Submission No 5

INQUIRY INTO NSW GOVERNMENT'S USE AND MANAGEMENT OF CONSULTING SERVICES

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The Director, Public Accountability and Works Committee, Parliament House,

Macquarie Street, Sydney NSW 2000.

Introduction

Thank you for the opportunity to make a personal submission to this inquiry. Our submission is informed by research we are undertaking in the consulting industry in Australia, especially the Big Four accounting firms.

We note the inquiry into the New South Wales Government's use and management of consulting services Terms of Reference. We will not specifically address each point but make evidence-based observations about Australia's consulting industry structures and practices.

The various Australian governments spend billions of dollars of taxpayers' money yearly on external contractors and consultants. The State's Auditor General, Margaret Crawford, identified $1bn in spending on consultants by the NSW Government between 2017 and 2022.[1] Despite this enormous expenditure, there is no transparency over what is provided and the knowledge these consulting services produce. Further, reporting perceived or actual conflicts of interest relies entirely on self-reporting and self-regulation.

As critical accounting academics, our interest lies in issues associated with:

1. The culture of professional services partnerships and consultancy services practices
2. Conflicts of interest
3. A lack of transparency and accountability
4. The 'hollowing' out of the public service

We are particularly concerned about these issues, given that the business model of the consulting industry is that the clients, and in the case of government contracts, our society, bear the risk of failure while partners profit.

The significance of the consulting industry shaping a new public sector is widely acknowledged. It is consistent with the new public management approach whereby governments adopt management structures, techniques and processes from the private sector to deliver public services. In our submission to the Commonwealth Senate inquiry into management and assurance of integrity by consulting, we highlighted concerns about conflicts of interest, the culture of consulting services firms, the apparent lack of transparency and accountability for consulting arrangements, and the hollowing out of the public service. We discuss these in more detail below.

Our submission focuses on the overuse of consultants by the NSW Government and its impact on the NSW public sector and public services. Our central proposition is simple: consulting partnerships and firms are not publicly regulated. However, self-regulation lies with individual members of a professional accountant body or a registered auditor or tax agent. This self-regulation is embedded in professional bodies' codes and ethical practices. It is not applied to firms' partnerships but to individuals. Currently, there are few enforcement measures for integrity breaches and unethical behaviour by consultants and firms. Professional bodies, such as the accounting and legal professional associations, take limited action against members who are partners at the Big Four consulting firms. Revelations about conflicts of interest and unethical behaviour are primarily due to whistle-blowers and investigative journalists rather than as a result of self-regulation and self-reporting. Even if there is some self-regulation and self-reporting, it is conducted behind closed doors with limited or no public transparency.

1. The culture of consulting services firms

The nature of consulting firms is to maximise returns to partners. To do so means that the firms regularly engage in unethical behaviour and, as outlined above, an absence of regulation beyond self-regulation. Few measures currently exist to prevent unethical behaviour by consulting firms, as seen in the following example of how consulting firms' so-called 'BigCon' works.

KPMG provided consulting services to the NSW Government, enabling it to manipulate asset valuations so that a new entity, the Transport Asset Holding Entity (TAHE), would not be required to comply with specific accounting standards. On the advice of KPMG, the NSW

Government established TAHE as a statutory state-owned corporation (SOC). The NSW Auditor-General's report on government agencies' use of consultants revealed that KPMG was paid around $72 million between 2017 and 2022 and received over $30 million for establishing the NSW TAHE. Research by Guthrie et al. (2023, forthcoming) identifies a significant conflict of interest in the work of KPMG on TAHE and a cover-up over accountability to Parliament.

The KPMG case has many elements of the 'Big Con.' It highlights unethical behaviour, as revealed by the *Australian Financial Review*'s analysis of evidence and documents associated with parliamentary committees, the NSW Auditor-General and internal KPMG documents, including failure to prevent information leaking between Treasury and TAHE, and accusations of bullying and attempts to discredit a Transport Secretary and former KPMG partner, who advised that it was neither safe nor financially viable for TAHE to proceed.

The NSW Auditor General's audit of the *Design and implementation of the Transport Asset Holding Entity* (TAHE), tabled 24 January 2023, found that the agencies involved in designing and implementing TAHE (which included NSW Treasury and Transport for NSW) were over-reliant on consultants and that they also used consultants for tasks that the public service should have performed. Key findings relevant to this current inquiry include the following:

- 16 consulting firms worked on 36 engagements connected with TAHE from 2014 to 2021
- 20 of these 36 engagements were conducted by three consulting firms – Boston Consulting Group (5), Ernst and Young (8) and KPMG (7)
- there was one instance of a consulting firm (KPMG) being engaged by two agencies simultaneously (NSW Treasury and Transport for NSW), and any real and perceived conflicts of interest arising were left to the consultants to manage

We recommend **a much more significant role for the NSW Audit Office and NSW Auditor-General to provide oversight**. These offices have a long history of overseeing public accountability.

2. Conflicts of interest

Big consultancies often work on 'both sides of the street' – advising, for example, both the leading fossil fuel polluters and government mandates to reduce national emissions or auditing a large prime contractor while bidding for similar contracts, or writing federal tax legislation at the same time as advising clients on how to sidestep it.

To illustrate our concerns regarding conflicts of interest, we outline recent cases of conflicts of interest exposed by investigative journalists. The first concerns PwC and its failure to disclose its interest in a private education provider while conducting a confidential review into the Commonwealth regulator of private colleges, the Tertiary Education Quality and Standards Agency (TEQSA). In 2016 PwC was contracted by the Department of Education to analyse the cost-recovery funding model used by TEQSA, roughly eight months after the firm had invested in one of Australia's most prominent and politically active private colleges, 'Top Education Group'. This is the second time PwC concealed its $5.5 million interest in addition to $2.5 million of personal investments by eight senior partners of PwC and the fact that former PwC chief executive Tom Seymour sat on Top Education Group's board until last year. TEQSA's regulatory decisions directly impact Top Education Group. The contracts between the department and PwC required PwC to advise of any conflicts of interest, to which the department asserts that there are no records of PwC declaring any conflicts. In the wake of PwC's tax scandal, a spokesman admitted that concerning TEQSA, "we did not make the appropriate disclosure regarding a review completed for the department in 2017, in line with their policy and our own professional standards".[2]

To further illustrate conflicts of interest within consulting firms, KPMG was paid by the aged care safety and quality commission to undertake audits of residential aged care facilities while charging providers for advice on audits and accreditation. KPMG's website promotes consulting on "integrative innovative approaches with a deep sector expertise of both government aged care policy and the issues faced by service providers". These services offered simultaneously with government contracts represent at least a perceived conflict of interest. The government relied on KPMG to self-report any conflicts of interest, which, until recently, it argued did not exist. On 27 June 2023, KPMG announced it was launching an internal review to address concerns about potential conflicts of interest after facing sustained criticism from senators, unions and transparency advocates.[3] The scope and duration of the review is unknown. However, it is an internal process conducted behind closed doors under self-regulation.

As a final example, we point to the unethical behaviour and numerous conflicts of interest made apparent with the PwC tax scandal that has unfolded over the last couple of months. The case is likely well-known to the committee and the public. To summarise, PwC walked both sides of the street in advising the government on its new anti-tax avoidance legislation (MAAL) while simultaneously devising tax schemes designed to circumvent the new legislation once it was enacted for its most prominent clients worldwide. A cache of emails revealed that over 60 partners at PwC were part of email chains outlining different elements of the scheme, with NDAs flouted as confidential information from the ATO was distributed to other PwC partners to assist their clients and pocket additional fees while depriving Australia of potentially billions of dollars in tax revenue. PwC's response was consistently obfuscated until it could no longer stem the public outcry and demands from senators, primarily from the Federal Government's inquiry into using consultants.

This scandal is still a developing story, with the matter referred to the Australian Federal Police (AFP). This presents further conflicts of interest due to the personal relationship between AFP commissioner Reece Kershaw and former NSW police commissioner Mick Fuller, who joined PwC as a partner in March 2022. Multiple meetings between the two were made concerning a contract to conduct an ACT policing review. PwC was awarded millions of dollars worth of contracts with the AFP, including working as the agency's auditor.[4] The two also exchanged text messages on the same day Treasury referred the tax scandal to the AFP for criminal investigation. No conflicts of interest between the two were ever disclosed. These relationships and the unethical behaviour of PwC highlight the endemic nature of conflicts of interest between the government and its agencies and consulting firms, which undermine public confidence in the government's ability to carry out its social services and the democratic system upholding Australian society.

Therefore we **recommend that consulting firms that want to work for governments should be made to disclose things such as any clients they advise that could potentially conflict with the public sector work and the advice provided. Further, this disclosure should be made available on a publicly-accessible register.**

3. Lack of transparency and accountability for consulting arrangements

There is growing scepticism about the ability of consultants to add value and manage their inevitable conflicts of interest. In Appendix A, we have collected recent relevant newspapers and other articles, which we ask to be placed on the public record. These articles highlight that, while PwC is the focus of current media attention, other consulting organisations are involved in 'both sides of the street' activities. Allan Fels and James Guthrie's opinion piece in the *Australian Financial Review*[5] notes that the Commonwealth Parliamentary Joint Committee on Corporations and Financial Services Inquiry into the Regulation of Auditing in Australia did not provide a detailed final report. After the inquiry, the previous government spent billions on consulting and appears to have privatised many public services to enable a shift away from the public service and its values towards private for-profit consulting organisations. For instance, in the 2021–22 financial year, Australia's top consulting firms secured $2 billion worth of Commonwealth taxpayer-funded work. These consulting firms include the Big3 advisory firms (Accenture (formerly Arthur Andersen), McKinsey and the Boston Consulting Group, and the Big Four accounting partnerships (PwC, Deloitte, KPMG and EY). As detailed in the authors' evidence to the Senate Inquiry into the Regulation of Auditing in Australia, the culture of these consulting firms is characterised by conflicts of interest and secretive practices that discourage whistleblowing while encouraging coercive and unethical behaviours. As partnerships, not companies, the big four firms do not have to disclose where their money is coming from, even though they are the most powerful private institutions in the world. Much of their work comes from governments and large multinationals, for which they are both consultants on how to avoid tax and auditors providing so-called 'transparency'.

One possible solution can be drawn from recent innovations in the US under President Biden relating to conflicts of interest with consulting firms. Specifically, in December 2022, the US introduced new legislation to prevent conflicts of interest by requiring contractors to disclose information relevant to potential organisational conflicts and limit future contracting concerning potential conflicts. No such legislation exists about Australian Government procurement and would go some way to overcome some of the problems raised in our evidence to the inquiry. Hence, **we recommend contractors be required to disclose potential organisational conflicts and limit future contracting where there are potential conflicts**.

4. The 'hollowing out' of the public service

Mazzucato and Collington (2023) highlight the hollowing out of the public service and offer proposals liberating public organisations from overripe compliance in the consulting industry. The first is a new vision, narrative and remit for the civil service, which has faced years of 'hollowing out'. For a government to rebuild capability in public sector organisations, it is essential to recognise the government as a value creator rather than a wasteful entity. This requires implementing learning and adaptive processes, empowering risk-taking within public sector organisations, and evolving the narratives around the government's role in the economy (Mazzucato and Collington, 2023, pp.239-242). Policymakers and the media will play a crucial role in this transformation.

The second is to invest in internal capacity and capability creation (pp: 242-247). Attracting capable and purpose-driven individuals to public sector careers is crucial while building digital infrastructure and in-house IT expertise is necessary to manage digital infrastructure and procurement contracts within the government (Mazzucato and Collington, 2023, pp. 242-247). Governments can also establish public labs and in-house consultancies. For genuine partnerships, governments can work with research institutions, organisations can learn through networks (like MOIN), and local Governments can apply the 'Community Wealth Building' principles.

Hence we **recommend that the Government (i) educate and empower the public service and (ii) invest in capacity building and creation.** We further **recommend that the government embed learning – and an end-point – into contract evaluations**. In existing contracting processes, value is often viewed in transactional terms: capacity or expertise is provided in exchange for money. But when knowledge-sharing agreements are included in terms of reference with contractors, procurement and other forms of partnership can also be a source of learning. Organisations can adopt 'dynamic' forms of evaluation that assess different impacts over time.

References

Guthrie et al. (2023), Vehicles For Deception in NSW Transport: Are Management Consultants Monsters or Benign Change Agents? MBS working paper.

Mazzucato, M. and Collington, R. (2023), *The Big Con: How the Consulting Industry Weakens Our Businesses, Infantilises our Governments and Warps our Economies*, Allen Lane, London.

[1] https://www.theguardian.com/australia-news/2023/jun/14/nsw-inquiry-to-review-1bn-spending-on-consultants

[2] https://www.abc.net.au/news/2023-06-28/pwc-second-failure-to-disclose-interest-in-top-education-group/102530918

[3] https://www.theguardian.com/australia-news/2023/jun/27/kpmg-australia-launches-internal-review-after-potential-conflict-of-interest-concerns-raised?

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[5] https://www.afr.com/companies/professional-services/pwc-scandal-makes-a-case-for-breaking-up-the-big-four-20230522-p5dadi