28 August 2023
Online submission: corporations.joint@aph.gov.au
From: Dr Kelli Larson, Curtin Law School, Curtin University

Committee Secretary
Parliamentary Joint Committee on Corporations and Financial Services
PO Box 6100
Parliament House
Canberra ACT 2600

Re: Audit, Assurance and Consultancy Inquiry

Dear Parliamentary Joint Committee on Corporations and Financial Services:

Thank you for the invitation to make a submission to the Parliamentary Joint Committee on Corporations and Financial Services in relation to the timely Ethics and Professional Accountability: Structural Challenges in the Audit, Assurance and Consultancy Industry Inquiry. I am pleased to submit this comment based on some of the Inquiry's Terms of Reference noted below for consideration.

Introduction

The auditing, accounting and consultancy profession plays an important role in Corporate Australia. Audits and auditors provide a key external monitoring role of companies and provide information to investors ensuring that they and others can be informed when making investment decisions. Accountants and accounting practices are an effective instrument of corporate governance as they monitor a company's financial performance and transactions, while consultancy services add value to organisations by providing specialist advice on industry, market, management, legal or product and service matters.

The Australian public is concerned about the recent consultancy scandal that has specifically involved the Australian government, the PwC tax leak scandal. Allegedly, international tax partners at PwC Australia used confidential government information to secure new clients and help current clients sidestep tax laws while at the same time advising the then-government on the design of those tax laws.

The use and entrenchment of consultancies in the government is not surprising. The use of consultancies is seen in almost every government department from central government, defence services, social services, health services, information technology, infrastructure, transport and regional government to name a few. What is seemingly new, however, which the PwC tax leak scandal has brought to public light (besides the leaking of confidential government information and breaching public trust) is the staggering amounts to which such consultancies and external labour has apparently been utilized and paid for under the Coalition government. Some estimates suggest $5 billion a year of taxpayers' money was being spent on external labour, with the Coalition government effectively operating a 'shadow' workforce of over 50,000 full-time equivalent staff costing around $21 billion.[1]

To an extent, the Australian government understandably requires the use of consultants not only to provide a level of business acumen to different government departments but also to

[1] Ronald Mizen, 'Big four in firing line for $1.6b cuts to consultants, lawyers', *Australian Financial Review*, 18 July 2023.

help make public services more efficient. However, the government outsourcing the core of public work to consultants must be reduced. The use of consultancies in the government calls for greater parliamentary scrutiny and transparency of the industry overall and its relationship to the government.

(1.) the global and national firm structures, including:

a. the legal basis for partnership, corporate, hybrid, and other structures.
Corporate governance principles, such as mandatory disclosure obligations, should be mandated to partnerships, which would help make them more open and transparent. A partnership is a business structure where two or more people enter into a relationship in order to carry on a business with a view to making profit. Unlike a company, a partnership is not a separate legal entity, and depending on the type of partnership (general, limited or incorporated) partners may have unlimited or limited liability for the debts of the partnership. Generally, partnerships are regulated at the state level and are not subject to the *Corporations Act 2001* (Cth) (exception: section 115 of the *Corporations Act 2001* (Cth)). This means that partnerships are not subject to the same transparency requirements and public scrutiny as corporations.

PwC Australia is part of PwC International Limited and operates as part of a global network on a partnership model. Most, if not all, the big four consultancies in Australia operate on a partnership model. This likely means that there is no requirement to have their accounts audited. They are not required to submit yearly audited financial statements and reports which the public can access, and they are not bound to obligations or any other reporting requirements under the *Corporations Act 2001* (Cth). It also means that any corporate governance models, ethic guidelines, codes of conduct, etc are all left to the partnership to voluntarily determine. This not only makes it difficult to source basic information about the big four consultancies, but it also raises questions about who checks the auditors? who audits the auditors? and what assurances does the public have of any governance principles being in place, especially when such consultancies are working with the government? The latest PwC tax leak scandal illustrates the need for a new federal corporate governance framework to be established and applied to partnerships as a firm structure. Partnerships should also be required to complete yearly independent annual audits of financial information and lodged those documents on a register with the Australian Securities and Investments Commission (ASIC).

(2.) The extent to which governance obligations applying to a professional services firm may vary depending on the structure adopted, such as a partnership, a company, a trust, or other structure. Consideration of any gaps and international best practice in areas such as:

a. entity reporting and transparency;
The function of an auditor is to conduct a review and verify the financial affairs of a company and to ascertain whether the financial report provided by the company complies with relevant legal requirements and accounting principles. Once the auditor report is completed, the auditor is to provide the report to members of the company for the financial year which is disseminated at the Annual General Meeting (AGM) and lodged with ASIC. Auditing is an assurance service that is to objectively gather information and communicate that information to third parties. This function of the auditor helps to ensure, but does not guarantee, market integrity. Auditors play a crucial governance function, however in practice their audit reporting may only be as good (or bad) as management, or the board of directors allows it to be. There are past examples of

auditors simply doing what they are told by management of the company, for fear of otherwise risking their appointment.

Auditors have statutory importance under the *Corporations Act 2001* (Cth). Section 301 of the *Corporations Act 2001* (Cth) requires companies subject to the Act to have their financial report audited and to obtain an auditor's report. Recommendation 4.1 of the Australian Securities Exchange (ASX) Corporate Governance Principles and Recommendations (4th edition, 2019) states that a board of a listed entity should have an audit committee and appropriate processes to verify the integrity of its corporate reports. Audit committees assist board of directors to fulfill their corporate governance and oversight responsibilities by inspecting and raising any audit quality concerns. However, companies must have appropriate processes and records to support what is stated in their end of year financial report, rather than relying on the (independent) auditor. For listed companies, CEOs and CFOs are required to provide declarations concerning the company's financial records, and whether the financial report complies with accounting standards and the requirement to give a fair and true view. These declarations do not reduce the responsibility of any director on the board for ensuring that the financial report complies with obligations under the *Corporations Act 2001* (Cth).

Auditor Independence

For publicly listed companies, the board of directors is responsible for appointing the auditor. Directors must ensure that the independence of the auditor is not compromised. The *Corporations Act 2001* (Cth) requires the audit committee of a listed company to review non-audit services and whether they affect auditor independence. The Act also requires a declaration by the auditor on their independence and applicable codes of professional conduct to be included as a part of the directors' report.

Audit quality relates to the auditor's main undertaking: to obtain reasonable assurance that the financial report, as a whole, is free from misstatement and to communicate this to third parties. Audit quality can be impacted by several factors, including a company's culture, the auditor's understanding of the business and its risks and how effectively and often audit engagements are supervised and reviewed (quality reviews). Auditors must demonstrate appropriate qualifications and skills and be fit and proper before ASIC will register independent auditors, registered audit companies or authorized audit companies on its professional register.

Learning from several high-profile company collapses, notably the demise of HIH Insurance in Australia, poor audit quality and the lack of transparency and accountability, the audit function has since been improved (at least for public companies). *The Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Act 2004* (Cth) (CLERP 9) introduced significant reforms in audits, executive remuneration, CEO/CFO certification of annual financial statements, shareholder participation and continuous disclosure obligations under the *Corporations Act 2001* (Cth).

Focusing on audits, CLERP 9 introduced auditor rotation requirements for listed companies to promote auditor independence, which are now included under the *Corporations Act 2001* (Cth). Auditor rotation requires that individuals may not play a significant role in the audit of a listed entity for more than five out of seven successive financial years. CLERP 9 also created a cooling-off period up to two-years before members of an audit firm can become an officer of an audited company. This safeguard against self-interest, familiarity and lack of auditor independence, means that there needs to be a two-year period before any professional member

of the audit engagement team for the audit can become an officer in the audited firm. This restrictive time interval of two years should be increased to a minimum of five years.

g. duties of care;
Directors of companies are subject to numerous duties and obligations under general law (common law duties and equitable fiduciary duties) and the *Corporations Act 2001* (Cth). Part 2D.1 of the *Corporations Act 2001* (Cth) sets out some of the most significant duties of directors, secretaries, other officers and employees of corporations.

Under a partnership structure, typically there will be a partnership agreement which stipulates specific duties of the partners, among other issues such as roles and responsibilities of each partner, how debts and liabilities will be managed, etc. Under a partnership structure, partners own fiduciary duties (based on loyalty and trust) to each of the other partners and must act in the best interests of both the partnership and the other partners.

h. management of conflicts of interest.
It is difficult to legislate for every type of conflict of interest because they will differ in size and complexities given different circumstances. Business leaders need to have a strong moral compass and be prepared to call out potential conflicts of interest for themselves and for others. For companies, conflicts of interests are dealt with by directors' duties under the general law and the *Corporations Act 2001* (Cth). Breaching these duties can lead to serious civil penalties being applied to directors.

One concern regarding consultancy use in government departments is the so-called 'revolving door' where individuals move between public and private jobs, notably between working for the government and then moving to work at a consultancy firm and vice versa. The problem with the revolving door is that it can lead to conflict-of-interest situations, increasing the risk of corruption. Given their decision-making power, access to information and influence, former Ministers and other government members can be great assets for private companies. Governments should ensure that appropriate measures are in place so that former public servants do not misuse their power and influence to benefit their private interests.

Cooling-off periods are one way to handle such conflict of interests. Like the CLERP 9 auditor rotation reform discussed above, a minimum time interval restricting government members from working in the private sector may help. According to the Code of Conduct for Ministers, the current cooling-off period for ministers of the Australian government is 18 months (after ceasing to be a Minister). This means that Ministers undertake to not lobby, advocate, or have business meetings with members of the government, parliament, public service or defence force on any matters on which they had official dealings in their last 18 months in office. These standards are not legally enforceable.

The time interval restriction of 18 months and its unenforceable nature is quite unacceptable. The time interval is much too short. There needs to be a statutory ban that is legally binding and a time interval restriction that is at minimum five years. This would help to limit the revolving door between government workers and consultants moving between public and private work where potential conflicts of interests may arise.

Final comments
The auditing, assurance and consultancy professions play an important role in maintaining and promoting confidence and integrity in corporate Australia. As the PwC tax leak scandal

illustrates, there are structural, ethical and professional challenges that remain to be solved in these industries. Transparency and accountability must be at the forefront of these required changes. Consultants should be required to answer questions about government contracts when called before parliamentary and other inquiries and consultancies should be required to publicly disclose information to the public when working with the government. One way to effect change for the big four consultancies that operate as partnerships is to mandate stronger, transparent and mandatory governance practices to be applicable to partnership structures and ensure enforcement sanctions have real consequences.

I would like to thank the Parliamentary Joint Committee for taking an active interest in this important area. I thank the Joint Committee for the opportunity to comment.

Dr Kelli Larson