

EXCLUSIVE

BUSINESS BANKING & FINANCE NAB FILES

Call for rules shake-up to avoid 'Enron style' collapses in Australia

By [Adele Ferguson](#) and [Clancy Yeates](#)

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The former chief of the corporate watchdog Greg Medcraft has warned of Enron-style corporate collapses without radical reform to the way banks are audited, saying an independent body should set fees and select auditors to avoid conflicts of interest.

The *Sydney Morning Herald* and *The Age* on Friday revealed that National Australia Bank had confessed serious problems, including the ongoing sale of dud products, to its auditor EY, as part of a review last year.

The revelations, which included evidence of a very close "no surprises" relationship between NAB and EY, sparked an immediate parliamentary inquiry into the management of conflicts of interest between consulting companies and their clients.

Finance Minister Mathias Cormann on Friday led calls for NAB to account for the answers its executives gave EY in private interviews. A minute of chairman Ken Henry's interview records him saying he was confident the bank was still selling dud products to its customers.

"All those who were involved should explain themselves as part of restoring confidence," Senator Cormann said.

Mr Medcraft, who is now head of financial affairs at the Organisation for Economic Co-operation and Development in Paris, said audit quality was important and the standard was declining.





Greg Medcraft calls for an overhaul of the big four audit. COLE BENNETTS

"It is the black swan," he said. "It could result in a collapse like we had with Enron."

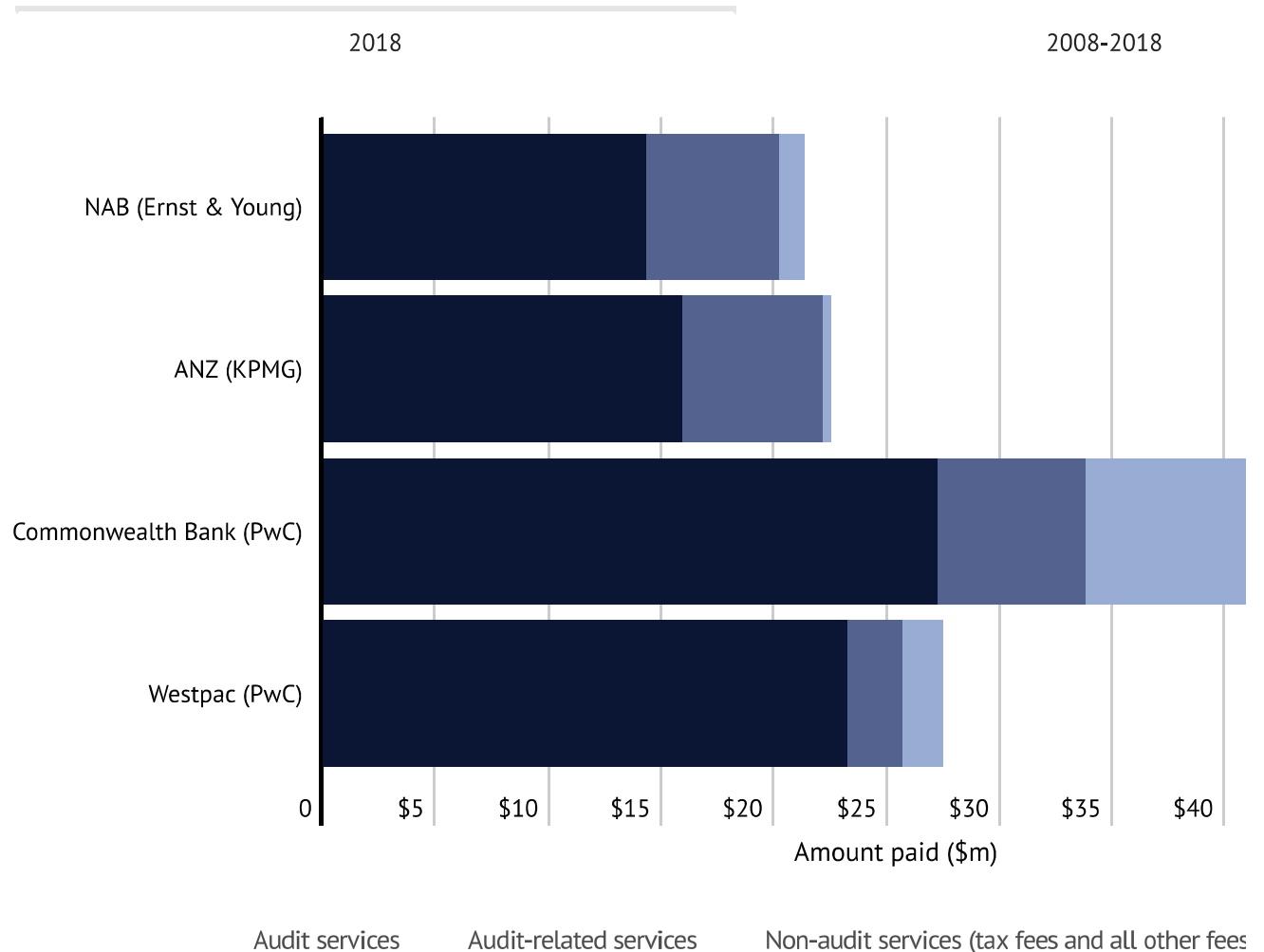
He said the management of conflicts of interest for auditors was a global problem with big firms cutting audit fees to get the higher paying consultancy work.

The Australian Securities and Investments Commission came in for criticism at the royal commission over its regulation of the corporate sector during Mr Medcraft's chairmanship, including over its close relationship with the banks.

An analysis by *The Age* and *The Sydney Morning Herald* show the big four banks paid EY, KPMG and PwC almost \$120 million last year for audit and consulting works.

What the banks spend with their auditors

The big banks have spent hundreds of millions of dollars on audit and other services.



Source: Company annual reports

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NAB's latest annual report showed that it had paid EY more than \$21 million for audit and non-audit work in 2018, plus another \$3.9 million for its work on non-consolidated trusts. It said that it had policies to protect the auditor's independence.

[A trove of leaked documents supplied by a whistleblower](#) included a proposal letter written by EY pitching to provide early communication of findings based on a "no surprises approach".

The leaked documents also included confidential private observations by EY consultants that were far blunter than the phrasing used in the draft report. APRA was sent a copy of the final report.

As the big banks and audit firms defended their policies to safeguard independence, Mr Medcraft said the best way to fix the problems around conflicts was to establish an independent body to set the audit fees and chose the auditor.

“Declining quality of auditing in Australia and globally could lead to a black swan event, such as an Enron-style collapse.”

Former corporate regulator Greg Medcraft

He said there needed to be a three strikes rule for auditors that were assessed to be performing poorly and companies should have to change their audit firm every seven years.

Mr Medcraft, who had worked as an auditor earlier in his career, said the big accounting firms were an influential oligopoly.

"They control the auditing standards and they are very powerful lobbyists," he said.

"If you want independence you need to ask who is paying the bill?" he said. "He who pays is master or mistress of the servant so there needs to be a change in culture on that issue."



Senator Deborah O'Neill: "Auditors... a burning issue". ELESIA KURTZ

The scandal prompted Labor MP Deborah O'Neill to call a parliamentary inquiry into the conduct of the big audit firms including the management of conflicts of interest. It was supported unanimously by all sides of politics and a report will be handed down in March 2020.

"There have been a lot of questions about why auditors were not included in the terms of reference for the banking royal commission," she said.

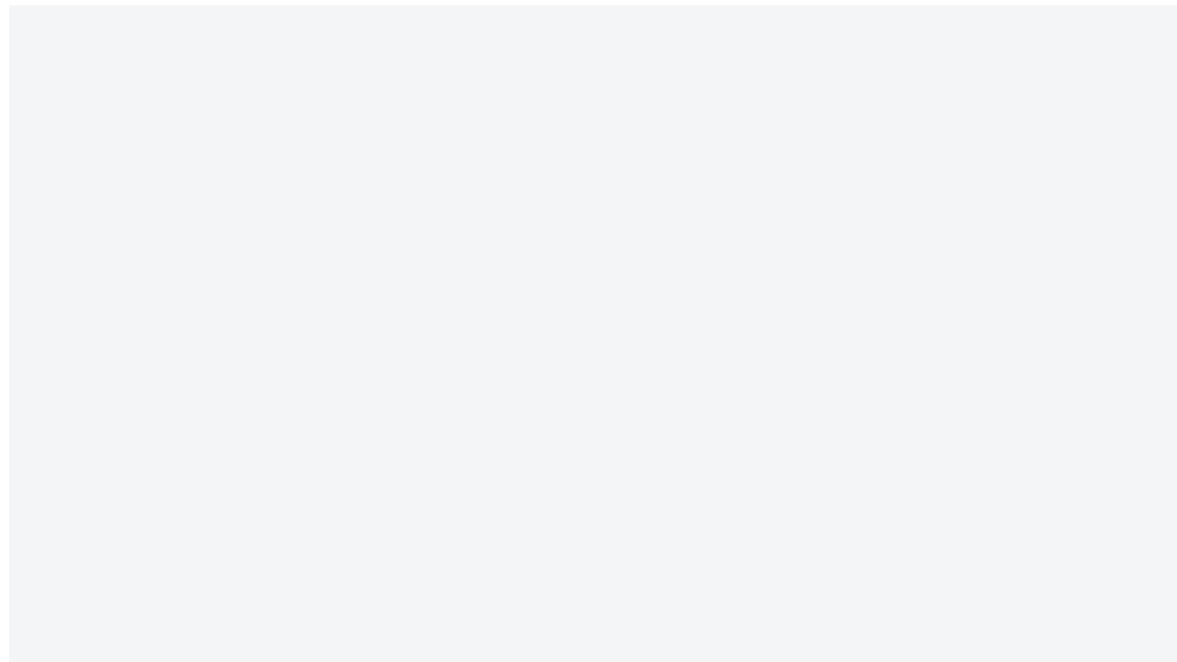
The inquiry will look into the relationship between auditing and consulting services and potential conflicts of interests, other conflicts of interest, the level and effectiveness of competition in audit and related consulting services, audit quality, the role of audit in detecting fraud and misconduct, and the effectiveness of enforcement by regulators and other matters.

The terms of reference for the inquiry could be amended, with Liberal MP and inquiry member Jason Falinski saying the review could need more than seven months and should look into whether previous inquiries had been acted on.

The whistleblower who leaked the documents, and asked to remain anonymous, said "the royal commission gave the banks' auditors and consultants a free pass".

The dual role of auditing and consulting is a global issue. In the UK it has sparked a number of inquiries after the collapse of construction giant Carillion, which is estimated to cost UK taxpayers £148 million.

In April, the UK Competition and Markets Authority recommended that the audit and consulting arms of the big four global accounting firms be split into separate operating units to reduce the influence of the consulting practices upon the smaller auditing divisions and avoid conflicts of interest.



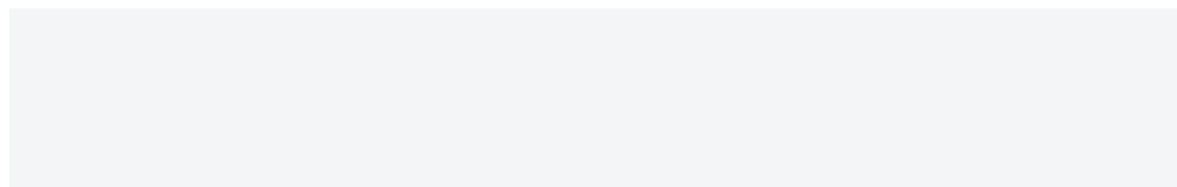
Shaw and Partners analyst Brett Le Mesurier said that while he was not aware of the full context of Dr Henry's remarks, the comment about the shoddy products attributed to the former Treasury Secretary was "extraordinary."

"If you're in the middle of a royal commission and you think you're selling something that's going to lead to remediation, I would have thought the thing to do would have been to stop selling it immediately," Mr Le Mesurier said.

Mr Le Mesurier said the revelation appeared to support NAB's move to replace its CEO and chairman earlier this year.

Mr Le Mesurier said there was an "obvious conflict" between auditing firms providing consulting services to clients, as well as auditing work.

Although the practice is common, he said "that does not make it right."



"I think auditors should do just that," he said.

Mr Le Mesurier suggested regulators should appoint auditors, instead of corporate boards.

NAB's share price fell 0.45 per cent on Friday to \$28.51.

Adele Ferguson's book *Banking Bad* is out on August 5. Click [here](#) for more information. An extract will run in Saturday's *Good Weekend* in *The Age* and the *Sydney Morning Herald*.



Adele Ferguson



Adele Ferguson is a Gold Walkley Award winning investigative journalist. She reports and comments on companies, markets and the economy.



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