



**Parliamentary Joint Committee on Corporations and Financial Services
Ethics and Professional Accountability Inquiry**

Submission in response to further question on notice

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1. Question on Notice

The Committee has asked me to provide comments on the following submission extract, from Submission 32 by Emeritus Professor James Guthrie, Professor John Dumay, Dr Twyford and Associate Professor James Hazelton:

In Australia, the contemporary audit processes and lowballing for audits create intense time and budget pressure, employing juniors, working unsupervised hours, and using cheaper labour from Asia, especially India. Deloitte, for instance, plans to have around 30% of its workforce operating from India within the next four years, with an estimated total employee count ranging from 150,000 to 160,000. Such practices may mean the members of audit teams resort to irregular auditing practices – including falsifying some of the audit's working papers.

The specific question on notice was: **'Could you have a look at that and give your thoughts on a diversified workforce that's offshore and the impacts that might have on the systems of conduct that you refer to?'** In order to respond fully to that question, I have also had regard to the subsequent and closely related paragraph of Submission 32, which expands on the quoted section.

The Big Four privileges partnership profits and capital accumulation, creating an audit culture that impacts audit quality. To this end, recent developments at the Big Four include outsourcing audit work to cheaper locations, relying on third-party sites to undertake audits, and providing cheap tenders for audits to secure lucrative non-auditing work. Changing the composition of audit teams through practices like offshoring audit work and relying on third-party workers is a significant cultural issue, as is the custom of having a senior partner sign off on the audit, having spent only a few billable hours involved. Such practices are key to maximising profits for these partnerships, but they are seldom disclosed.

2. Systems Intentionality and assessing corporate values, purposes and knowledge

As the Committee is aware, my model of Systems Intentionality proposes that organisations manifest their states of mind as a matter of social fact through their real-life (actual, as opposed to formal) systems of conduct, policies and practices. Not only, however, do these express and give effect to their knowledge, values and purposes, in the way demonstrated in my submission of 30 August 2023. It also follows from the model that one can assess some key elements of a firm's purposes, normative characteristics or traits (such as honesty) and knowledge from the extent to which its practices and real-life strategies align with the values and purposes it formally represents to the world. To the extent that there is a difference

between these, the firm may be considered (through mis-representing its organisational state of mind) to be engaging in misleading conduct. Even where negligent, such misconduct likely causes harm to those who appoint firms to carry out services on the represented basis, undermines the integrity of their choice and the broader market, and calls for both specific and general deterrence. However, through the lens of Systems Intentionality, where there is a significant gap, and the divergent practices are sustained, promoted and defended, or left unaddressed, the misleading conduct may be considered deceptive. This is because firms can be taken to understand and intend to engage in the conduct enabled through their own deployed systems, policies and practices. A failure to test the problematic systems prior to deployment, or to audit and respond to correct those practices as they evolve, provides further support for assessing them as manifesting a reckless indifference or specific intentionality, commensurate with a deceptive mindset, and reinforces the culpability of misleading virtue-signalling to the marketplace.

The analysis, therefore, provides a means to assess whether a firm is a fit and proper, or suitable, organisation to provide auditing services, whether these be to public or private clients. What values an ethical firm should possess can be understood from a range of sources, including Australia's core legal norms of fair trading practices, but also from the values identified as fundamental by experienced firms themselves.

3. Deloitte's Global Principles of Business

With that in mind, I have assessed the practices alleged in Submission 32 above through the lens of Systems Intentionality, and in light of Deloitte's published statements regarding its organisational values and purposes, found at

<https://www.deloitte.com/global/en/about/story/purpose-values/global-principles-of-business-conduct.html>

In focusing on these statements, I have assumed that these are representative of the sorts of value-claims made by other leading audit firms. They clearly contribute to understanding what values we might expect from ethical and thus 'fit and proper', or 'suitable' firms. But, further, they are valuable to model how firms' published representations of their values can be assessed in light of their actual practices and vice-versa, as part of the Systems Intentionality analytical tool-kit. They also serve as a useful measure by which to assess Deloitte's India strategy outlined in Submission 32.

To be clear, the following assessment uses these sources (the Global Principles and described practices in Submission 32) for illustrative (modelling) purposes. In particular, while it accepts that Deloitte's Global Principles reflect values that should be manifested by ethical firms, it does not assert the truth of the described practices in Submission 32, nor that these represent Deloitte's practices. Rather it uses the described practices and Deloitte's published Global Principles for the purposes of modelling how organisational mind-sets may be readily identified through the lens of Systems Intentionality.

On that basis, I observe that Deloitte's Global Principles of Business Conduct include, for example, Integrity, Quality, Professional Behaviour, Objectivity, Competence, Fair Business Practices, and Confidentiality, Privacy and Data protection. Through the lens of Systems Intentionality, these are representations of its values and purposes: the high-level 'policies' that are ostensibly meant to nudge behaviours on the ground, such as the development of daily 'practices' that manifest in a more organic and granular way the organisation's intentions and knowledge for the everyday transactions at hand. Here, it is noteworthy that, in its Global Principles, Deloitte appears to accept Systems Intentionality's starting proposition that we can and should assess organisational character from a firm's daily practices:

'Deloitte's commitment to quality and integrity underlies everything we do – day in and day out – as we seek to make an impact that matters for clients, our people, and our communities.' It follows that Deloitte's formal values (its policies) provide a set of standards against which Deloitte's true (in practice) character may be assessed, including as to the degree to which it honestly represents that character to customers, or (conversely) engages in misleading or deceptive conduct. The same follows for other firms: as I noted in my original submissions, PwC and KPMG both also have values statements and these can also be assessed in light of their real-life practices, and vice-versa.

From the perspective of Systems Intentionality, a number of the practices alleged in Submission 32 arguably manifest deeply problematic organisational mind-sets. Further, these mindsets are strikingly at odds with the sorts of ethical values and purposes that should inform leading firms' behaviours. As explained, Deloitte's Global Principles provide a good example of the sort of published values to which leading firms regularly and explicitly commit, and which they claim to manifest in their daily practices. I use these to highlight how a significant divergence between real-life practices and values-statements (of which the Global Principles are an example) can itself constitute deliberately misleading, and hence deceptive, conduct.

4. Lowballing

Consider the identified practice of 'lowballing for audits'. Merriam-Webster defines lowballing as 'to give (a customer) a deceptively low price or cost estimate' and 'to give a markedly or unfairly low offer'. In legal terms, 'deception' speaks to deliberately misleading conduct. 'Unfairness' arguably points to normative standards of fair trade practices, with a view not only to the impact of practices on consumers or clients but also on competitors who seek to engage in ethical practices.

The knowledge and intention with which underquoting occurs are relevant to both aspects. These state of mind questions are readily assessed through the lens of Systems Intentionality, and in light of a firm's professed fair trading values. Here, we may consider Deloitte's Global Principles as an example:

Fair business practices

- We respect our competitors and are committed to fair business practices.
- We receive fees that reflect the value of services provided and responsibilities assumed.

Systems Intentionality tells us that, as a 'practice' (a customary or habitual system of conduct) the alleged low-balling misconduct is both intended (not accidental or mistaken) and knowing. A firm engaging in a practice of low-balling cannot be conceived of as sleep-walking its way through this sort of contracting behaviour, nor be ignorant of what is its own conduct. Rather, and consistently with the Merriam-Webster definition, the practice necessarily (because it is a practice, or system of conduct) reflects an organisational intention knowingly to engage in misleading and unfair business practices, which manifests disrespect for competitors and customers alike. This conduct potentially contravenes a range of general law and statutory prohibitions in Australia: most obviously, Australia's statutory prohibitions on misleading or deceptive conduct, but may also contravene other prohibitions on fraudulent and dishonest behaviour. For example, as a form of deliberate 'sharp practice', lowballing would likely merit characterisation as an 'unconscionable system of conduct' pursuant to Australia's fair trading laws (for example, section 12CB ASIC Act).

Further, were a firm to be engaged in the practice of lowballing, this would be clearly and substantially at odds with the sorts of fair business practice values and purposes represented through published values-statements, such as the Deloitte's Global Principles. Where this occurs, the published values-statements arguably themselves constitute deceptive conduct, as they reflect a deliberate and knowing misrepresentation of the organisation's true (in-practice) values. Presumably, formal values-statements are published in order to influence parties (for example, future clients) to choose to deal with this firm over others. Misleading or deceptive conduct in trade or commerce contravenes the law. This means that deceptive virtue-signalling may itself be actionable, both by regulators and those who have (for example) contracted with a firm on the basis of its misleading, ethical public face.

As will be clear, this sort of analysis should give practical impetus to firms to ensure that their values-statements are embedded into daily practice and actively reviewed over time. The omission of any suitable mechanism to do this itself arguably suggests organisational indifference to ensuring that the firm does not engage in misleading or deceptive conduct through its published values-statements. The normative significance of that indifference, in particular whether it should be assessed as negligent or reckless, is addressed below.

5. Time and Budget Pressures

Submission 32 suggests that lowballing in turn has an inherent tendency to compromise quality of audit services. Junior (presumably less experienced but less expensive) employees are given the main workload, 'working unsupervised hours' under considerable time pressures. Beyond lowballing, it may also be that partners take on more work than they can personally service and supervise, with competence. Consistently, submission 32 identifies a broader 'custom of having a senior partner sign off on the audit, having spent only a few billable hours involved'. From the perspective of Systems Intentionality, both in the lowballing contexts and beyond, practices of overloading juniors within minimal supervision may manifest an intention to protect or expand partner profit.

Systems Intentionality also directs attention to what processes are in place to protect audit quality in the face of these workplace practices: omission of appropriate processes patently required to address inherent risks of mistake and incompetence within an audit workforce, for example, represents an organisational choice. We may expect that leading firms are only too well aware of the need properly to staff and supervise audit services. Thus one of Deloitte's core Global Principles is 'competence', by which it undertakes to 'use due care to match client needs with practitioners who have the competence required for their assignments.' The alleged practices are clearly contrary to these sorts of prudent values and purposes. Through the lens of Systems Intentionality, they manifest a conscious decision to use overly junior employees, subject to inadequate supervision in the face of the risk of compromised quality and error, in the name of partner profit. To proceed knowingly in this manner is likely negligent. However, given the critical role played by audits both to customers and to the broader integrity of Australian and global markets, a knowing decision to take the risk of audit error and/or incompetence, repeatedly, may be characterised as reckless. This finding would be particularly open, given leading firms well understand the critical value of audits, hold themselves out to be experts in the field and presumably all embrace competence as a minimal core organisational value. I deal separately with the attendant risk of employee misconduct in section 8.

Again, both the practices themselves and misleading values-statements published by firms may, through this form of analysis, manifest blameworthy firm values, purposes and knowledge that may be separately actionable, as explained previously.

6. The India Strategy and Outsourcing

Returning to the facts as stated in Submission 32, Systems Intentionality sees Deloitte's India strategy as an organisational-intentional act, itself reflecting organisational values. It is a scheme, strategy or plan, which reflects organisational intent to act in this coordinated way, in order to achieve some ultimate outcome. Submission 32 further identifies that Indian employees are cheaper than their Australian counterparts: it may be inferred that so are 'outsourced' 'third party sites'. Through the lens of Systems Intentionality both shifts in business practices (or strategies, schemes or plans) to prefer foreign or outsourced labour over comparable Australian employees suggest a further strategy (intention) geared to protect or expand partner profits.

While the comparative levels of competence of Indian junior employees (or employees generally) is unclear, it may be inferred that such employees will be subject to at least similar levels of supervision to Australian employees. If that is unduly low, it is already problematic for the reasons explained in section 5. However with the huge contemplated workforce of 150,000 to 160,000 contemplated in the described Indian strategy, very significant levels of coordinated supervision and quality assurance processes will need to be embedded, reviewed and revised on an ongoing basis, in order to address the very significant risk of error and misconduct (including that potentially generated through work pressures, as to which see further below at section 8).

A very significant risk of third party outsourcing, of course, is that appropriate senior or partner supervision is even more attenuated, and may be entirely absent.

It is unclear from the described India strategy and outsourcing practices how, if at all, quality control and supervision is maintained on the part of the primary firm, so as to meet proper audit standards and to manifest a prudent and competent organisational mindset. To the extent that there is a significant gap between a firm's published values and lived practices of this sort, again, the values statements may be considered misleading or deceptive in their own right, as explained previously.

7. Changing Audit Teams

Additionally, the described practice of 'changing the composition of audit teams' (presumably, to a cheaper team alternative) following successful tender suggests deliberately misleading conduct in the tender process. This is because, as will now be clear, through the lens of Systems Intentionality, a 'practice' reflects a business strategy or system, and therefore premediated and knowing conduct, rather than a response to one-off or occasional events unforeseen in the original tender, or beyond partnership control. As a system or practice that deploys repeatedly, over time, it suggests that, at the time of making a tender, the organisation held no genuine belief in the proposed team's composition, but rather held a contrary (true) intention to substitute members of the team for cheaper labour following successful tender, and to mislead the customer for the purpose of profit. It follows that the malpractice may be characterised as knowing and deliberate, so as to constitute deceptive conduct.

This malpractice can be contrasted with a firm having embedded processes to substitute equivalently qualified and capable person to original team members, in the event of illness or similar. These would manifest prudent and honest mindsets (and reflect a firm embedding 'competence' as a core value within its daily conduct). Related processes manifesting this more positive attitude would also encompass briefing and handover practices (for example, clear and effective records and instructions), as well as review and oversight mechanisms for quality assurance. Lack of these correspondingly reflects poorly on organisational values.

While miscommunications might still occur, taking a systems approach allows us to understand the prudent mindset adopted by an organisation: in this respect, Systems Intentionality has an exculpatory as well as inculpatory effect.

8. Individual forgery: the bad apple narrative

Submission 32 further suggests that the lowballing and outsourcing practices 'may mean the members of audit teams resort to irregular auditing practices – including falsifying some of the audit's working papers.' Clearly forgery is both unlawful and dishonest. However, one may expect associated partners to disavow any knowledge, authorisation or permission of this misconduct: the 'bad apple' narrative. This blames or scapegoats the individuals involved, thus ring-fencing responsibility and substantially reducing overall organisational blameworthiness.

Systems Intentionality suggests this narrative may be tested in a range of respects. For example, suppose this misconduct is repeated and, in reality, how junior employees find that they must behave in order to meet partners' demands and progress their careers. In these circumstances, such misconduct starts to resemble an organisational practice in its own right. Here, partner silence may be better seen as signalling tacit endorsement of the practice. This view is fortified where there is no active oversight mechanism, or remedial action(s) taken, to identify and correct the misconduct. The combination of significant time frames, heavy workloads, and inexperienced (and relatively powerless) employees who are subject to exacting completion targets, raises a patent risk of mistake but also individual fraud or forgery. Where partners choose not to have real or effective oversight and remedial mechanisms in place, that is a choice that, where repeated over time and in the face of ongoing risks, arguably indicates a reckless indifference to the dangers posed to the integrity of the audit process equivalent to tacit acceptance. Where these harms eventuate, and still no effective oversight, review or remedial systems are established (but, rather, the bad apple narrative is repeated), it is possible to see the misconduct as clearly 'permitted' or even 'endorsed'. The conduct may be seen as more actively and clearly 'endorsed' or 'adopted' when individuals engaged in that activity are rewarded through (for example) promotions or bonuses, or where new employees are trained in the practice.

In all these scenarios, while, partners may (truthfully or not) deny subjective and individual knowledge, the malpractice nonetheless has taken on an 'organisational' character and cannot be contained within a 'bad apple' narrative.

9. Implications for Employee Development and Welfare

This foregoing analysis also arguably challenges implicated firms' stated commitment to their employees' welfare: see, eg, Deloitte's Global Principles, which commits to its employees' 'professional development and support'. For example, it seems indisputable that adequate supervision and timeframes for workloads is fundamental to enabling employees to 'develop the professional knowledge and skills necessary for them to effectively perform their roles.' Even more importantly, it is arguable that placing junior employees in positions where they must cut corners, or cheat, to survive or prosper is to place them in an unsafe work environment. That is most obvious when junior employees are exposed to the risk of individual criminal or civil enforcement proceedings, as occurs through successful deployment of the bad apple narrative. However, the risks of significant harm to employee health and wellbeing are also obvious, and contrary to appropriately supportive and ethical values represented by, for example, the Global Principles.

10. Conclusion

This additional submission has sought to show how Systems Intentionality may be used to assess critically a firm's values, purposes and knowledge, including by comparing the published values of the firm with its true, everyday practices (in this case, as described in Submission 32). Were the described practices and strategies to be broadly reflective of conduct by the major audit firms, the Systems Intentionality analysis provides significant, independent support for the view expressed by Submission 32 that:

The Big Four privileges partnership profits and capital accumulation, creating an audit culture that impacts audit quality.

Most evidently, the analysis challenges any claims by firms engaging in such misconduct that they seek to act with 'Integrity'. Again to use Deloitte's Global Principles as an example:

Integrity

- We are straightforward and honest in our professional opinions and business relationships.
- We are truthful about the services we provide, the knowledge we possess, and the experience we have gained.

The analysis explains that deceptive virtue-signalling to the market for the purposes of attracting and retaining audit business contravenes Australia's fundamental commercial norm against misleading conduct and is independently actionable, both by regulators and by those who rely on it to their cost.

Finally, the analysis provides support for the view that a firm engaged in such practices is, arguably, not a 'fit and proper' or 'suitable' organisation to attract government business, by the very value-metrics by which leading audit firms seek to define themselves in the market.

I welcome any further discussions with the Committee regarding my model and its potential application in this or other fields, relevant to its work.

Yours sincerely,

Elise Bant
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