

EROSION OF TRUST IN AUDITS DEMANDS ACTION FROM GLOBAL FIRMS

The Big 4 audit firms over the last decades have been facing public outcries for missing frauds. Comments like 'I think there is a big question over how much you can trust an audit?' and 'there is a global crisis in audit' are frequently made by important users of audited financial statements. James Doty, former PCAOB chairman emphasized in a speech how important trust is and the pivotal role of auditors in maintaining trust by saying: 'as sophisticated our markets are, they are dependent on trust. We cannot take trust for granted. Independent audits provide that trust'.

The collapse of Wirecard a former DAX company in June 2020 lays bare another painful example of one of the Big 4 missing a billion euro fraud. Here it seems that EY was ignoring on-going and intensifying rumors about accounting manipulation. In 2020 EY also failed to spot a massive \$ 4 billion fraud in the UK at NMC Health, a former respected FTSE Company. A fraud that probably started immediately after NMC's IPO in 2012 and was only discovered in 2019. The quality of EY's audit of NMC Health was also questioned for a potential lack of rigor due the fact that the NMC's board included former EY partners.

Global Audit firms have to heed the repeated warnings about missing major frauds and the consequential erosion of trust and should learn from Johnson & Johnson's approach to a crisis. Johnson & Johnson was facing a deeper and more sensitive crisis in the early 80's, when poisoned capsules of their leading product Tylenol appeared in the market which led to a number of deaths. Following the discovery the Chairman dropped the low key communications strategy of J & J and focussed on the benefits of open communication. Most importantly the Chairman explained in personal messages the concrete steps and actions to avoid a recurrence of these terrible events. The Washington Post said in the aftermath of the crisis "Johnson & Johnson has effectively demonstrated how a major business ought to handle a disaster" and applauded the Company for being honest with the public and its prompt reaction.

Unlike Johnson & Johnson audit firms when facing public criticism respond in a defensive way. They explain the missed fraud by stating, 'fraud is hard to detect and we were also a victim of this fraud' or as one German politician pointedly said about Wirecard, 'EY was openly trying in their defense to hide behind the CEO and CFO'. The EY chairman di Sibio expressed in a letter to the German partners regret over the firm's failure to uncover the material 1,9 billion euro Wirecard fraud, saying 'many believe that the fraud should have been detected earlier and we fully understand that. Even though we were successful in uncovering the fraud, we regret it was not uncovered sooner'. The EY Chair signaled that EY in response to the Wirecard affair would increase the use of technology to improve audits and demand annual training in forensic auditing and accept greater responsibility for detecting fraud.

This response misses to address market concerns that have arisen as a result of the Wirecard affair, even does not address some basic concerns regarding routine audit procedures.

In the spirit of open communication, answering the following questions would help to alleviate some of the concerns;

- Has EY introduced additional review procedures before the engagement partner can sign-off the financials of exchange listed clients in the years following an IPO?
- Has EY established additional audit procedures for companies that have been featuring in a plethora of critical articles and analysts reports?
- How does EY secure and promote a true "culture of challenge" towards the auditee executive management, especially with clients that have been stonewalling during the audit and that have put undue pressure on the engagement team?
- Has EY over the last years adapted the requirements put on the audit team how it is preparing itself to identify and assess risk of material misstatements through understanding the entity and environment? This relates in particular to clients with new business models combined with a disruptive nature of their activities and with an acquisitive growth path.

EY's global audit clients deserve to know what the global firm EY is doing and will be doing to strengthen its quality of audits and how this will help EY to take greater responsibility for detecting fraud.

Paul M. Koster is CEO of European Investors-VEB and member of the global Advisory Group to the Investor and Other Stakeholders Working Group (IOSWG) of the International Forum of Independent Audit Regulators (IFIAR).