# The case of water wheel holdings: a slippery tale

Environment, Water

The Case of Water Wheel Holdings: A Slippery Tale

Water Wheel Holdings Ltd (Holdings) was a successful company listed on the Australia Stock Exchange (ASX). It wholly owned and operated a trading entity called Water Wheel Flour Mills Pty Ltd (Mills)1 from whom business was primarily conducted. Mills was a 127-year-old company that functioned as a commodities and stock feed mill, operating out of the town of Bridgewater, north-west of Bendigo. Despite rising from humble begins and being a prosperous company for many years, the group ultimately ran into significant trouble –resulting in the halting of trading on the ASX, the appointment of Administrators to consider the group's financial affairs, a successful action being brought about by the regulators against the executive and non-executive directors for insolvent trading, and many other serious consequences.

The following is an extract from paper2 which outlines events which lead previously mentioned problems: " In 1997 Mills entered the rice industry with a $7 million purchase of capital equipment. Water Wheel purchased large quantities of wheat and paddy rice. Tofinancethis Mills entered an " off-balance sheet" arrangement with financiers. In December 1998 the group's accountants and auditors, Hall, Puddy and Wales (HPW), carried out an audit for the financial year ending 3 December 1998. The auditors noted a trial balance as at 31 October 1998 prepared by management. This suggested a profit of $1 million but HPW believed this was due to major oversights in the recording of wheat and rice costs. By February 1999, HPW stated the result for the year ending 3 December 1998 was likely to be a loss of $1. 5 million. The directors refused to believe this and blamed the accountants for not invoicing sales of up to $1. 8 million. The directors said a new computer system was the problem, although they were unable to prove it. The directors then sought another opinion by engaging the accounting firm of Deloitte Touche Tohmatsu (Deloittes) to ascertain the cause of the loss. On 13 March 1999 Deloittes' report agreed with HPW. It said that the computer system had recorded all invoices and the group's operating expenditure had increased by $1. 2 million.

On 16 March 1999 HPW, sent a 28 page " audit management letter" to the directors of Water Wheel highlighting areas identified in the 1998 audit and stating the accounts required urgent attention to enable an acceptable standard of internal control and reporting systems to be put in place. HPW offered to discuss these matters with the directors but the directors failed to acknowledge or reply to this letter. By April 1999 Nankervis, Water Wheel's General Manager - Finance and Administration (appointed in February 1999) was increasingly concerned about the continued financial viability of Water Wheel and his own legal position. He wrote to his solicitors expressing concerns of a severe cash flow shortage, angry creditors, shareholder concerns and that the group was approaching insolvency. Nankervis resigned on 19 April. This type of tension between directors and accountants gave the accountants little choice but to be involved in the illegality or to resign." 3 On the same day Nankervis resigned, a board member John Calvert-Jones also resigns about the group's financial position and ability to meet future obligations. Despite the obvious warning signs, the remaining directors continued to trade the group. However, on 16 1 The collective of Holdings and Mills is referred to as " the group". 2 Mescher, B. (2005) "

Directors and Accountants and the Obligation to Ensure Proper Accounts are Kept” Financial Reporting, Regulation and Governance, 4(2), 1–25. 3 Ibid, p. 11 – 13.

February 2000, trading of shares was suspended pending clarification of the group’s financial position. On 17 February 2000, the group appoints joint and several Administrators and on 30 June 2000; it was ultimately decided that the company should enter into a Deed of Company Arrangement (DOCA). Despite executing the DOCA and paying secured creditors and satisfying all provisional employees as at 23 November 2000, the group still had significant liabilities, namely: ? Property, Plant and Equipment had been sold at a loss of $4, 597, 000 (excluding land with a book value of $54, 000) ? Intangible Assets were sold at a loss of $148, 000;

? Terminated all employees for a cost of $300, 000 above that which was disclosed in books; In spite of the above, the group still had a deficiency in their books of approximately $6, 000, 000. On 27 November 2000; the ASIC issued proceedings against three board members of the group: Chairman, William Harrison, their Managing Director, Bernard Plymin and Non-Executive Director, John Elliot for incurring debts at a time when the company was insolvent4. The case played out in the Supreme Court of Victoria and ultimately made its way to the High Court of Australia. Part way through the hearing, William Harrison, the group’s chairman, admitted all allegations contained in ASIC’s Statement of Claim and agreed to pay the sum of $300, 000 for his part in the group’s demise. In opposite, Managing Director, Bernard Plymin and Non-Executive Director, John Elliot continued to vigorously fight the charges brought about by ASIC. In the end, on 5 April

2003, the Supreme Court of Victoria held that Plymin and Elliot failed to prevent the company and a subsidiary from incurring debts after the companies became insolvent on 14 September 1999. The case was heard on appeal however the initial ruling was upheld and on 14 December 2004; John Elliot filed for bankruptcy. One conclusion that can be made…

This case illustrates the importance of good internal controls and the consequences of an absence of these. The relationship between accountants and management can deteriorate when issues arise concerning the financial viability of the company. The accountant's professional integrity was very much under threat and they had little choice but to either resign, or be complicit in the group's ultimate fraud. However, as this case shows, accountants whom maintain their professional integrity are likely to be looked upon favourably by courts and that ultimatelyresponsibilityfalls solely on directors. 4 Section 588G of Corporations Act, 2001.

Further Readings:

Mescher, B. (2005) " Directors and Accountants and the Obligation to Ensure Proper Accounts are Kept" Financial Reporting, Regulation and Governance, 4(2), 1-25. Letts, S. (2000) " Victoria ricegrowers face uncertain future" ABC online – http://www. abc. net. au/landline/stories/s114701. htm Allens – Capital Markets Publications, Focus: Corporate Governance (October 2003): " Water wheel serves as a timely reminder" – http://www. allens. com. au/pubs/cm/focgoct03.