PwC Tax Scandal’s Aftermath: It’s Time to Seriously Regulate the Big 4

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Abstract

In the PwC tax scandal, a former PwC advisor, signed confidentiality agreements with the Australian government on proposed stricter multinational tax legislation. Instead, he emailed his PwC colleagues so they could warn clients about impending events. PwC partners then created "a global team" to think about how this information may be exploited for commercial gain globally. This latest scandal, and many other worldwide accounting and auditing scandals before, raise some fundamental questions of the relationship between governments and the accounting and auditing profession, especially the Big-4.

This article explores whether it is time for an independent body set-up by Parliament, to be responsible for setting accounting standards. Also, it is argued that Australia should take a lead from the United States, where the regulation of the accounting profession has shifted from self-regulation to statutory regulation. Finally, the paper proposes that governments should have a Register of Miscreants of consultants who have been involved in scandals and banning them from future government contracts.

Introduction

A tax expert from Australia started speaking like a spy in the dead of winter in 2015. He emailed classified information obtained from a confidential briefing by *the Australian Tax Office (ATO)* to associates with the message, *“For your eyes only”,* knowing they would subsequently exploit this information to benefit clients and profit handsomely.**[1]**

That email and dozens more like it have embroiled *PricewaterhouseCoopers* (PwC) in a scandal that has compelled resignations **[2]**, raised the possibility of criminal and corruption investigations**[3]**, elicited ire and accusations of insider trading**[4]**, and threatened future government contracts worth hundreds of millions of dollars**[5]**. This scandal has been unfolding for nearly eight years.

This latest scandal, and many other accounting and auditing scandals before, raise some fundamental questions of the relationship between government and the accounting and auditing profession, especially the Big-4:

1. Why are governments getting advice on policy matters, especially on Tax Policy, from the very consultants from the Big-4 who will be advising clients on how to take advantage of such policies?
2. Why are governments allowing the accounting and auditing profession to determine what outcomes are expected from a statutory audit?
3. Why are governments allowing the accounting and auditing profession to self-regulate in the wake of continuing scandals that put into question their ethical and moral integrity?
4. Why are the professional bodies such as the Chartered Accountants, and the global umbrella body for the accountancy profession, the *International Federation of Accountants (IFAC,)* keeping silent on these scandals?
5. Why are governments using the big private consulting firms (with big price tags) when there are public sector organisations such as universities and scientific institutes that already employ experts in the field, and who are less likely to have a conflict of interest?

6. Why are governments not having a *Register of Miscreants* of consultants who have been involved in scandals, and banning them from future government contracts?

The Origins of the Scandal

The *OECD G20 Base Erosion and Profit Shifting Project* (or BEPS Project) is an OECD/G20 project to set up an international framework to combat tax avoidance by multinational enterprises ("MNEs") using base erosion and profit shifting tools.**[6]** The project, led by the OECD's *Committee on Fiscal Affairs*, began in 2013 with OECD and G20 countries, in a context of financial crisis and tax affairs (e.g., Offshore Leaks). The report was delivered in 2015. OECD member countries and jurisdictions had agreed to join an accord to impose a two-pillar global tax reform plan which imposes global minimum corporate tax of 15%. The BEPS project is now in its implementation phase, and 116 countries are involved including most developing countries.

Peter Collins, a former PwC advisor, was assisting the Australian government in developing stricter multinational tax legislation at the time. The BEPS Project was a part of an international campaign to stop large corporations from reducing their tax obligations and moving profits elsewhere. Collins agreed to keep the information secret and had signed confidentiality agreements with the Australian government to this end.

However, instead of keeping the information confidential, Collins sent in 2015, an internal PwC email consisting of 144 pages to his PwC colleagues so they could warn clients about impending events. Collins also gave a private copy of an OECD draught document on *"mandatory disclosure of tax planning schemes"* that highlighted potential steps to minimise tax evasion globally; and included information about various tax efforts, meeting agendas, anticipated timings, and government thinking.**[7]**

PwC had, two years before, identified US tech as representing a significant upside sector for the Australian firm to provide tax advice as the ATO had problems with their structures. PwC diligently built relationships with key offshore buyers.**[8]** The stakes were high. The *Australian Financial Review* reported that three of the largest global corporations – *Apple, Google and Microsoft* – were among those targeted with confidential information about the government's plans to focus on tax avoidance.**[9]**

One PwC internal source told the Sydney Morning Herald, *"We were aggressive in telling these relationships they needed to act early (heavily helped by the accuracy of the intelligence that Peter Collins was able to supply to us)."***[10]** With this confidential information on hand, PwC partners created "a global team" to think about how this information may be exploited for commercial gain globally, but especially in the United States.**[11]**

This was just months before an alarmed *Australian Tax Office* sent out a series of alerts when it became apparent that multinationals had responded with extraordinary speed to anti-avoidance measures under the *Multinational Anti-Avoidance Law (MAAL).*

Australian MPs are now disparaging of PwC, calling the whole episode *"A sickening example of a lack of integrity*". One senator in parliament compared PwC to a cancer and warned other governments that the company may also be conducting "deception and betrayal" in other nations.

The Global Scope of the Scandal

The global PwC business is desperate that the Australian scandal does not bleed into their international business.

However, the horse may have already bolted.

It has been reported that PwC employees from Singapore, the Netherlands, and the US collaborated on the US project, which brought in around $2.5 million in revenue. Senior UK partners made separate comments and suggestions on the private information.**[12]**

The PwC global network has been accused of not being transparent about the worldwide scope of the problem and how many employees may have been involved, according to the Australian senator who demanded the release of the PwC emails. The emails that have been released to date show that PwC employees from Singapore, the United Kingdom, Ireland, the United States, and Europe collaborated internationally on this problem.

Ms. Deborah O'Neill, a senator for the Australian Labor Party, stated that as PwC is a global organisation, "*This is a disgraceful breach of trust, a sickening example of a lack of integrity, and it reveals a toxic culture of unprofessional practise at PwC that stretches across the globe."*

Accounting and Auditing Scandals Worldwide

This not the First Case Embroiling a Big-4 Firm. They have been the auditors in the biggest accounting scandals in the last 25 years, including:

- *Waste Management Scandal (1998)* – Arthur Andersen (AA)
- *Enron Scandal (2001)* – Arthur Andersen (AA)
- *HIH Insurance (2001)* – Arthur Andersen (AA)
- *WorldCom Scandal (2002)* – Arthur Andersen (AA)
- *Tyco Scandal (2002)*- PricewaterhouseCoopers (PwC)
- *HealthSouth Scandal (2003)* – KPMG
- *Freddie Mac Scandal (2003)* – PricewaterhouseCoopers (PwC)
- *American International Group (AIG) Scandal (2005*) – PricewaterhouseCoopers (PwC)
- *Lehman Brothers Scandal (2008)* – Ernst & Young (EY)
- *Satyam Scandal (2009)* – PricewaterhouseCoopers (PwC)

In many Western economies, the "too big to close" syndrome continues to prevent effective regulatory retribution of the auditors. However, in India, under Section 140 of its Companies Act, PwC was banned in early 2018 from auditing listed companies in India for two years after being accused of negligence in its audit work at the now defunct *Satyam Computer Services*. The Securities and Exchange Board of India said that PwC chose to rely on "glaring anomalies" and huge differences in Satyam's balance confirmations during its audit work between 2001 and 2008.

Although the initial ban did not include ongoing 2017-18 audits for listed companies, the date was extended into 2019, and PwC was allowed to carry on auditing its clients until 31 March, 2019.**[13]** In 2019, Indian regulators also pushed for a five-year ban on Deloitte and KPMG over allegations the firms helped conceal bad loans at *Infrastructure Leasing & Financial Services*, a major infrastructure and finance group whose default last year triggered a credit crisis.**[14]**

In South Africa, some notable audit failures included:

- *Steinhoff International* Holdings NV a listed global retailer that inflated its profits and assets in 2016 by ZAR 250 billion, becoming the largest accounting scandal in the market to date. The auditor was Deloitte.
- *Tongaat Hulett Ltd,* South Africa's largest sugar producer that overstated its 2018 equity by ZAR 3.5-4.5 billion. The auditor was Deloitte.
- *South Africa-based Gupta family*, whose leaked conversations with several key state officials in 2017 led to allegations of state capture eventually ending Jacob Zuma's presidency in 2018. The auditor was KPMG.

These events ultimately resulted in their investigation by the *Independent Regulatory Board for Auditors (IRBA),* the country's audit regulator.**[15]**

In Australia, in 2019, a scandal erupted when a treasure-trove of leaked documents was handed to the Australian newspapers (*The Age* and the *Sydney Morning Herald*) by a whistle-blower that shone an embarrassing light on the private workings of the bank and the cosy relationship it had with its auditor of 13 years, Ernst & Young (EY). The leaked documents included confidential minutes of a meeting where NAB's chairman Ken Henry privately told EY consultants in the midst of *the Royal Commission of the Banking and Financial* sector that he was "confident" the bank was still selling products that ripped off its customers and would eventually trigger compensation. The documents made for disturbing reading.**[16]**

In 2021, the Australian arm of one of the world's biggest and most prestigious accounting firms, *KPMG*, was fined A$613,000 by the US accounting watchdog, the *Public Company Accounting Oversight Board (PCAOB)*, after a review found widespread cheating by staff on training tests over a four-year period.**[17]**

In 2023, it was reported that a senior partner at consulting giant *Deloitte* ran a suspected multimillion-dollar fraud while working at the firm, ensnaring dozens of executives, and many of the prestigious company's own partners. The figure at the centre of the suspected scandal, ex-Deloitte lead partner *Amberjit Endow*, can no longer be found by the worried investors who advanced him millions of dollars. Some investors estimate the 13-year company veteran's suspected fraud could involve more than $60 million. Victoria Police is now investigating following a complaint in December 2022, while other investors have made separate complaints to police in NSW. Investors now have hired asset tracers to find him and the missing money that he personally guaranteed investors was safe.**[18]**

In the USA, in March 2023, *Silicon Valley Bank* failed just 14 days after KPMG LLP gave the lender a clean bill of health. *Signature Bank* went down 11 days after the accounting firm signed off on its audit. What KPMG knew about the two banks' financial situation and what it missed will likely be the subject of regulatory scrutiny and lawsuits.**[19]**

Why are so many companies around the world failing after getting clean audit reports? Because the audit report does not tell us what we think it certifies.

What the Audit Report Tells Us About the Company

The audit report of financial statements uses the term *'True and Fair'* to express the condition that financial statements are truly prepared and fairly presented in accordance with the prescribed accounting standards. As such, an unqualified audit opinion of the financial statements' states that the audited financial statements are *true and fair* in all material respect, i.e., after the auditors

performed their audit, they found no material misstatements in the financial statements and that financial statements are correctly prepared.**[20]**

They do not attest that the value of the company as stated in the financial statements (called book value) is a true and fair measurement of its market value; nor do they attest that the financial transactions recorded arose out of only ethical practices; and they do not attest that there has been no fraud. They only attest that the financial reports are prepared and presented in accordance with the prescribed accounting standards. In addition, the auditors have significant influence over the development of accounting standards through direct involvements in standard setting bodies like *International Accounting Standards Board (IASB)* and intensive lobbying activities throughout the standard-setting process.

Using a university analogy, it's like the Big-4 are setting the subject syllabus, preparing the exam paper, writing the answers to the exam, and finally giving a grade. If there is a complaint, they are the adjudicators of the quality of their own work!

It is time for an independent body set up by Parliament, to be responsible for setting accounting standards.**[21]**

Regulating the Accountants and Auditors: From Self-Regulation to Statutory Regulation

In the case of the KPMG exam cheating scandal discussed above, why was it that it was a USA watchdog, the *PCAOB,* that was fining Australian auditors? Australia's own watchdogs, the *Australian Securities and Investments Commission (ASIC)* and the *Financial Reporting Council ('FRC')* have kept silent in most cases involving the Big-4. Also, the *Chartered Accountants of Australia and New Zealand (CA ANZ)* – the professional body to which a majority of Big-4 auditors belong – also keeps silent.**[22]** Further, the *International Federation of Accountants (IFAC)*, the global organisation for the accountancy profession, has no teeth to impose any bans on recalcitrant member organisation bodies or their members. *[More on this later].*

Unlike in Australia and the most countries in the world, the regulation of the accounting profession in the United States has now shifted from *self-regulation by peer review* to ***statutory regulation*** by the *Public Company Accounting Oversight Board (PCAOB).*

The main reason for the U.S. policy on oversight changing over the years – from a fairly hands-off approach, then to a negotiated oversight of self-regulation by the profession, and now to a statutory-based oversight that is independent of the profession – is mainly due to the *Enron* and *WorldCom* accounting and auditing scandals in the early 21st Century.

Following these scandals, a *Senate Banking Committee* was set-up in the USA to evaluate the effectiveness of the profession's self-regulatory framework, which included the peer review system and the *Public Oversight Board (POB*) – a forerunner to the PCAOB. The Senate Banking Committee found that the peer review system had never resulted in an adverse or qualified report on a major accounting firm in its 25 years of existence!**[23]**

Even after *Enron* revealed its accounting errors, its auditor *Arthur Andersen* received a clean bill of health from the peer review system. How could this be? The answer was obvious, peer reviews were *"mutual back scratching"* exercises. Audit firms choose their own reviewers, who were likely to be connected through prior relationships and tended to receive 'friendly' reviews. This led to the inescapable conclusion that independent standards-setting and independent oversight, while

perhaps not guarantees of reliable financial reporting and auditing, are still indispensable elements of a strong financial reporting and auditing system.**[24]**

In the latest PwC scandal, former Telstra chief *Ziggy Switkowski* was named to head an independent review of the firm's governance, accountability and culture following the issues identified by the *Tax Practitioners Board's* investigation into the firm's use of confidential information.**[25]** Greens Senator Barbara Pocock was not impressed with the PwC review, saying:

"Regardless of who they put in charge, it's still paid for and run by PwC. Promising to release a summary of the findings is not the same thing as making the findings available to the public."

"We can't have any confidence in it. This is a matter for the National Anti-Corruption Commission where it will be properly investigated."

Due to the whitewashing often done in a *self-regulation by peer review* process, the USA Senate Banking Committee *rejected self-regulation* of the Auditing Profession and required instead *independent oversight and standards-setting*. The US Congress passed these recommendations as the *Sarbanes-Oxley Act of 2002* by a near unanimous vote.

In addition to examining the profession's self-regulatory system, the USA Senate Banking Committee also examined the effectiveness of *accounting and auditing standards-setters*. Among other things, the Committee focused on was whether private standards-setters' funding mechanisms fostered inherent biases.

Upon consideration, Senate Banking Committee Chairman Paul Sarbanes assessed the risk of undue influence over standards-setting as follows:

". . . the current arrangements of the standard setting bodies, both FASB and the international standards-setters … are funded by basically going around with a tin cup. So, you go to the very people who are going to be most intimately affected by the standards, you ask them for money to support the operation, and if they don't like what they think the standard setting body is going to do, they're obviously either unwilling or reluctant to give money.**[26]**

Chairman Sarbanes went on to propose an independent funding source for both the new oversight board, as well establishing auditing and related professional practice standards applicable to public companies, and any accounting standards-setters.

The U.S. experience teaches the auditing professions in other parts of the world, including Australia, many lessons, some of which are:

- That rigorous auditor oversight is critical to maintaining an environment in which auditors can stand up to clients and enforce comparability in financial reporting.
- To gain public confidence, oversight must be independent of the profession, both in fact and appearance.
- The efforts at more modest oversight did not fail for lack of highly competent practicing auditors – they failed because they used highly competent practicing auditors.
- This is not to say that expertise in auditing should not play a role in oversight, but it must be expertise that is independent of the profession itself.

Unfortunately, these lessons have had little or no impact in the regulation of accounting standard setters and auditors in Australia and other parts of the world.

The Regulation of Accounting in Australia

Why is it that it was the US audit watchdog the PCAOB, and not the Australian watchdogs, ASIC and FRC, that fined KPMG Australia in the exam cheating scandal? Why were CA ANZ and IFAC silent in the KPMG Scandal and provided only muted responses in the latest PwC scandal? And why are the members of the *Global Accounting Alliance (GAA),* comprising 10 of the world's leading professional accounting organisations (supposedly set up to promote quality professional services) trying to keep a lid on this and other multiple incidents of bad ethical behaviour amongst its members?

It was reported by the *Australian Financial Review (AFR)* that in the KPMG exam cheating case, ASIC had in fact, assessed the material and concluded it did not have the power to sanction KPMG partners and staff over internal training misconduct. An ASIC spokesman had told the AFR that:

"ASIC has no power to intervene directly on such matters … it is of course very disappointing. The audit profession is in a position of considerable authority and trust, and it is important that the corporate and broader communities can rely with confidence on their expertise, honesty and professionalism."**[27]**

Typical of the glacial speed at which chartered accounting bodies worldwide move with regards to disciplinary matters involving the Big-4 professional service firms – KPMG, Deloitte, EY and PwC – CA ANZ told AFR reporters that it was, "monitoring the case". Had the PCAOB report from the USA not been published, it is most likely that CA ANZ would be monitoring the case forever.

None of the chartered accounting professional bodies in countries that have had major scandals from just a few years ago, have disciplined their Big-4 members (or the chartered accounting partners within these firms) for professional misconduct.

This is because globally, chartered accounting professional bodies like CA ANZ that are responsible for enforcing the professional standards of its members, receive major funding from Big-4 auditing firms – and almost always have Big-4 partners on their boards.

The Big-4 are also major sponsors of the *IFRS Foundation* and the *IASB* that issues *International Financial Reporting Standards (IFRS)* – according to which 'true and fair' opinions are given. As such, they have a strong voice in those organisations, the whole process of standard setting can be seen as somewhat incestuous.

Independent Oversight is Needed of Professional Bodies that can Undertake Audits

CA ANZ is one of the three generalist professional accounting bodies who have members that provide public practice services in Australia; and are recognised in s88B of the Corporations Act (Australia) to issue a certificate under paragraphs 708(8)(c) or 761G(7)(c) after compiling or auditing a financial report in public companies. The other two are *CPA Australia* and the *Institute of Public Accountants*. All these bodies supposedly hold their members accountable to the principles set out by their *'codes of conduct and professional standards'.* However, very few cases are enforced where the rulings are reported publicly, and almost never against the member who is linked to the Big-4.

All three bodies – as well as many other accounting bodies globally – are also members of IFAC, which is a global advocacy organisation mainly for the financial accounting and auditing professions. On IFAC's website it states that it supports the development, adoption, and implementation of international standards for accounting education, ethics, and the public sector as well as audit and assurance. It says that it also supports four independent standard-setting boards, which establish

international standards on ethics, auditing and assurance, accounting education, and public sector accounting; and issues guidance to encourage high-quality performance by professional accountants in small and medium business accounting practices.

However, despite these lofty ideals, IFAC is not an accreditation organisation. It is merely a lobby group. Membership of IFAC is not obtained via an accreditation process, but instead, IFAC membership is obtained via an application process that must be sponsored by at least two current IFAC member organisations. No individual members belonging to its professional bodies globally has been brought in front of it for disciplinary action.

Therefore, it is time that all three generalist professional accounting bodies in Australia come under strict independent scrutiny of their auditor training programs and professional qualifications; similar to how the *Tertiary Education Quality and Standards Agency (TEQSA)* reviews higher education degrees issued by higher education providers. Also, although Universities have self-accrediting power, TEQSA regulates them through the re-registration process.

This is the only way to ensure that Australian reputation in corporate governance is maintained and capital markets are protected.

Controlling the Consulting Gravy Trains

Governments all across the world, including those in Australia, utilise the services of consultants. Since the 1990s, commercial companies that provide advice and assistance to government and non-government organisations have played an increasing role in the political scene. The global consulting services industry was estimated to be worth between US$700 billion and US$900 billion (A$1.06 trillion to A$1.37 trillion) in 2021-22.**[28]**

The benefits of organisations using external consultants is that they may need an independent view for consensus building and decision making. Organisations cannot afford to employ, cultivate, and retain the wide range of skills and expertise they might need for specific projects. Also, they may lack the in-house capacity, or have difficulty recruiting the right skills to deliver key projects. Most importantly, in these times of budget restrictions, organisations can achieve results within defined fixed term and cost parameters.

There is no question that the right consultants, with the right expertise in the right contextual situation can bring value to organisations.

However, critics claim that governments and the larger public sector have, frequently to their harm, become unduly dependent on a few big consulting firms, especially when they are appointed in an opaque process without any perceived expertise in the area, carry an expensive price-tag, and are not accountable when the advice they give is a failure in the implementation.

In the 2021–2022 fiscal year, five major consulting firms: *Accenture, Deloitte, EY, KPMG,* and *PwC* received $2 billion in contracts from the *Australian Federal Government*. Of these, the *Australian Department of Defence* employed consultants from these five firms in the greatest numbers. Around a third of the Commonwealth's $2 billion in 2021–2022 defence spending was spent on contracts with those five companies, totalling nearly $700 million.**[29]**

Such consulting assignments were also illogical, especially because there were public sector organisations that already employed experts in the field. When legitimate research institutions such as universities and scientific institutes like the Australian government-funded *Commonwealth Scientific and Industrial Research Organisation (CSIRO)* are bypassed despite having the kind of

expertise required for a specific project, questions are being raised as to why consulting firms with little to no expertise and experience in the subject matter are awarded the contract in the first place.

The *Australian National Audit Office* estimates that the overall committed value of contracts linked to private consulting firms was $888 million in the fiscal year 2022.**[30]**

Several analyses and investigations have also brought attention to many issues with regards to the Commonwealth's reliance of consultants — including the high cost of external advisers;**[31]** the regular cost overruns that go along with them;**[32]** and the resultant deskilling of the public service.**[33]**

Register of Miscreants

As the major four accounting/advisory firms are significant government clients, it was tactically inconceivable that any firm would abuse this trust. This scandal alone should guarantee that they will never receive consulting work again. Governments should have a *Register of Miscreants* of those consulting firms that have been involved in scandals and banning them from future government contracts.

In the case of the latest PwC scandal, PwC made the wrong decision in trying to take advantage of government secrecy violations by betraying the one institution, the *Australian Tax Office (ATO)*, that carries a big stick and is a lucrative source of consulting income.

Government administrations around the globe have suffered from their naiveté in terms of who they admit into their confidentiality. In the PwC tax scandal case, the ATO should not have invited a fox to give advice as to how to protect the chicken coop. The good news for the Australian government (but the bad news for PwC) is that there are many ways to publicly torture someone, such as a Senate estimates interrogation that resulted in the release of a variety of PwC internal emails that showed how widely the information had been disseminated within the company and how it was being used to attract new business.**[33]**

Summary

In order to stop the rot once and for all, it is time that governments around the world start looking at the accounting and auditing profession from ground up: questioning the need for a statutory audit; financing an independent body to set accounting and auditing standards; having a statutory-based oversight that is independent of the profession; and stopping the gravy train for consultants by using more qualified experts such as scientists and academics to support the public service.

After all, the ATO could have consulted leading tax law academics for the BEPS Project to develop stricter multinational tax legislation. Most likely, Peter Collins and other Big-4 tax accountants often would have consulted the textbooks written by these academics in providing tax advice to their clients!

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