

ENLIGHTENING PROFESSIONS?



AuditFutures^{fi}

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A vision for audit a better society

This report is a partnership between the RSA and AuditFutures. It draws on a literature review, a call out for evidence through the RSA Fellowship, semi-structured interviews and a variety of contributions from people inside and outside of the audit profession who became aware of the project. We invited people to look to the future and take a view of what value audit could bring to society in the 21st century, either as a practice, or a profession.

We found the audit profession in a reflective mood. Of the more than 200 people we interviewed or who fed into the project, the majority were auditors, and most were keenly aware that their profession faces searching questions. Thrown into the spotlight by the 2008 financial crisis, it is grappling with the consequences of long-term changes in business, technology and society.

The struggle is unusually public, but the issues it faces are shared by many other

traditional professions, whose value is challenged by our inexorable move into a demanding, global, data-rich and trust-poor world.

We believe that the decisions made by the audit profession in the coming years could prove influential in shaping the future value of professionalism. We hope that this report will serve to encourage greater collaboration and debate across all the professions.

This report offers a place for the profession and its peers to look forward, to assess the bigger picture and express their highest aspirations.

You can download the full report from our website.





TURNING A NEW PAGE

Setting a new stage

This is an optimistic report, looking at the potential of audit. We have set a new stage for a positive discussion around what is possible. Over two hundred people have contributed with comments and interviews - people mostly from the audit profession but also many Fellows of the Royal Society of Arts. Participants were committed to the future, but candid about the problems and challenges facing audit.

We found the audit profession in a reflective mood. We invited people to look to the future and take a view on what value audit could bring to society in the 21st century. One of the common themes was the desire to participate in a collaboration with other professions and the wider society.

Reaching escape velocity

One of the main challenges for innovation is to navigate around the

issues that have been locking audit into the cyclical and unproductive debates of recent years. The common emphasis has been around the change that could be driven by regulators and legislators, which is ultimately self-defeating as it further undermines confidence in auditors. This debate is unusually public, but the issues that audit faces are shared by many other traditional professions, due to our inexorable move into a demanding, data-rich and trust-poor world where accepted values and faith in institutions are being challenged.

Economic failures which sap people's confidence in business represent both challenges and opportunities for auditors to listen, reflect and learn so they can improve what they do and provide better forms of assurance. In taking responsibility for the dynamics of change, the profession can reaffirm its role in serving the public interest by enhancing trust in audit and institutions. The profession will face significant challenges in taking charge

of its future but it should prove to be a liberating experience.

Inviting big questions

Our discussion is not about regulations, standards and processes. Technical debates are very important but they tend to focus on specific failures and they can be sourced extensively elsewhere. However necessary such a focus may be, the focus on failures and controversies tends to entrench audit in its backward-looking familiar zone – trapped in negativity, and labouring within technical and defensive debates.

Instead, we are inviting challenging questions about the future of audit in 21st century society. Many reflections on the lack of change in audit or its scope seem to chime with some aspects of the discourse that we have had within the profession. We hope to be a catalyst for change that will give the profession the confidence and the voice needed to reach out and move forward.

We are seeing a palpable desire to look ahead and think about aspirations. We wish to be more ambitious, not less. Our belief is that the decisions made by auditors in the coming years could prove influential in shaping the future value of professionalism. We hope that this report will serve to encourage greater collaboration and debate across society. Our goal is to offer a place for audit professionals and their peers to look forward, assess the bigger picture and formulate their highest ambitions.



TOMORROW IS ALREADY HERE

Modern accounting, and the extension and application of its processes into audit, has been fundamentally important in transforming our world. Conceptually and instrumentally, it has encoded the economic rationalism that has brought us to where we are today. Looking at tomorrow, however, globalisation, changing technologies and demographics will drive transformations with far-reaching implications for the function and purpose of the audit profession. The retrospective assurance of a clean audit report on historical and dated information in the annual accounts will buy relatively little confidence in a business world where fortunes can fluctuate overnight on the basis of a tweet or a negative news story.

The profession's traditional object of review – the single business or business group – is increasingly multi-faceted, as companies become interwoven in intricate alliances and relationships. One aspect of this is the spread of complex and often opaque, cross-national

forms of governance, ownership and partnership. The life and health of companies is now assessed on a continuous basis. Seventy years ago, the average shareholding period was eight years; thirty years ago it was four years; today it is measured in weeks, days or even seconds. Traditional business information, which is annually audited, will continue to have some value, but that value is diminishing.

Should we repurpose audit?

Audit is in the uncomfortable but inevitable position of being judged by the public on its failures or the failures with which it has been associated. Understanding the positives about someone working behind the scenes is often challenging and many people only associate audit with the things that go wrong. It has been bruised by the financial crisis, rightly or wrongly.

The audit process risks being overtaken by external events. It is quite possible that statutory audit will be maintained much as it is now to provide a basic policing function within the corporate world, assuring consistency around minimum standards. These standards may be marginally more or less demanding and the information provided slightly more or less expansive. However, the technical focus of much of the current debate – for example, about auditor rotation and non-audit services – fails to engage with the risks and opportunities of a changing society, let alone advance a case for how audit can help to drive that change in the public interest.

Audit should be part of value-creation

Some of the cornerstone activities of audit will diminish in their value. Thus the value of audit in the traditional landscape can only diminish if it does

not evolve. Do annual reports take sufficient account of the total value an organisation creates? For too many businesses, the process of audit is seen as a mandatory procedure to be completed as painlessly as possible. How does it add value to what they want to achieve as organisations?

The sheer pace of change brings massive uncertainties. Audit faces profound challenges to its epistemological and methodological foundations. The profession has traded on regular, authoritative, methodical assessments of business information, on the assumption that these processes result in useful knowledge or confidence in information.

An evolution for audit is needed

Tomorrow's businesses will have to thrive in a world where markets, goods and services can be created and reinvented at unprecedented speed. Waves of new start-ups and micro-

businesses – which currently largely fall outside the scope of statutory audit and have relatively weak links to the profession – will epitomise and fuel this volatility. Regardless of whether or not their market share grows substantially, these enterprises are likely to be among the key innovators that will, for example, pilot new forms of governance, financing and accountability.

The future we have sketched in the report sees a diminishing value for familiar audit functions. However, it also suggests that the role of the profession – as trusted intermediaries, skilled in holistic business analysis and committed to transparency – should be more important than ever. The increased public demand for information and accountability will surely need a body of people skilled at removing opacity and serving the public interest.



RENEWING TRUST

Building social capital

Many political economists stress the fundamental importance of trust in social and economic life. It has been demonstrated that the more trust a nation has in its institutions, the greater economic strength that nation will have. The key to understanding the varied distribution of trust lies in understanding the patterns of social capital. By this account, the economic wealth of modern nations depends less on their ability to formalise trading mechanisms, contracts and bureaucratic insurance functions, than on their ability to extend circles of trust. This trust removes the need for formal controls, which are ever more expensive, and never sufficiently comprehensive.

Fascination with social capital often comes from the fear that it is slipping away. Arguably, the erosion of trust had started long before the financial crisis occurred. The seriousness of the events that precipitated the financial meltdown

have to some extent exacerbated the decline of faith in big business and big auditors. Other longer-term trends, as well as systemic and cultural changes, have also disrupted established patterns of trust and authority. The way we live our lives is weakening the traditional bonds of trust between individuals, society and its institutions. Our relationships with each other and the business and services we use are becoming more distanced, more complex but more immediate. We are becoming more unequal and more individualistic, even though evidence from countries with social democratic political systems indicates that equality and solidaristic values are supportive of trust.

Audit for a trust-rich society

Given the fundamental importance of trust, shouldn't auditors then feel immensely valuable in the context of a society with declining trust? Among our interviewees, a consensus has

emerged that the audit profession is under-producing trust at a critical time. One aspect of the problem is the lack of visibility of audit: it is a profession that literally goes about its work behind the scenes. The face and processes of the auditor are rarely seen by the organisations they scrutinise, and relatively rarely by the outside world. Yet, if we listen to the mounting evidence of the importance of social capital, we know that frequent and reliable contacts between groups are important in strengthening and expanding trust.

We are seeking to improve levels of trust in the audit profession and to explore the contribution that audit can make to building a trust-rich society. To do this, it is important to be aware of the range of different networks and relationships in question. These include relationships of auditors with managers and owners of organisations, with investment fund managers, with politicians and with members of the public. Audit

faces challenges in renegotiating its relationships in a number of directions. Strengthening trust with one set of stakeholders may not be possible without causing discomfort to another.

Audit as a 'glass-box' process, focused on outcomes

Audit for the 21st century should be understood and designed as primarily a confidence building process between the audited organisation and its stakeholders. If the audit is a way of ensuring the client's accountability, much more needs to be done to make the audit itself exemplary in its openness and inclusiveness. Instead of an audit report being a product, the audit process could become a trust-producing practice in which the auditor uses his or her position as a trusted intermediary to promote rigorous learning between all dimensions of the organisation and its stakeholders.

The views of investors, staff, suppliers

and customers could routinely be considered, as could questions from the general public; online technologies offer numerous opportunities to inform, involve and invite. From being a service that consists almost exclusively of external investigation by a warranted professional, auditing needs to become more co-productive, with the auditor's role expanding to include that of an expert convenor who is willing to share the tools of enquiry. Audit should move from 'black box' to 'glass box'.

The profession will still struggle to secure trust unless it can stake a stronger claim to be supporting improvement. Does it increase the economic, social or environmental value of the organisations it reviews? It is one thing to believe in the accuracy of a financial statement audit, but it is another thing to believe in its utility. This requires the audit profession to ask for trust from the public, politicians, business and the market. In any trust-building process, admitting vulnerability

can be much more effective than claiming power. In place of the false assurance offered by dense regulation, the audit profession will offer more realistic levels of certainty, based on a more complex, multidimensional account of the truth.



THE PUBLIC INTEREST

Professions challenged

The audit profession is not alone when it comes to declining levels of trust. It is hard to think of a modern profession that genuinely enjoys unequivocal public trust. Even where levels are still high, our relationships with professionals can still be uneasy. Expected by society to represent the public good above personal gain, the professional was once seen by many as a trustee of the public interest. Today, the respect for professional expertise has significantly lost its value and public trust that would once have been taken for granted is now waning.

People are better educated, better informed and more used to making their own decisions, so why rely on professional knowledge and judgment? Do professional structures, disciplines and forms of accountability – internal and external – provide socially valuable assurance? Certainly, in what has been termed an ‘age of suspicion’, the way professions are often called to account

seems to be problematic. The popular response to failures and abuses has been increased regulation. One consequence of this has been that professional behaviour has necessarily become more bureaucratic.

Trust and respect are afforded most readily to professions whose services are provided in a way that can be observed and understood by the wider public and those who are not seen to work directly for their own interest. Audit fares badly on both counts. Yet of course, motives for choosing one professional path over another can very rarely be reduced to either self-rewarding rationalism on the one hand, or unselfish altruism on the other. In reality, people often enter a profession with motives and ambitions that are reshaped and reformatted over time.

Acquired skills, technical capacities, ethical codes and career goals all define professional culture and legitimise the expertise of those working within it.

While personal incentives define the way a person performs his or her job, they are supplemented and actualised by the culture that defines the professional. Thus the profession as an institution also provides the script that articulates what a successful career is like in a given sphere.

What is the public interest?

Nebulous as a concept, the public interest is most often understood by what it is not. The public interest is best understood through tests of whether it has been breached or compromised. Nevertheless, it is crucial that professionals use it to account for why they perform their role. The public interest should be conceptualised most fruitfully as a state of being and as an ongoing process, not as an identifiable end point. Its quality and significance are bound up in both the act of seeking it and in the realisation that it must always be pursued.

Inquiry and reflection help us evaluate the impact of our actions on society. Critically, this process of review – and ultimately accountability – cannot be conducted simply within the bounds of any single profession. It must be an intrinsically public process. Professional associations and bodies form valuable channels for reflection, but in exploring the public interest, they need to reach out and collaborate more widely. Without taking visible – and therefore confidence-building – steps to bring wider society into a dialogue, there is a risk that professions are simply seen as their own keepers, justifying their actions in the name of the public interest.

Audit for the public good

The audit profession occupies a unique position, with unique privileges and responsibilities. Audit is a publicly mandated service for publicly listed companies, designed by government to

support the public good; this is the case whether audit is being performed on a private or a public authority. It is a public service, and auditors should recognise themselves as public servants with a duty to pursue the public interest.

Embracing a definition of the public interest as an inherently public dialogue will be extremely challenging for the audit profession. It will mean taking responsibility and stepping away from the security provided by its rules and regulations. This could be uncomfortable. To be credible, audit will require an open invitation to wider society and other professions that is based squarely on the proposition that audit for the public good involves the promotion of the public good rather than the minimisation of harm and abuse. From the outset, it will be crucial to acknowledge the scale of disquiet and the gulf of trust to be bridged, and the initiative needs to come from the profession itself.

An open dialogue about audit's role in



supporting the public interest will take in complex issues and divided opinions. It would be a process, not a panacea. At the same time, the core elements of a conversation on the public interest are actually very simple. People inside and outside of businesses want accuracy of financial information, a clear narrative about performance and purpose, and an understanding of the risks ahead. The public also value assurances that companies act within the law. They do not support firms that harm or unnecessarily pollute their environment, avoid paying an appropriate amount of tax, behave unethically, treat their workers unfairly, give poor customer service, and do not do what they have promised.

Audit is still a long way from the publically enlightening profession that its unique public service role implies. Far from using its insights to extend understanding and learning about modern businesses for the public good, audit has for the most part maintained

rather narrow products and services. The fundamental challenge for 21st century audit is to adapt the way it works in order to become an exemplary trust-building process in which internal and external stakeholders are participants, rather than passive subjects. Exciting developments are underway that are shifting audit in the direction of more inclusive practices and a wider set of reckonings – including social values, outcomes and impacts.

THE ENLIGHTENED PROFESSION

Audit as a collaborative and systemic activity

Step change in other fields has been initiated by people who recognise the need to innovate, and are then prepared to 'go back to the drawing board' and redesign how services are delivered, based on the outcomes demanded. These leaders look at the whole system in which their service operates and they are willing to recognise and adapt to technological and social developments. Crucially, they do not solely construct solutions within their own institutions, but look to use partnerships.

Collaboration works best when it involves sharing values and aspirations. Some of the most transformative instances of cross-professional work have brought people from diverse backgrounds together in order to face shared social and economic challenges.

Audit leaders and innovators now have the technological tools to push collaboration in ambitious new

directions. Technological and social innovations should be driven by the public interest, rather than used simply as tools for efficiency. Audit works best by engaging widely. In order to take charge of its own destiny, the audit profession will need to reach out and collaborate, not fragment into small specialisms. It needs to adapt by learning from existing developments that can provide valuable lessons and models.

A new architecture for the profession

Over the centuries, several structures for the professions have emerged – from classical models, emphasising the importance of broad education and specific expertise, to the technocratic models of mediaeval trade occupations and industrial production. Work in the future will be organised in ways that are far more decentralised and networked, making organisational forms more



complex. Traditional departmental structures and hierarchy will be disrupted as will conventional routes of progression and assumptions about authority.

The incoming 'millennial generation' is more project-based than its careers-based predecessors. Companies will have to devise ways to orchestrate work talent in an environment of constant churn.

The structuring of audit teams to include individuals who have particular skills relevant to clients may become increasingly important and this will mean accountancy and audit firms becoming more interdisciplinary, without losing the core values of the audit skills themselves.

The audit profession has seen significant and controversial consolidation in recent

years. Yet the skills and technologies that will be needed to produce valued audit services in the modern business world will not sit neatly in traditional firms with vertical hierarchies. A successful audit practice will take the form of a constellation of firms, able to capture and analyse the diverse information needed by businesses and society. Such a networked platform will be enabled by modern technology to plug into talent, intelligence, and user-generated content wherever it can be accessed.

As the boundaries of the firm become more permeable and elastic, many of the established privileges of scale will not apply. Top-heavy organisations may simply be too inflexible to meet the myriad of needs and opportunities of modern business. Ambitious young auditors, or audit entrepreneurs, may feel that they can achieve more, personally and professionally, outside of the bureaucratic norms of large organisations. In recent years, a variety of socioeconomic forces have led to the

declining appeal of partnerships because of the increasing organisational size and complexity of firms, the increasing need for capital, and the increasing risk of litigation.

The new professionals

The audit profession includes people of exceptional talent and energy. Entry is fiercely competitive, and is, in most instances, dependent on impressive formal qualifications. Training within the profession is no less demanding, requiring auditors to continue updating their skills and to prove their competence to practice. Yet, audit education is thin in areas where it needs to be rich. Auditors with a wider vision, a deeper sense of personal accountability and a greater appetite for innovation need support to become professional learners. Therefore, we believe that education and training for audit should become much broader, in order to deliver a more enlightened profession with new skills, capabilities and attitudes.

If we are to reach an agreement on putting the long-term needs of society ahead of the short-term needs of individual businesses, the stock of global empathy has to grow.

If auditors are to become the trusted intermediaries to ensure transparency and produce trust, they will need strong interpersonal skills, grounded in good emotional intelligence. This involves knowing oneself, being able to self-manage, being able to connect to others and being able to understand the needs of others.





KEYNOTE CHALLENGE

I wasn't expecting to be excited when I read the report, but I found myself highlighting things and writing in the margins. It really rings true for so many things even beyond auditing.

This is how the economist Mariana Mazzucato started her keynote speech at the report launch. Mariana is a professor of Economics of Innovation at the University of Sussex and her interests and expertise are in policies for smart growth and the role of the public sector in modern capitalism. We invited Professor Mazzucato to the launch event to reflect on our report and to contribute to our discussions with further questions and challenges for the profession. Here is a summary of her views:

What kind of society do we want to become and what is the role of auditing in it?

We often think that most social problems are rooted in finance. We think that we have to rebalance the economy, and go away from finance towards a real economy. The truth is that the real economy is just as sick as finance! We need to rebalance the economy but not in an abstract way, which is in some way the idea for the ‘groundhog day’ term in the report. This is the very important idea, which is at the beginning and end of the report - ‘what kind of society do we want to become and what is the role of auditing in it?’ Capitalism is a fundamentally market-based system and yet many economists do not have a clue about how markets work. Unfortunately, most economists are completely bound up with the notion that the best thing that we can do today to fix the system is to sort out the different types of market failures.

Markets are outcomes. They are outcomes of how organisations interact - business, government, the public sector and households - this interaction creates markets and market pressures. My challenge is that if you are just sitting and putting bandages here and there, you will not be able to set up a framework that will allow you to answer the big questions that the report sets out. I see the auditing community as having a role in shaping that interaction. The report asks the brave question: what kind of businesses do we actually want to have?

Should there be a role for audit in promoting long-term investment behaviours?

We often hear that we are governed by short-termism and market pressures. For example, in telecommunications, there is a huge variety of how business organisations react to market pressures. Companies like Cisco are currently





spending money not on research and development but on share buybacks to boost stock options and executive pay. Ericsson on the other hand, has done exactly the opposite of that with focussed investment in innovation, research and long-term strategy. Regardless of whether we think share buybacks are good or bad, the point is that these short-term tactics are primarily designed to boost stock options and quarterly returns. The bigger challenge here is how we should enable better options to be made within the firm.

If we want to be able to encourage long-term investments over short-term speculative investments, we actually need to be able to value and audit those kinds of investments in a different way. It is not yet clear to me whether the way audit is done on the ground differs in those countries that have committed long-term finance to investment from audit in places where investment is short-term. Should there be a role for audit in creating the challenges for

business - how to face these market pressures and how to be able to justify the level of long-term investments?

Value-creation

Much of the critique on the financial crisis focused on 'rent seekers' and 'value extractors'. What we need to do to transform and reach a different kind of smart growth within a theory of value-creation. I especially liked how the report talks about value-creation. Unfortunately, this word has been completely high-jacked and the real question, which the report also makes, is where does value come from in the first place. This is not just about values but what is this ecosystem, who are the different types of actors that are necessary in order to create value and then how can we make sure that we nurture that process to limit the amount of value-extraction.

What I find today is that things that have led to the financial crisis are

actually getting worse. You can make money every time there is turbulence. The fact that so much of the debate has been divorced from value-creation, brings the questions of what we know about wealth creation processes. Can we go back to Adam Smith's book on wealth creation and use this story to even differentiate profits from rent? It's about the narrative and the discourse but also to challenge our categories and models. We need to find a language that could be understood by wide stakeholders and engage and secures trust in society more widely" (quote from the report). But this is what is missing today in terms of nurturing different types of assumptions to what means to create value.

I was surprised in a positive way how willing auditors are to actually pause and rethink what kind of capitalism and businesses we want. This is a big question that not many politicians or business people are willing to engage with.



AuditFutures^{fi}

AuditFutures is a thought-leadership programme of ICAEW's Audit and Assurance Faculty, run in partnership with the Finance Innovation Lab

AuditFutures aims to inspire innovation and positive debate about the role of the audit and accounting profession in 21st century society. We want to look beyond marginal and incremental changes in audit, mandated by the regulatory landscape and business. If audit has an aspiration to serve society and remain relevant to the public interest, it has to engage with a greater range of stakeholders and invite critical thinking and constructive debate.

We hope to become a catalyst for change and to inspire the profession to take responsibility in determining its own fate by leading the discussion on the future of our society. By working across the profession at international level, we are building programmes to enable innovative thinkers and 'tempered radicals' to develop thinking and ideas on the future of audit.

A fundamental aspect of our work is to invite diverse and divergent perspectives to the debate. No single organisation can tackle the wider systemic issues that we are facing today, so this is why we are working by building partnerships and collaborations. We believe that by welcoming diverse views, we will stimulate the debate beyond our comfort zone and generate innovative ideas and creative solutions.

We focus on thought-leading ideas that have the potential to drive systemic change and develop solutions for wider impact. By taking an action research approach, we are creating a community of practice to improve the way we work on specific issues.

www.AuditFutures.org