

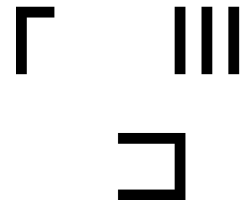
Parliamentary Joint Committee on Corporations and Financial Services

# **Ethics and Professional Accountability: Structural Challenges in the Audit, Assurance and Consultancy Industry**

SUBMISSION BY THE ETHICS CENTRE

## **INTRODUCTION**

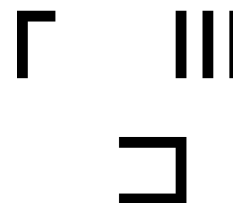
1. This submission focuses on a number of core ethical questions that underpin the Committee's inquiry. The most relevant Terms of Reference elements are Number 3 and Number 4.
2. The concerns we address are:
  - a. The relationship between the proper role of government, and the intersection of a government's role with that of the professions
  - b. The mechanisms available to governments, with a particular focus on preventative measures, rather than reactive measures.
3. It is the core contention of this submission that government functions should only be outsourced to third parties who have an unalloyed practical commitment to subordinating self-interest in favour of the public interest.
4. In principle, such parties ought to include members of the professions due to their fundamental commitment to act solely in the spirit of public service.
5. In practice, it can be difficult to determine whether such commitments are sincere and practical – rather than merely rhetorical.



6. It is in the public interest that governments have access to a pool of professional advisers and potential partners who it can engage to support its work. Such a pool can only be maintained if the structures and governance obligations are fit for the purpose of sustaining *genuine* professions and *genuine* professional firms.
7. This should orient the Committee towards supporting proposals that reinforce the distinct ethical obligations of the professions rather than those of the market – which tend to be dominant when left unchecked.
8. Fortunately, there are reliable mechanisms by which the ethos of professional service firms may be evaluated.

#### **THE PROPER ROLE OF GOVERNMENT**

7. It is a basic tenet of democratic government that public power be exercised exclusively in the public interest. To do otherwise is to corrupt both the purpose and practice of democratic politics.
8. Modern democratic governments have tended to 'privatise' a number of their functions ranging from the incarceration of criminals, the building and operation of physical infrastructure through to the development of policy.
9. Typically, privatisation has been justified by governments on either ideological or practical grounds.
10. Ideological justifications have centred on an antipathy to government, per se, as representing a threat to individual (private) liberty.
11. Practical justifications have included projected efficiency gains (cost savings), reduced capital costs (enabling investment in other priority areas) and access to people with knowledge and skills not to be found within the public service.



12. While there are apparent boundaries limiting what might be 'outsourced' or privatised (one assumes anything touching on national security is 'out of bounds'), there is no clear delineation as to where those boundaries may lie.
13. It is our submission that, in any case, government takes on 'ethical risk' whenever it outsources any of its functions to those who prioritise self-interest over the public interest. None of this is meant to imply that those who pursue self-interest are 'unethical' or to be considered 'bad actors'. Indeed, as explored below, the whole 'logic' of the free market is based on the assumption that the pursuit of self-interest is entirely legitimate and that the 'invisible hand' will ultimately lead to an increase in the stock of common good.
14. However, as we discuss below, there is no avoiding the fact that there co-exist in society two separate 'worlds', being; the 'world' of the market (that legitimises the pursuit of self-interest) and the 'world' of the government and the professions (which require the subordination of self-interest in favour of the public good).
15. It is this tension that must be acknowledged and resolved whenever governments consider outsourcing or privatising their functions, in general. More specifically, this same tension lies at the heart of this Inquiry.

## **TWO WORLDS: THE MARKET AND THE PROFESSIONS**

16. Adam Smith challenged the underlying assumption that love-of-self (self-interest) was a problem. Instead, he argued that a free market driven by self-interest would increase the stock of common good through the operation of an 'invisible hand':

It is not from the benevolence of the butcher, the brewer, or the baker, that we can expect our dinner, but from their regard to their own interest. We address ourselves not to their humanity but to their self-love, and never talk to them of our own necessities, but of their advantages.<sup>i</sup> Every individual ... neither intends to promote the public interest, nor knows how much he is promoting it ... he intends only his own security; and by directing that industry in such a manner as its produce may be of the greatest value, he intends only his own gain, and he is in this, as in many other cases, led by an invisible hand to promote an end which was no part of his intention.<sup>ii</sup>



17. This radical notion of self-interested actors in a free market inadvertently serving the public interest was a direct challenge to the perceived moral superiority of those engaged in selfless, noble service. For Smith, the free market would produce at least as much good, just as long as it was not distorted by those who lie, cheat or use power oppressively. In each case, these 'vices' erode the capacity of market participants to make informed choices and to engage in a free exchange of value. That is, Smith realised that markets could only remain free and efficient if built on a solid ethical foundation. Self-interest was fine, as long as it was checked by ethical restraint.

18. Adam Smith championed the combination of self-interest and ethical restraint precisely because he was suspicious of the way merchants could and do occasionally behave:

People of the same trade seldom meet together, even for merriment and diversion, but the conversation ends in a conspiracy against the public, or in some contrivance to raise prices.<sup>iii</sup>

19. Given the tendency for merchants to collude (in defiance of the logic of the free market), societies have frequently put in place checks and balances, both formal and informal, that are designed to ensure that the 'invisible hand' has the greatest chance to achieve the increase in the stock of common good that the market is intended to produce.

20. The professions are an essential component in this system of checks and balances, and are an expression (albeit in different form) of the older aristocratic and clerical traditions of vocational service. Indeed, in some cases the modern professions are direct descendants of the 'noble' orders. However, even the newest of the professions, such as financial advisers, carry the legacy of this older world.

21. As noted above, the world of the market is defined by two core principles. First, the market endorses and justifies the pursuit of self-interest in terms that are unchanged since the time of Adam Smith. Second, the market operates on the basis that the only obligation of the merchant is to satisfy the wants of each customer.



22. The world of the professions is also defined by two core principles, each diametrically opposed to those of the market. First, the professions require the subordination of self-interest. Second, the professions must serve the interests of their clients, patients, or relevant parties. That is, they may never satisfy mere wants if to do so is not in the interest of those whom they serve.
23. The following example illustrates the difference. Imagine a person wishing to consume a block of chocolate. They head to a local corner store where they find their preferred brand of chocolate on the shelf, then head to the counter where the store owner stands ready to receive payment. The merchant has not stocked chocolate in order to benefit the customer; rather, it is stocked by the store owner in the expectation of profiting from the sale. The merchant does not care why the customer wants to buy the chocolate. It could be for immediate consumption or as a gift for someone else. The only thing that really matters to the owner is whether or not the customer can pay the purchase price.
24. Contrast this with the case of a doctor whose diabetic patient asks to be given a block of chocolate. Knowing that it is not in the interests of the patient to be given the chocolate, the doctor will refuse. It will not matter that the patient states clearly that they want the chocolate and that it is no business of the doctor to say what they can and cannot have. In response, the doctor will agree that it is for the patient to decide whether or not to harm themselves. However, the doctor will refuse to be complicit in causing that harm, because to do so is inconsistent with their duty to act solely in the best interests of the patient. It will not matter if the patient offers a large inducement to provide the chocolate: for example, a massive fee or a special favour. The doctor is bound by their professional obligation to set aside their personal interests, subordinating them to the extent necessary to serve the interests of the patient.
25. For the sake of clarity, it should be noted here that the word 'professional' is often applied to persons who are not members of *the professions* – and are therefore not subject to their ethical strictures. For example, it is common enough to refer to 'professional' (as opposed to 'amateur' athletes. We might even say that certain merchants are 'professional' in the way they perform their roles. It is worth noting this here because many consulting firms will be made up of employees – some or all of whom might operate in a 'professional' manner without being



members of a profession (as defined in this submission). For the avoidance of doubt, when speaking of the professions in this submission, we are speaking of those who meet the ethical commitments and standards that define what it means to be a profession.

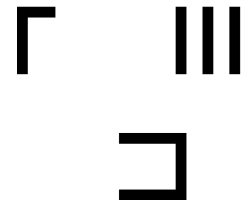
As a case in point, consider the Chartered Management Consultant Institute (CMCI). The CMCI provides a charter or official recognition for management consultants that meets certain standards of excellence, professionalism, and ethical conduct in the field of management consulting.

In its competency framework it includes a 'Code of Conduct and Practice' comprising a number of 'Foundation Values,' 'Ethics,' and 'Behaviours.' Notably, public interest (or variations of the same) are not included in its foundation values. Notably, 'Behaviours' includes 'Acting in the best interests of your organisation, customers, clients and /or partners.' Compare this with the fiduciary duty of financial advisors under section 961 of the *Corporations Act 2001* (Cth) which explicitly requires advisors to act in the best interests of their clients and to place their clients' interests ahead of their own when developing and providing personal advice. The latter group has actively been moving towards becoming a true profession – despite the resistance of some who, for reasons of self-interest, would prefer to retain the capacity to offer 'conflicted advice', etc.

#### **ACTING IN A SPIRIT OF PUBLIC SERVICE**

26. It should be noted that members of the profession uphold their professional obligations in the spirit of public service. That is, although they serve the interests of their client, their doing so is also for the public good. For example, in the case of the doctor who refuses to provide chocolate to their diabetic patient, society shares in the benefit of illness being prevented. That is, the private benefit to individual patients in not being harmed is aggregated in a way that serves the public interest.

27. In a number of cases, a professional's commitment to the public good is 'hardwired' into the structure of the profession. For example, lawyers are formally admitted as officers of the courts in whose jurisdiction they practise. As such, they are bound by a series of professional obligations that take precedence over the duty owed to a client. For example, a lawyer may not knowingly enable a client to act unlawfully, even if the client claims that to do so is in their



interest. For a similar reason, an officer of the court may not present evidence that they know to be false, may not backdate a document and so on, no matter how much the client might benefit.

28. It should be observed that the overarching duty to act in a spirit of public service is not necessarily incompatible with a certain view of self-interest. For example, members of the professions may have an interest in preserving their professional status (via accreditation, etc.) - a somewhat paradoxical, complementary source of *motivation* for subordinating self-interest. However, although this dimension might *motivate* professional conduct, it cannot justify it – as a reliance on self-interest is, by definition, an attribute of the market ethos.
29. The idea of the professions having an overarching obligation to serve the public interest (beyond the duty owed to the individual client or patient) is widespread. For example, doctors and teachers are bound to report certain matters relating to child welfare and risk of violence, even if this would be against the wishes of those whose interests they serve. Auditors owe a public duty to ensure accounts are true and fair, even if their client may prefer that this was not so. Engineers have a duty to keep the public safe, even if a client would prefer to generate greater profits by using less reliable materials.
30. The extent to which members of the profession are bound by formal (often legislated) duties to act in the public interest varies according to each occupational group. However, all members of the profession are assumed to act in a spirit of public service. As noted above, the professions help to balance the forces of the market, thus ensuring that society can enjoy the benefits of private enterprise without being exposed to the costs which would occur if not mediated by ethical restraint.

## **DEFINING GOODS**

31. Each profession exists to secure a 'defining good': some benefit that it is especially well-suited to attain. As a rule, these 'goods' are of value to society as a whole, thus fitting in with the idea that professionals act in a spirit of public service. Indeed, it could be argued that each type of good secured by the professions is essential to the maintenance of a healthy society. For example, lawyers are supposed to secure the good of justice. Doctors, nurses and other



healthcare providers secure the good of health and wellbeing. Engineers ensure our safety. Accountants and journalists pursue the good of truth and those who belong to the profession of arms are meant to work for peace.

32. Each of these defining goods is difficult to attain and preserve. Indeed, the meaning of concepts like 'truth', 'peace' and 'justice' are open to debate. Yet, despite the ambiguity inherent in such terms (or perhaps because of the ambiguity) each profession is required to care about the good they are meant to provide. In turn, this requires members of the professions to wrestle with the concept to achieve as much clarity as possible. As noted above, attaining clarity can be an elusive goal. Another approach is to become clear about what counts as the absence of a particular good. For example, although we might find it hard to define perfect health, we can reasonably easily recognise its absence, as when someone is diseased. The same can be said for the other goods. While it is difficult to offer a positive definition of terms like 'truth', 'peace' and 'justice', their absence or negation is reasonably easy to recognise.
33. Understanding a defining good has wider ethical implications for members of each profession. Having understood the good to be attained, each profession must then ensure that its members are 'fit for purpose'. The criteria for being 'fit' goes well beyond having the necessary knowledge and skills required to secure the good. Members of the professions must also possess the required dispositions of character and be aligned with a framework of values and principles that enable their purpose to be realised.
34. This adds depth to some of the core ethical principles we have already identified, such as the subordination of self-interest in the service of others. For example, it is difficult to imagine any professional being able to perform their role if they lack moral courage. All professionals need to possess a capacity for empathy so that they can properly discern the interests of those they serve.





### THE SOCIAL COMPACT

35. The choice to be a member of a profession, to subordinate self-interest in favour of wider society and one's clients comes with a cost, especially in a society in which the 'logic of the market' is so dominant. Most members of society operate within the market economy. Their day-to-day life and route to prosperity are regulated by its norms. As a result, for most people, the commercial ethic of self-interest and the satisfaction of wants is not merely expected but accepted. Indeed, modern liberal democratic societies now tend to celebrate the success of its greatest merchants. In a reversal of the old norms of aristocratic societies, today's celebrities are valued because of their success (marked by wealth) rather than because of their virtue or contribution to wider society. Given this, one might be tempted to abandon the ethos of the professions; let go of that older sense of vocation and public service. After all, why subordinate self-interest when all the world is encouraged to do the opposite, and when this is the standard most celebrated?
36. There have always been some people who feel they have a calling to serve others, and who derive immense personal satisfaction from practising learned arts in which they develop knowledge and skills to a level well beyond those of ordinary people. However, there has also been a recognition, by society, that members of the professions should receive a measure of formal and informal public support in recognition of their decision to moderate their participation in the market economy. For example, society has been willing to reserve certain types of work for those who are fully trained and accredited members of the professions. Occupational restrictions — excluding non-professionals — are common in, for example, medicine, law, auditing and engineering. They also apply now in the case of financial advice: the terms 'financial planner' and 'financial adviser' are legally restricted for use by *bona fide* members of the profession. Society also accords a special status to members of the professions: sometimes informally bestowed, and sometimes reflected in formal rights such as the right to witness official documents. Finally, although society does not promise members a minimum income, it is more common than not that members of the professions will find themselves at the upper range of the income curve.

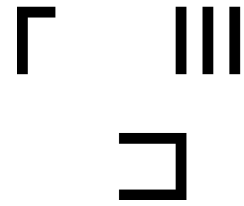


## **IN SUMMARY**

37. Members of the professions are the 'inheritors' of a much older social structure that privileged those with a vocation-to-serve over those who pursued self-interest. With the rise of the market economy and the legitimization of the pursuit of self-interest, the professions have evolved to provide ethical restraint of a kind that 'tames' the excesses of the market. In recognition of their subordination of self-interest and their advancement of public goods, society accords certain privileges to members of the professions by way of a social compact.
38. The most pressing challenge facing the modern professions concerns their willingness and capacity to honour their professional commitments in practice, rather than merely in name. From time to time one sees members of the professions who trade on their status as a member of a profession while behaving as if they are simply participants in the market. This kind of behaviour, left unchecked, eventually destroys the social compact, allowing the logic of the market to envelop all.

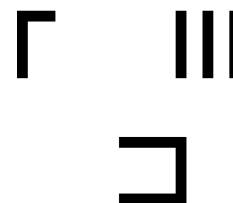
## **THE INTERSECTION OF THE PROFESSIONS WITH GOVERNMENT: SOME CONSIDERATIONS**

39. As noted above, democratic governments are bound to act solely in the public interest – especially if they are to maintain their legitimacy. This obligation extends, unmediated, to the 'agents' of government – whether directly employed as public servants or engaged as contractors to undertake functions on behalf of government.
40. This requirement extends to those who act on behalf or serve the interests of government irrespective of the function they perform. That is, the same obligation extends to those who *advise* government as to those who carry out its functions – with advisers bound to act in the best interests of government – which is consonant with the public interest.
41. As in all other cases, members of the professions are required to subordinate their personal or institutional interests to those of their client – in this case, the government. To do otherwise, risks ethical failure not only on the part of members of the profession but also their client, the government. To be clear, ethical failure by the professions – in and of itself – risks 'contaminating' the ethics of government by subverting its sole, proper purpose (to act in the

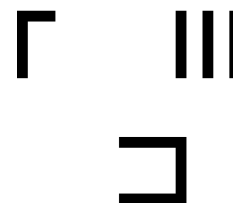


public interest). The contamination occurs the moment a private interest (self-interest) is given priority.

42. Government ought to be able to rely on the professions to exercise ethical self-restraint of the kind outlined above. That they should be able to trust the professions in this regard is one part of the 'ethics dividend' to be earned when trustworthy conduct removes the need to impose the far less efficient 'deadweight' costs of regulation and surveillance (the alternative to trust).
43. Of course, the 'ethics dividend' is lost in cases where an individual merely pretends to embrace the ethical obligations of the professions while, in fact, operating according to those of the merchant.
44. So, one of the immediate challenges for government is to discern the difference between the authentic professional and the mere 'pretender'. Part of the answer may be found in the quality of governance a formal profession exerts over its members. For example, does the profession apply – in practice (rather than in rhetoric, alone) high ethical standards that are monitored and enforced? In particular, does the professional body hold its members accountable for the practical application of the core values and principles that define the ethics of the profession rather than simply enforce adherence to rules of conduct? While the latter are important, it is not uncommon to see poor ethical conduct excused because it fell outside a strictly defined series of rules.
45. Another consideration is the underlying culture of those wishing to offer services to government. This is a more exacting consideration. However, it is necessary because a potential service provider may have avoided censure for many reasons other than the quality of their practical ethical commitments. For example: wrongdoing might not have been detected, wrongdoing might have been avoided by rule following (a narrow form of compliance) – neither of which would be a reason for confidence in the organisation's ethics more generally.



46. It should be noted here that there are good reasons for re-examining the concept of a 'culture of compliance'. As originally conceived, the concept was meant to take account of cultural drivers that might either undermine or reinforce compliance with the law (and applicable standards). For example, an organisation might have a formal set of policies that appear to promote strict adherence to workplace safety laws and standards. Yet, the same organisation might have a culture that consistently privileges 'profit' over 'safety' – leading people to 'cut corners' or 'turn a blind eye' to unsafe practices so as to meet, say, production targets and thus, preserve jobs, etc. Unfortunately, this original understanding has been lost or supplanted to such a degree that the concept of a 'culture of compliance' is often reduced to being nothing more than a 'culture of following the rules'. This narrow form of 'mere' compliance offers little protection from conduct risk – which too often becomes manifest the moment that the rules become ambiguous, or absent or when surveillance is irregular. This risk is especially great when there is a perceived gap between what an organisation *espouses* (in terms of values and principles) and what it does in *practice*.
47. Government is only really able to have confidence in the ethics of those with whom they contract if those parties are able to demonstrate:
- what lies at the foundation of their culture – an Ethics Framework of **both** core *values* and core *principles*, linked to a defining *purpose*, and
  - the extent to which what is espoused is aligned to what is practiced (including as embedded in key systems, policies and structures).
48. Fortunately, it is possible to measure such alignment and to report on it – with a degree of fidelity such that a government might rely on the data. However, that assumes that key aspects of the process of measurement and evaluation is undertaken by an independent and disinterested third party (rather than being the product of the party that, itself, seeks to contract with government). That is, it is not enough that potential contracting parties simply self-assess and report without any independent assurance process being applied.



49. Governments should be wary of contracting with entities that are unwilling or unable to disclose:

- the contents of their Ethics Framework,
- a demonstration of how their Ethics Framework is consistent with Public Sector Ethics as may apply from time to time, and
- reliable evidence of practical alignment (including with the structures, systems and policies that shape conduct) between what is *espoused* and what is *practiced*.

50. Evidence of 'misalignment' ought not exclude a party from contracting with government.

However, it might prompt a measure of caution – which itself could be offset by:

- the party putting in place programs of remediation, and/or
- additional oversight, etc.

51. As noted above, not all possible advisers or service providers will be made up of members of the professions (as defined here). This does not mean that one should be indifferent to the ethics of those who fall outside of this group – simply accepting that the self-interested ethos of the free market should apply. Instead, for the purpose of their own dealings with such groups, governments should require that service providers meet basic requirements (especially in relation to the public interest test) that might apply as if the organisation was formally bound by the distinctive ethical obligations that define the professions.

52. Beyond this, governments might look to employ a number of other possible means of gaining confidence in the underlying ethical character of those with whom it might contract. Such measures might include:

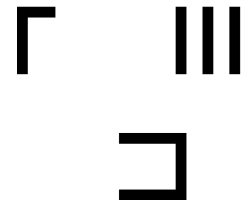
- Establishing a framework of 'fit and proper person' standards that should apply to key personnel – especially in cases where services involve either especially sensitive or high value work. There are numerous precedents for how this might be done.
- Establishing a 'consequences management' regime in which graduated 'penalties' are imposed according to the seriousness of the ethical infractions reported or detected. Features of such a scheme might include that:
  - lower penalties would be imposed in cases of self-reporting,



- penalties would range from increased oversight and reporting obligations (for relatively minor infractions) to banning (for major infractions).

## CONCLUSION

53. The evolution of the professions – and the corresponding ‘social compact’ that has been entered into with society – is an important part of the ‘ethical infrastructure’ on which we all depend. Unlike physical and technical infrastructure (roads, rail, internet, etc.) all of which receive considerable investment, society’s ethical infrastructure is largely taken for granted. Yet, Deloitte Access Economics has estimated that a mere ten percent increase in ethics in Australia would, by itself, increase Gross Domestic Product (GDP) by 45 billion dollars *per annum*.
54. The most potent driver of that effect is the increase in trust that would be produced – with the ‘dividend’ being lower deadweight costs, a more permissive environment for reform, etc.
55. An important recipient of both the direct and indirect benefits of such an improvement would be government itself. But it is essential that government also play its part in this process. In turn, this requires government to ensure that it act with absolute integrity – in both senses of the word. The first sense is that government, itself, be aligned in *practice* with what it *espouses*. The second sense of ‘integrity’ is that each of the parts of one entity should relate well to the whole. It is this second sense of ‘integrity’ that is brought into focus when thinking about the relationship between government and the professions.
56. Thus, government has a particular interest in ensuring that there are bodies available to assist it in its work that will not compromise it (being government) when discharging its ethical obligations.
57. It follows from this that governments need to promote the development and maintenance of genuine professions – and not their mere semblance.
58. It is with this in mind that The Ethics Centre in partnership with the Universities of NSW (UNSW) and Sydney (USYD) have proposed the establishment of a new, national body, the Australian



Institute of Applied Ethics (AIAE) – an independent entity that, amongst other functions, would promote and coordinate the development and application of practical measures to improve the quality of Australia’s ethical infrastructure – not least the professions.

59. This brings this submission back to the central focus of this Inquiry. The largely philosophical discourse about the role of the professions and their intersection with government – as outlined above – has far more general application than might seem to be the case. The Committee is bound, we think, to address its Terms of Reference with these broader philosophical considerations in mind. Only then will questions of structures (Terms of Reference 1) and governance structures (Terms of Reference 2) be properly addressed. Otherwise, the risk is that ‘commercial considerations’ – such as should apply in the market – will be predominant.
60. All of this might seem to be weighted towards the needs of government as opposed to those of the private sector. However, while this might be understandable given the focus of this submission, it would also be mistaken. The private sector (or society more generally) benefits from the preservation of the professional ethos as a continuing reality. For example, corporate stakeholders, in general, and owners and investors, in particular, have a vital interest in the integrity of the process of auditing. Audits are far more likely to serve their proper purpose of enabling informed decision-making if undertaken by people bound by the ethical obligations of a profession rather than if undertaken by people who simply offer an audit service on a purely commercial basis. But that is only true if the ethical commitments of the members of the profession are genuine and embedded in practice.
61. In other words, the whole of society – not least the private sector – is best served when governments enable the professions to flourish. They can do so in part by virtue of the legislative arrangements that they put in place as part of the social compact. They can also do so by way of the regulation of structures and governance obligations. And they can do so through their own procurement practices.
62. In this submission, we have not sought to specify which structures or governance obligations ought to apply. Our task has simply been to outline the arguments for what might count as a



defensible 'standard for judgement' when deciding such questions. In its simplest form this standard might be captured in the following questions:

- a. Is the nature of the work to be undertaken likely to have a material impact on the public interest?
- b. If yes, then will this structure or governance obligation undermine the ethical foundations of the social compact between society and the relevant profession(s)?
- c. If no, then questions of structure or governance obligations may be determined by the market.

Dr Simon Longstaff AO  
Executive Director  
The Ethics Centre

23 August 2023

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<sup>i</sup> A Smith, *The Wealth of Nations*, Book I, Chapter II, pp 26–7, para 12.

<sup>ii</sup> Ibid, Book IV, Chapter II, p 456, para 9.

<sup>iii</sup> Ibid, Book I, Chapter X.