

A Maturity Institute (MI) Project – Auditing the auditors

Are the Big 4 fit enough for their professional purpose?

Context

The world's largest professional services firms should be providing a very important public service. Effective auditing is the bedrock of corporate legitimacy and legality. It builds trust and reassurance with all stakeholders. However, there is growing evidence, from external assessments and a series of high profile scandals, that the quality and integrity of audits by the major firms has declined. Auditors are also paid to help protect companies from themselves but it appears that many have assisted companies under pressure (e.g. Tesco over-stated profits) to present a more favourable picture that is incompatible with complete evidence. The "Big 4" are now mirroring the banking syndrome of 'too big and too few to fail' and their current configuration, culture and behaviours are being seen to undermine the legitimacy of modern day capitalism.

With the benefit of hindsight, the failure of Arthur Andersen, in the wake of the Enron scandal, may no longer be viewed as an isolated event. Accounting was supposed to have improved after Enron, yet it seems to be in a parlous state in 2017. Serious questions are being asked whether a major accounting firm failure could and should happen again unless the Big 4 are seen to be recognising, acknowledging and starting to address their problems.

Alongside this deterioration in standards of corporate responsibility, conventional accounting and auditing firms are using outmoded methods that do not cater effectively for whole system assessment and risk management. The very existence of an integrated reporting movement (e.g. IIRC and SASB) is a clear indicator that accounting and auditing practice needs to undergo fundamental change; including the development of new instruments and tools for organizational analysis and diagnosis.

Whole organization analysis, assessment and rating: MI's OM30 diagnostic instrument

Conventional measures of profit and loss and balance sheets are now rightly viewed as severely limited and crude measures of long-term organizational performance and sustainability. Today, responsible organisations fully accept that they are accountable to a much wider range of stakeholders; whose individual and combined interests have to be respected and addressed in company reporting. Investors, regulators, and employees all need a much higher level of confidence to be reassured that no unseen harm awaits them. Trust can only be re-built when a much more comprehensive picture of organizational health and overall value is presented.

Corporate, and especially, *human* governance has to be measured in concert with culture and human capital management, which are now firmly on the leadership agenda. The evidence is now plain to see that these factors are material in both investment and societal value terms. Organisational value and risk management now require a much broader range of factors integrated into analysis and reporting.

MI uses a simple instrument, the OM30, to produce a complete, whole system picture of organizational health and management effectiveness to reassure stakeholders. The OM30 also produces an overall societal value measure for the organisation, [Total Stakeholder Value](#), which can be used to benchmark firms against peers and act as a comprehensive strategic tool with in-built monitoring of continuous performance improvement. OM30 represents a revolutionary change in organizational auditing as it integrates financial performance and system effectiveness within a human, whole system framework of indicators. It is the OM30 instrument that we will use to rate the Top Ten accounting firms using this initial pilot project to focus on the Big 4.

The Top Ten (2016)¹

FIRMS	REVENUE (\$BN)
Deloitte	36.8
PwC	35.9
EY	29.6
KPMG	24.4
BDO	7.3
RSM	4.6
Grant Thornton	4.6
Baker Tilly International	3.8
Crowe Horwath International	3.5
Nexia	3.1

Aims, objectives and outputs:

1. To gauge comparative organisational health, with a specific focus on underlying corporate purpose, of the Top Ten firms with publication of an auditors' OMINDEX and summary report

¹ <https://www.icas.com/ca-today-news/the-top-30-accountancy-firms-revealed>

2. To analyse Total Stakeholder Value (TSV) across the sector and potential for improvement with TSV scores and overall \$fEUR value opportunity available for the sector
3. To engage with firms within the sector and encourage use of the OM30 as an instrument to diagnose strategic priorities aimed at improving TSV
4. To demonstrate that audit practice needs to fill an important capability gap by integrating OM analysis

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"...the far bigger issue is the expectation gap between what society wants and needs from an audit, and what an audit provides...I can report that the audit of financial statements has barely changed in [20 years]. Audit reports are more detailed and useful now, but the underlying process has not changed. If audit is failing to meet expectations (and these expectations are unlikely to change), audit is at risk of imminent death unless it is more willing to highlight potential negative issues, whatever the pressure from the directors. **Paul Merison, Financial Times 25 September 2017**