

Consultants: structurally unsound

The audit, assurance and consulting industry has failed to meet expectations. The industry needs clear standards, better monitoring and strong sanctions for misconduct.

Submission to the inquiry into ethics and accountability in the audit, assurance and consulting industry

September 2023

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Summary

The Australia Institute has a growing body of research on the harms caused by the over-use of consulting firms by Australian governments. This paper summarises and expands on that research in the context of the inquiry *Ethics and professional accountability: structural challenges in the audit, assurance and consulting industry*. While our research focuses on the relationship between governments and consulting firms, some of the findings will be applicable for consulting firms more generally, including their relationships with private clients.

The Australia Institute identifies five types of conflict of interest risk that can affect consulting firms: giving advice to government that may favour their private clients; distorting advice to government to receive favourable treatment; acting for different arms of government on related issues; making political contributions that may influence government tendering; and taking advantage of a trusted professional relationship to secure more work.

Governments should better manage conflicts of interest by adopting guidelines on how to identify and resolve conflicts of interest, introducing a strict revolving door policy and banning political contributions from government contractors. The committee should also consider whether there should be a ban on auditors doing other work for their client.

The Australia Institute has identified improvements governments could make in monitoring and sanctioning consulting firms' misconduct and poor performance. One of these improvements, professional standards for economic consultants, would improve the quality of consulting for private clients as well. The others, including making consultants' reports for government publicly available and requiring large consulting contracts to be approved by another arm of government, are limited to addressing the government–consulting firm relationship.

Introduction

The Australia Institute welcomes the opportunity to make a submission to the Parliamentary Joint Committee on Corporations and Financial Services' inquiry *Ethics and professional accountability: structural challenges in the audit, assurance and consulting industry*.

The Australia Institute has researched matters coming under the following terms of reference:

2. Gaps in areas such as (h) management of conflicts of interest
3. Mechanisms available to monitor and sanction misconduct and poor performance
4. Any other related matters

This work is contained in:

- Our submission to the Senate inquiry into the Commonwealth Government's use of consultants titled *Neither frank nor fearless*, our supplementary submission on the *Australia Institute experience with economic consultants* and our *Replies to questions on notice* from our Senate inquiry appearance.¹
- Our submission to the inquiry into the NSW Government's use of consultants titled *Consultants: corrosive and conflicted*.²

While the above work focused on government use of consultants, many of the problems we identify exist generally when consultants are used. The *Australia Institute experience with economic consultants* in particular highlights the problems that arise because of the lack of professional standards that apply to economic consultants.

¹ All three documents are available here: Shields, Adhikari and Browne (2023) *Neither frank nor fearless*, <https://australiainstitute.org.au/report/neither-frank-nor-fearless/>

² Shields, Adhikari, Campbell and Browne (2023) *Consultants: corrosive and conflicted*, <https://australiainstitute.org.au/report/submission-consultants-corrosive-and-conflicted/>

Identifying conflicts of interest

Australia Institute research identifies several categories of conflict of interest that can affect consulting firms:

- Giving advice to government that may favour their private clients
- Distorting advice to government to receive favourable treatment
- Acting for different arms of government on related issues
- Making political contributions that may influence government tendering
- Taking advantage of a trusted professional relationship to secure more work.

Giving advice to government that may favour their private clients

Most consulting firms that give advice to government also have private clients, which gives rise to a risk that the advice that they give to government will favour their private clients.

Examples where consulting firms gave advice to government that might have benefited their other clients include:

- In 2020 Ernst and Young (EY) were employed by the Climate Change Authority to advise on carbon market schemes policy. EY had previously done unpaid work for Verra and Gold Standard but “EY did not declare any competing interests”. In its final report, EY concluded that Verra and Gold Standard were “the leading international offset schemes for governance”.³
- In 2019 Commonwealth, state and territory governments were considering changes to Australia’s air quality standards. The Commonwealth employed Aurecon to conduct a cost-benefit analysis (CBA) of the changes. Aurecon is a design and engineering company which likely does considerable work for companies that produce air pollution. The CBA significantly over-estimated the cost of air quality improvements and under-estimated the benefits. In fact, the CBA found that the costs of the proposed changes (most of which were already in place in other countries) would be up to 100 times greater than the benefits of air quality improvement. The resulting report was a major outlier in the economic literature, as international studies almost always show that the benefits of air quality

³ Lo (2023) *Consultants close to industry shaped Australia’s controversial carbon credit policy*, <https://www.climatechangenews.com/2023/03/30/revealed-consultants-close-to-industry-shaped-austalias-controversial-carbon-credit-policy/>

improvement outweigh the costs. For example, an analysis of the economics of the US Clean Air Act estimated that its benefits could have been 90 times its costs.⁴

- The federal government paid KPMG to audit aged care facilities while KPMG was advising the aged care providers on audits and accreditation.⁵
- PwC acted for the Queensland coal mine, Adani, when it applied for a \$1 billion loan from the federal government's Northern Australia Infrastructure Facility (NAIF). However, at the time, it was also doing working for NAIF *and* for the federal Department of Industry, Science and Resources which oversees/facilitates NAIF.⁶

A more extreme example is PwC's use of confidential government information to potentially help their clients game Australia's tax avoidance laws, discussed further in *Neither frank nor fearless*.⁷

Although these examples focus on the consultant–government relationship, a risk of conflict of interest would also exist if a consulting firm were in a position to give advice to one private client that favoured another private client.

Distorting advice to government to receive favourable treatment

When a consulting firm takes public money to provide advice to government, there is the risk of a conflict of interest between the firm's duty to the public to do honest, accurate, useful work and their desire to secure more work by making the relevant minister or senior public servants happy.

Examples of consultants potentially telling the government what it wants to hear include:

- In 2015, Infrastructure Minister Warren Truss commissioned Predictive Analytics Group to conduct a cost–benefit (CBA) analysis of coastal shipping regulations. Truss indicated that he supported changes to the regulations,⁸ but analysis from the Australia Institute found significant problems with the CBA report.⁹

⁴ Shields and Campbell (2019) *Coffin it up*, <https://australiainstitute.org.au/report/coffin-it-up-submission-to-nepm-air-quality-review-regarding-cost-benefit-analysis/>

⁵ Belot (2023) *KPMG Australia launches internal review after potential conflict-of-interest concerns raised*, <https://www.theguardian.com/australia-news/2023/jun/27/kpmg-australia-launches-internal-review-after-potential-conflict-of-interest-concerns-raised>

⁶ Campbell (2023) *PwC and the Adani mine triple dip. A conflict of interest? Surely not*, <https://michaelwest.com.au/pwc-and-the-adani-mine-triple-dip-a-conflict-of-interest-surely-not/>

⁷ Shields et al (2023) *Neither frank nor fearless*, pp. 20–21

⁸ Cauchi (2014) *Freight vessels coasting to their demise*, <https://www.smh.com.au/business/freight-vessels-coasting-to-their-demise-20140207-327c5.html>

⁹ Campbell and Richardson (2015) *Shipping legislation amendment bill 2015*, <https://australiainstitute.org.au/report/shipping-legislation-amendment-bill-2015-submission/>

- In 2019, consultant economist Brian Fisher produced estimates of the cost of Labor's climate change policy that were five to ten times higher than estimates from numerous other economists.¹⁰ In Senate estimate hearings in October 2021, officials from Energy Minister Angus Taylor's office confirmed that Fisher was being paid \$100,000 for work in climate modelling. Fisher stated, "There is potentially other work that might be mentioned in the future in the context of the model when it's released. I do have a contract. And I can't discuss it with you."¹¹ Other work by Brian Fisher is discussed in *Consultants: corrosive and conflicted*.¹²
- In 2019, the Government commissioned a report from Boston Consulting Group on the future of Australia Post. The relevant ministers wrote to Australia Post's board and management "mak[ing] clear that the BCG review should be used to guide Australia Post's next strategic plan".¹³ A former Australia Post director said, "The brief they were given was with a preconceived answer in mind ... and the data was rubbery".¹⁴
- BCG wrote an earlier report on Australia Post in 2014. Australia Institute researcher Mick Peel identified six specific problems with this report, noting that some of its claims were "selective", "arbitrary" and "exaggerat[ed]".¹⁵ The report appears to have been commissioned to justify a reduction in Australia Post's letter delivery service.

The Robodebt scandal provides examples of consultants being paid *not* to provide advice the government does *not* want to hear.

- PwC did not document the decision to drop a 70-page report into the Robodebt scheme, despite it making up part of a body of work they were paid almost \$1 million to produce.¹⁶

¹⁰ Secombe (2021) *The man behind Scott Morrison's climate panic*, <https://www.thesaturdaypaper.com.au/news/politics/2021/11/13/the-man-behind-scott-morrison-climate-panic/163672200012870>; Australia Institute (2019) *New Analysis: Brian Fisher modelling climate outlier*, <https://australiainstitute.org.au/post/new-analysis-brian-fisher-modelling-climate-outlier/>

¹¹ Secombe (2021) *The man behind Scott Morrison's climate panic*

¹² Shields et al (2023) *Consultants: corrosive and conflicted*, pp. 13–14

¹³ Carr (2021) *Pipped at the post: how the government tried to sell Australia Post*, <https://johnmenadue.com/pipped-at-the-post-how-the-government-tried-to-sell-australia-post/>

¹⁴ Durkin (2021) *Secret BCG report is key to Christine Holgate saga*, <https://www.afr.com/companies/retail/secret-bcg-report-key-to-holgate-saga-20210414-p57j7j>

¹⁵ Peel (2014) *Review of the Boston Consulting Group's report to the Minister for Communications: briefing for the CWU on Australia Post's operations*, <https://australiainstitute.org.au/report/review-of-the-boston-consulting-groups-report-to-the-minister-for-communications-briefing-for-the-cwu-on-australia-posts-operations/>

¹⁶ Royal Commission into the Robodebt scheme (2023), *Transcript hearing day 31 – 3 February 2023*, <https://robodebt.royalcommission.gov.au/publications/transcript-hearing-day-31-3-february-2023>

- Advice from law firm Clayton Utz that found that the use of “income averaging” to raise debts was unlawful. The advice was apparently left in draft form.¹⁷

Acting for different arms of government on related issues

When consulting firms act for different arms of government on related issues, it gives rise to a risk that the firm will tailor its advice to one client based on the interests of the other.

Examples where consulting firms may have been conflicted due to acting for different arms of government are:

- KPMG acted for both NSW Treasury and Transport for NSW (TfNSW) on the proposed Transport Asset Holding Entity and gave contradictory advice to each. See *Consultants: corrosive and conflicted* for more details.¹⁸
- The Department of Home Affairs engaged Deloitte to audit its financial statements. However, the Australian National Audit Office had also engaged Deloitte to audit Home Affairs’ environment, social and governance data. Home Affairs terminated the contract after it found out about the conflict of interest.¹⁹

Making political contributions that may influence government tendering

Consulting firms often make financial contributions to political parties. Academic research on corporate donations to political parties in Australia indicates that donations help to gain access and increase influence.²⁰ There is a risk that government will consider a consulting firm’s contributions when deciding which company to award work to.

¹⁷ Jones (2023) *Taxpayer-funded review that found 'flaws' in Robodebt scheme was discontinued by Department of Human Services, royal commission told*, <https://www.abc.net.au/news/2023-02-03/qld-robodebt-scheme-government-royal-commission-review-pwc/101900514>

¹⁸ Shields et al (2023) *Consultants: corrosive and conflicted*, pp. 10–12

¹⁹ Belot (2023) *Deloitte admits misuse of government information as scandal engulfing PwC widens*, <https://www.theguardian.com/business/2023/jul/14/deloitte-misuse-of-government-information-senate-inquiry-pwc-scandal>

²⁰ Edwards (2017) *Political donations in Australia: What the Australian Electoral Commission disclosures reveal and what they don't*, doi: 10.1111/1467-8500.12283; Kypri et al (2019) *If someone donates \$1000, they support you. If they donate \$100 000, they have bought you*, doi: 10.1111/dar.12878

Taking advantage of a trusted professional relationship to secure more work

Once a consulting firm wins a contract it gains specialised knowledge specific to the department it is working with. This knowledge can be exploited to give the firm an unfair advantage in pitching for subsequent work.

- In 2019 McKinsey applied a discount of 66% to its typical commercial rate to win an initial consulting contract on the transformation of the Human Services Department. The low price would mean that “the initial work is being treated as a loss leader by the firm and will put them in the box seat to pitch for, and win, the subsequent stages of work in what will be a mammoth program”.²¹
- PwC used information gained as a strategic partner to the Department of Agriculture, Fisheries and Forestry (DAFF) to make unsolicited proposals to DAFF to do more work.²²

Audit firms face conflicts of interest when they undertake other more lucrative work for their audit clients. They have the incentive to reduce audit quality so their client will retain them as auditor and they can carry out more other more lucrative work for the client (discussed further below in “Banning auditors from doing other work for their clients”).

²¹ Tadros and McIlroy (2019) *Revealed: McKinsey partners charge \$16,000 a day (before discounts)*, <https://www.afr.com/politics/federal/revealed-mckinsey-partners-charge-16-000-a-day-before-discounts-20190808-p52f2a>

²² Chan (2023) *PwC warned for using confidential information to suggest more work for Australian agriculture department*, <https://www.theguardian.com/australia-news/2023/may/24/pwc-warned-for-using-confidential-information-to-suggest-more-work-for-australian-agriculture-department>

Managing conflicts of interest

Governments can manage some of the conflicts of interest that can arise with consulting firms by introducing public service guidelines on identifying and resolving conflicts of interest, outlining a clear and strict revolving door policy for public servants and banning political contributions from government contractors.

If the law were changed to ban auditors from doing other work for the companies that they audit, it would reduce the risk of a conflict of interest arising where a professional services company audits a client but also offers them other services.

Guidelines on identifying and resolving conflicts of interest

US Government rules on using contractors include how to identify, evaluate and resolve conflicts of interest.²³

Clear and strict revolving door policy for public servants

Post-separation requirements in the Public Service Commission Code of Conduct reportedly rely on the goodwill and ethical behaviour of the individuals involved.²⁴ A more detailed or strict policy would help address these ambiguities. Worth consideration is whether it should include a mandatory post-separation period for public servants who have had direct contact with consulting firms.

Banning political contributions

One way to avoid the conflict of interest that arises from contractors making political donations to governments that may award them contracts would be to ban political contributions from contractors altogether.

²³ United States Government (2023) *Federal Acquisition Regulations: Part 9 – Contractor Qualifications*, <https://www.acquisition.gov/browse/index/far>

²⁴ Barratt (2018) *Joint Parliamentary Committee of Public Accounts and Audit: Submission to Inquiry into Auditor-General's Report No. 19*, p. 12, https://www.aph.gov.au/Parliamentary_Business/Committees/Joint/Public_Accounts_and_Audit/AGReport19/Submissions

PwC has announced it will stop making political donations.²⁵ Accenture has not made political donations for some time.²⁶ The other Big Four consultants (KPMG, EY, and Deloitte) are, so far, not following suit.²⁷

State governments already ban political donations from industries where the conflict of interest risk is considered too large. The NSW Government bans political donations from property developers, and the tobacco, liquor and gambling industries.²⁸ Queensland bans political donations from property developers.²⁹

Australia Institute polling research finds three in four Australians (74%) support banning political donations from organisations that receive funding from government contracts, including 80% of Coalition voters, 70% of Labor voters, and 75% of Greens voters.³⁰

Banning auditors from doing other work for their clients

The 2020 Parliamentary inquiry into *Regulation of auditing in Australia* investigated the risks to audit quality from auditing firms doing other work for their clients.³¹ Witnesses recommended barring audit firms from doing other work for their clients.

Professor Allan Fels summarised the conflict of interest that the provision of non-audit services poses to an auditor's independence:

It's a simple conflict of interest. Someone is tasked with providing an independent, error-free audit of a big business; it's a very important role. If that auditor is also performing services for the person they're auditing, there may be a conflict of

²⁵ Ross (2023) *PwC dumps political donations as new CEO prepares to land in Australia*, <https://www.theaustralian.com.au/business/financial-services/pwc-dumps-political-donations-as-new-ceo-prepares-to-land-in-australia/news-story/112c079f5f8e1cbee190715f894cfcc2>

²⁶ Ross (2023) *PwC dumps political donations as new CEO prepares to land in Australia*

²⁷ Belot (2023) *KPMG and Deloitte refuse to join PwC in banning political donations in Australia*, <https://www.theguardian.com/australia-news/2023/jul/12/pwc-scandal-kpmg-deloitte-ban-political-donations>

²⁸ Minns (2023) *Minns government introduces bill to ban clubs with pokies from donating to NSW political parties*, <https://www.nsw.gov.au/media-releases/bill-to-ban-pokies-donating-to-politics>

²⁹ Electoral Commission Queensland (n.d.) *Prohibited donors scheme*, <https://www.ecq.qld.gov.au/donations-and-expenditure-disclosure/prohibited-donors-scheme>

³⁰ The Australia Institute (2023) *Voters back donations ban for government contractors*, <https://australiainstitute.org.au/post/voters-back-donations-ban-for-government-contractors/>

³¹ Parliament of Australia (2023) *Regulation of auditing in Australia*, https://www.aph.gov.au/Parliamentary_Business/Committees/Joint/Corporations_and_Financial_Services/RegulationofAuditing/Interim_Report and https://www.aph.gov.au/Parliamentary_Business/Committees/Joint/Corporations_and_Financial_Services/RegulationofAuditing/Report

interest—they may be compromised—because they want to continue providing those profitable services, and that could be threatened with unfavourable audits.³²

It is worth noting that some witnesses to the 2020 inquiry argued that audit quality was not reduced.³³ However, this year's consulting firm scandals have furnished examples of professional services firms using their privileged position inside departments and agencies to solicit more work.

The committee should consider whether audit firms should be banned from doing other work for their clients or the audit arms of professional services firms split from their other business.

³² Parliament of Australia (2023) *Interim report: Regulation of auditing in Australia*, para. 4.16, https://www.aph.gov.au/Parliamentary_Business/Committees/Joint/Corporations_and_Financial_Services/RegulationofAuditing/Interim_Report/section?id=committees%2freportjnt%2f024330%2f72618

³³ Parliament of Australia (2023) *Interim report: Regulation of auditing in Australia*, chapter 4

Mechanisms to monitor and sanction misconduct and poor performance

The Australia Institute has identified improvements governments could make in monitoring and sanctioning consulting firms' misconduct and poor performance. One of these improvements, professional standards for economic consultants, would improve the quality of consulting for private clients as well.

Professional standards for economic consultants

Our Senate supplementary submission *Australia Institute experience with economic consultants* highlights the problems with economic consultants and notes that:

Economics consultants have no professional governance or standards. There are no repercussions for consultants if they are wrong or if they inflate a client's case. This is not the case for other professions. Doctors, accountants or plumbers that have carried out work found to be faulty can be punished or deregistered. While there are no consequences for private consultants, standards are more likely to be applied to economists working within the public service, where some degree of accountability is generally required.³⁴

Require approval for government consulting contracts

In some states, large contracts between departments/agencies and consulting firms must be approved by another arm of government. This allows for consulting contracts across government to be monitored and makes it harder to default to using consultants out of institutional inertia.

The Western Australian Government requires that entities must liaise with, and seek approval from, the WA Department of Premier and Cabinet before engaging consultants for strategic advice (for contracts of \$50,000 or more).³⁵ NSW also has an approval process, but

³⁴ The Australia Institute (2023) *Australia Institute experience with economic consultants*, p. 21

³⁵ Western Australian Government (2019) *Engaging consultants to provide strategic advice*, <https://audit.wa.gov.au/wp-content/uploads/2019/05/Engaging-Consultants-to-Provide-Strategic-Advice.pdf>

it is for projects worth more than \$275,000 (notably, it applies to more than just strategic consulting).³⁶

Other jurisdictions, including the Commonwealth Government, should consider similar rules to ensure that the government is aware of, and tracking, the extent and quality of consulting firm contracting.

Better data on consulting firm use by government

Clear and easy to use data on government use of consultants makes it easier for both government and civil society to monitor them. *Neither frank nor fearless* made three recommendations to do this:

- Improve the usability of the AusTender website.
- Include more information in tenders/contracts listings on AusTender.
- The Senate issue an order for the production of documents that requires the appropriate minister for each Commonwealth department or agency to table details about requests for tender/contracts with consultancies, covering the purpose, scope and anticipated elements of the consultancy's report or advice.³⁷

Monitoring by accountability organisations

The work consultants do for government is often hidden from public scrutiny. *Neither frank nor fearless* recommended using the Senate to make consultants' work public.

- The Senate should issue a standing order for production of consultant reports.
- The Senate should consider whether consulting firms could be called before Senate Estimates when they have taken government work.³⁸

Australia Institute polling research found an overwhelming majority of Australians (85%) agree that consultants should be required to answer questions about work commissioned by the government when called upon in parliamentary and other inquiries (6% disagree).³⁹

³⁶ Tadros (2019) *Revealed: the maximum rates NSW will pay for consultants*, <https://www.afr.com/companies/professional-services/revealed-the-maximum-rates-nsw-will-pay-for-consultants-20190829-p52luq>

³⁷ Shields et al (2023) *Neither frank nor fearless*, p. 15

³⁸ Shields et al (2023) *Neither frank nor fearless*, pp. 23–24

³⁹ The Australia Institute (2023) *Polling – government use of consultants*

Sanctions

Strong and clear sanctions for misconduct send a strong message that consultants need to act appropriately or pay a significant penalty.

The US Government's rules on using contractors feature formal sanctions, including debarment and suspension of contractors.⁴⁰

The Australia Institute has recommended two sanctions for PwC's poor behaviour:

- PwC should be banned from receiving government contracts for a suitable period. This has already been implemented in limited form as a "shadow" ban.⁴¹
- There should be an independent inquiry into the quality and integrity of PwC consulting.⁴²

After being imposed on PwC, these sanctions could be generalised to apply to any consulting firm that misuses confidential government information or is found to have done poor-quality work for government.

Australia Institute polling research found:

- Four in five Australians (79%) want PwC banned from receiving new government work, including nearly half who back a permanent ban.⁴³
- Similarly, four in five Australians (80%) agree that consulting firms that leak confidential government information should be banned from consulting for the government (10% disagree).⁴⁴

⁴⁰ United States Government (2023) *Federal Acquisition Regulations: Part 9 – Contractor Qualifications*; Williams (2009) *Transparency and fairness in the acquisition process: Excluded Parties List System*, <https://www.gsa.gov/about-us/newsroom/congressional-testimony/transparency-and-fairness-in-the-acquisition-process-excluded-parties-list-system>

⁴¹ Tadros, McIlroy and Chenoweth (2023) *PwC shut out of future federal contracts*, <https://www.afr.com/companies/professional-services/pwc-effectively-banned-from-government-contracts-20230525-p5dbde>

⁴² Shields et al (2023) *Neither frank nor fearless*, p. 24

⁴³ The Australia Institute (2023) *Four-in-five want PwC banned from new government contracts*, <https://australiainstitute.org.au/post/four-in-five-want-pwc-banned-from-new-government-contracts/>

⁴⁴ The Australia Institute (2023) *Polling – government use of consultants*

Conclusion

The problems governments experience with consultants in many cases also apply to the private sector. Consultants have shown they are prepared to compromise their advice and tell government ministers and public servants what they want to hear, rather than what is in the public interest. Similarly, there is a risk that auditors could compromise audit quality to keep on good terms with company management, rather than work in the interest of the company and its shareholders.

The Australian Government is one of the biggest and most powerful clients any consulting firm would have. That consulting firms are willing to breach the trust placed in them by the Australian Government, cut corners on its contracts and treat it as a cash cow is a worrying hint at how they must treat their smaller and less powerful clients.