Australian Citizens Party

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MEDIA RELEASE

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Katter's audit bill targets corrupt bank-auditor nexus, systemic financial risks

Bob Katter will open a new battlefront in the war on financial corruption when he introduces the Australian Banks (Government Audit) Bill 2019 in Parliament on Monday 25 November.

Expect stifled fits of rage and gnashing of teeth in the board rooms of the Big Four banks and among the partners of the even bigger four global accounting firms when he does it.

Katter's bill, which the Citizens Party (formerly CEC) helped to draft, applies the lessons of the banking royal commission and recent inquiries in Australia and the UK into the auditing sector.

It addresses both corruption and systemic risk in the financial system, by directing the government auditor, the Commonwealth Auditor-General, to conduct an in-depth audit of Australia's big four banks, and details specific audit requirements to ensure that the audit goes deep enough to uncover system risks.

Cut to the chase

Corruption of auditing is currently the subject of an inquiry by the Parliamentary Joint Committee on Corporations and Financial Services into "Regulation of auditing". The inquiry received a large number of submissions that are still being processed, and is holding public hearings in Sydney, Canberra and Melbourne. Some regulators and experts who made submissions have called for the Big Four global accounting firms—KPMG, EY, PwC, and Deloitte—to be broken up into separate auditing and consulting businesses. This is to remove the conflict of interests of an auditor checking the books of a company from which it receives larger fees as a consultant, which has thoroughly corrupted the auditing of big banks and corporations in Australia and worldwide.

One of the consequences of this corruption of auditing materialised during the 2008 global financial crisis, when numerous banks and other financial institutions failed spectacularly soon after receiving clean audit certificates from Big Four firms. EY covered up the bankruptcy of Lehman Brothers; KPMG hid the risks of the biggest US sub-prime lenders, which lit the fuse of the crisis; PwC ignored Northern Rock's extreme recklessness.

Katter's bill cuts to the chase and removes the corrupt conflict of interests in the auditing of the big banks by replacing the Big Four altogether with the Auditor-General. Besides combatting corruption, the rationale for the bill is detecting and addressing systemic risks. As the big banks enjoy an implicit guarantee from the Commonwealth government, which enables them to borrow at a discount from overseas, the government will be on the hook for any losses in a crisis. It should therefore know what are the actual risks that lurk hidden on and off the banks' balance sheets. This is a systemic issue for the Australian economy, as a crisis in the big banks will smash the entire economy.

In 1937, the original Royal Commission on Banking recommended that as the government was responsible for protecting deposits in all the banks, it should appoint the Auditor-General to audit the banks so it could detect any risks before they materialised. This was legislated in the *Banking Act 1945* and the *Banking Act 1959*, and it remained in Commonwealth banking legislation until the current bank regulator APRA (Australian Prudential Regulation Authority) was established in 1998. While APRA's legislation empowered APRA to audit the banks, it didn't specify using the Auditor-General, so APRA has used the Big Four global firms instead. Katter's bill reverses that and restores the role of the Auditor-General for the same reason it was recommended by the 1937 Royal Commission.

Audit requirements

The bill has audit requirements which direct the Auditor-General to dig deep into areas that normal audits don't touch; these areas are where the risks are hidden. They include:

- Derivatives—collectively Australia's banks have $48.7 trillion in derivatives exposure, held "off-balance sheet", but three of the big four banks do not disclose their full exposure to these high-risk gambling instruments.
- Mortgage portfolios—as mortgage lending is 65 per cent of each of the big four banks'

businesses, far greater than any other banks in the world, the shaky housing bubble is their greatest vulnerability. An audit must drill into the valuations of the mortgage portfolios, marked against current market prices, and the calculations for the levels of capital held against those mortgage loans.
- Internal ratings-based models—the big banks have been allowed to assess their own risks in a way that enables them to hold less capital in order to boost profits, so an audit must examine those models in detail to assess the true risks.
- Provisions for bad debts—the less money that banks keep aside to absorb bad debts, the more profit they can make, but it puts the banks at grave risk in a crisis, which is a risk to the whole economy.

Faked data

Australia's financial system is currently hanging by a thread, and that thread is the price direction of the Australian housing market. If prices are rising, as the government, regulators and industry all desperately hope, it buys time for the over-exposed banks; if prices are falling, the banks are facing catastrophe. The official housing statistics from the main data agency, CoreLogic, purport to show that prices are suddenly rising fast, but genuine experts have attacked those figures as faked data , when assessed against other indices and the layoffs in construction and real estate firms etc.

There are therefore serious grounds to fear that Australia is plunging towards its own Lehman Brothers moment, when a housing crash triggers a banking crash. Bob Katter's bill to extract real data from the banks is urgent, if the government is to be able to detect this threat before it happens and take steps to avert it. These steps must not be the usual scams to keep propping up the system, but far-reaching reforms to overhaul the banking system. They should include:

- a full Glass-Steagall separation of banks from speculation;
- a moratorium on foreclosures of family farms and family homes, accompanied by an orderly write-down of mortgage debt; and
- a national bank to direct public credit into investments that foster productive industries and restructure the economy away from its concentration on housing, mining and financial services.

Support the fight to clean out entrenched financial corruption and protect Australia from financial disaster!

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Click here for copies of the new "Fight the totalitarian ban on cash!" flyer to distribute.