crim R 266). Effective control, therefore, is not to be judged by the defendant's legal coercive power over the property but the degree to which the defendant is able to treat the property as his own (s. 9A(1)(b)). In determining whether or not a person has effective control over property or an interest in property, or whether or not there are reasonable grounds to suspect same (s. 9A(2)(a)(b)), the court may have regard to:

- Shareholdings, debentures over or directorships of any company that has a direct or indirect interest in the property (s. 9A(2)(c));
- any trust that has a relationship to the property; (s. 9A(2)(d));
- family, domestic and business relationships between persons having an interest in the property or companies or trusts.

The far-reaching scope of these provisions is illustrated by the case of *DPP v Walsh and Ors* (1989) 43 A Crim R 266 in which the defendant had been the central figure in a complex of family companies and trusts, being the guardian and appointor in respect of the latter. He had been charged and convicted of numerous counts of Medicare fraud. Almost all of the family income came from him and before his arrest he was in effective legal control by a combination of powers under the trust deed and shareholdings and by his directorship of the trustee company. However, following his arrest, he took steps to divest himself of legal control. The Director of Public Prosecutions obtained a restraining order against the defendant and his companies. Without telling his legal advisers, the defendant transferred the shares in the companies, raising the question of whether or not, despite his resignation of the directorships and the share transfers and his renunciation of the offices of appointor and guardian under the trust deed, he was still in effective control. The judge ruled that the transfers were real and not

shams. However, it was clear that the defendant had taken deliberate steps to divest himself of the shareholdings and the effect of the above provisions (in particular s. 9A(2)(e)) together with the fact that the properties were acquired out of defendant's earnings, satisfied the court that the property was, and had always had been, in practical terms, under his complete control and not that of the nominal owner, the wife.

Property under effective control to be made available

The consequence of a finding that property is under the 'effective control' of the defendant is that, upon application by the appropriate officer, the court may make an order declaring the whole or part of the property under the defendant's effective control be available to satisfy the pecuniary penalty order (s. 28(3)). The property so made available need not be property which is the proceeds of crime, merely property under the defendant's control. As Seaman J noted, this provision is

> entirely consistent with the principal objects of Act that where the benefit cannot be traced, a fortune under a person's effective control, however, derived, should be reduced by amount of benefit (DPP v. Walsh and Ors 5 May 1989 Supreme Court of WA).

Forfeiture orders

The application to the court is for an order in respect of the convicted person against certain property (*see* s. 4(1)), generally termed 'tainted property'. Tainted property is broadly defined as property used in, or in connection with, the commission of the offence, or the proceeds of the offence, that is, property that was derived or realised, directly or indirectly from the commission of the offence (*see* s. 4(1)).

'Used in connection with' The requirement that property be 'used in, or in connection with' the commission of the offence, is the most obvious and ubiquitous in the legislation. It is often not difficult to demonstrate a physical link between property and the offence. A gun may be used in an armed robbery; drugs may be sold in a house or a car or a vehicle may be used to transport a person to a meeting where drugs are to be bought or sold. A broad approach would allow any connection between the property and the offence to amount to a 'taint' and so empower a court to order the forfeiture of the property. In relation to white-collar crime, an expansive approach to tainted property could have startling results. Would the courts order the forfeiture of all the firm's computer equipment if one terminal was used in connection with an insider trading case? If the house of a drug dealer is forfeited, why should not the office of a corporate offender or the surgery of defrauding doctor? (For comparison, *see* Brickey 1990, p. 905).

The courts have emphasised two aspects of the decision-making process, first, the demonstration of the connection and secondly, the discretion which reposes in the court to make the forfeiture order. The emphasis on the latter again arises from the possibility of there being a gross disproportion between the offence and the sanction if the link is made. Both aspects serve as control, or limiting devices.

Courts have generally required that there must be a 'real and substantial connection' between the property and the commission of the offence but opinions on this vary between courts (*Murdoch v. Simmonds* [1971] VR 887, 889, Adams J; *see also Maher v. French* (1974) 7 SASR 504; *re an application pursuant to the Drugs Misuse Act 1986* [1986] 2 Qd R 506; *Price Unreported*, Court of Criminal Appeal, Victoria, 14 April 1987).

'**Derived or realised**' The second major limb of the concept of 'tainted property' is that which renders liable to be forfeited the proceeds of an offence (s. 4(1)(b)), that is, property that was derived or realised, directly or indirectly, by any person as a result of the commission of the offence.

The experience in the United States has been that similar confiscation legislation has been extended beyond the traditional offences of narcotics, arson, murder, loan sharking to corporate misbehaviour and commercial frauds (Spaulding 1989, p. 235). Concern has been expressed that the application of the 'derivation' provisions in the white-collar crime context will create problems of overbreadth and disproportionality of punishment because defendants would not be allowed to deduct the costs incidental to obtaining forfeitable property. The Criminal Justice Section of the American Bar Association has observed that:

> If 'derived from' means a more attenuated relationship, but nevertheless a causal connection, then there should be concern again about the danger of disproportionate and unintended forfeitures. If tainted money is invested in a sandwich shop and, by hard work and ingenuity, the investor parlays his operation into a restaurant chain, arguably the final product of all his labours is 'derived from' the tainted money. In short, 'derived from' is not a useful concept because it would carry the forfeiture beyond interests in an enterprise and profits and proceeds from criminality.

The implications of the extensions of these concepts has been further speculated upon by Spaulding (1989, p. 250). If, for example, a defendant acquired a licence illegally through bribery or by offering a secret commission, not only would the licence be subject to forfeiture, but it is possible that any money received by virtue of the licence would also be forfeitable, if a 'but for' rather than a 'substantial connection' test were employed. The issue of double counting is also problematic (Spaulding 1989, p. 259). Thus if A has a drug- derived $100 note which he asks B to change for five $20s both the $100 and the $20s would be 'proceeds' subject to forfeiture (*see US v. Four Million, Two Hundred Fifty-Five Thousand Dollars* 762 F 2d 895 (1985) cert denied 474 US 1056 (1986)). Or if D pays X $10,000 to bribe Y who gets $5000, theoretically, both amounts (that is $15,000) could be forfeited. The problems of 'derivation' create even further complexities. In the commercial context, if 'cash received from a tainted commercial transaction goes into a common fund and is used to make purchases and to satisfy the obligations of the business' would these purchases be forfeit (Bush 1990, p 1001)?

The discretion to make the order A forfeiture order under the legislation is discretionary. Before a forfeiture order can be made, a court must first be

satisfied that the property was used in the manner described in the Act, that is, that it is forfeitable property and only if the court is so satisfied, does the question of the exercise of the discretion arise (see comments of McGarvie J in *Order in the Matter of P.J. Allen Order in the Matter of PJ Allen* Supreme Court of Victoria). The latter is not an inevitable consequence of the former. Before making an order a court may have regard to the hardship which may reasonably be likely to be caused to the defendant or any other person as a result of the order (s. 19(3)(a)) and the ordinary use made of the property. This may prove to be an important ameliorative provision where office premises or equipment have been used in connection with frauds.

Enforcement of the Confiscation Legislation

It should now be apparent that the confiscation legislation is a far-reaching weapon in forcing the disgorgement of the proceeds of crime, including white-collar crime. The limits of the legislation in this context have yet to be explored as most applications in the Commonwealth sphere to date have been in respect of drug and social security offences.

It is also apparent in this context, as in many other areas of white-collar crime, that the law has been under-enforced. In Victoria, a Director of Public Prosecutions Working Party into the confiscation legislation has deplored the disorganised nature of enforcement of confiscation legislation. It noted (Victoria 1990, p. 99):

> The Working Party's deliberations on the issue of enforcement revealed an unsatisfactory hotchpotch of vague provisions, apparently unsatisfactory responsibilities, legislative 'gaps', misunderstood or ignored statutory obligations and administrative inaction, the consequence being a collection of unenforced orders in relation to deteriorating property, and a general lack of accountability on the part of the various responsible agencies.

Victoria has recently established a Police Corporate Crime Group with a mandate to focus on large and complex fraud cases. One of its major problems will be that of jurisdiction. Until the commencement of the Corporations Law on 1 January 1991, offences against the Victorian Companies Code could have provided the foundation for proceedings pursuant to the Crimes (Confiscation of Profits) Act 1986 (Vic). However, following the proclamation of the Commonwealth *Corporations Act 1989*, offences committed against that legislation are 'federal' offences and will found applications only under the Proceeds of Crime Act 1987 (Cwlth). Applications under state law in respect of certain company offences are thereby precluded.

Prior to January 1991, where offences were charged under both the Companies Code and general 'criminal' legislation, state law applied to both types of offences. After that date, where similar 'mixed' charges are laid, conflict may arise between federal and state agencies in relation to the same course of conduct (*see* for example, charges laid against Brian Yuill including charges under s. 229

of the Companies (NSW) Code and under s. 176 of the *Crimes Act* (NSW); charges against John Gibson include 239 theft charges, forgery, use of false documents and violations of the Companies Code, including failing to act honestly and improper use of position as company officer). The post-1991 regulatory scheme whereby the ASC and the federal Director of Public Prosecutions will have responsibility for offences under the corporations law may result in enhanced enforcement of corporate criminal law but it will certainly diminish the potential scope for state action against corporate criminals. State enforcers will be restricted in their activities to corporate offences against state criminal law and will be required to cooperate with the federal authorities where one course of conduct gives rise to offences against both state and federal law. The matter of the appropriate distribution of the proceeds of successful confiscation applications has yet to be determined but it would appear that if the new federal scheme is to take effect as intended, the amounts projected to be realised by the states through confiscation orders against white-collar criminals will be far less than anticipated.

Competing Claims and Remedies

The victims of fraud are often numerous and frequently left unsatisfied by the legal process. In the wake of the collapse of the Pyramid Building Society the state government obviated vociferous public calls for indemnification or civil or criminal restitution by guaranteeing depositors funds and levying petrol taxes to cover the costs of its borrowings, once again demonstrating how the modern state tends to socialise losses and privatise profits.

The application of the confiscation legislation into the white-collar crime area, however, raises the problem of potential competition between claimants. For example, where a fraud is discovered, prosecution agencies may decide to take action by laying criminal charges and/or by applying for confiscation orders. Investors and creditors may be left with private law suits to recover losses. Administrative agencies may act on behalf of investors and impose administrative sanctions.

One of the major problems in the area of corporate and white-collar crime is the disparate range of sanctions and remedies which can be employed. Little thought has thus far been given to the relationship between these sanctions, let alone to their harmonisation, and it is not unlikely that the current spate of litigation will highlight conflicts of interest between the state and the individual, between federal and state agencies, between liquidators and the state, between shareholders and companies and others, all of whom will be competing for limited resources.

Shareholder remedies will, in the main, fall within the province of the common law or of 'federalised' state law under the *Corporations Act 1989* and include actions for compensation and restitution. Bankruptcy and insolvency legislation

may also be relevant. The competition for the limited funds which are likely to be available in the wake of a corporate collapse raises questions of priorities. It is generally accepted that fines and forfeitures inure to the benefit of the state, although suggestions have been made for the more specific distribution of the proceeds of confiscation orders to the agencies directly involved in the enforcement of the legislation (Victoria 1990, Chapter 12). However, if the interests of the victims of corporate crime are to take precedence over the interests of the state, a number of techniques can be applied.

Re-directing confiscated assets

Current confiscation laws direct all recovered assets to the government. This is not, however, the only possible outcome. In cases where frauds have resulted in the failure of financial institutions, the forfeiture provisions can be used not only to return the proceeds of crime to regulatory agencies but also for the benefit of defrauded depositors, creditors and other innocent persons (Cf 18 USC s. 1963(6) 1988). Given that the demands on such a fund are likely to far exceed the funds themselves, and the competing claims upon such a fund to underwrite enforcement activities, it would be necessary to apportion the funds in a manner specified by legislation or by administrative direction. Where funds are available, it would be possible to give effect to a restitutionary policy by creating a dedicated trust fund to hold and disburse funds arising out of one criminal proceeding (or a set of related criminal proceedings) to the persons directly affected by that offence. Alternatively, victims could be compensated by a general fund into which all the proceeds of confiscation orders (and perhaps even fines) would be paid. However, this would require amendment to current legislation which provides for the destination of forfeited funds: see, for example, Part X of the *Drugs, Poisons and Controlled Substances Act 1981* (Vic.). Consideration might be given to creating separate funds for drug- related orders and other confiscation orders although such fragmentation is not desirable.

Private confiscation actions

The enforcement of RICO in the United States was not left to federal prosecutors, for Congress also added a civil remedy under the guise of the private Attorney-General rationale. RICO creates a right to civil enforcement of the legislation. This was modelled on the United States antitrust laws and can be seen as essentially a remedial provision providing relief to injured persons, although it can also be regarded as a supplement to the enforcement agencies and as having a punitive and deterrent role (*see* Lynch 1990, p. 945):

> The practical effect of civil RICO has been to accuse a wide range of people of violating criminal laws of a moral, rather than a purely economic nature, in situations where the functional criminal law, as applied by the official administrators of the criminal statutes, would not treat them as criminals.

A civil RICO action (Rasmussen 1990, p. 623) requires that the defendant commit the predicate offence, but not that the defendant be convicted of the offence. The action requires proof of the claim and damage merely on the balance of probabilities. No indictment is necessary before a plaintiff brings an action

under the civil provisions of RICO and civil actions may be maintained without regard to criminal charges. The growth in the use of the civil RICO remedy over the last decade in the United States has been dramatic as plaintiffs come to realise its advantages over the more traditional forms of action.

The epidemic scale of the problems arising from the failure of American savings and loans institutions, in many cases caused by the criminal activity of insiders, together with the unparalleled junk bond and securities frauds, pension and bankruptcy frauds have led to calls to increase the range of predicate offences to include offences such as bank fraud (Note 1989). The emphasis is changing from using RICO against organised crime to using it in relation to common or 'garden variety' frauds. It is now not uncommon for financial institutions to be sued in a wide variety of actions under civil RICO (Mannino 1990).

The types of cases in which civil RICO has been used include businesses suing a bank for charging higher interest than in the loan agreement, a savings and loan organisation suing a former executive for kickbacks from customers for whom he approved loans (*Sun Saving and Loan Association v. Dierdoff* 825 F 2d 187 (1987) and investors in a tax shelter scheme who subsequently suffered both actual losses and loss of expected tax benefits (*Fleishchhauer v. Feltner* 879 F 2d 1290 (1989).

RICO has been used in the context of securities fraud or 'business frauds' (Bertz 1985), including such illegal activities as extensive 'churning' of accounts - that is excessive transactions for the purpose of generating commissions; commissions taken when not agreed to; unauthorised trading on accounts and parking of shares - that is selling stock under a secret agreement to repurchase it at a prearranged time and price. For example, parking of shares was the central allegation against Michael Milliken in a ninety-eight count criminal RICO indictment. In the *Ivan Boesky* case, in addition to penalties imposed by the state, investors brought a class action to collect damages which they allegedly incurred following announcement of the defendant's illegal activities. This was dismissed as it did not claim a RICO violation: *Sperberg v. Boesky* 672 F Supp 754 (1987); affirmed 849 F 2d 60 (1988). This was a putative class action on behalf of persons who bought stock during a certain period and who claimed to be damaged by insider trading. They claimed that the alleged injuries stemmed from a pattern of racketeering activity in violation of the RICO statute, the pattern alleged being insider trading, fraud and commercial bribery. The case was dismissed as no proper cause of action was stated under RICO and there was no evidence that the violation was a proximate cause of the injury (*see also Haroco Inc. v. American National Bank and Trust Company of Chicago* 747 F 2d 384 (1985) affirmed 473 US 606 (1985)).

It has been estimated that up to 1985 90 per cent of published civil RICO cases relied upon the use of mail, wire or securities fraud as predicate offences. Only 9 per cent were the traditional organised crime activities (Mathew 1990, p. 930).

The dangers of using RICO in such contexts are clear. The major problem is the potential conflict of remedies. The traditional private remedies have complex rules regarding standing, culpability, causation, reliance and materiality and the question has been asked whether Congress, in enacting comprehensive enforcement mechanisms over such regulated industries as securities, should create more powerful forfeiture remedies that have the effect of usurping or effectively eliminating these private civil remedies (*see Sedima, SPRL v. Imrex Co* 473 US 479 (1985) per Marshall J). It has been argued that Congress should not, by accident, create a different, and more powerful private cause of action applicable to a particular regulated industry. Legislatures should consider whether existing enforcement mechanisms are fulfilling their original mission (*see* Reed 1990; Mathews 1990).

RICO has also been used against tax fraud, even though it was not a RICO predicate offence, by using the protean mail fraud provisions. (In the United States, the use of the federal mail and wire fraud provision to bring cases within federal jurisdiction and to found a RICO action is common. Where the mail and wire are used in pursuance of a fraudulent scheme, as they almost always are, the potential for the use and abuse of RICO is great.) In *United States v. Regan* 726 F Supp 447 (1989) the government sought RICO forfeitures of $15m for tax evasions of $60,000. Prosecution authorities in the United States insist that RICO is a valuable tool in the fight against white-collar crime but the critical reaction to the perceived misuse of civil RICO is gaining momentum and Congress has been asked to consider limiting its scope. Civil RICO is one variant of the American confiscation legislation that Australia should not emulate, but it would be unwise to ignore the significance of the shift in the use of the legislation from organised crime to white-collar crime as both plaintiffs and prosecutors find that white-collar pockets are more accessible if not deeper than those of their black or blue collared counterparts.

Conclusion

The potential for the use of state and federal confiscation legislation against white-collar criminals has yet to be realised. Unlike the United States, where private RICO actions have, with the help of a highly imaginative and competitive bar, expanded the reach of the legislation into areas previously unimagined. State control of confiscation actions in this country will ensure that any similar development will be slower. But the application of the confiscation legislation to white-collar crime will prove to be an inexorable process as its advantages to the prosecution are made apparent. And when such steps are taken, there is sure to be a loud and public reaction as the more draconian aspects of the legislation come to light (Freiberg forthcoming).

The business world will also come to realise the scope and effect of the confiscation legislation when it finds that it has unknowingly engaged in transactions with persons the subject of confiscation proceedings (Bush 1990). It

will find that property it owns may be liable to forfeiture as a result of its being used in the commission of an offence by a borrower, lessee, customer or even a partner and that it will be put to some expense to extricate its property from the confiscation process. Corporations may find themselves the subject of criminal charges and have their assets frozen pursuant to restraining orders which have the potential to cripple its business (Baird and Vinson 1990). These ramifications have yet to be explored.

In view of the diminished potential scope for action by individual states against corporate criminals, the next few years will need to see the development of a national approach to the use of the confiscation legislation in the context of white-collar crime. Consideration should be given to rationalising the disparate range of sanctions and remedies which can be used in response to corporate and white-collar crime and an attempt should be made to harmonise the various and often competing claims which will be made on the proceeds of white- collar crime.

Whatever the shape of the law of the future, it is abundantly clear that any person contemplating committing, prosecuting or defending white-collar crime will need to have an intimate knowledge of this potent weapon of criminal confiscation.

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Media Coverage of Complex Commercial Fraud

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According to various definitions, fraud is a form of deceitfulness involving theft of money, criminal deception, the use of false representations, dishonest artifice or trick to benefit thieving. It involves one or more parties taking money from others without their knowledge.

Complex fraud is merely a more artful and difficult to trace version of this form of activity, usually involving a number of companies (often $2 companies), the activities of company directors, large amounts of money or assets being shifted - sometimes offshore - and sometimes into other corporate entities, or luxury cars, or homes, antiques, yachts, and paintings, or merely fine living at five-star hotels and the enjoyment of three-star restaurant meals, imported clothes and jewellery. Basically, funds are taken out of a company structure where they ought to be and put into someone's pocket or corporate structure or trust or Swiss bank account, where they ought not to be. It may also involve transfer of funds from investors' accounts to the accounts of the perpetrator of the fraud. Often the money chain is difficult to trace, as it moves around the world, into numbered Swiss bank accounts and in and out of tax havens.

There is a lot of this sort of activity, far more than is found in the newspapers and certainly far more than is seen on television because of the difficulty of getting good picture stories on the subject.

The best television coverage of a recent fraud story was by Channel 9's 'A Current Affair' intrepid reporter in Spain who tracked down the former media magnate, Christopher Skase, in his hideaway in Majorca. One picture said it all - the double storey stone villa with Olympic-sized inground pool, surrounded by bougainvilleas and complete with servants, was not what his creditors had imagined when they read about him living in a 'dilapidated farmhouse in Spain'. Those pictures of Skase basking in the sun with his family cooling off in the pool were enough to convince the federal government the following day that the bankruptcy laws, at least as they apply to the return of passports to bankrupts facing charges and creditors, ought to be changed immediately.

Another classic example was Paul Barry's 'Four Corners' report on the Estate Mortgage debacle, where the camera panned in on the trust prospectus outlining the sorts of secure bricks and mortar investments that would be underpinning the investors' money, and then panned to a few holes in the ground which is what

was actually invested in by the company. Again, pictures like that are instantly powerful. They are worth more than a thousand words. In fact, once the camera has done its job, very little extra need be said.

Unfortunately, these sorts of stories are rare. Television news directors find it a lot easier to use plentiful and horrific footage of car accidents, fires, shootings and chemical spills, than to put faces and pictures to a complex theft piece.

Complex fraud stories are hard to get across on television simply because they are so complicated. They involve a lot of diagrams and events that are far more difficult to get on a screen than into print. One '7.30 Report' producer advised that the only way they work is to be given a lot of time and to follow the story chronologically. It is not possible to jump from deal to deal. The story has to be presented as it unfolds in time, otherwise the viewer is lost.

From a reporter's point of view reporting on complex fraud presents two major difficulties. One is that complex fraud tends to be a complicated and longwinded affair and fails the KIS (keep it simple) test, and the other is that it is riddled with defamation problems, which appear to get worse every week.

Their complexity means that this type of fraud involves a lot of research and checking, which means time and money. It also means that when it is fully researched it is often difficult to turn it into a good read - that is to put it in layperson's terms so that it is easy to understand. Lots of research means you are often not able to see the wood for the trees. Both the writer and the reader can get so bogged down in detail that they lose the gist of where and how the money went.

Unfortunately, if you write these sorts of articles too simplistically you are accused by lawyers of not having researched it thoroughly enough. Yet if you include a lot of the detail of the money trail and the often large number of companies involved you lose the reader in eye-glazing detail. The reader simply gets lost in the foliage. The editors, and sub-editors, for that matter, tend to fall asleep as well while they are reading it and then say they do not have the space. Therefore it is a fine line one must tread.

During the research process the writer has to talk to a lot of people and do a lot of searches, both company and property. The reporter has to try to get as many people as possible to speak on the record, which understandably most people involved in fraud cases are most reluctant to do. Many people are quite happy to talk to journalists and spill the beans, but for all sorts of legal and personal reasons, they do not want to put their names to their comments in a publication. Usually the victims of frauds are prepared to talk, but the employees of the companies involved in fraud, the directors, the investigators and the police are mostly reluctant to put a name to their comments.

Consequently, you end up with a lot of information from unnamed or anonymous sources, and this is a real worry to editors and lawyers. You have to convince

them that your information is sound and that you are not simply making it all up and at the same time, know that if it comes to a defamation action you have enough information to defend it, but that you cannot name those sources without their permission.

This means you have to be prepared to face up to a contempt of court action, which may mean a spell in gaol, which is what has happened a couple of times to colleagues. The threat is always there.

Then there are the legal hurdles. We all know that the law schools are producing too many lawyers. And they are all told to bring in fees by the firms they join. They are expected to go out and find new business, and when they get that business, to develop it and make it pay.

With conveyancing and mergers and takeovers in the doldrums, more and more of these smart young lawyers on the make and keen to earn $200,000 a year salaries look to defamation law as a rich seam of fee growth. These lawyers are ambitious and aggressive and in some cases, openly tout for business. For example, one call I had was from a senior insolvency partner of one of Australia's biggest insolvency firms who was irate about a piece I wrote in our business gossip column about a particularly suspect arrangement a receiver had stitched up with a company director who milked more than $20 million from a company and whose assets the insolvency partner was trying to stretch to meet creditor demands. He rang one morning and said he would sue me over the article. I asked him which bits he particularly objected to and pointed out that he had not been named. He then reluctantly admitted he had not read the piece himself but was acting in response to two telephone calls he had received that morning from defamation lawyers who assured him he had a 'strong' defamation case against him. We had not even named him - although we had named the director of the company in receivership - but the lawyers convinced him anyway that his reputation had been tarnished. I told him if he felt strongly enough about it to sue, but we heard no further. It is a worry though to know that there are teams of lawyers out there, just scanning the pages of publications looking for possible actions they can follow up.

You cannot talk about reporting on complex fraud without also talking about the archaic defamation laws in this country, particularly in NSW, which still require the publication to prove not only that the story is true but that its publication is in the public interest.

What this latter test means is that you can have 100 per cent proof of a fraud having been perpetrated but it only affects a small number of people. The courts may rule it has failed the public interest test, and no matter that the article in question is true, your publication can end up paying huge damages.

The other problem with defamation is that juries tend to award ridiculous damages figures - they pick a number with a lot of noughts out and say that that

is what the publication should pay. In some cases, the people to whom these damages are awarded actually cannot show that their business suffered. In some cases, the people who claim they were defamed are promoted and actually earn more money after the article they complain of was written than before.

Of course the 'telephone number' figures get wide publicity and many think it is worth a try: this may be my new house or car or extended European holiday. They also hear on the grapevine that newspapers and magazines settle because the publication fears the huge costs involved in defending defamation actions. They hear that a case that might run for four or six weeks while the lawyers play word games in court with the meter ticking over rapidly might settle for $50,000, so they have a go.

Reporting on complex fraud therefore is like walking a minefield. It can be enormously exhilarating and satisfying, to expose a clever and shameful scam, and at the same time the process is riddled with anxiety and battles.

It is a hassle. It takes days, sometimes weeks and months to get a good fraud story in print, and then the lawyers cut out all the interesting bits and you are left with a dry story where the reader is forced to read between the lines to work out what is really going on. It can become a very esoteric and frustrating exercise. And sometimes we wonder why we do it at all.

But at the same time it needs to be done, because if we relied on the authorities to expose fraud and put it into the public domain we would wait for ever. It takes months, if not years, for the authorities to investigate fraud transactions and fraudulent activities, to the point where they can lay charges. In the meantime, the public is often unaware of what is going on, and worse, may still be handing over their money to fraudulent operators.

In many cases, after long-running investigations, charges are not laid for various reasons, such as insufficient resources, inexplicable dropping of charges, influence of various sorts being brought to bear on the regulators or because it is decided that the exercise could involve throwing a lot of money at someone who either has no funds left, or has already left the country. Or maybe a cautious prosecutor does not have enough confidence in his ability to make the case stand up in court.

There is little doubt that one of the things that banking deregulation has done is that it has enabled paper entrepreneurs to become flush with funds. Of course, apparent wealth imposes a corporate legitimacy upon individuals.

Further, large amounts of credit provide the structure to create or take over companies, to facilitate the process of directors taking company money via the charging of excessive fees and administrative costs without telling the shareholders or auditors of the company that that is what they are doing. Money could thus be taken 'legally' from the corporate structure until there is nothing left, except collapse.

An example of this is early last year when an expatriate Australian businessman had a property he wanted to sell. What better way to do it than to gain control of a suitably cashed up company to buy it at a price which guaranteed a substantial profit? The businessman, incidentally, was well practised in this technique of making money and is having his problems now with the authorities, but as far as we know is still living well offshore and may never be back.

Through a contact at an overseas bank, he arranged finance for four of his friends to buy shareholdings just under the 10 per cent disclosure limit. We will call his mates John, Peter, Daniel and Rudolph, all of whom were provided with sufficient money for each to buy 9.9 per cent of the selected company - a cashbox following the sale of some of its assets. Let us call the selected company Generous Ltd.

These were lucky guys. As well as being given the money to buy the shares, sharebuying was all arranged for them from overseas. They did not even have to lift a phone to put in the orders.

It was all very well orchestrated, involving three people and a trust which hid the identity of the fourth shareholder, three different firms of solicitors, two Swiss banks and four stockbroking firms. The directors of the company noticed the turmoil in their share register, but were unable to ascertain anything other than the probability that their stock had found new favour in the market. If an investor remained under 10 per cent of a company, Australian law at the time did not demand that it make a declaration as a substantial shareholder. This has since been changed to a 5 per cent threshold.

The next thing the directors knew of all this was when they received a visit from one of the four men, to inform them that he spoke for 40 per cent, or sufficient shares to unseat them. Surprisingly perhaps, they all went quietly, and they include some well respected names.

Very quickly after this happened, the entire cash reserves, over $7 million, of the company were lent to a property development company - let us call it Unlimited Horizons Ltd - controlled by friends of the expatriate who funded the four into buying shares in Generous Ltd. There were no direct or even indirect links, through shareholdings or directors between Generous and Unlimited Horizons, and for all intents and purposes, they were separate and unassociated.

This property company then used the funds to help it buy the asset the expatriate wanted to sell, for a 300 per cent profit - incidentally.

At precisely this time, the chairman of Unlimited Horizons was fortunate enough to have a substantial sum deposited into an offshore bank account of one of the banks which had financed the earlier share buying. This was all very clever, and our businessmen were smart enough to realise that they would have to cover their tracks sooner or later.

Less than a week after the payment was made, Unlimited Horizons launched a paper takeover offer for Generous Ltd. The directors of Unlimited Horizons were sufficiently confident and perceptive in their Part A statement to declare that Generous Ltd. would not require repayment of the money borrowed . . . in the short term at least.

After six months or so and several renewals of the offer, Unlimited Horizons got to about 80 per cent of its target - not enough, because it still had some disgruntled minorities asking all sorts of questions. Eighteen months later it is still unsettled. There are a lot of angry minority shareholders with their shares virtually worthless, but it appears that the corporate watchdog may, after several articles, at long last be taking an interest.

This was a story that unfolded over a period of months. The lawyers recommended against running it. We ran it and were sued. But we are confident that the defamation action will not go anywhere, because we have a great deal of documentation that the parties will not want to see aired in a court.

The easy credit conditions of the past five years have also enabled many so-called entrepreneurs to hire the best lawyers to send threatening letters to anyone who dares query or criticise the activities of the directors or company officers involved.

In nearly every case fraudsters are assisted in their endeavours by teams of lawyers and accountants, sometimes from Australia's largest firms. These professionals then get most upset when found out, threatening all sorts of defamation actions of their own for having their reputations impugned by being mentioned in the context of any hint of fraud.

The easy credit conditions of the eighties have provided plenty of facilities whereby investment funds provided by shareholders can be converted into the personal wealth of directors. Apart from the sort of share deals described a few moments ago, companies can be operated to facilitate a wide variety of fees being obtained whilst it continues to exist. The shell is then dispensed with.

Some white-collar frauds are quite simply 'bucket shop' operations. The company in question promotes an investment which sounds attractive and secure, and may plug into some new vehicle created by changes in regulations or conditions. But instead of the money being invested in these areas, they go to paying sales commissions, directors' fees, entertainment costs, cars, holiday houses and so forth. During the mid-eighties, several such schemes involved options and commodity or currency futures.

The leveraged currency scams which raged for three years were an example. Hundreds of thousands of investors who thought they had found the perfect scheme to play the currency futures and commodities market with limited risk and relatively little money, sank a fortune into the pockets of a number of operators after being offered returns of up to 300 per cent on their money in the

space of 6 months.

The investors, of course, were not told that all of their investment instantly became a fee and they started with nothing and it was only when the currency or commodity moved substantially in the direction that they were punting that they began to claw back their initial investment, which had evaporated in fees.

Needless to say 98 per cent of them never saw their money again. Some perceived the scam and managed to hustle for a return of their original funds. A conservative $25 million was siphoned from life savings in this way by smart operators who used it to fund a high lifestyle, or set up accounts in their names overseas, pretending to use the funds to set up legitimate overseas operations, again with the help of lawyers and accountants.

Of all the operators in this type of business - there were about 10 during 1985 and 1986 - all folded, some shot through, but only four people were charged. Of these, only two lots of charges still stand. One lot of charges were dropped in return for the charged person giving Crown evidence. Another had charges dropped against him because a key Crown witness disappeared. Two are awaiting trial. The rest are believed to be living in England and in Queensland.

We had a lot of defamation threats while we were exposing that fraud over two years. None came to a writ, but we are still defending an action brought by one of the accountants involved, who helped prepare the tax returns and the accounts, and who was aware of the large amounts of money going offshore, and also another brought by a solicitor who was outraged when we found out that he managed to get his fees paid two days before his clients fled this country as the NSW Corporate Affairs Commission, as it was then called, closed in on them.

This was a relatively simple fraud. The more complex ones are achieved by constructing a hopelessly complex web of companies with dozens of subsidiaries extending from Panama to Hong Kong.

The object is to have such a confused network of cross shareholdings involving nominee companies, offshore family and discretionary trusts that the journalist has no hope of tracking them with limited resources.

In addition, any other type of legal corporate form can be thrown in to turn the barely comprehensible into the incomprehensible corporate picture. This corporate scenario is not too difficult to create with the help of the right lawyers and creative accountants who help directors decide what level of profits they want to achieve and manipulate the figures accordingly to achieve that.

Often there are secret put and call options to muddy the waters even further. This is a cunning device which enables a company to announce a large profit which makes investors happy. But what they do not know is that the transaction which generated the profit provides the buyer with the option that at a later date the entire transaction can be reversed so that the original profit is a fiction.

Other techniques to create a fictitious result to enable more funds to be borrowed or attracted from the public include engaging in off balance sheet transactions or the sale of assets to associated companies at inflated prices to produce excessive profits.

As well as intimidating companies, defamation laws can be used to intimidate journalists, by suing them personally. The supreme irony is that company directors who do not have a twinge of guilt about robbing others suddenly show themselves to be incredibly sensitive souls when they are written about critically. They also have no qualms about further using shareholders' funds to defend their reputations.

The effect of these draconian defamation laws is that many good articles criticising the running of companies before they crash and written by highly competent journalists are aborted before they are printed.

A further problem we face is evidence. Often when we go through the discovery process we find many of the documents we need to produce as evidence in court have been consigned to the shredder, or the bottom of the river. If a person commits a serious offence and documents are destroyed after a subpoena has been issued ordering their production, there is little anyone can do about it if the documents have already been destroyed. In any event, oral deals are difficult to prove.

Another minefield is this. Even if you know someone is about to be charged, you cannot say it. The lawyers point out the dire consequences of stating that someone is to be charged and then the charges do not get laid. Journalists retort that we know they will because we have spoken to the investigator, or the corporate affairs commission, or the fraud squad and they are preparing the charges. But 'will' is a word lawyers do not comprehend. It has a nasty future connotation and to them is akin to fantasy land or Disney's never-never land. Lawyers deal only with facts, and things that have happened in the past history. Therefore you wait until the charges are laid, by which time background comment is sub judice and the reporter is restricted to reporting on what the charges are and what is said in court or at the subsequent committal proceedings.

These proceedings are often two or three years down the track. By this time the editor does not remember the fraud and if he or she cannot remember it no-one else must be interested.

You go on with the story anyway, promising the lawyers you have the evidence, hoping if you get it and it all falls into a big hole and the charges don't get laid or are subsequently dropped, and you get sued, that you can rely on getting access to investigator's reports and corporate affairs investigation papers during the discovery process. You acknowledge that a journalist's life is a thankless one, and move on to the next project.

At times serious economic pressure is also brought to bear on journalists when articles are written about big companies who are also big advertisers. An example of this is what happened following the 1986 article on Alan Bond which dealt with the irregularities in Bond Corporation purchases of Australina Occidental Petroleum and of Burmah Oil's petroleum and gas interests in the Cooper Basin.

The bottom line was an allegation that Bond had made $16 million in tax free profits for his family company Dallhold by cashing in on public company deals and without disclosing the Dallhold benefits to Bond Corporation shareholders.

The person who broke the story, Martin Saxon, was at the time a senior investigative reporter with the *Western Mail*, then a quality weekly newspaper owned by Robert Holmes à Court's Bell Group. The *Western Mail* refused to publish. Saxon took the article and all his background research to the *Sydney Morning Herald* (SMH). The SMH journalist, Colleen Ryan, spent six weeks working right through the research and independently checking the facts.

Twenty-eight questions were put to Bond Corporation and a meeting was held with five senior Bond Corporation executives, including Alan Bond and Peter Beckwith. The Bond Corporation executives refused to deal with any of the detailed questions.

The SMH decided to publish on the grounds that Bond Corporation was being investigated by the Western Australian Corporate Affairs Commission (WA CAC) and that the documentation appeared to be conclusive.

Bond sued and withdrew all Bond group advertising from the Fairfax group. At the time, Fairfax had Channel 7 and the Macquarie radio network. Bond advertised Tooheys, Waltons Bond and Hyundai. The advertising amounted to $8 million a year and it was withdrawn for 12 months. The defamation actions launched by Bond were not proceeded with, the advertising eventually returned without any apology ever being printed.

Two lessons can be drawn from this experience - one is how difficult it is to publish controversial articles in provincial centres such as Perth. The second is the reaction of the authorities.

When the Fairfax group was prepared to risk a big slice of its advertising revenue and to run the risk of a costly defamation action, the authorities did not put their neck on the line at all. The WA CAC concluded there was no case to answer under the criminal law and did not bother to check any civil breaches. This was despite adamant statements from senior investigators over a period of several weeks that this was a very strong case and that several sections of the Companies Code had been breached.

The editors and journalists who pushed for publication of that Bond Corporation piece were subjected to years of doubts and questionings. Now, in the 1990s we are instead questioned on why it took so long to expose the WA entrepreneurs. If

charges are laid, and the fraudster eventually gets to trial, the road is far from clear. Most trials involving company law are ridiculously complex and lengthy. So you have a problem with cost. You also have a problem with intelligent jurors not wanting to sit on a long case and finding all sorts of excuses for not being available. They not only have to battle their employers to get the time off work but have a further battle trying to stay awake while a sea of documentary evidence is put before the court. Too often the trial is heard by a jury of people who are intellectually and socially unsuited to decide the complex issues presented to them.

It takes years to get these cases to court - often up to eight or nine years. By this time memories dim and witnesses are unsure of events. So there is more doubt. Witness die or disappear to other parts of the country. And the jury thinks it all happened such a long time ago anyway.

And of course if the jury is left with any doubt as to the defendant's guilt - and in many cases they do simply because of their limited understanding of how the evidence fits together - they have to hand down a not guilty verdict. If by chance they do find the defendant guilty, more often than not the magistrate or judge is impressed by the defendant's civilised demeanour, good quality suit and impressive references, and they end up getting weekend detention rather than a stiff sentence.

Reporting trial proceedings presents its own problems. It is not only a battle to stay awake, but in a trial involving a lot of documentary evidence, the reporters do not get access to the affidavits, letters, memos and expert reports which the prosecution, defence, witnesses and the judge have access to. So half the time the reporter sits there guessing what might be in the document and tries to fit a jigsaw puzzle together from the few words that are spoken.

So why do we perservere with it? The reason is that it is important. The public want to read about it. It is how frauds are perpetrated, who the victims are, how much money is taken, what is wrong with our laws that people who commit frauds can get away with them and what happens to them when they get caught; and how to avoid them. But it is a minefield.

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Responding to Fraud in the 1990s

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Fraud is not just a criminal offence; it is a major social problem. In determining how we should respond to it in the 1990s we must bear that in mind. It is not good enough to concentrate just on the criminality involved as we have in the past. A different approach is needed.

In simple terms, fraud is the art of deception for gain. Dishonesty is an essential ingredient. Fraud varies in type, size and complexity. It is encountered in many different contexts. It is very much a creature of its time; it changes as society changes, with all its different attitudes and technological advancements.

Fraud is generally covert and therefore difficult to detect. Many devices are employed to conceal the way in which the fraud was perpetrated. Typical of the ingenuity and sophistication generally found in serious fraud is the case of *R v. Rosenthal and Ors* which concerned a revenue fraud:

> We are satisfied the proper characterisation of this scheme is that it was a sophisticated and large scale conspiracy designed to defraud the Commonwealth. It was sophisticated, insofar as its creation, manipulation and operation, required devious intellects to devise, professional and technical skills to manage, application and tenacity to operate. The scheme, in its pristine condition, was intricate and deliberately embellished with legitimate aspects in order to make it appear attractive. The manoeuvring of the taxpayer's money into and out of superannuation funds in Liechtenstein and Swiss Banks gave the scheme, to the uninitiated, a superficial reality. It was deliberately designed to beguile. The very heart of the scheme was to make it complicated, and thus less easily detectible. The scheme had in-built 'audit breakers' which were devices for making it impossible for an auditor or the Commissioner to follow the flow of funds. This was a deliberate ingredient of the scheme, designed not to obscure its workings, but to go further and make the various fraudulent transactions undetectable. It is probably this reason which inhibited the Commonwealth authorities from speedily untangling the scheme (Rosenthal and Ors, unreported decision of the Victorian Court of Criminal Appeal, 26 June 1987, pp. 5, 6).

We will never completely eliminate fraud, but we should be able to reduce it significantly. As in all forms of crime, there are varying degrees of seriousness. In this paper particular emphasis is placed on serious fraud, which is generally masterminded by highly intelligent and clever offenders. Such criminal behaviour is generally difficult to detect, costly to investigate, and requires great skill to prosecute. That should not deter our commitment.

Setting the Scene

The 1980s will be remembered for the extraordinary excesses perpetrated by corporate Australia. It is only now that we are getting to the heart of the matter and revealing much of the wrongdoing of that decade. Clearly, the appropriate structures to identify and deal with the problem, were not in place at the time. The law enforcement agencies on which we relied were ill equipped to deal with the problem. Like the taxation frauds of the 1970s, the corporate crimes of the 1980s were allowed to flourish largely unabated, at great cost to the community and our reputation.

They both occurred against a backdrop of laxity and impotence on the part of our law enforcement and regulatory institutions and an attitude of resignation on the part of the public.

There was little our established institutions and authorities could or did do against them. In both periods, it was not until Royal Commissions, Special Investigations and the appointment of Special Prosecutors that the frauds were effectively investigated and prosecuted (*see*, for example, Costigan 1982; McCabe and Lafranchi 1982; Australia 1983-85; Western Australia 1990; Royal Commission into the Tricontinental Group of Companies 1991). A package of measures were also introduced which included the *Crimes (Taxation Offences) Act 1980* and the *Taxation (Unpaid Company Tax) Assessment Act 1982*. This is a poor indictment on our criminal justice system, and our existing investigatory and regulatory institutions.

Clearly our method of dealing with the problem has been inadequate, and neither responsive nor effective. The fact that we have had to rely on Royal Commission or Special Investigations to get to the truth, indicates that our existing institutions are letting us down.

The prime objective in the 1990s should be to tackle the problem of fraud in its entirety, recognising it as a social problem, and not one simply for lawyers and the law. We should aim to respond to fraud with the same dedication, sophistication and agility with which it operates. In meeting these objectives it is imperative that we have the appropriate structures in place.

Much more will need to be done in the field of education and the prevention of fraud. There must be a committed and continuing program of monitoring and controlling the problem, and where necessary anticipating and focusing upon new areas of fraudulent activity. The measures required may include education programs and recommending changes in structures, systems and work practices and procedures.

There are many obstacles. Hopefully, some will be eliminated, or at least lessened, so that we can get on with the job of fighting fraud. This paper analyses those obstacles, and propose measures and initiatives to tackle the overall

problem.

Some Obstacles

Too Many Laws, Rules and Regulations

There are too many sets of laws, rules and regulations dealing with the same mode of conduct. The business sector is riddled with requirements emanating from all tiers of government, professional bodies, work organisations, government agencies and a host of other bodies having regulatory responsibility for particular areas such as corporations, financial institutions and trade practices. It is therefore necessary that a uniform and consistent set of laws, rules and regulations be produced in plain English that are clear and precise in their terms. Admittedly, in some areas there will need to be specific provisions dealing with the conduct of people peculiar to that field of endeavour. Whether it be in the public or private sector, the conduct of business is much the same. Honesty and integrity are essential no matter what field of work you may be in. In other words the principles are the same and that surely should be reflected in a set of laws, rules and regulations that can be uniformly applied to most fields of endeavour.

Lack of Uniformity

Different jurisdictions have different requirements. It is not surprising to find significant differences between the Commonwealth, states and territories in the criminal law and procedure, and rules of evidence. Recently, Mr A. Roden QC succinctly described the problem when he said:

> We have nine separate and at times conflicting systems of law, sometimes contending with one another for supremacy, frequently causing confusion and working injustices, and always at least threatening to impede our national objectives.

Criminal conduct knows no boundaries and this is particularly true of fraud. Yet, in its effort to investigate and prosecute fraud the criminal process has to cope with different provisions - both substantive and procedural - in different jurisdictions. It is a poor state of affairs that there is no national and uniform system in relation to the criminal law even though corporate behaviour is now regulated under a national system. Mr M. Weinberg QC (1991) recently highlighted the unsatisfactory state of affairs that exists in the prosecution of Commonwealth offences and the various jurisdictions of this country. Mr Weinberg urged for the introduction of a national and uniform set of rules of procedure and evidence. Whilst Commonwealth offences are uniform throughout the land, procedure and evidence remain governed by state law. Even more ludicrous is the fact that conduct which occurs in one state may give rise to criminal liability whereas in another state it may not.

In 1989 the Commonwealth enacted the *Corporations Act* and the *Australian Securities Commission Act*. The Australian Securities Commission replaced the National Companies and Securities Commission and the State Corporate Affairs Commissions and is the sole regulatory body for corporations and securities. As a

consequence the Australian Securities Commission and the Commonwealth Director of Public Prosecutions will be responsible for the investigation and the prosecution respectively of corporate crime. This is a significant and overdue initiative but may not in itself be the answer to serious fraud.

International Nature of Fraud

International cooperation is absolutely imperative, if we are going to combat fraud effectively. Fraud transcends national boundaries. As the business community and their commercial activities become more international, so does fraud.

Overseas investigations can present serious difficulties in serious fraud matters. The Commonwealth enacted the *Evidence Amendment Act 1985* to obtain overseas evidence, and the *Mutual Assistance in Criminal Matters Act 1987* to enter into treaties and arrangements of mutual assistance with other countries to facilitate obtaining evidence and other help in relation to criminal proceedings. Although these are important and significant initiatives, the revision of these provisions is urgently required as existing provisions for obtaining evidence from overseas are cumbersome, expensive and at times impracticable (*see* Weinberg 1991, pp. 21-6).

Our efforts in this area need greater attention. Our existing provisions need strengthening, and our international focus must be increased. This factor probably highlights the need to strengthen and tighten controls within our national boundaries, as we monitor more closely transactions into and out of Australia. More particularly there appears to be an inadequate system of monitoring and checking the activities of people and corporations outside Australia and immediate action should be taken in this regard. Clearly, what a person or company does elsewhere may be very relevant to what they do or are allowed to do in Australia.

Too Many Bodies

As a relatively small nation we have too many bodies responsible for policing and regulating people's behaviour. The fragmentation of law enforcement responsibility is a serious problem. In general there is insufficient cooperation between these bodies, and this results in unnecessary duplication and competition for areas of responsibility and resources. Disorganised law enforcement is a blessing for organised crime. We should strengthen our main or national law enforcement agencies: amalgamation may be necessary.

Role of the Professional and Professional Bodies

A characteristic feature in most serious frauds is the use of various commercial and legal devices designed to conceal the perpetration of fraud. Invariably this is all done behind a veneer of respectability and legality. Without the participation of professionals, whether wittingly or otherwise, serious fraud could not succeed.

Professionals should be made to account for their involvement in such activities.

Professionals and professional organisations could and should assist far more in the prevention and detection of fraud. In fact, professionals are a readily accessible source of information about current trends in fraudulent behaviour. Stricter duties should be imposed upon professionals requiring them to report any suspicious or illegal activities.

Financial institutions should be more accountable. Essential to any serious fraud is the ability to transfer large sums of monies internationally. That cannot be achieved without utilising financial institutions. There must be greater accountability and recording of financial transactions. Recent initiatives in this regard are proving successful but more needs to be done. The Cash Transactions Report Agency (CTRA) is a first step in the right direction. It is essential that international financial transactions be monitored in the same way that the CTRA monitors movement of funds into and out of Australia. Additional powers of inspection to audit and examine financial records should be given to the CTRA in relation to suspicious financial activity. Additional obligations should be placed on financial institutions to report suspicious financial activity.

Response to the Problem of Fraud

Education

Educating people so that they understand their obligations and responsibilities is a very important task. We are doing very little, if anything, constructive towards that end. Education will enhance people's appreciation and understanding of fraud. They will be made to appreciate the consequences of any fraudulent behaviour. At the same time, public awareness can stimulate an expectation of integrity.

Law enforcers have a role to play as law educators. Some law enforcement agencies have shown a number of initiatives in this area and this should be encouraged. Law enforcers should not operate behind a veil of secrecy, but should be prepared to involve themselves in public education programs designed to increase community awareness and individual appreciation of the laws and their obligations and responsibilities. Public participation in this process is essential and may go a long way to changing community standards and codes of behaviour.

Fraud Prevention and Control

Fraud prevention and control must be undertaken by both the public and private sectors. The first serious examination of fraud on government in Australia was undertaken by the Federal Government in its *Review of Systems for Dealing with Fraud on the Commonwealth in 1987*. The report made a number of recommendations for improving the efficiency of existing arrangements. Basically, it concluded that the responsibility for the prevention, detection and investigation of fraud rested with the government agency concerned and that the

more serious matters should be referred to the Australian Federal Police. Recommendations were made encouraging government agencies to train staff in fraud prevention and detection, and regularly to communicate about such matters with law enforcement and prosecutorial bodies such as the Australian Federal Police, the Office of the Director of Public Prosecutions and the Australian Government Solicitor.

After the release of the report, various attempts were made to follow some of the recommendations with education programs and greater liaison between the federal agencies, but that appears to have tapered off considerably, with most agencies doing very little, if anything at all, in the area of fraud control. It is not good enough merely to put together a document purporting to deal with fraud prevention and control. A policy is one thing; a continuing and effective implementation program is another. An adequate system of monitoring, detection and review is essential.

A similar initiative needs to be undertaken with other sectors of government and in particular the private sector, but there needs to be a continuing commitment to the program.

The New South Wales Independent Commission Against Corruption, as part of its objective to minimise official corruption in the state, has a corruption prevention strategy. Although the strategy deals with corruption, it is readily applicable to the subject of fraud. The strategy is predicated on the principle that it is better to prevent than to cure a problem. A problem may be possible to cure after it has been identified, but with no certainty either that the cure is complete or that the problem has not done irreparable damage.

The corruption prevention work of the Commission depends much on the cooperation and wholehearted involvement of management and staff of the agencies we work with. The strategy recognises that corruption prevention is a managerial function and that administrative and managerial failures in an organisation may give rise to loopholes that could be exploited. Such exploitation will undoubtedly jeopardise the normal operations of the organisation. It is therefore essential for managers to watch out for opportunities for corruption and introduce preventative measures where appropriate. The strategy also recognises that a system of accountability is a valuable tool in the attempt to eliminate opportunities for corruption. Accountability should result in the pinpointing of problems before they become serious and allow potential loopholes to be closed (Independent Commission against Corruption 1990).

The Commission undertakes its corruption prevention work by conducting formal studies, critically examining existing systems and procedures for the purposes of identifying weaknesses and recommending methods of improvement. The Commission monitors the progress of implementation of recommendations and provides support where necessary. As corruption prevention plays a critical role in the process of change, the Commission participates in working groups with an

organisation in relation to any proposed change of legislation, systems or procedures. In addition the Commission holds seminars and gives advice on corruption prevention matters.

Detection

Detection of fraud is regrettably one of the areas that appears to be most neglected. Many organisations which have a fraud prevention and control program do not have a system of monitoring and detection. It seems the prevailing attitude is that if you have an established fraud control program, then there is no need to worry about fraud taking place. The fact is that a fraud prevention or control system only makes things a little more difficult for the dishonest. Sometimes it makes things considerably easier, because complacency sets in.

The introduction of compliance officers in other Western countries has been very successful. Much could be gained, and a great deal of serious fraud prevented and detected, by appointing compliance officers within public and private sector organisations. Their responsibility is to ensure that the organisation is complying with the law in all its dealings. Primarily the function of a compliance officer would be to examine the activities of the organisation and the conduct of personnel with a duty to report irregularities and wrongdoing. The compliance officer would be akin to an internal roaming police officer. To some degree auditors perform this function, but they are limited to financial assessment and do not perform a fraud audit which is what is required.

In 1978 the United States introduced the Inspector-General Act, bringing together audit and investigative activities within the various arms of government. The Act was based on the notion that waste, abuse and fraud could be most effectively controlled by altering the way that information about such activity was generated, reported and circulated. The establishment of the Inspector-General's Office was designed to increase the scale of effectiveness of audits and investigations, and to ensure the dissemination of information which was gathered to departments, government and the public. The concept and principles of such an office should be followed in Australia.

Investigation

The fragmentation of responsibility for law enforcement is a major obstacle in the fight against fraud. There are too many bodies with investigatory or law enforcement responsibility. This results in poor investigation, because of the lack of cooperation and definition of responsibility.

The Roskill Fraud Trials Committee Report (1986) concluded that the principal weakness in the process of investigation and prosecution of fraud was the fragmentation of law enforcement organisations and the diverse nature of their responsibilities. It has generally been acknowledged that extensive criminal activity has been successful because it traversed the areas of responsibility of a number of law enforcement agencies and government departments which failed

to cooperate with each other. Regulatory agencies are less inclined to investigate fraud and on some occasions cover up any fraud detected because of embarrassment and disruption to the agency.

A more basic requirement is the need to ensure that law enforcement agencies with responsibility to investigate fraud, are capable and equipped to do so. Most law enforcement agencies neither have the expertise nor the resources to engage in long and complex investigations. It is essential to bring together a wide range of skills and experience for the investigation of serious fraud.

The National Crime Authority (NCA) in recent announcements has noted that it will concentrate its efforts in investigating white-collar crime. There are a number of other law enforcement agencies such as the Australian Federal Police, Australian Securities Commission, the relevant state Police Fraud Squads and a host of other regulatory and law enforcement agencies that have as their responsibility the investigation of serious fraud. There are too many bodies and there is an urgent need to rationalise our law enforcement effort into one single body equipped with the special powers and skills to deal with serious fraud. Such an initiative occurred in the United Kingdom with the establishment of the Serious Fraud Office. In light of the NCA's announced focus on white-collar crime, consideration should be given to changing it to a Serious Fraud Office similar in nature to the office in the United Kingdom. However, failing this, it is at least imperative that the various bodies coordinate their activities and clearly define their areas of responsibility.

Prosecution

Fundamental to a successful prosecution of serious fraud is the early involvement of lawyers in the investigative process to ensure that the investigation and evidence gathering are proceeding on the right track. This is yet another compelling reason for the establishment of a Serious Fraud Office. Such an office would be responsible for the investigation and prosecution of serious fraud. Additionally, its responsibility should include education, fraud prevention and control, and the ability to recommend to government and government agencies appropriate action to minimise fraud.

Due to the myriad of matters that law enforcement and prosecutorial bodies have to handle, there is a risk that serious fraud will suffer, because of its difficulty and complexity. This is a specialist area requiring special skills. It cannot be effectively or properly handled by maintaining traditional concepts. It is imperative that a multi-disciplinary approach be taken when investigating and prosecuting serious fraud.

The Office of the Commonwealth Director of Public Prosecutions until recently had major fraud branches within its regional offices. These specialist branches have regrettably been disbanded, and the lessons learnt and the skills developed are likely to be lost.

In the United Kingdom the Serious Fraud Office was created by the Criminal Justice Act 1987 for the purpose of investigating and prosecuting cases of serious or complex fraud. Special powers were granted to the Serious Fraud Office for the purposes of investigation. A range of other measures was introduced under the Criminal Justice Act 1987 designed to facilitate the just, expeditious and economic disposal of serious or complex fraud cases. These measures included the introduction of pre-trial procedures and changes to the rules of evidence.

Confiscating Criminal Assets

Confiscating criminal assets is an important response to the perpetration of fraud. Removing the profit from fraud reduces the motivation.

Anybody convicted of fraud should not benefit by their wrongdoing by using or keeping the proceeds of their crime. When a person commits an armed robbery and steals money from a bank, we do not allow him to keep the money. It is not his to use or keep. The same principle applies to fraud. Admittedly, the context in which money is obtained in a fraud may not be as obvious as an armed robbery. However, if there is a conviction, then the money taken and any profits generated should be confiscated. There is a tendency with law enforcement authorities to deal only with part of the criminality of a serious fraud. This can have deleterious consequences in any civil recovery action. While it is difficult and in some cases impossible to present to a court all the criminality involved in a serious fraud, concentration on only part of the criminality can have an impact on the amount of criminal assets that can be taken. Rather than being a disincentive, it may be an incentive for people to continue with their fraudulent activities, if the result is going to be only partial treatment of their conduct with only partial punishment and partial loss of the proceeds of the crime.

Regulatory Action or Remedy

Far too often people are investigated and prosecuted for criminal offences with no attention being given to the underlying problem that brought about the wrongdoing in the first place. The law enforcement effort is mainly devoted to processing cases rather than solving underlying problems. Also, it is only concerned as to whether a criminal offence has occurred or not and therefore the wider issues may be of no relevance or concern to a criminal court. Once a criminal court punishes a wrongdoer, that invariably is the end of the matter. While it has not been the function of the court in the past, serious consideration should be given, in cases where apparent underlying problems are the basis for the crime, for the court to report and recommend to government, action concerning the problem. In many instances vital information about the inadequacies and deficiencies of systems and procedures arise in court hearings and yet nothing is done about it. No administrative action or remedy is taken to deal with the problem. So the crime is committed again, and the courts deal with new offenders. The process continues and yet the underlying problem remains untouched, tempting new offenders to commit crimes.

The Independent Commission Against Corruption was established because our

legal system was unable to effectively tackle the problem of official corruption. The Commission was given a wide range of functions to investigate corruption and included providing advice to public authorities on ways in which to prevent corruption and to educate public authorities and the community regarding the detrimental effects of corruption and the importance of maintaining the integrity of public administration. It was recognised in setting up the Commission that important though it is that the guilty be brought to justice, this is an area in which disclosure of the facts and discovery of the truth can be more important than punishment of the individual. Exposure of the problem of official corruption and doing something about the problem was more important than securing convictions. That has been the approach taken by the Commission. The Commission has been given extraordinary powers for the purpose of getting to the truth and reporting to parliament about the outcome of its investigations. Such reports describe and examine the problem and recommend changes and action. The Commission is also empowered to recommend administrative action or remedy to be taken in dealing with the problem of official corruption. This is a very important function. Much can be achieved by exposing a problem and making changes to structures, practices and procedures to prevent or at least minimise fraud.

The establishment of an inquisitorial body may be the answer. However, the problem with our existing institutions still remains. The criminal justice system is obviously in need of reform. A change of thinking is required and a new approach.

The Commission is able to examine and deal with the overall problem and make recommendations to government to take action in relation to it. An approach of this type may be a more effective way of dealing with the problem of fraud than our traditional and conventional methods.

Solving the problem

Ronald Goldstock (1990), Director of the New York State Organised Crime Task Force, recently emphasised the need to examine problems of corruption as discrete problems to be analysed and solved using a variety of remedies. Mr Goldstock's comments equally apply to situations of fraud. He pointed out that we tend to react to problems of corruption haphazardly. Mr Goldstock stressed the need to create the capacity to develop and plan individualised programs of treatment in an organised way. He further stressed that in addressing the problem appropriate analysis is needed to design the appropriate remedial action.

In analysing the problem, Mr Goldstock said that the first step in the process was to recognise it and its symptoms. The second step was to understand the mechanisms which effect the integrity of the system. Mr Goldstock put forward three concepts that may help in pursuing the analysis of these mechanisms. The first is corruption susceptibility which concerns the levels of corruption. The second concept is corruption prevention which concerns the fruits of corruption. The third concept is corruption resistance, and focuses on characteristics of

particular agencies which militate against or tend to discourage people from misuse or abuse of official positions even when the susceptibility or potential corruption exists.

Mr Goldstock placed considerable emphasis on ensuring that issues be visible and be publicly aired in an effort to mobilise public opinion or support.

However, solving the problem requires a capacity to do that which you think is necessary to correct or remedy the problem. Therefore, appropriate powers need to be given to facilitate effective problem solving. Furthermore, problems of fraud will only be solved by a variety of remedies. A fresh approach with fresh ideas needs to be employed in the fight against fraud. If we are to do something about this pattern of behaviour we must consider new approaches and in some instances assume additional or new roles.

Conclusion

Responding to the problem of fraud in the 1990s will require an innovative and broad approach. We must not wait for a crisis or a scandal before we act: consideration should be given to the establishment of a serious fraud office in Australia. Its function should not be purely investigatory and prosecutorial. It should have an educative and preventative function as well. Education and prevention are probably the most important weapons in the fight against fraud.

The ability to change structures, systems, work practices and procedures and to direct action provide a powerful blow to fraud. A serious fraud office equipped with these responsibilities would offer and do much in reducing the social problem of fraud as well as the crime.

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