Dear Committee,

The following submission was published today on independent journalism website michaelwest.com.au.

https://www.michaelwest.com.au/black-holes-high-rises-and-the-meatloaf-principle-australias-top-audit-fails/

I submit:

1. That the four global accounting firms operating in Australia - EY, KPMG, PwC and Deloitte - be broken up along the lines of tax, consulting and audit to eliminate conflicts of interest and make audit independent.
2. That audit firm rotation, period of 7-10 years, becomes mandatory
3. That General Purpose financial reporting be mandatory for all companies with $100 million or more in revenue.

The following story - and links to specific audit failures and aggressive tax schemes - is submitted to corroborate the view that the audit profession is failing and compromised by tax and consulting operations of Big Four audit firms.

STORY

Over the past ten years analysing the financial statements of multinational companies in Australia, this reporter has found literally hundreds of failures to comply with the Australian Audit Standards Board (AASB) standards, failures by the biggest companies in the world to comply with AASB are therefore failures to comply with the Corporations Act. The Corps Act requires companies follow the standards, so if they are not followed, the law has been broken.

They've let it slide, over many years, to the point where some multinationals file accounts which are okay but plenty, those which are not listed on ASX that is, don't. When it comes to standards, the Big Four appear to subscribe to the Meatloaf Principle; that is, two out of three ain't bad.

There is a double standard in this. Small business people will be well aware that, if they fail to comply, for instance fail to file on time with the regulator ASIC, they face swingeing fines. No such penalties for the Big End of Town however. When the Business Council of Australia, or Johnson & Johnson break the rules, nothing happens.

Overall, and we shall get to this later, there has been a decline in transparency masterminded by the Big Four which is evident in the switch en masse into Special Purpose reporting from General Purpose, that is reporting financial statements which seriously reduce disclosure. This has been systematic and unexplained.

Then there are the rorts, huge rorts which go unpunished. Almost all financial statements for multinational companies in Australia are audited by Big Four. These four firms audit most of the world's largest companies.

Here are the michaelwest.com.au Dirty Dozen audit fails:

Rupert Murdoch's News Australia Holdings (News Corp)

His accounts signed off by EY, Rupert's flagship in Australia is a master at siphoning money out of the country. His accounting wizards devised a scheme a few years ago where they cooked up a $7 billion billion soufflé of intangibles from which they helped themselves to $4.5 billion in capital returns over ensuing years, $4.5 billion tax-free ripped offshore.

That's not all. Regarded for many years by the Tax Office as Australia's "number one tax risk", Rupert's auditors also sign off on "Special Purpose" accounts, bush-league accounts which minimise disclosure to maximise tax avoidance.

By producing Special Purpose accounts, News is asking Australians to believe that – even though this company employs thousands and affects the course of government in this country – the only parties who have a stake or an interest in seeing these "public" statutory accounts are a couple of Rupert-controlled shareholders overseas.

There's more. A few years ago we outed News for orchestrating a $903 million loan to Foxtel. As if Foxtel needed a loan at the very apogee of its profitability. No matter, the loan carried a hefty interest rate of 12 per cent. So News was effectively lending money to its cashed-up pay TV business Foxtel at 12 per cent, claiming tax deductions on the loan and lending the money back to itself at an interest rate of zero.

https://www.michaelwest.com.au/rupert-murdochs-us-empire-siphons-4-5b-from-australian-business-virtually-tax-free/

Goldman Sachs

The Wall Street investment bank makes hundreds of millions of dollars in income in Australia but if you shell out $41 for a copy of its "public" financial statements, the head entity in Australia, Goldman Sachs Holdings ANZ Pty Ltd, disclosed revenues of just $US24 million (2016), well shy of the $US45 million booked in finance costs.

How do they do it? They don't bother to consolidate (to include all companies in the stable) so the accounts for the world's most powerful investment bank in Australia are meaningless. Auditor is PwC.

https://www.michaelwest.com.au/how-goldman-sachs-and-australias-biggest-brewer-sab-pay-no-tax/

SABMiller

How do you sell $3.5 billion worth of beer a year to Aussies but pay no tax? You engineer a takeover, generate billions in paper losses, and match them off against your profits for years to come. Auditor PwC.

Instead of billions in beer sales you will only find $57 million in income in SAB's accounts because, like Goldman, the accounts are not consolidated so they simply don't show all the earnings. Directors and auditor even have the cheek to label this brewing giant a "small proprietary company".

https://www.michaelwest.com.au/companies/tax-dodgers/sabmiller-australia-pty-ltd-2/

William Hill

Paying millions in audit fees certainly does not ensure getting it right. Accounting academic Jeff Knapp discovered a $55 million black hole in the accounts of William Hill, Australia's largest better company, "They are showing a false exchange rate in the annual report," said Knapp. "We can say with reasonable confidence that the amount shown for equity in the financial statements is out by £30 million ($55 million).

"The balance sheet has to balance. So that (the £30 million hole) means something else is wrong in the financial statements." Auditor is Deloitte.

https://www.michaelwest.com.au/taxman-closes-in-as-william-hill-skips-the-country/

American Express

Amex has managed to pay no tax for a decade in Australia thanks to a suspect restructure the company did in 2004 which has siphoned out billions to an associate in the tax haven of Jersey. Auditor PwC.

https://www.michaelwest.com.au/how-amex-paid-no-tax-in-nine-years-on-10-billion/

Lendlease

Like Amex, Lendlease has managed to pay almost no tax in Australia for ten years. Its accounts are a supreme exercise in financial engineering which bump up profits through accounting manoeuvres such as asset revaluations and reclassifications. The upshot is to distort the responsibilities of auditors and directors because they fail to produce "true and fair" financial statements.

But the *piece de resistance* is that Lendlease has been buying retirement villages, claiming a bonanza of deductions by changing the contracts from lease to loan arrangements, booking the benefit of those deductions to its bottom line, and ignoring the tax law that says you can't double dip.

It surely doesn't help that Lendlease has had the same auditor since 1957, KPMG.

https://www.michaelwest.com.au/what-lies-beneath-how-lendlease-put-a-shine-on-its-numbers/

Burns Philp and Carter Holt

This one again epitomises the gaming of the rules by auditors for their multinational clients. Deloitte signed off on accounts of tricky dual holding company structure designed to bamboozle regulators and the Tax Office.

True to the form of the Big Four, Deloitte is therefore instrumental in abusing the spirit of the tax and disclosure laws, which are intended to show a true and fair picture, to help rather than to hinder.

According to Jeffrey Knapp, the retired UNSW accounting lecturer, Special Purpose financial reports for corporate groups with total income approaching $1 billion are an "abomination masquerading as transparency."

https://www.michaelwest.com.au/loophole-how-deloitte-games-the-tax-laws-for-kiwi-raider/

Ansett

Perhaps the most profitable insolvency in Australian corporate history, Ansett's managed to lose eight years of audited financial accounts. ASIC says it issued a financial reporting exemption covering the other two years of this 10-year administration (2004-05), but that document has never been made public.

The year before the airline bit the dust in 2001, Ansett produced non-compliant financial statements because they ignored the accounting standards for related parties and financial instruments.

https://www.michaelwest.com.au/mystery-flight-of-ansett-accounts/

Glencore

Formerly audited by EY (now Deloitte), the Swiss-controlled coal giant paid almost zero tax for years in Australia despite revenues of more than $5 billion a year. One trick to radically reduce its tax exposure was to take large, unnecessarily expensive loans from its associates overseas.

At the top of the China boom, Glencore's operations here were borrowing $3.4 billion from overseas associates at an exorbitant interest rate of 9 per cent, double what the company would have had to pay had it simply borrowed the money from the bank.

In other words, EY was signing off on accounts which were to the benefit of foreign bodies corporate rather than the company it was auditing.

Apart from being one of the world's most aggressive tax avoiders, Glencore's accounting and its corporate structure in Australia makes it impossible to get a true picture of the group's financial affairs. As one of this country's biggest exporters, the cost to Australians has been immense.

Glencore is given to constant restructuring, which clouds the picture in accounting terms. When we last searched them – a painstaking and expensive process – the head entity in Australia didn't even have a name, just a number, GHP 104 160 689 Pty Ltd.

This enigmatic entity is in turn owned by a Glencore International Investments Ltd, domiciled in Bermuda. You get the picture. It has since been restructured again.

https://www.michaelwest.com.au/glencore-tax-bill-on-15b-income-almost-zero/

Pfizer

Pfizer and KPMG had ample time to respond to questions before we published a story revealing a sham, a series of transactions designed to avoid tax by creating almost $1 billion in share capital. They didn't.

In an ultra aggressive tax ploy, Pfizer "invested" almost $1 billion of cash in two companies in the Netherlands which went belly up within three years and left the Australian entity – indeed Australian taxpayers – carrying the can for its losses as the freshly created $1 billion in share capital is now sitting pretty for tax-effective distribution to Pfizer overseas.

Share capital created, assets written off. This is the Pfizer pattern. They create share capital and then the assets vanish.

https://www.michaelwest.com.au/pfizers-billion-dollar-sham-audited-by-kpmg/

Compass Resources

Here we have KPMG as the incumbent auditor of the company but it does not do the review of the Melbourne Cup half-year accounts. Rather, an auditor hand-picked by Ferrier Hodgson comes in and signs off on a set of half-year accounts that conveniently ignore 139 days that Ferrier Hodgson was in charge of the company.

ASIC's Regulatory Guide 26 states that "Opinion Shopping" is the practice of searching for an auditor willing to support a proposed accounting treatment. It is unlikely that a Big Four audit firm such as KPMG would associate itself with a 42-day financial report with zero comparatives.

So the Compass Melbourne Cup half-year accounts are audited by Grant Thornton. Yet – in a storyline redolent of the Twilight Zone – the auditor of the company is KPMG. The Compass Christmas Eve disclosure states that KPMG and Grant Thornton are joint auditors of the Compass Melbourne Cup half-year accounts.

The Corporations Act does not allow two firms to be jointly appointed auditor. The act refers to the appointment of ”a firm”, one firm that is.

If KPMG and Grant Thornton were the joint auditors for these accounts, how is it that Grant Thornton alone signed the audit review report?

https://www.michaelwest.com.au/how-asic-went-astray-in-the-faulty-compass-case/

Aldi

This one is funny because, when you open up the Aldi accounts, there are no numbers in it. The P&L, the balance sheet, the cashflow statement, all unblemished by the presence of actual numbers.

“Without transparency there is no trust. Robust and balanced external reporting is needed” KPMG told Twitter via a conference. But its Aldi accounts don’t even show a revenue number.

Aldi actually makes about $7 billion in grocery sales but it also has a tricky partnership structure which it relies on for minimal disclosure.

https://www.michaelwest.com.au/kpmg-do-as-i-say-not-as-i-do-just-check-out-aldi/

Solutions solutions

As they are so big, so pervasive and so dominant, the Big Four ought to be broken up along tax, audit and consulting lines. The myriad audit fails are clear evidence that the global accounting firms are beyond the law. Their failure to properly carry out their role as guardians of commerce puts the entire financial system at risk.

Their role in orchestrating tax avoidance, along with the rising concentration of power and falling standards, is causing economic loss as billions are raked offshore to tax havens. Government and regulators, if they had the will, could go some way to arresting the slide by forcing proper financial disclosure.

Four years ago, in the story linked below, Jeff Knapp, exposed the rort by the Big Four to switch their multinational clients into skimpy Special Purpose financial reporting. We revealed dozens of the world's largest corporations operating in Australia had changed from General Purpose accounts to Special Purpose. This trend went hand in hand with coincided with more aggressive multinational tax avoidance.

Yet standards bodies like AASB and the Financial Reporting Council have done nothing about it since, despite being put on the spot at the Senate Inquiry into Corporate Tax Avoidance in 2015.

As Jeff Knapp puts it: "The Big Four auditors have knifed general purpose financial reports for multinationals and taken Australian accounting practice back 30 years".

In the wake of the successful Senate Inquiry into tax avoidance, the Government – whose position had originally been that there was no problem with tax avoidance by large corporations – moved to tighten up the laws and one reform was to require large companies to file General Purpose accounts.

Only some companies appear to be complying. Sources in the Tax Office have told *michaelwest.com.au* that many companies, advised by Big Four, have found loopholes in the new legislation, including filing foreign parent company General Purpose reports (flagrantly against the spirit of the law which intends for them to file Australian GP accounts).

https://www.michaelwest.com.au/special-purpose-approach-by-accountants-hides-corporate-secrets/

In the immediate aftermath of Knapp revealing 20 multinationals had slinkily switched from producing full accounts to the Special Purpose variety, UK health insurance juggernaut BUPA (auditor KPMG), switched to special purpose reporting although its marketing materials claimed it was: "Proudly looking after the needs of 4.7 million Australians."

To do this, KPMG and BUPA had to form the view, and sign off statutory documents, that BUPA's 4.7 million policyholders were not users of their financial statements.

At the ensuing Senate Inquiry into tax, then powerbroker Nick Xenophon asked one of the standards-setting regulators: "Are you able to shed some light as to why Ladbrokes prepares general purpose financial reports but the other three (betting) companies – that is, Sportsbet, William Hill and Bet365 – do not?

They only prepare special purpose financial reports. Does that seem to you to be a strangely divergent accounting practice?"

While the standards were crumbling, the revenue of the digital giants was exploding. But their success was coming at the cost of traditional taxpaying corporations, leaving a hole in the national revenue.

The Government has since moved to address this, forcing some better compliance by the likes of Google and Facebook but others like Booking.com and eBay continue to pay almost no tax. These companies too all produce Special Purpose reports. They too are all audited by Big Four.

When the Parliamentary Joint Inquiry into Corporations and Financial Services convenes this year to examine audit quality and Big Four conflicts of interest, it would do well to make strong findings on transparency and disclosure, to force once and for all the Big Four to make their clients deliver decent General Purpose financial statements.

After all, we are talking about the biggest companies in the world here. Beyond that, the massive conflicts of interest of advising multinationals how to dodge tax while auditing them are untenable in the long run, as are the enormous government consulting contracts. That the Big Four have been producing double digit revenue growth in a low-growth environment strongly suggests something is wrong. It suggests an oligopoly with undue power over governments.

Ultimately, they must be broken up. But it is unlikely to happen soon. As soon as the Parliamentary inquiry was announced, the Big Four began dropping weights on the Government and the Opposition to neuter the inquiry. There is much at stake, including large political donations for both major parties.

Just last week, it was announced that a KPMG partner was joining the office of Anthony Albanese as his chief policy advisor. The tentacles are everywhere and the Big Four are gearing up to stonewall. This will be the ultimate test of political will.