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RESERVE BANK OF AUSTRALIA



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RECEIVED

21 JUN 2010

TSY LIAISON

2 June 2010

The Hon. Wayne Swan, MP
 Treasurer
 Parliament House
 CANBERRA ACT 2600

Correspondence Received - Office of the Treasurer	
Office Circulation	
Treasurer	Contact Adviser -
Chief of Staff	Other Adviser -
Deputy Chief of Staff	DLOs -
08 JUN 2010	
Departmental Action	Briefing
Acknowledge	Speech
Substantive Response	Refer to
Appropriate Action	No Further Action
Information	URGENT
Constituent Response	Att:
Signatory	

Dear Treasurer,

Given the recent repetition of allegations against Securrency by *The Age*, and recently also aired on the ABC, I am writing to set out the Bank's position on the matter and the actions that have been taken.

The allegation is that agents used by Securrency in other countries may have made corrupt payments to foreign government officials to secure contracts, and that some people in Securrency may have known about such payments.

The Reserve Bank, as half owner of Securrency, is deeply concerned by these allegations. It condemns corrupt behaviour of any kind. The alleged behaviour would go against the high ethical standards that the Bank has always sought to maintain in carrying out its functions, and that it expects of related entities.

I want to assure you that the Reserve Bank is taking all possible steps to address the issues that have been raised. The measures that have been taken are outlined below, but let me first set out some background.

As Australia's central bank, the Reserve Bank is responsible for the production and issue of Australia's banknotes. The Reserve Bank manages its banknote responsibilities through its Note Issue Department, which arranges for Australia's banknotes to be printed by Note Printing Australia Limited (NPA), a wholly owned subsidiary of the Reserve Bank.

The polymer substrate on which Australian banknotes are printed is manufactured by Securrency International Pty Ltd. Securrency is the sole global supplier of polymer substrate. It was established in 1996 as a 50:50 joint venture between the Bank, which developed the technology in conjunction with the CSIRO, and UCB, a Belgian conglomerate that manufactured polymer film. While the Bank's main objective was

to improve the security and durability of Australian notes, the polymer substrate was innovative technology with export potential. The purpose of establishing Securrency was to maintain a supply of substrate for Australian use and to meet potential foreign demand. The involvement of a private partner was necessary to develop the market and was also seen as bringing commercial discipline to the enterprise. In 2005, UCB sold its film division (including the joint-venture holding) to a UK-based venture capital firm. This division became Innovia Films, which is the current owner of the other 50 per cent of Securrency. NPA was also seeking export markets at that time, and on occasion would work alongside Securrency.

Responsibility for the management of these companies rested, quite properly, with their respective boards. The Reserve Bank itself was not involved in this management. It did appoint board members (half the board, including the chair, in the case of Securrency) whom it expected to oversee the companies' operations and compliance with all relevant laws.

On occasion, Reserve Bank officials would have discussions with officials of other central banks where there was an interest in Australia's experience with using polymer currency. Exchanges of information between central banks are quite common on a wide range of issues.

As relatively small companies without the resources to maintain on-the-ground presence in a large number of countries which were potential markets, both NPA and Securrency used local agents to represent them. In some cases they used the same agent.

While the use of agents is a common and accepted practice, it does carry certain risks. These risks were highlighted by the incidents involving the Australian Wheat Board. Following those events, the Reserve Bank sought, through its representatives on the relevant boards, reassurance about the use of agents by NPA and Securrency. This involved audits by the Bank's Audit Department and a review of agency arrangements at NPA.

That work revealed a number of control weaknesses in NPA's agency arrangements, which the Bank regarded as unacceptable. In response to these findings, and as part of a more general review of NPA's performance and objectives, the Bank took several measures:

- it tightened its control of the board of NPA, by replacing the chairman and some other directors with board members who are Bank executives;
- it endorsed the decision of the NPA board to replace the chief executive; and
- it insisted that NPA change its business model to stop using agents and cut back its operations for offshore clients. It was decided that, in future, NPA would largely limit itself to responding to requests for printing by existing clients.

These changes were completed by late 2007.

The Bank's Audit Department also undertook a review of Securrency's use of agents in 2007, and again in 2008. Those audits showed none of the short-comings of the NPA audit. In fact, the conclusion was that the company had sound and robust processes in place for managing the risks associated with the use of agents.

Given this audit result, it was felt that there was not a sufficiently strong case to insist that Securrency adopt the same arrangements as NPA, and cease the use of agents.

Nonetheless, the Bank strengthened its representation on the Securrency board. In mid 2008, it replaced the chairman with one of its executives, and appointed one of its board members as a director. The other two board members appointed by the Bank are a current RBA executive and a former executive. These changes were designed to improve governance and strengthen oversight.

The audits of both NPA and Securrency took place well before *The Age* first raised its allegations in May 2009. Neither the board of Securrency nor the Reserve Bank was aware of these allegations until that time. The allegations were completely unexpected, given that the company had strong policies prohibiting the payment of bribes, including by the agents, and that audit findings had provided re-assurance that the company's procedures supporting those policies were robust. Neither of the former employees who appear to be among the sources used by *The Age* had made their concerns known to the board of Securrency or to the Bank. Had they done so, given the seriousness of the issues, the Bank, as in the NPA case, would have carried out investigations and made any necessary changes immediately.

Following the publication of *The Age's* articles, the board of Securrency immediately referred the allegations to the Australian Federal Police to ensure that they were fully and credibly investigated. It also commissioned a large accounting firm, KPMG, to undertake a forensic review of the company's procedures, as well as its transactions dating back several years. The Reserve Bank fully endorsed both actions.

In late 2009, KPMG informed the board of Securrency that, although its review was still on-going and not all files could be located, it had uncovered information which suggested deficiencies in the implementation of policies and procedures relating to the use of agents. It also emerged that important information relevant to evaluating the agent arrangements had not been available to Securrency's board or to the auditors who examined the arrangements. It is likely that the auditors would have reached a different conclusion in the 2007 audit had they been aware of this information. On receipt of this information in November 2009, Securrency's board immediately suspended the chief executive and another executive, and suspended the use of agents.

The KPMG review was completed in March 2010 and was released to the public. The review concluded the following:

- The use of agents is a cost-effective and well-understood model used by many organisations to pursue business in foreign countries. The company had sought to understand and manage the associated risks, and the board endorsed policies and procedures which should have been adequate in managing and/or mitigating them.

Furthermore, management consistently sought legal advice on agent-related matters. However, KPMG concluded that management did not properly implement these policies and procedures.

- Securrency's records lacked documentation to evidence compliance with the company's policies relating to the appointment and monitoring of agents and the recording of relevant information concerning payments to agents.
- The company did not have a formally documented process for responding to concerns or allegations relating to agents, and the manner in which management dealt with concerns raised by an employee in 2007 about the activities of some agents was not transparent. Management did not bring these concerns to the attention of the board or to the company's internal auditors, and also did not bring to the board's attention other instances where the company's policies in relation to agents had not been strictly applied.
- Several measures could be taken to strengthen Securrency's code of conduct.

In its report, KPMG made twelve recommendations to enhance the company's policies relating to agents and ensure proper compliance with those policies. The board of Securrency accepted all of the recommendations and committed to implement them in full.

In view of the findings of the review, the board of Securrency terminated the contracts of the managing director and another senior executive, who had been on suspension since November 2009. The Reserve Bank fully endorses these actions taken by the board of Securrency.

The Bank remains extremely concerned about these developments. Its priorities have been, first, to ensure that the allegations are fully investigated by the Australian Federal Police and, second, to put in place arrangements to ensure that there is no possibility of corrupt or even questionable behaviour occurring in the future.

It is important to stress that the Australian Federal Police investigation is still continuing. Whether or not the various claims made in the media are accurate, and whether or not they constitute evidence of corruption in other countries or by employees of Securrency, is something that only the AFP are really in a position to judge. The Bank has strongly supported the AFP's work and all information is available to them. There is nothing further the Bank can do in this regard at this stage than await the AFP's findings.

In relation to ensuring strict controls over operational and reputational risks in future, a number of important steps, as noted above, have already been taken:

- the Reserve Bank has tightened its governance of Securrency (and NPA) by appointing its executives and/or board members to those companies' boards, including to the position of chairman;

- the senior management of both companies have been replaced;
- the use of agents has been suspended; and
- all the recommendations of the KPMG review to strengthen Securrency's procedures are being implemented.

Finally, looking to the future, I should note that with the company having become established and with its long-term viability more secure, the original rationale for the current shared ownership structure is becoming less compelling. Accordingly, the Bank is now intending to undertake a strategic review of this structure, to be assisted by independent expert advisors. The review is to evaluate options which would better allow the Bank to meet its objectives of ensuring security of supply for polymer substrate for Australian currency notes and avoid the risks that come from being involved in a commercial operation in a joint venture with the private sector. It is intended that this review will be completed later this year.

This letter is for information. No reply is expected or necessary.

I am, of course, available at any time to discuss any of these issues in more detail.

Yours sincerely,

