The Director, Public Accountability and Works Committee, Parliament House,
Macquarie Street, Sydney NSW 2000.
Attention:
Ms Abigail Boyd, MLC
Parliament House
Macquarie Street
SYDNEY NSW 2000

Dear Ms Boyd

Re: Inquiry into the NSW Government's Use and Management of Consulting Services

Further to our original submission, we provide further evidence to the Inquiry.

First, we correct the amount provided in our original submission relating to KPMG consulting fees and rely upon the evidence KPMG gave in the recent Parliament of Australia Senate Inquiry Into Management and Assurance of Integrity by Consulting Services (Consulting services). KPMG responded to a question at that Inquriy about how much it was paid for its work for TAHE: "We were paid for TAHE by Transport something in the order of $920,000. By Treasury, over, I think, three or possibly four years, we were paid approximately $2½ million. So, all up, it was about $3.4 million across that four-year period".

Second, we clarify the New South Wales Auditor-General (NSW A-G) powers and whether it can examine and judge KPMG and its work for Treasury and Transport NSW. We are surprised that a KPMG partner, Heather Watson, in her response to a submission by Professor Brendan Lyon to the Senate Inquiry into Consulting Services, observed that the A-G NSW had made no findings against KPMG: "Ms Crawford's testimony and related report to Parliament on State Finances 2021 contain no reference at all to the independence of consultants, of KPMG or me. With no reference, it follows that there can be no criticism. The mandate of the Auditors-General does not include confirming consultants' compliance with professional standards. It follows that the Auditor-General does not make findings or observations about such matters and, indeed, has not done so in this instance".

Watson also observes: "The implementation of TAHE was a significant reform and scrutiny would have been likely regardless of any involvement by KPMG or me. For example, there is a legislative requirement for the Auditor-General perform an audit of the financial statements

of the State of NSW and TAHE every year and the Auditor-General takes into account NSW government policy objectives and its reform agenda when selecting performance audit topics".

This is a misrepresentation of the purpose and function of performance audits, which assess whether entities are carrying out their activities effectively and doing so economically, efficiently, and in compliance with relevant laws.[1] They "cannot question the merits of state and local government policy objectives. Further, the A-G takes a strategic approach to selecting the topics of performance audits, which balances the performance audit program to reflect issues of interest to Parliament and the community. Each year, the A-G seeks input from key stakeholders on proposed topics before publishing the performance audit program. The Auditor-General also considers performance audit topic suggestions from the Public Accounts Committee, Members of Parliament, local councils and members of the public".[2]

Performance audits may be undertaken on topics requiring specialised skills and knowledge beyond those the audit team possesses.[3] In these cases, the A-G will engage consultants to provide expert assistance to the audit team and discuss this with the audited entity. The audit team must ensure that any consultant engaged in the audit has the necessary competence, capabilities and impartiality to complete the work required.

Third, we recommend the powers required by the NSW A-G to enable it to undertake what is known in the academic literature as a 'follow the money' audit. The issue of trust in our democratic system of government is essential, especially given the hollowing out of the public sector. The deskilling of the public service means we rely on consultants, particularly the BigFour, to undertake public sector work. The A-G's role is to oversee, in a transparent and public way, that the conduct of the public sector is legal, financially responsible, effective and efficient.[4]

However, the current arrangements for the audit office are a legacy of the past that does not reflect contemporary program funding initiatives, such as Commonwealth, State and other partnership arrangements, nor the practice of contracting out public services work to third parties (private and not-for-profit) and entering into public-private partnerships.

To be fit for purpose, the A-G of the future should have a mandate, supported by legislation, to monitor all of NSW's public operations. For this to happen, the *Government Sector Audit Act 1983* (NSW) must be broadened beyond the current focus on public sector entities to enable adequate audit coverage of all publicly funded programs, operations and activities such as consulting, especially when consultants are asked to, or offer, policy advice to the government.

Previous high standards of public sector accountability in NSW have deteriorated in the past decade, primarily because of the change in approach to program delivery using the private or not-for-profit sectors without a corresponding revision of the audit mandate.[5]

Therefore we recommend New South Wales Parliament take the advice of the former A-G of Victoria, Des Pearson AO,[6] who argues for three categories of reform:

1 Audit Mandate

There is a need to update the audit mandate to align with contemporary program funding and delivery practices that now extend beyond public sector entities' traditional direct delivery of programs. The mandate should encompass all public sector-funded programs and government-controlled entities. This would better ensure that public sector accountability principles are applied consistently across all operations.

2 Providing Appropriate Discretion

There is a need to empower the Auditor-General to be able to acquit their statutory responsibilities without fear, favour or affection by providing reasonable discretion about the content and timing of audit reports, and

3 Removal of impediments to allow for the efficient delivery of the audit program.

There are multiple levels of oversight of the Auditor-General and operational constraints on the performance audit process. These are not warranted and should be removed to honour the letter and spirit of the independence provisions in the Constitution Act that the Auditor-General be an independent Officer of the Parliament and not be subject to direction by anyone in performing their audit duties.

Fourth, we address the matter of accountants' liability being limited to $10 million. We preface this discussion by clarifying that we are not liability experts and rely on the submissions of two parties to the Inquiry (Consulting services). Mr Larocca, from EY, states that as a partnership, all EY partners are liable for any damages. However, Professor Lyon argues that partnerships such as BigFour are not ordinary. Instead, they enjoy special protections that limit their damages to just $10 million, which is then insured. That special legal protection is gifted by the Professional Standards (Accountants) Scheme under professional standards acts." The following is the exchange in the recent Senate inquiry about this issue:

Mr Larocca, EY: I might actually take the opportunity to correct one of the statements that were made in one of the testimonies yesterday, around liabilities and

liability caps. We operate under a $75 million liability cap per event, not the $10 million that was claimed yesterday. That is not true. There are many other professions that are subject to a similar scheme, and some of these do operate under smaller caps. Importantly, none of these caps limit liability for breach of trust, fraud or dishonesty. To walk through an example—and I'm hoping I don't have to encounter one of these examples—if we have an audit where one of our partners has acted dishonestly or participated in a fraud, we are uncapped, and all of the partners suffer. I suffer. Scott suffers. Leigh suffers. All of our 700 partners are on the hook. So I really wanted to correct some of the discussion that was brought to the Committee yesterday.

Professor Brendan Lyon, Private capacity: Partnerships, on the other hand, are an older, simpler model where two or more people conduct a business and they personally share profits and losses. Partnerships are not a separate legal entity, meaning partners incur unlimited personal liability for losses of the partnership. In other words, partners can and do lose their houses and personal savings if a partnership fails to meet its obligations or liabilities. An ordinary partnership is not regulated, because it is not protected. The BigFour are not ordinary partnerships. Instead, they enjoy special protections that limit their damages to just $10 million, which is then insured. That special legal protection is gifted by the Professional Standards (Accountants) Scheme under professional standards acts. The cap on damages for accounting firms was developed to protect audit and accounting firms from the risk of extinction if damages were claimed for isolated good-faith errors. They were implemented to enable the entry of smaller firms to promote competition and, through accompanying insurance, protect claimants by ensuring compensation awards are insured and able to be paid. But, in application to the large pseudocorporate BigFour firms, the professional scheme sees them enjoy a much higher level of protection than a comparable corporation would. By way of example, the Goodman Group is No. 20 on the ASX. Goodman Group has a smaller revenue than any of the BigFour firms and reported owners' equity of $16.4 billion in its last annual report. In the event of wrongdoing, that means that Goodman Group could be sued for damages up to $16.4 billion. If they were awarded, it would go broke and the shareholders would lose their investment. Moreover, its management and its board of directors would face civil claims and legal penalties if engaged in breaches of Corporations Law. By contrast, a BigFour firm, with greater revenues than Goodman Group, could be sued for only $10 million. That equates to less than one half of one per cent of annual revenue for these BigFour firms and there could be no legal pursuit by ASIC against the CEO, the board or other officers because they are not bound by the duties in the Corporations Act.

Fifth, we discuss the issue arising from recent inquiries into consulting centred around how the accounting profession has traded on its professional status and ethical codes.[7] The BigFour and Chartered Accountants in Australia and New Zealand have extensively appealed to ethical codes and disciplinary arrangements as part of their professional status. However, investigating journalists, whistleblowers, and parliamentary inquiries have highlighted alleged unprofessional conduct by accountancy firms and their partners in Australia. We conclude that events belie the rhetoric of ethical conduct, that is, the failure or inability of the professional accountancy bodies to take effective action against the offending firms and their partners.[8]

Sixth, our submission referred to research into the Transport Asset Holding Entity (TAHE), and we responded to questions asking for more information about the findings of this research. Our draft academic working paper, 'Vehicles For Deception in NSW Transport: Are Management Consultants Monsters or Benign Change Agents?' by James Guthrie, Jane Andrew, Erin Twyford, Ann Sardesai and John Dumay (2023), which we hope to publish in the highly-ranked *Accounting, Auditing and Accountability Journal*. This paper finds that "KPMG Australia signalled the establishment of TAHE as the best practice for Transport NSW. However, our analysis reveals that TAHE was an artificial quasi-market invented to market public transport assets in a case to help balance the State budget before an election while creating a financial obligation for future governments. This case highlights the role of consultants in creating hybrid public sector organisations and tainting the state railway's traditional financial and accounting practices using controversial accounting techniques".[9]

Yours faithfully

Emeritus Professor James Guthrie, Member of the Order (AM), FCPA

Professor John Dumay, CA

Professor Jane Andrew, CPA

Dr Erin Twyford, CA

[1] Guthrie, J. and Parker, L. (1999), "A Quarter of a Century of Performance Auditing in the Australian Federal Public Sector: A Malleable Masque", *Abacus*, Vol. 35, No. 3, pp. 302-332.
[2] Audit Office of NSW (2021), *Performance Audit Guide*, https://www.audit.nsw.gov.au/sites/default/files/documents/Performance%20audit%20guide%20for%20audit%20agencies%20-%20current%20version.PDF
[3] Parker, L. and Guthrie, J. (1991), "Performance Auditing: The Jurisdiction of the Australian Auditor General — De Jure or De Facto?", *Financial Accountability and Management*, Summer Issue, pp. 107-116.
[4] Guthrie, J. (1992), "Critical Issues in Public Sector Auditing in the 1990s", *Managerial Auditing Journal*, Vol. 7, No. 4, pp. 28-34.
[5] Guthrie, J. and English, L. (2000), "Mandate, Independence and Funding: Resolution of a Protracted Struggle Between Parliament and the Executive over the Powers of the Australian Auditor-General", *Australian Journal of Public Administration*, Vol. 59, No. 1, pp. 98-114.
[6] Pearson, D. (2015), "Following the Money – An Auditor's View!", Independent Community Accountability Network, https://www.accountabilityrt.org/following-the-money-an-auditors-view/
[7] Murison, A. (2023), "Strengthening the Disciplinary Framework", *Acuity*, https://www.acuitymag.com/opinion/Strengthening-the-disciplinary-framework
[8] Mitchell, A., Puxty, T., Sikka, P. and Willmott, H. (1994), "Ethical Statements as Smokescreens for Sectional Interests: The Case of the UK Accountancy Profession", *Journal of Business Ethics*, Vol. 13, No. 1, pp. 39–51.
[9] Guthrie, J. (1993), "Australian Public Business Enterprises: Analysis of Changing Accounting, Auditing and Accountability Regimes", *Financial Accountability and Management*, Vol. 9, No. 2, pp. 101-114.