

Ethics and Professional Accountability: Structural Challenges in the Audit, Assurance and Consultancy Industry.

Submission from John Ferguson - 27th June 2023.

The biggest problem for a small retail investor in ASX listed companies is the potential for “soft” annual audits. “Soft” audits are those where the auditor avoids tough questions of company management, professional scepticism is benign and the audit is structured to provide credence to the company’s narrative of its performance.

Small retail investors place faith in the integrity of these annual audits to get a true picture of the financial state of the companies they invest in. The bulk of ASX company audits are carried out by the Big Four global professional services firms. Given the *pwc* revelations, a big question now hangs over the integrity of these firms and the quality of their audits. The proposal for a complete split up of companies providing audit and assurance services from those providing consultancy services is a good one, but it does not completely solve the “soft” audit problem.

Compounding the problem is the story titled “How the Big Four ‘infiltrate’ Boards” (*Weekend Australian* 10-11 June 2023). The opening sentence says it all: “ The boards of Australia’s Top 100 companies are heavily populated by people drawn from the ranks of professional service firms, with almost 25 per cent of directors with multiple seats coming from the Big Four...”. This introduces another potential conflict of interest - the way an auditor is selected.

To improve auditor accountability, I think good **comparative** data is needed in order to quiz company management and the auditor at the company’s AGM. ASIC could be charged to publish data like:

1. Audit and assurance fees based on market capitalisation or sector average are published. To provide an example here, I sampled ten companies in the ASX 150 (BHP through to CSR) comparing market capitalisation and audit fees paid in FY22. For each \$1b of market cap the average audit and assurance fee was \$227,780.
2. Information is provided about the background of the Chair of the company’s Audit and Risk committee and links to the company selected to complete the annual audit.
3. A snap-shot of Key Audit Matters is provided. Of particular interest is the amount of Goodwill written down or written off in the course of the year (thereby wiping out shareholder equity in a company). The data would provide an insight into shareholder value generated by business acquisitions.

In order to illustrate my case, I submit a real case study. The company in question listed in November 2021 and sits within the ASX 200. Private equity sold into the float and continues to hold Board seats on a non-independent Board. Most of the public money went into the progressive acquisition of many businesses (some privately owned by Board members) which now carry a Goodwill valuation of \$1.6b (current market cap is \$1.93b). The auditor is from *pwc* and the Chair of the Audit and Risk committee is ex-*pwc*. The audit and assurance fee for FY22 was \$2.093m, 4.75 times more than the average calculated by me above. There may be good reasons for all of the above, but questions need to be asked. The quality and impact of these questions would be bolstered by having current and authoritative comparative data available. Without the data, the questions become personal and this benefits no-one. (Disclaimer alert: I hold no shares in the company).

Thank you for the opportunity to make a submission about this important but complicated issue.

