

14 February 2020

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

By email:

Dear Sir/Madam,

Thank you for the opportunity to present to the Committee on Friday, 7 February 2020.

From our reading of the draft transcript, we have also determined that there is one Question on Notice to which we committed to respond with additional information. Senator Whish Wilson, on pages 39 and 40, requested that we assist by providing:

“...some case studies where audit quality has been seen to have failed in relation to [preventing corporate collapse or wrongdoing in the Australian context]”

I noted during my testimony to the Committee that there is a lack of relevant jurisprudence in these matters. I am, however, able to suggest below some case studies which may assist the Committee in understanding the link between audit quality and corporate collapse/wrongdoing, in the eyes of the judiciary.

Case Study #1

Australian Securities & Investments Commission v AMP Financial Planning Pty Ltd (No 2)
[2020] FCA 69

ASIC's description of this case reads as follows¹:

In this case, ASIC alleged that a number of AMP's financial planners engaged in 'rewriting conduct' – which is providing advice that results in the cancellation of the client's existing insurance policies and the taking out of similar replacement policies by way of a new application rather than through a transfer. By cancelling insurance policies and advising clients to submit new applications, clients were exposed to a number of significant risks and the planners received higher commissions than they would have by simply transferring the policies.

The Federal Court found² that AMP Financial Planning was reckless in its:

... lamentable failure of corporate will to take the necessary steps to prevent greedy and unlawful conduct taking place, and a further failure to adopt a swift and proper remedial response.

On the issue of AMP's auditing practice, His Honour Justice Lee stated³:

There is a danger that even with the best will in the world, a partner of a firm retained by a large institution earning very significant sums from professional fees charged to the institution, could display a degree of "subconscious partisanship", in that the expert is influenced by the client with whom he has a long running commercial relationship; moreover, issues of "selection bias" might arise.

His Honour's full findings can be found on the Federal Court's website⁴.

His Honour's finding that: '*the expert (in this case the auditor) is influenced by the client with whom he has a long running commercial relationship*' is central to Maurice Blackburn's concerns about audit quality. The results of the reports that emanate from these 'long running commercial relationships' are often material to ASIC's decision making as to the appropriate course of action to take against a financial services firm, and determining whether an Enforceable Undertaking may be appropriate. These reports can thereby be material to the terms negotiated including the parameters of any remediation schemes, and thus impact the future financial wellbeing of consumers.

Case Study #2

Australian Securities and Investments Commission v Healey and Others (2011) 196 FCR 291.

This case was in relation to Centro's revelations in late 2007 that it had wrongly classified billions of dollars of short-term debt.

The court held that each of the directors of Centro failed in their duties to exercise the degree of care and diligence required of them by law. Specifically, they failed to properly read and understand the financial statements; apply the knowledge they had or should have acquired to perform that task; make appropriate inquiries; and have apparent errors corrected.

¹ <https://asic.gov.au/about-asic/news-centre/find-a-media-release/2020-releases/20-024mr-amp-to-pay-5175-million-penalty-for-failing-to-prevent-insurance-churn-by-its-financial-planners/>

² www.federalcourt.gov.au/law-and-practice/national-practice-areas/commercial/consumer-protection

³ <http://www.austlii.edu.au/cgi-bin/viewdoc/au/cases/cth/FCA/2020/69.html>; para 253

⁴ <http://www.austlii.edu.au/cgi-bin/viewdoc/au/cases/cth/FCA/2020/69.html>

The directors pointed to the fact that the errors were not detected by anyone in Centro's accounting team or by its external auditors, PricewaterhouseCoopers (PWC).

Remarkably, a PWC partner who presided over their flawed audit of Centro in 2007 told the court that he did nothing wrong, and instead blamed the debacle on a junior PWC staff member he supervised⁵.

It is interesting to note that:

The Centro class actions were commenced in May 2008 against various entities within the Centro Group. PWC was joined to the proceedings in 2009 and a separate claim was brought against PricewaterhouseCoopers Securities Limited⁶.

It is also instructive to review ASIC's statement on the matter⁷.

Once again, Maurice Blackburn's concerns centre around the capacity for individual consumers, impacted by the wrongful classification of short-term debt, to achieve justice when independent audit advice is relied upon by decision makers.

Thank you again for the opportunity to participate in the Committee's valuable work. If the Committee identifies any way that Maurice Blackburn might further assist, please do not hesitate in making contact.

Yours faithfully,

Josh Mennen
Principal Lawyer
Maurice Blackburn

⁵ See for example <https://www.smh.com.au/business/junior-employee-blamed-for-centros-bungled-audit-20120418-1x7j4.html>

⁶ <https://www.lexology.com/library/detail.aspx?q=175d0ca8-c50e-4dc4-bd8b-3eaef8830f2f>

⁷ <https://asic.gov.au/about-asic/news-centre/find-a-media-release/2012-releases/12-288mr-former-centro-auditor-suspended/>