From: Mrs Monica Coulson

Date: 8th October 2019

To: The Parliamentary Joint Committee on Corporations and Financial Services

Submission: Inquiry into auditing in Australia

I am an Australian researcher with a background in administration and accounting (now retired). For a number of years, I have been looking at monetary policy particularly in relation to Banks. My focus has included their accounting/auditing firms and how their combined influence affects government policy.

To support this submission, information from outside sources is highlighted in *italics*.

<u>Potential Conflicts of Interest due to Diversification of the Big Four Accounting Firms (Deloitte, EY, KPMG, PwC)</u>

<u>November 6, 2018 AFR</u> - Firms which have emulated big four firms Deloitte, EY, KPMG and PwC by moving into non-accounting services have been the big winners.

An example of the extent to which KPMG has diversified is quoted on their own website: *"KPMGs Banking and Capital Markets practice is well placed to help clients successfully navigate challenging times and capitalise on opportunities."*

<u>September 6, 2019 The Australian</u> - Gatekeepers of Capitalism ....In Australia, companies representing 95 per cent of the $1.6 trillion market capitalisation of the local stock exchange are audited by one of the big four. Just about every major company, super fund and not-for-profit has some reliance on the services of the big four.

There is an oligopoly of the Big Four accounting firms with no competition in the auditing of mega corporations and banks.

Expanding their activities into information technology, advisory and legal services for their clients creates a real problem for the independence of auditing of those same clients. Independent detection and reporting of fraud and misconduct by their clients is virtually non-existent when the same accountants are so entrenched in their clients' affairs.

Likewise, the revolving door of personnel between these global accounting firms and the agencies that regulate them, creates a culture of impunity, as has been the case with the Big 4 Banks in Australia and the bank regulators.

The joint provision of advisory accounting and legal services by these firms can also provide a 'cover' for legal privilege of documents and information, circumventing investigations into the myriad of tax avoidance schemes that have been employed by multi national companies, and to which I believe the Big Four are complicit.

Accountants are not going to self-regulate, so the government must regulate the industry to separate the ever growing conflicts of interests, and to target tax avoidance advice and practices at the source - the global chartered accountants.

Self regulation doesn't work. We saw for example, the fraudulent activities of the banking industry during the Royal Commission hearings, which has been a windfall for the Big Four accounting firms assisting banks through the remediation process to regain trust.

Influencing Tax Laws

In addition to their large corporate clients, the Big Four accounting firms also provide services and advice to governments, including Australia. The Australian Treasurer's "High Level Advisory Panel" on tax is dominated by these accountants (five executives from EY, three from Deloitte, five from KPMG and seven from PwC).

Their influence within government circles, creates a conflict of interest to potentially influence tax laws, gain 'insider' advantage and expose tax loopholes for their clients.

On the one hand you have these accountants advising government on tax, whilst at the same time being investigated by the Australian Taxation Office, eg:-

October 18, 2018 Business Insider - The Australian Tax Office (ATO) is reportedly looking at Deloitte, EY, KPMG and PwC for tax promoter schemes. The investigation stems from the Paradise Papers, 13.4 million leaked confidential documents from legal firm Appleby. The ATO has been looking at thousands of emails and documents that were part of the Paradise Papers as they relate to Australia. The tax office's Tax Avoidance Taskforce has collected $5.6 billion over two years from its audits of global tech companies, miners and private wealth groups. Now the ATO's focus is on big accounting firms after the ATO allegedly found tax schemes to get around provisions of the Multinational Anti Avoidance Law.

Influencing Government Monetary Policy - The Black Economy Taskforce

Equally, the Big Four also sit on government inquiries, such as the Black economy taskforce which recommended a cash ban on Australians, which brought about the Currency (Restrictions on the use of Cash) Bill 2019 currently under parliamentary scrutiny.

The chair of this Taskforce was the former chair of KPMG. Yet KPMG alone has been fined more than $500 million for tax and accounting fraud. It's not just tax evasion. KPMG was the auditor for British banking giants HSBC and Standard Chartered when they were caught money-laundering in 2012, involving massive accounting fraud that occurred on KPMG's watch (under the leadership of the same person who headed the black economy taskforce in Australia).

It was the organisation of Chartered Accountants Australia New Zealand who pushed for a much lower cash ban for all entities (both businesses and individuals). According to the International Monetary Fund, a cash ban is necessary for banks to effectively move to negative interest rates and avoid a customer run on deposits. It is the Big Four accounting firms who have the influence and leverage to affect this global phenomenon for their clients, the banks.

Quality Assurance and Oversight

October 1, 2019 AFR - *The main professional body for auditors decided it would not review the quality of the big four firms' audit work because it believed it would duplicate the work of the corporate regulator.Chartered Accountants Australia and New Zealand (CA ANZ), which is partly funded through the membership fees of its big four members, Deloitte, EY (the former Ernst & Young), KPMG and PwC, also could not say if it had conducted any reviews of the quality control systems of the big four.*

The above would suggest a conflict of interest by even the professional body. It appears that the Big Four are beyond the review of even their own professional organisations.

So who is auditing these auditors?

Flying under the radar

In Australia it is only in recent years that the government has turned its attention to tax avoidance by large multi national corporations and tax avoidance schemes supported by the Big Four accounting firms.

Both in the US and UK, an increased number of malpractice suits against the Big Four accounting firms has resulted, because those governments have applied resources and been quicker to react to investigating audits where companies have failed, acting on leaked documents and whistleblower information.

Given that the Big Four accounting firms in Australia are part of a global network, it is very likely that their misconduct here is merely a consequence of them 'flying under the radar' and not being targeted in investigations as has happened overseas.

The below shows just a sampling of auditing 'misconduct', with no prosecutions and merely negotiated fines. This is the same modus operandi applied to the Big Four's client Banks here in Australia. Good for government coffers, but not the deterrent that society would expect.

April 16, 2015 Corpwatch.org - *Ernst & Young, one of the Big Four auditing firms, has agreed to pay $10 million to New York state to settle a lawsuit for overlooking accounting gimmicks by Lehman Brothers, the defunct Wall Street bank. The scheme allowed Lehman to hide billions of dollars in bad deals as they are supposed to hold the companies they audit accountable."*

<u>May 29, 2018 The Guardian</u> - After the fall of Lehman Brothers brought economies to their knees in 2008, it was apparent that Ernst & Young's audits of that bank had been all but worthless.

<u>June 13, 2019 BBC</u> - Accounting giant PwC has been fined £6.5m over its audit of the cloud computing firm Redcentric. The Financial Reporting Council (FRC), which regulates auditors, reduced the fine to £4.55m after PwC admitted its mistakes. The FRC said some of the breaches were of a "fundamental nature, evidencing a serious lack of competence in conducting the audit work". Two partners at PwC were each fined £200,000. The auditor has run into trouble with its regulator several times in recent years:

- *In 2018, it was fined £6.5m for poor auditing of collapsed department store BHS*
- *In 2017, it was fined £5.1m for a poor audit of failed auditor RSM Tenon Group*
- *Also in 2017, PwC was fined £5m for misconduct in its audit work for failed maintenance firm Connaught*

<u>June 18 2019 WASHINGTON (Reuters)</u> - KPMG LLP has agreed to pay a $50 million fine over allegations former staffers used stolen information to alter some of the accounting firm's previous audit work and cheated on training exams, the U.S. Securities and Exchange Commission said on Monday.

<u>July 4, 2019 Bloomberg</u> - Deloitte LLP was fined 4.3 million pounds ($5.4 million) for its failure to properly audit the accounts of a unit of Serco Group Plc in the latest case of a Big Four firms being sanctioned for its accounting shortcomings. Deloitte will also pay 300,000 pounds toward the costs of the investigation and has arranged to send all its audit staff on training program to improve behavior related to its "misconduct," the U.K.'s Financial Reporting Council said.

<u>July 24, 2019 Financial Times UK</u> - KPMG has been handed a £5m fine for misconduct in work for BNY Mellon, the world's largest custodian bank, over breaches that were described as "truly exceptional" by regulators.

<u>July 31, 2019 The Guardian</u> UK - Fines against accountants more than doubled to a record £32m last year as the regulator cracked down on auditors in an attempt to repair its reputation in the wake of Carillion's controversial collapse.The penalties imposed mark a significant rise from the £13m in fines handed out by the Financial Reporting Council over the 2017-18 financial year. The total would have reached £42.9m in the year to March 2019 if the FRC hadn't offered discounts to firms that volunteered to settle cases early. The accounting watchdog said the rise in penalties last year was partly due to more cases coming to a close over the period, as well as a rise in serious misconduct by accountants and the size of the auditing firms involved. The "big four" accounting firms – KPMG, Deloitte, PwC and EY – accounted for six of the nine fines imposed.

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I thank the Committee for the opportunity to lodge a submission and respectfully request that their scrutiny results in recommendations for a greater scrutiny of the Big Four accounting firms' audits and to separate auditing from the conflicted areas of consulting, legal and advisory services provided to the same clients.