PARLIAMENTARY JOINT COMMITTEE ON CORPORATIONS AND FINANCIAL SERVICES

ETHICS AND PROFESSIONAL ACCOUNTABILITY: STRUCTURAL CHALLENGES IN THE AUDIT, ASSURANCE AND CONSULTANCY INDUSTRY

SUBMISSION

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I SUMMARY

1. Thank you for the opportunity to make a submission to the Parliamentary Joint Committee for this reference.

2. This submission relates to Term of Reference 2, which is as follows:

> 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;
> b. executive accountability and remuneration;
> c. fit and proper person requirements;
> d. the structure of contracts and the fiduciary responsibility to public and corporate sector clients;
> e. prevailing cultural practices;
> f. consumer and client protection;
> g. duties of care;
> h. management of conflicts of interest; and
> i. access to whistle-blower protections.

3. Terminology: the term ‘partnership’, as used here, means a normal partnership, which is

unincorporated; the term 'incorporated partnership" means a partnership that is an incorporated partnership under a Partnership Act in a State or Territory.

4. **This submission *recommends* that the exemption under s 115(2) of the Corporations Act 2001 (Cth) by r 2A 1.01 of the Corporations Regulations be amended to limit the maximum number of partners in an accounting firm (or a law firm) to 100.**

5. Section 115(1) of the Corporations Act lays down the general rule that a partnership cannot have more than 20 partners, unless the partnership is incorporated or formed under an Australian law. However, s 115(2) of the Corporations Act allows regulations to provide for this limit to be higher for a particular kind of partnership. Regulation 2A.1.01 of the Corporations Regulations permits accounting partnerships to have a maximum of 1000 partners, and law firms a maximum of 400 partners. The extent of that exemption is unjustified and contrary to the public interest. The latitude of r 2A.1.01 in its current form creates two major loopholes:

   (a) non-application of the governance requirements of the Corporations Act to large partnerships; and

   (b) non-application to partnerships of corporate criminal or civil penalty liability under a very wide range of Commonwealth, State and Territorial legislation, including: the Corporations Act 2001 (Cth); the Criminal Code (Cth); the Competition and Consumer Act 2010 (Cth); the Fair Trading Act 1987 (NSW); and the Australian Consumer Law and Fair Trading Act 2012 (Vic).

6. These are glaring loopholes.[1] They should be removed by amending r 2A.1.01. See further Part IV below. Larger partnerships could continue, but as incorporated partnerships under Partnerships Acts. Alternatively, they could incorporate themselves as companies under the Corporations Act.

7. I will be happy to provide further details if so desired.

II NON-APPLICATION OF THE GOVERNANCE REQUIREMENTS OF THE CORPORATIONS ACT

8. Large accounting firms have organised themselves as partnerships and some have many hundreds of partners. For example, PwC Australia is a partnership under the Partnership Act 1963 (ACT) and had 937 partners at the beginning of 2023 ('PwC Australia admits 67 new partners', 1 January 2023, at: https://www.pwc.com.au/media/2022/pwc-new-partners-Jan-2023.html).[2]

[1] Further loopholes arise from the use of partnerships to avoid the operation of the Corporations Act. For example, auditing requirements in a partnership depend on the partnership agreement.

[2] See also: 'EY announces 82 new Australian partners', 1 June 2023, at: https://www.ey.com/en_au/news/2023/06/ey-announces-82-new-australian-partners; 'Deloitte

9. Directors' duties under the Corporations Act do not apply to partnerships.[3] Consider, for example, the duties under s 180 and s 183 of the Corporations Act, which duties apply to 'a director or other officer of a corporation'[4] Section 180(1) of the Corporations Act creates a duty to exercise reasonable care and diligence. Section 183(1) creates a duty not to improperly use information to gain an advantage. By contrast, the Partnership Acts in States and Territories (eg Partnership Act 1963 (ACT)) do not proscribe conduct equivalent to breaches of directors' duties under the Corporations Act. Moreover, to the extent that partners are subject to fiduciary or other obligations under the Partnership Acts or general law, those obligations are not enforced by ASIC but depend on action being taken by partners or other private parties, or State or Territorial fair trading enforcement agencies.

10. The non-application of officers' duties under the Corporations Act to partners and senior managers in partnerships is remarkably lax. First, large partnerships are run in much the same way as companies of a comparable size and typically have a 'board' that, apart from the non-application of directors' duties under the Corporations Act, closely resembles a board of directors in a company. Secondly, it would be fallacious to suggest that large partnerships differ from companies of comparable size because these partnerships are operated more ethically or more carefully than companies and therefore that there is a lower risk of law−breaking. Any such suggestion would lack credibility given the indications to the contrary in the PwC tax leak scandal[5] and extensive investigative reporting about the conduct of the Big Four in Australia and elsewhere in recent years.

11. As one example, consider the position of an accounting firm, Partnership A, that obtains confidential information from the Commonwealth during the course of giving advice to the Commonwealth on certain tax issues where that confidential information is subsequently misused

promotes 51 members to Australian partner team', 18 June 2023, at: https://www.consultancy.com.au/news/7629/deloitte-promotes-51-members-to-australian-partner-team (which admits to 'pushing its total tally beyond the 1,000-mark'); 'KPMG welcomes new partners', 15 June 2023, at: https://kpmg.com/au/en/home/media/press-releases/2023/06/kpmg-welcomes-new-partners-june-2023.html.

3 If a partner is a corporation, the duties of directors and officers of a corporation under the Corporations Act will apply to directors and officers that corporation, subject to any partnership Act limitations on the extent of that potential liability. An incorporated partnership is a corporation under the Corporations Act and hence the duties of directors or other officers of a corporation apply to officers of that type of partnership.

4 The terms 'director' and 'officer' are defined by Corporations Act 2001 (Cth) s 9. 'Corporation' is defined by Corporations Act s 57A.

5 Parliament of Australia, The Senate, Finance and Public Administration References Committee, *PwC: A calculated breach of trust*, June 2023, at: https://www.aph.gov.au/Parliamentary_Business/Committees/Senate/Finance_and_Public_Administration/Consultingservices/PwC_Report.

by several senior partners, X, Y and Z, who provide the information to other clients of the firm. The partners (X, Y and Z) are not officers of a 'corporation'[6] and hence the duties of officers under the Corporations Act, including the duty not to improperly use information under s 183, would not apply. By contrast, if Partnership A were an incorporated partnership, or if it were a company incorporated under the Corporations Act, X, Y and Z would be officers of a corporation and would be subject to the duties of officers under the Corporations Act, including the duty under s 183(1) not to improperly use information. The maximum civil penalty for individuals who breach s 183(1) is the greater of 5,000 penalty units (currently $1.565 million) or three times the benefit obtained and detriment avoided. Section 184(3) makes the dishonest use of information by an officer an offence punishable by imprisonment for up to 15 years.

III NON-APPLICATION OF CORPORATE CRIMINAL LIABILITY OR CORPORATE CIVIL PENALTY LIABILITY UNDER VERY WIDE RANGE OF LEGISLATION

12. A partnership in Australia is not subject to corporate criminal liability or corporate liability for breach of a civil penalty prohibition. That general principle is subject to possible statutory exceptions, but there are very few such exceptions. Individuals who are partners or employees of a partnership are subject to criminal liability for offences or civil liability for breaches of civil penalty prohibitions where they commit an offence or breach, or are subject to ancillary liability (eg as an accomplice, or a person knowingly concerned in the offence or breach). Partners are also liable as a collective firm to a penalty (see eg Partnership Act 1963 (ACT) s 14; Partnership Act 1892 (NSW) s 10; Partnership Act 1958 (Vic) s 14).[7]

13. The avoidance of corporate criminal liability or corporate civil penalty liability by partnerships is remarkably lax. The laxity is starting if compared with the position of corporations. Corporations generally are subject to corporate criminal liability and corporate civil penalty liability. Where liability is imposed, sanctions apply against the corporate entity. Two examples of remarkable laxity extended to partnerships are given below.

14. Assume first that an accounting firm, Partnership B, engages in a large-scale tax fraud. Numerous partners and employees are implicated and potentially are subject to individual liability. However, Partnership B is not subject to corporate criminal liability for the offence of general dishonesty under 135.1 of the Criminal Code. The offence under s 135.1 applies to a 'person' (an individual

6 As defined by Corporations Act 2001 (Cth) s 57A.

7 Under these provisions, a firm is liable e to a penalty to the same extent as the partner who committed the wrong. By contrast, the conventional practice in Commonwealth legislation creating offences or civil penalty prohibitions is to provide higher maximum penalties for corporations than for individuals.

or a body corporate) and Partnership B is not a 'person'. By contrast, if B were a body corporate, the tax fraud in which B engaged would subject B to corporate criminal liability and a fine of up to 300 penalty units (currently $939,000). The maximum corporate fine today is low and should be brought into line with the much higher maxima that apply to corporations under the Competition and Consumer Act 2010 (Cth) (see [15] below) and other Commonwealth legislation (contrast eg the much higher maxima for foreign bribery offences under s 70.2(5) of the Criminal Code).

15. As a second example, assume that an accounting firm, Partnership C, engages in cartel conduct with a competing accounting firm, Partnership D, by fixing the prices they charge for various services and allocating customers. Partnership C and Partnership D are not subject to corporate criminal liability or corporate liability to civil penalties under the Competition and Consumer Act 2010 (Cth): the cartel prohibitions apply to corporations as defined by s 4 of the Act, not to partnerships. Nor would Partnership C and Partnership D be subject to corporate criminal liability or corporate liability to civil penalties under the Schedule version of the cartel prohibitions that apply in the States and Territories: those cartel prohibitions apply to a 'person', and a partnership is not a 'person'. Partners and employees who engage in cartel conduct would be subject to individual criminal and civil liability in a State or Territory. However, the general policy in Australia is that both corporate and individual criminal and civil liability are necessary. There are many reasons for that approach, including the practical difficulty of bringing participating individuals to justice where a corporation has many employees. By contrast, if C and D were corporations as defined by s 4, the cartel conduct in which they engaged would subject them to corporate liability for potentially severe criminal and civil sanctions. The maximum fines or civil monetary penalties for a body corporate are the greatest of:

- $50,000,000
- three times the value of the 'reasonably attributable' benefit obtained from the conduct, if the court can determine this; or if a court cannot determine the benefit,
- 30 per cent of adjusted turnover during the breach period.

There would also be the possibility of non-punitive orders under s 86C of the Competition and Consumer Act, including probation, community service and publicity orders.

IV AMENDING REGULATION 2A.1.01 CORPORATIONS REGULATIONS

16. The glaring loopholes described above should be removed, and would largely be removed, by amending r 2A.1.01 to limit the maximum number of partners to 100 in the case of accounting firms (and law firms).

17. Accounting partnerships that now have more than 100 partners would thereby be induced to comply with the new limit on the number of partners. Typically, large partnerships would restructure themselves as corporations.[8] Alternatively, they could restructure themselves as incorporated partnerships.

18. Two major changes for the good would result if partnerships become companies under the Corporations Act, or incorporated partnerships under State or Territorial Partnership Acts:

    (a) the duties of officers under the Corporations Act would apply; and

    (b) the companies or incorporated partnerships would be subject to corporate criminal liability and corporate civil penalty liability under Commonwealth, State and Territorial legislation.

19. A transitional period (12 months?) would enable accounting firms (and law firms) with more than 100 partners to restructure themselves in a timely, orderly and compliant way.

[8] See M Cohen, 'Why The Big Four Should Adopt A Corporate Structure', *Forbes*, 5 July 2022, at: https://www.forbes.com/sites/markcohen1/2022/07/05/why-the-big-four-should-adopt-a-corporate-structure/amp/.