

14 August 2023

To

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

Re: **Management of conflicts of interest (2h)**

Dear Committee Secretary,

This submission has been prepared by Dr Sarowar Hossain, Dr Jeff Coulton, and Dr Jenny Jing Wang. Dr Hossain and Dr Coulton are employed as Senior Lecturers in accounting at the University of New South Wales. Dr Wang is employed as a Senior Lecturer in accounting at the University of Wollongong. Dr Hossain, Dr Coulton and Dr Wang conduct auditing research in the areas of the economics of auditing, the pricing of audit and non-audit services, auditor independence and the determinants of audit quality.

We appreciate the opportunity to contribute to your inquiry into allegations of misconduct in the Australian operations of major accounting, audit, and consulting firms. As part of our submission, we present evidence from our recent research on *the management of possible conflicts of interest in audit firms (2h)*.

Key Findings:

- Audit quality *increases* with a client's economic importance, where a client's economic importance is measured by the proportion of audit fees received from a client compared to total audit fees. The concern often expressed is that audit quality would decrease with client importance.
- Higher non-audit service fees from a client *do not compromise* auditor independence.

Research Details:

Our study, "Client Importance and Audit Quality at the Individual Audit Partner, Office, and Firm Levels"¹, provides unique insights by focusing on the audit signing partner - the individual holding the greatest responsibility for audit quality and most susceptible to potential pressures that may compromise auditor independence.

¹ Hossain, S.; Coulton, J.; and Wang, J. 2023. Client Importance and Audit Quality at the Individual Audit Partner, Office, and Firm Levels. *Abacus: A Journal of Accounting, Finance and Business Studies*, vol. 59., issue 2, pp. 650-696. <http://dx.doi.org/10.1111/abac.12289>

We examined the correlation between a client's economic importance and audit quality by analysing financial statement, audit fee and non-audit fee data from 2,939 unique ASX-listed firms during the 2003-2017 period. This involved over 20,000 firm-year observations.

Measures of Client Importance:

We measured client importance at three levels:

1. **Audit Partner Level:** The proportion of audit fees from a client compared to the total audit fees received by the partner from all of their listed clients.
2. **Audit Office Level:** The proportion of a client's non-audit service fees to total non-audit service fees, and the proportion of total fees (audit and non-audit) from a client compared to the total (audit and non-audit) fees received by the audit office from all of their listed clients.
3. **Audit Firm Level:** The proportion of non-audit service fees from a client to total non-audit service fees, and the proportion of total audit and non-audit service fees from a client compared to the total of audit and non-audit service fees received by the audit firm from all of their listed clients.

Implications:

Our findings should reassure regulators, audit clients, and stakeholders that pressure from economically important clients on audit partners does not lead to worse auditing and accounting outcomes, on average. This suggests that the ongoing training and professional education within audit firms is beneficial. However, we acknowledge the study's limitations and the potential for overstating client importance due to the lack of identification of private clients and the assumption of lower litigation risk in Australia compared to the US.

We believe our study contributes valuable insights to this important topic and we look forward to seeing its implications considered in your committee's deliberations.

Yours faithfully

Dr Sarowar Hossain

Dr Jeff Coulton

School of Accounting, Auditing, and Taxation,
UNSW Business School, UNSW Sydney

Dr Jenny Jing Wang

School of Business, University of Wollongong.