

Gambling with recordkeeping compliance

On the whole Australian businesses managers and even senior public servants are unreceptive to the concept of recordkeeping compliance.

It's not unusual to hear managers say "bugger compliance – we need to focus on the business solution" or "we'll take the risk of not complying" or "it won't happen to me, mate!"

Chances are that it will happen and it could be sooner than they think, because the recordkeeping practices of many companies are increasingly under close scrutiny by the courts, regulators, auditors or other outside parties.

What penalties if any are there for poor record keeping practice?

Until recently the chances of a company having their recordkeeping knuckles rapped were slight, and any penalties imposed for poor recordkeeping were inconsequential. It was therefore understandable that many executives assessed record keeping compliance as low risk and focused instead on other organisational priorities.

These attitudes are slowly changing, helped along by recent events such as the collapse of Enron, Arthur Andersen and HIH. The spotlight is on records management systems and practices.

The cost of electronic discovery

It's taken a long time for many managers to accept that electronic documents and email really are records and should be managed accordingly. For some the trigger to understanding is the experience of being involved in a legal discovery exercise where they discover that the cost of electronic discovery within a chaotic electronic environment results can be prohibitively high. Industry experts estimate that costs of fulfilling a single discovery request can run from tens to hundreds of thousands of dollars. The cost to the White House of recovering 246,000 emails from approximately 4,900 backup tapes was estimated at US\$ 10 million.¹

The cost of lost litigation

The recent \$1.45 billion judgment against Morgan Stanley in the Ronald Perelman case (May 2005) is a stunning example of what can happen when an organisation cannot reliably produce e-mails for the court. In this case the judge ruled that Morgan Stanley "deliberately" violated her orders.²

McCabe v British American Tobacco Services Ltd brought to our attention Justice Geoffrey Eames who struck out British American Tobacco's defense in the Victorian Supreme Court, citing that the creation and implementation of a document retention and destruction policy was prejudicial to the Claimant's right to a fair trial. The Victorian Court of Appeal (6 December 2002) overturned the decision of the Victorian Supreme Court, but the cost to British American Tobacco was still high given that their public image suffered as a result of the first decision.³

More recently, two employees of a Western Californian branch of the INS were indicted for ordering low-level employees to destroy documents. Over 90 thousand documents were destroyed including American and International passports, originals of birth certificates, work permits, citizenship application and associated documents that cannot be replaced. The documents were destroyed to reduce a growing backlog of unprocessed paperwork.⁴

These are just come of the dozens of examples of litigation lost due to an inability to produce records or due to the willful destruction of records.

The role of corporate regulators

Five years ago a search for "recordkeeping" on any regulator's web site would have provided thin results. Today many of the regulators publish record keeping guidelines for their corporate clients. A search on the Australian Tax Office web site returned 94 hits for recordkeeping.

Recordkeeping requirements are now being explicitly stated in legislation and accompanying regulations. The Australian Securities and Investment Commission (ASIC) state that, under section 286(1) of the Corporations Act, a company must keep written financial records that:

- correctly record and explain its transactions and financial position and performance; and
- would enable true and fair financial statements to be prepared and audited.

The Australian Tax Office (ATO) web site states you must keep records:

- that specify and explain all transactions. This includes any documents that are relevant for the purpose of working out your tax liabilities. You should make records of transactions as soon as they occur or as soon as possible afterwards
- relating to all taxes for which you are liable. This may include income tax, goods and services tax, pay as you go taxes, capital gains tax, and fringe benefits tax.

Fines and penalties

From the US there are recent examples of organisations being fined for the deliberate destruction of records.

Securities regulators fined the brokerage arm of **Fidelity Investments** \$2 million for permitting its employees to alter and destroy documents at "numerous" branch offices. The regulator charged that employees at 21 branch offices of Fidelity Brokerage Services were encouraged to alter or destroy records in order to achieve better scores on annual inspections of the books and records at the branches. The document destruction took place between January 2001 and July 2002.⁵

In March 2004 the Bank of America's securities unit agreed to pay a record \$10 million penalty to the Securities and Exchange Commission for record-keeping violations and failing to produce documents (in particular, e-mails) requested as part of an SEC investigation.

And we can all remember when, in October 2002, the major American accounting firm, Arthur Andersen, received a \$500,000.00 fine and five years probation for destruction of documents relating to its client, Enron, after it was aware that civil litigation and government investigations were imminent. We now know that that verdict was the death knell for the 89-year old company, once one of the world's top five accountants.

Enforceable undertakings

Within Australia, corporate regulators are increasingly using an instrument called an enforceable undertaking as a means of bringing non compliant agencies into line. An enforceable undertaking is a legal agreement in which a person or organisation undertakes to carry out specific activities as a result of a contravention of the relevant Act. In many

circumstances enforceable undertakings are viewed by the regulators as an effective alternative to litigation.

In 2001, financial planning and share broking group, D&D Tolhurst agreed to be subject to a court enforceable undertaking after the Australian Securities and Investment Commission (ASIC) became concerned about internal compliance procedures. The group agreed to engage a consultant to review and assess compliance within the company and to report on any possible further changes to Tolhurst's compliance and training programs. The assessment included **record keeping** as a key review area.⁶

More recently Zurich Financial Services Australia agreed to an enforceable undertaking with APRA after two Zurich entities failed to properly account for two reinsurance transactions entered into in 2000. Recordkeeping was included as a key area for review.⁷

Beefing up legislation

Since Enron, a raft of regulations such as Basel II, International Accounting Standards (IAS) and Sarbanes-Oxley (SOX), have been introduced to deliver improved corporate governance regulate, and all have included tightened recordkeeping requirements. Australia is following with similar changes– such as the Corporate Law Economic Reform Program (CLERP).

The main thrust of change, however, is within existing legislation, in the form of minor amendments to Acts and regulations detailing more explicit recordkeeping requirements.

The Dept of Immigration advises on their web site that amendments were made to Part 6 'Record Keeping and Management' of Schedule 2 of the Migration Agents Regulations 1998⁸

The Federal Government's review of Australia's anti-money laundering system recommends that record-keeping obligations (of financial institutions) will need to be reviewed to ensure that information can be made available within three days of a request by an anti-money laundering regulator or nominated agency.

Changes to the Therapeutic Goods Act, following the Pan Pharmaceuticals product recall, which increase the manufacturers' responsibilities for ensuring the quality and safety of therapeutic goods available in Australia, include additional recordkeeping requirements.

The Crimes Legislation Amendment (Telecommunications Interception and Other Measures) Bill 2005 contains detailed record keeping and reporting requirements for law enforcement agencies.

Amendments to the *Chemical Usage (Agricultural and Veterinary) Control Act 1988* recommend significant changes to the way that veterinary surgeons can use, prescribe, supply and recommend the use of veterinary chemical products came into effect on 4 April 2003. These include a requirement for veterinary surgeons to make and keep detailed records of the treatment of trade species animals.

And so on and son on.

Still prepared to gamble?

Evidence points to an unprecedented level of interest by the courts, regulators and auditors in organisational recordkeeping systems and practices. The examples quoted here are just the tip of the iceberg.

Many mangers complain that the cost of creating complaint recordkeeping systems is unreasonably high. And yet in a recent report, 10 out of 12 IT chiefs on silicon.com's CIO Jury user panel said an investment in better information management systems had produced benefits well beyond simply meeting regulatory targets and deadlines. The high IT

cost of compliance projects was proved worthwhile for the wider business benefits brought about by such projects, according to these UK CIOs. Some cited improvements in business processes as an immediate benefit. One commented that "compliance at first seems like a necessary evil but the long-term benefits will eventually manifest themselves".⁹

The challenge facing the industry is in being able to deliver recordkeeping solutions that achieve both compliance and the delivery of better business outcomes, within the same system. Now that could be a gamble worth taking.

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¹ Source: Washington Times, May 4, 2000

² Juris e-prudence, Sue Bushell, CIO October 11 2005

³ http://www.vctc.org.au/tc-res/McCabe_summary_and_implications.pdf

⁴ Source www.INQ7.net

⁵ www.Thestreet.Com March 8 2004

⁶ Source: www.asic.gov.au

⁷ Source: www.apra.gov.au

⁸ <http://www.immi.gov.au/legislation>

⁹ CIO Jury: Are high compliance costs worth it? IT chiefs see long-term benefits despite short-term headache. www.silicon.com