

Dr Peter Wells, Phd, M Com(Hons), FCA

26 July 2023

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

Submission – Ethics and Professional Accountability: Structural Challenges in the Audit, Assurance and Consultancy Industry

Dear Sir / Madam,

I appreciate the opportunity to make a submission to the Committee on its enquiry into ‘Ethics and Professional Accountability: Structural Challenges in the Audit, Assurance and Consultancy Industry’. I am well aware of the circumstances that have led to this enquiry and hope that I can offer some insights that may be helpful. These may not necessarily align well with the Terms of Reference but I will endeavour to address them as far as possible.

1. The large accounting firms have been evolving for well over 100 years, and in recent years there has been a significant increase in market concentration. In 1980 the large accounting firms were referred to as the ‘Big 8’ and today this has reduced to the ‘Big 4’. Throughout history the ‘driver’ of this evolution was the need to be ‘fit for purpose’ to service the needs of its clients that were initially increasingly national and are now global. This has implications not only for the audit of large corporations operating across many countries, but also the necessary business support services. For example, IT platforms which increasingly operate across large corporates internationally, and tax advice where clients operate in many jurisdictions. While the increased market concentration might be viewed adversely by many, it was probably economically efficient and inevitable. The alternative would be negotiating audit and other services in different cities / countries for large corporations with a large number of small auditors and service providers. This would be extremely difficult, expensive and in the case of audits, quality undoubtedly compromised. Developing and maintaining the infrastructure to support a large global accounting firm is however costly. It is doubtless for this reason that there is persistent evidence in the academic literature of large accounting firms charging an audit fee premium. This would doubtless spillover into other service areas. This ensures a clientele effect whereby the clients of the large accounting firms are themselves generally large and sophisticated entities. These large clients are doubtless capable of recognising and addressing any potential conflicts. Furthermore, many of the consulting services provided a complimentary and share a common goal of enhancing client performance. This is not a conflict. Concerns are often raised about conflicts between auditors and others within the large accounting

firms, however the joint and several liability across partners provides an important check on this and self-interest ensures self-monitoring.

However, there are potentially significant conflicts created by the diverse nature of the relations between the clients of the large accounting firms. This is most difficult to address in relation to policy and legislative advice provided by consultants generally to public sector entities when the consultants concurrently provide services and advice on compliance with the legislation to other clients. This is not limited to taxation. A similar conflict would arise for firms providing consultancy services relating to the mandating of 'sustainability reporting' when they are positioned to be a significant provider of 'sustainability reporting' services. Interestingly, the cost in this instance is born by the corporate client rather than the government. I would characterise these conflicts as 'poacher and gamekeeper' conflicts. You can't do both.

Accordingly, I do not believe it is the structure of the large accounting firms that is the problem, rather their involvement in providing policy and legislative advice to government. This can only be provided by independent consultancies - actual separation.

2. If there was one major criticism of the large accounting firms it is their lack of transparency. There is no disclosure of clients, or the range of services that are provided to these clients and this precludes a critical evaluation of conflicts interest by all clients. Hence these disclosures should be required.

For public sector entities these disclosures and identification of the conflicts should preclude engagement of many consultants on policy and legislative matters. The steps identified in the Terms of Reference can't be relied upon.

3. The large accounting firms developed for reasons of economic efficiency. Hence it is likely that economic constraints or sanctions are likely to be the most successful, and joint and several liability is an integral part of this. Provision of conflicted advice to large corporate entities that are the typical clientele of these firms would significantly impair their reputation and impose a significant economic penalty. The only impediment would be a lack of transparency and disclosure of clients and the range of services that are provided to these clients. Hence these disclosures should be required.

I am sceptical about whether any of the mechanisms listed in the Terms of Reference could be enhanced to provide sufficient assurance that conflicts of interest are avoided.

4. Not addressed in the Terms of Reference is the efficacy of public sector entities engaging consultants to provide policy and legislative advice who concurrently provide advice and services to impacted corporate sector clients. This creates an intractable conflict.

In summary, I believe is difficult (probably impossible) to regulate situations of potentially extreme conflicts of interest. Accordingly, I believe it is necessary for public sector entities to avoid consultancies for the provision policy and legislative advice from firms that concurrently provide advice and services on these matters to corporate sector entities. This is not dissimilar to many codes addressing the issue of conflicts of interest and how they should be addressed.

If there is one challenge, it is identifying these conflicts of interest and this is impeded by a lack of transparency. There is no disclosure of clients, or the range of services that are provided to these clients by any of the large consulting firms and this precludes a critical evaluation of conflicts interest by all clients. Hence these disclosures should be required.

Yours faithfully

Peter Wells