

Submission by Professor Graeme Samuel AC, Monash Business School, Monash University Melbourne to PARLIAMENTARY JOINT COMMITTEE ON CORPORATIONS AND FINANCIAL SERVICES in relation to its Inquiry into ethics and accountability in the audit, assurance, and consulting sectors

Over several years I have formed some views in relation to issues concerning the audit, assurance and consulting sectors. Many of these views have been expressed publicly. My views can be summarised under the following headings.

1. The view held by many in the private and public sectors that they need to engage large professional consulting firms to undertake responsibilities that they feel inadequate to undertake themselves.
2. The inherent conflict between the same firm undertaking advisory work and audit responsibilities for the same client.
3. The inherent culture of major consulting firms in carrying out their professional responsibilities

I will deal with each in turn.

Do we need consultants?

For over over two decades, I have been involved in, and save for one project, led reviews and policy analysis and implementation at a Commonwealth Government level. I will list the more important as they will serve to illustrate my proposition in relation to the need to engage consultants.

National Competition Council

- Reviews of anti competitive structures, regulations and policies
- Review of Australia Post letter monopoly
- Development of the National Access Regime of monopoly infrastructure
- Review and determinations of applications for declaration of access to natural monopoly infrastructure
- Development of Gas Pipeline Code
- Development of Murray Darling Basin water rights

Australian Competition and Consumer Commission

- Countless reviews and determinations of applications for merger clearances (competition issues) and authorisation applications (competition and public interest issues)
- Specific reviews of Retail Grocery market and Petrol Markets

Commonwealth

- Review of Independent Medical Research Institutes (Dept of Health)
- Review of Private Health Insurance (Dept of Health)
- Review of Australia's Wool Selling Systems (Australian Wool Innovation)
- Review of Food and Grocery Code of Conduct (Treasury)
- Review of Governance, Culture and Accountability of Commonwealth Bank of Australia (APRA)
- Capability Review of APRA (Treasury)
- Independent Review of Environment Protection and Biodiversity Conservation Act (Dept of Environment)

I have listed all these Reviews because, with one notable exception - the APRA commissioned Review of the culture, governance and accountability of the Commonwealth Bank - APRA insisted on engaging Oliver Wyman to assist in the conduct of the Review, which proved to be a waste of money - none involved the engagement of major external consulting firms. In certain cases, specific experts were engaged to provide input on matters requiring special subject expertise.

But other than for these exceptions, the Reviews were led by individuals selected for that purpose - or in the case of the National Competition Council by Council members, and the ACCC, by Commissioners.

The Government authorised remuneration for appointed individuals tasked to lead these reviews is in the order of \$1500-2000 per day, prorated for part days. That would be a fraction of the remuneration paid to consulting firms.

In each of the above Reviews, the individual Review leaders came with experience, independence, intellectual and personal integrity and above all a commitment to undertake the Reviews placing the public interest foremost.

The Reviews have in each case been served by an outstanding commitment on the part of public service officers of the Agencies or Departments concerned. Each of those public service officers contributed with experience, an understanding of the independence of the Review, intellectual and personal integrity and a commitment to serve the Review placing the public interest foremost.

In the corporate sector, there have been mixed outcomes in relation to Reviews commissioned by corporate boards. The choice of Review panel members has at times been questionable as to the intellectual integrity of the individuals concerned and that has been evidenced by the quality of the Reviews.

In my experience, with some guidance by qualified independent and intellectually rigorous individuals, the public service has very capable internal resources to develop and implement the policy programs required by government. I have consistently been impressed by the intellectual rigour, and integrity of those assisting me in the conduct of Reviews and policy development. The engagement of external consulting firms should be rigorously assessed, and confined to circumstances where the public service has inadequate expertise, or they can offer an outside perspective that carefully chosen external individuals cannot provide - that should be rare indeed.

Conflict of interest

It has long been my view, expressed publicly, that major accounting firms, should not be conducting both audit and advisory roles for the same client (including in this prohibition, the global associates of both the accounting firms and their clients). The response from the accounting firms has been that Chinese Walls are in place to mitigate the conflicts. And then it is argued that the knowledge gained by performing one role will assist in the quality of the performance of the other role - in other words that the Chinese Wall needs several discrete holes to permit the interflow of information!

It is impossible to erect an effective impenetrable Chinese Wall between departments of the same firm. Each of the audit and advisory arms must be aware of the audit or advisory relationship. The annual accounts will clearly reflect the audit relationship, and it would be surprising indeed if, in the conduct of a comprehensive audit, those involved did not become aware of the advisory relationship. The very knowledge of the existence of those relationships must create a conflict of interest which, even subconsciously, will impact on the rigour and integrity of the audit. This has been acknowledged in international analyses of this matter and was overtly acknowledged in the aborted attempt by EY to split its firm to separate the audit and consulting functions into two separate firms.

It has been urged on this Committee, in the examination of the Big Four following the PWC tax leak issues, that the major accounting firms should be required to split their audit and advisory practices into two separate firms. I regard this as an extraordinary overreach and practically of limited impact in dealing with conflicts of interest, given the global structures of the firms concerned.

A far simpler and achievable resolution to the conflict dilemma would be to prohibit a firm (and its associates) from providing remunerated services to the same corporation (and its associates) which the firm is auditing. While that could

be an Australian regulatory requirement, it would apply in Australia if the global firm satisfied the prohibited criteria. Interestingly, this regulatory requirement should simply result in advisory mandates being redistributed amongst the accounting firms.

Culture

The culture of any firm or corporation is set by those who lead the entity, but unless regulatory disciplines are imposed, will often (inevitably?) be impacted adversely by the financial imperatives - the profit objective. It is a rare entity that is governed by shareholders or partners/directors, who are prepared to place the profit motivation in second place to intellectual integrity and the public interest.

That is the basic foundation of the capitalist model. It should not be criticised, but simply recognised for what it is. While there are strong and increasing pressures to integrate ESG (Environment, Social and Governance) considerations into business strategies and practices, much of what we are evidencing to date is more symbolic - the road to effective integration of ESG (or values based capitalism) is long indeed and replete with many road humps.

So it becomes an imperative for government to impose regulatory disciplines on firms and corporations such as that proposed in 2 above. These are simply to recognise the essence of the capitalist or market based model and to compensate for any weaknesses or failure of the unfettered model to reflect government policy or community expectations as they evolve.

The solutions

I have indicated above that I do not consider mandating a structural separation of the audit and consultancy divisions of the major accounting firms is either warranted or effective. That is both an overreach and in the context of global firms, ineffective in solving the conflict dilemma. And if applied to the Australian firms alone over which the Australian Parliament has jurisdiction, it would be ineffective in neutralising the global conflicts of interest referred to above. Similarly I see little to be gained by attempting to mandate that the corporate structure of the firms be set, such as to bring them within the regulatory jurisdiction of ASIC. A regulatory body cannot dictate or change the culture of an organisation. But activity oversight, transparency and resultant accountability can be effective in imposing disciplines on firms that ultimately mandate a cultural reset - the actions of this Committee are a testament to that.

It is important to note the ASIC Information paper - ASIC Audit surveillances (Information sheet 224, 11 January 2023). The need for rigour and transparency of that process cannot be overstated. It must inevitably result in accountability for deficient audit practices - with audited corporations choosing to migrate away from consistently poor performing audit firms. For a failure to do so must raise issues as to the diligence of directors in carrying out their responsibilities.

I would urge on the Committee the implementation of regulatory mandates to prohibit the same firm conducting both audit and consultancy services for the same corporation (including its associates in Australia and globally). This removes the inherent conflict of interest and resultant impact on audit quality. Similarly, where a firm has been found to have breached its contractual obligations, remedial action should be swift and severe - again a testament to the recent actions of this Committee and Government.

But importantly, transparency and resultant accountability is the most potent discipline to bring about cultural and ethical responsibility. Assigning this task to regulators alone, with a reliance on detailed technical regulations, will never keep pace with the technological evolution and human intelligence that can facilitate misbehaviour. And as noted above, it is impossible to regulate for ethical and cultural change. But market transparency, quickly reacts to community expectations, with resultant disciplines being imposed on miscreants.

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