

ENLIGHTENING PROFESSIONS?

A vision for audit and a better society

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AuditFutures^{fi}

RSA
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About the RSA's Action Research Centre

The RSA's Action and Research Centre (ARC) combines practical experimentation with rigorous research to create a unique programme of work. ARC's approach is inspired by the RSA's history of solving big problems by unleashing the human potential for enterprise and creativity. As part of ARC, RSA 2020 Public Services is a practice-research and policy development hub working with local authorities, public sector bodies, businesses and the third sector to develop social productivity approaches to public service reform, helping to create stronger and more resilient citizens and communities.

About AuditFutures

The aim of AuditFutures is to construct a holistic view and an innovative approach to rethinking the profession and to create opportunities for dialogue and for collaborative solutions to emerge. We are building a movement for a wider behaviour change and we are developing innovation projects for systemic effect. Through action research, thought-leadership, and practical engagement on the ground we are working on a number of interlocking initiatives to encompass the whole system. Our goal is to develop new thinking, to inspire innovation in audit and to ensure the profession is best placed to meet key public interest commitments and obligations.

AuditFutures is a thought-leadership programme of ICAEW, run in partnership with the Finance Innovation Lab.

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About the authors

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Executive summary

A future characterised by unprecedented organisational and informational complexity across business and public services, and where the public will demand more transparency, will need a body of people skilled at removing opacity in the service of the public interest. Yet the profession that could provide this service – the audit profession – is caught in controversies, and labouring within technical and defensive debates.

Following the financial crisis, and a series of scandals, the audit profession finds itself in the dock alongside a financial sector whose reckless self-interest plunged the much of the world into deep and long recession. Many in the profession feel wounded or irritated by what they regard as guilt through association and misunderstanding. Nevertheless, at precisely the point in its history when the profession needs to be conducting a searching and candid conversation with itself and wider society that could redefine its value in preparation for, and in service of tomorrow's world, it lacks the confidence and voice needed to reach out and move forward.

As currently constituted, audit assesses and reports on a system of business and finance that no longer enjoys broad social confidence, and reports on it in a variety of ways that miss the big picture. Political and social demands have changed, and so too have the demands of modern business. Audit's foundation stone – the statutory financial statement audit – risks being swept aside by events. The retrospective assurance of a clean audit report on historic and dated information in the annual report buys relatively little confidence in a business world where fortunes can fluctuate overnight on the basis of a tweet or a negative news story, and shareholding periods are measured in days, not months or years.

Audit is a service that can provide form and structure to the trust that business and society need to operate. That trust is bruised, as is trust in numerous established professions whose claims on knowledge and authority are fraying as a result of massive changes to information technology and social attitudes. Audit has been particularly disadvantaged by the fact that the benefits it generates for business owners or the wider public have often been hard to pin down. As a preventative service – a health check conducted with quiet diligence outside of public view – it has too often been known through its failures, or the failures of its client organisations.

To win back the public trust, audit faces the challenge of re-envisioning its service through its primary purpose. Audit is largely a publicly mandated service, designed by government to support a public good; and this is the case whether audit is being performed on a private corporate or a public authority. It is a public service, and the auditor should recognise him or herself as a public servant working in the public interest.

An elusive and messy concept, the public interest cannot be seized simply through regulations and tests. It can only be realised in ongoing dialogue. Audit can become exemplary in this regard. Instead of an audit report being a trust-producing *product*, the audit process should become a trust-producing *practice* in which the auditor uses his or her position as a trusted intermediary to broker evidence based learning across all dimensions of the organisation and its stakeholders, and bring into consideration all aspects of the organisation's value – economic, social and environmental. From being a service consisting almost exclusively of external investigation by a warranted professional, modern technology will allow auditing to become more co-productive, with the auditor's role expanding to include that of an expert convenor willing to share the tools of enquiry.

The auditor as convenor will need new skills, and will need to work in a more agile and interdisciplinary environment. Technical rigour will need to be maintained through training and professional support, but qualities like empathy, imagination and moral reasoning should be an increasingly important part of the training and support package. The auditor of the future will be a multidisciplinary team member, operating within and between companies as the market takes on the form of flexible platforms and innovative start-ups.

1. Introduction

Many of our most august professional bodies sprang out of the Victorian passion for administrative order, specialisation and social classification. Financial audit of corporations became mandatory in 1844, and the Institute of Chartered Accountants in England and Wales (ICAEW) was formed in 1880. But before 19th century professionalisation came 18th century Age of Enlightenment collaboration.

The RSA (Royal Society for the encouragement of Arts, Manufactures and Commerce) was founded in 1754, bringing together practical thinkers and energetic makers of all kinds in the optimistic belief that progress is possible through shared inquiry and mutual encouragement. Today the RSA still maintains that interdisciplinary dialogue between the professions is crucial to inciting change and maintaining a focus on our shared social and economic aspirations.

AuditFutures – a thought-leadership partnership between ICAEW and the Finance Innovation Lab – held its second assembly in 2012. As guest speaker, the RSA's Chief Executive Matthew Taylor issued a series of challenges to the audit profession:

- It should operate with radical transparency: 'as if in a glass box'
- It should account for its social purpose, aspiring to do more than service the status quo
- It should recognise that the way to achieve successful change at the scale required can only be through bold innovation and generous collaboration. In order to be relevant to the needs of society, the profession itself has to take responsibility for determining its fate and proactively engaging with the public that it aspires to serve.

Currently, the public sees change in audit being driven by legislators and regulators responding to perceived audit failures. This dynamic is understandable, but is ultimately self-defeating because it appears to be undermining confidence in auditors. It is therefore in the interests of society, as well as the legislators and regulators who act on society's behalf, that the audit profession is seen to take greater responsibility for the process by which audit evolves.

Economic failures which sap people's confidence in doing business represent challenges and opportunities for auditors to listen, reflect, learn, improve what they do and provide new and better forms of assurance. By taking responsibility for the dynamics of change, the audit profession can enhance trust in itself and business generally and reaffirm its public interest role. The audit profession will face significant challenges in taking responsibility for its future. But it should prove to be a liberating experience.

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

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.¹

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.

Detailed discussions about regulations, standards and processes are important and arguably plentiful, but they tend to focus on specific failures and they can be sourced extensively elsewhere. However necessary they may be, their focus on incidents and events tends to confirm audit within its backward-looking comfort zone. This report offers a place for the profession and its peers to look forward, to assess the bigger picture and express their highest aspirations.

1. For a brief account of challenges to professionalism in established professions (insurance, accountancy, law and architecture), see The Chartered Insurance Institute (2011) "Professionalism for the 21st Century – revisited", CII, www.cii.co.uk/media/854465/Papers_in_professionalism_n010_V5_PROOFED.pdf

2. New economy

Our popular images of capitalism's birth and growth are dominated by its most vivid aspects. We see the power of steam, imperial appropriation, massive factories and regulated ranks of workers. An alternative image would focus on something less dramatic, but arguably even more potent: a ledger set up for double-entry bookkeeping. Modern accounting, and the extension and application of its processes and controls into audit, have been fundamentally important in transforming our world.² Conceptually and instrumentally, they have encoded the economic rationalism that has brought us to where we are today; and we are at a difficult place economically, socially and environmentally.

Businesses of the Future

Globalisation, changing technologies and demographics are driving transformations that will have far-reaching implications for the audit profession's function and purpose. The profession's traditional object of review – the single business or business group – is becoming increasingly multi-faceted, as companies become woven together in intricate alliances and dependencies. One aspect of this is the spread of complex, and potentially opaque, forms of cross-national governance, ownership and partnership. In the past, these have often been designed on good professional advice to combine operational assets efficiently and access markets effectively but also to minimise tax liability. Popular and political opinion is hardening against this.

Firms are able to exploit ever more sophisticated information technology analytics to manage information – including financial data – across the business. While success remains dependent on being prudent about managing tangible assets, for many organisations the most important value-producing assets they have are not bricks, mortar and plant – assets that the audit profession has traditionally verified and quantified – but brand value, and intellectual and human capital. These assets, whether substantive or subjective, can be fragile; prone to sudden appreciation and equally sudden depreciation. Yet only some of these are routinely captured in financial reports that are then audited.

The life and health of companies is increasingly assessed on a rolling basis. Seventy years ago, the average shareholding period was eight years; 30 years ago it was four years; today it is measured in weeks, days or even seconds. Traditional business information regularly issued by companies, and to which audit can provide assurance, will continue to have some value; but that value is diminishing. The judgments of diverse

². Jane Gleeson-White (2012) *Double entry: how the merchants of Venice created modern finance*, London: Allen & Unwin

stakeholders are now made throughout the year on the basis of diverse formal and informal reports and pieces of intelligence from a variety of sources.

The retrospective assurance of a clean audit report on historic and dated information in the annual report buys relatively little confidence in a business world where fortunes can fluctuate overnight on the basis of a tweet or a negative news story.

Tomorrow's businesses will have to thrive in a world where markets, goods and services can be originated 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 they grow their market share substantially, these are likely to be among the key innovators that will, for example, test new forms of governance, financing and radical transparency.

The public services of the future

Public services are also being transformed. They are coming to bear little relation to the institutions the public and the audit profession have become familiar with, where accountability and value for money have been tracked and rated within single organisations. Tomorrow's public services will be provided by a wider range of organisations and sectors through partnerships, collaboration and transparent outsourcing. The strategic coherence of alliances at neighbourhood, town, county or city level will become more important than the performance of any single agency within the network.

More important still, in terms of how value is created, will be the relationship that services establish with citizens and communities. It will be based on the assumption that the resources (skills, networks, values and information) that citizens and communities can bring to public services are just as valuable as the resources brought by service providers. Increasingly services will be designed with the aim of enhancing the capabilities of citizens and their communities, individually and collectively to achieve the social outcomes they desire.

Public services based on relationships and capabilities will need to shift their spending from remedial responses to focus on longer-term investments. Auditing their performance will increasingly become linked to tracing long-term value. Services will also be expected to account for their local economic and social value: how their activity has contributed to the economic and social flourishing of the communities they are part of.

Tomorrow's uncertainties

The sheer pace of change brings massive uncertainties. Audit faces profound challenges to its epistemological and methodological assumptions. 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. But as Jan-Eric Furubo, Auditor General of the Swedish National Audit Office, has pointed out, the role of knowledge in relatively stable business and public service environments is categorically different than in an age of turbulence.

Services will also be expected to account for their local economic and social value: how their activity has contributed to the economic and social flourishing of the communities they are part of

The problem is that many of our ideas about the role of knowledge in decision making are based on the notion that we can do the same things today as we did before, and which we intend to do tomorrow.³

Audit for the future

The audit process risks being overtaken by current events. It is quite possible that statutory audit could be maintained much as it is now to provide a basic policing function within the corporate world, assuring consistency around minimum standards. Those standards could be marginally more or less demanding, the information provided slightly more or less expansive. But the technical focus of much of the current debate – for example, about auditor rotation, non-audit services, the Capital Asset Pricing Model or International Financial Reporting Standards – 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.

Ironically, the constricted debate is not the result of an isolated profession drifting into self-absorption. On the contrary, this is a profession that feels itself to be squarely in the spotlight of political, public and corporate attention. It knows that it is being subjected to scathing criticism, and that, following the financial crisis – and a series of scandals – it stands in the dock alongside a financial sector whose actions plunged Western economies into deep and long recession.

The economic system is viewed by many as being broken. Broad confidence in its ability to generate sustainable and equitable benefits has fallen away. As currently constituted, both as a practice and a profession, audit assesses a system that is suspect, and reports on it in a variety of ways that miss the big picture.

Many in the audit profession feel wounded or irritated by what they regard as guilt through association and misunderstanding. Nevertheless, at the point in its history when the profession needs to examine its place in wider society and redefine its value in tomorrow's world, it appears to lack the confidence and voice to engage in a wider, and more forward looking conversation.

The current narrative is defensive, self-justifying, technocratic and led by governments and regulators rather than the profession itself. To date, perspectives from other professions have been lacking. Without looking at these wider views, the audit profession risks simply repeating its previous post-crisis reactions which will mean failing to meet the scale of the challenges the profession faces.

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

Audit assesses a system that is suspect, and reports on it in a variety of ways that miss the big picture

3. Jan-Eric Furubo, "Public audit in hard times" in SOLACE Foundation (2012) *The Future of Public Audit*

3. Renewing trust

Political economist Francis Fukuyama has stressed the fundamental importance of trust in social and economic life. The ways trust is distributed in different societies, he claims, directly affects their relative economic strength. The key to understanding trust's varied distribution lies in understanding the patterns of social capital.

The radius of trust

Defined by Fukuyama as 'an instantiated informal norm that promotes cooperation between two or more individuals', social capital constitutes any society's primary stock of trust-generating relationships.⁴ Trust spreads beyond the groups that are bonded by social capital, but expansion of what Fukuyama terms the 'radius of trust' depends on recognition of shared advantages. By this account, the economic wealth of modern nations depends less on their ability to formalise trading mechanisms, contracts and bureaucratic insurance functions, than their ability to extend the circles of trust that remove the need for formal controls that are ever more expensive, and never sufficiently comprehensive.

Fukuyama's description of trust and social capital is one among many, but framing a consideration of trust in audit, and in the professions more generally, is helpful for two main reasons.⁵ First, it makes it clear that trust and the cooperation it facilitates within groups can be opposed to the wider good, economically and socially. For example, it may not be a good thing that big corporations and multinational audit businesses share informal norms that potentially generate overlapping circles of trust.

Second, Fukuyama's invitation to understand trust in society as a complex, networked phenomenon, is a useful counterpoint to trust as a quantum that rises or falls at any particular point. The erosion or extension of trust depends on relationships and expectation. Put simply, you may trust someone to mend your car but you may not trust them to drive your children to school.

Building a trust-rich society

If we are seeking to improve levels of trust in the audit profession, and explore the contribution that audit can make to building a trust-rich society, it is important to be aware of the range of different networks and relationships in question. Do the managers and owners of the organisations that

4. Francis Fukuyama (1999) "Social capital and civil society", IMF Conference on Second Generation Reforms, www.imf.org/external/pubs/ft/seminar/1999/reforms/fukuyama.htm

5. Jonathan Rowson, Steve Broome and Alasdair Jones (2010) *Connected Communities: how social networks power and sustain the Big Society*. RSA www.thersa.org/___data/assets/pdf_file/0006/333483/ConnectedCommunities_report_150910.pdf

As a narrative, the 'crisis of trust' had taken hold long before the financial crisis. Post-crisis, it has become more important than ever

buy auditing services trust the profession? Do investment fund managers trust it? Or politicians? What about members of the public, who see big business continuing on as before, with privileges intact?

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.

Properly understanding different stakeholders – the potential radius of trust – is important. But the specifics should not obscure the bigger picture. Trust in audit is fraying as part of much wider social and professional change. Academics and commentators have become fascinated by social capital, precisely because we fear that it is slipping away and that we are on our own. As a narrative, the 'crisis of trust' had taken hold long before the financial crisis.⁶ Post-crisis, it has become more important than ever.

The seriousness of the events that precipitated the financial meltdown accounts, to some extent, for the decline of faith in big business (and their auditors). But even putting these specific abuses aside, there are longer-term trends, systemic and cultural changes that are disrupting established patterns of trust and authority. Banking and finance have been hit by scandal. But so too, and quite separately, have policing, nursing, general practice, journalism and retail.

Our ways of living are shaking our traditional bonds of trust. Our relationships with each other and the business and services we use are becoming more distanced, more complex but more immediate. If trust is a solution to the problem of strangeness, the scale of that problem is being magnified by modern life.⁷ 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.⁸

In a globalised world, the goods and services that we are offered often appear detached from their complex histories of production. The overly complicated deals behind the latest financial products, the international brokering behind our bargain burgers, and the technology behind our latest tablets are mysteries to many of us; so when products or services fail to deliver on their promises, we often feel betrayed and blindsided. Some of us try to rebalance the equation, often turning to the internet to find our own sources of information and platforms of dissent. We find someone else to trust.

Trust and audit

Trust is what auditors sell. They review the accuracy, adequacy or propriety of other people's work. Financial statement audits are prepared for the owners of a company and presented publically to provide assurance to the

6. Baroness Onora O'Neill (2002) "A question of trust", The Reith Lectures www.bbc.co.uk/radio4/reith2002/lecturer.shtml

7. Florencial Torche and Eduardo Valenzuela (2011), "Trust and reciprocity: a theoretical distinction of the sources of social capital", *European Journal of Social Theory* 14(2), 181-198 https://files.nyu.edu/ft237/public/torche&valenzuela11_reciprocity_trust.pdf

8. LLAKES Centre for Learning and Life Chances in Knowledge Economies and Societies (2011) "Education, opportunity and social cohesion" www.llakes.org/wp-content/uploads/2011/06/SocialCohesion_webversion.pdf; Adolfo Morrone, Noemi Tontoranelli and Gilula Ranuzzi (2009) "How good is trust? Measuring trust and its role for the progress of societies", OECD Statistics Working Papers, 2009/03, OECD Publishing www.oecdilibrary.org/docserver/download/5ks712zkbrow.pdf?expires=1391446034&id=id&accname=guest&checksum=74A2051574049285535C0960D4493164

market and the wider public. Public service audits are presented to governing bodies and, in some cases, directly to parliament.

It is the independent scepticism of the auditor that allows shareholders and the public to be confident that they are being given a true and fair account of the organisation in question. The auditor's signature pledges his or her reputational capital so that the audited body's public statements can be trusted.

“We want to be seen to be professionals and trusted counsel as lawyers might be, upholding the integrity of systems of governance and control and providing assurance that people can trust – assurance that underpins a fair and efficient economy and society.”

Interviewee

Given the fundamental importance of trust, should auditors not then feel immensely valuable in the context of declining trust? Not so. Among our interviewees, a consensus emerged that the audit profession is under-producing trust at a critical time. One aspect of the problem is the quietness 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 in the organisations they scrutinise, and relatively rarely in 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 to strengthening and expanding trust.

So what can be done? Our research suggests that more frequent dialogue with audit committees, and a more ambitious, outward facing role for the sector's leadership would be welcome. But we think more is needed. Audit for the 21st century should be understood and designed as primarily a confidence building process within the audited organisation and across 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 trust-producing *product*, the audit process could become a trust-producing *practice* in which the auditor uses his or her position as a trusted intermediary to broker rigorous learning across 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 could move from 'black box' to 'glass box'.

Audit could move from 'black box' to 'glass box'

Trust, audit and outcomes

But the profession will still struggle to secure trust unless it can stake a stronger claim to 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.

For the most part, audit has been a preventative service that reports on historic activity. Regulators review the ‘quality’ of audits on a regular basis, but little has been done to construct models of quality that take account of the *outcomes* for the audited business. In a strangely circular manner, these reviews offer a scrupulous, systematic review of whether auditors have undertaken scrupulous, systematic reviews. It is as if school inspections were designed solely to review lesson plans and attendance but took no interest in results, qualifications, welfare or progression. Little wonder then that some business people candidly admitted to us that their highest aspiration while being audited is simply to receive a clean report requiring no action. This has led to a situation where much of the learning that could be most valuable from a business perspective falls outside the formal audit processes and may or may not be looped back into the company:

“It’s almost like we have audit with a capital ‘A’ and one with a lowercase ‘a’. The one with a capital A is the public-facing bit, but the ‘a’ is the added value internally, the one when you can have free discussions with the client. The challenge is to join the two up and steer clients towards good behaviour.”

There is a careful balance to be struck here. Moving closer to a support and learning model of audit is problematic, as it presses on the critical issue of independence. Audit cannot provide trust to markets and the public unless its views are clearly independent from, rather than beholden to, the organisations they report on. Some of the people we talked to were strongly critical of what they saw as a creeping tendency for audit to mix advice and reporting, falling in with business managers rather than standing back to provide independent assurance for business owners. The controversy over provision of non-audit services adds another dimension to the debate, which includes visibility and competence, but the core issue is the same: payment.

Trust and independence

Other professionals sell their services to clients on the basis of acting with independence and objectivity, and we would suggest that dialogue with these would be helpful. But audit professionals are unusual, perhaps unique, in being employed as a matter of course to look into the heart of their client’s business and take a public view on its health and propriety. Their fortunes are entwined, to the extent that a heavily qualified or adverse opinion is a public statement that is likely to put the client’s future in jeopardy.

Trust and regulation?

Trust and regulation exist in an uneasy relationship, and the consensus among those we spoke to is that the relationship is not working. Successive financial failures have seen the imposition of new tiers of regulation designed to secure a trustworthy process, but this emphasis on process has reduced professional scope and dampened aspiration.

We might think that job satisfaction in the audit profession is not the weightiest consideration, but the underlying point is much more

*Other professionals
are also
acknowledging
the power of
uncertainty*

significant. When we heard repeatedly that regulation was crowding out judgment, the issue was one of purpose rather than pride. If the highest aim of the auditor is to carry out prescribed audit processes, messy truth will escape; and if – as we argue in the next section – public interest is just such a messy truth, then focusing on compliance can lead to perverse outcomes.

Many in the profession counter the criticism that audit was ‘the dog that didn’t bark’ during the financial crisis by stating that it followed the rules laid down for it. Adding new rules in the hope that they will be the right rules to catch the next set of follies might be less effective than inspiring the profession through appeals to the value of transparency, accountability, business improvement and public interest.

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. Other professionals are also acknowledging the power of uncertainty. Today, doctors are encouraged to be open with patients about the complexity and uncertainty of some conditions. Actuaries have recently allowed themselves to tell clients that there is no single version of the truth, but rather a range of possibilities. Auditors, too, need to admit greater uncertainty and offer a more nuanced account of the businesses they review. Sadly, government and regulators unintentionally promote the view that perfection can be achieved and certainty produced.

“Yes, every audit could be perfect. Yes, audits could detect every fraud. The cost would be so astronomical that no business could afford to pay for it and the country would go bust. The same cost–benefit equation occurs in most professions – most obviously in the NHS and police – but the public is blissfully unwilling to meet this issue head-on and therefore has unrealistic expectations of what can be achieved. As a profession, we cannot deal with this issue alone: government needs to be more open about realistic expectations ... although expecting that is probably unrealistic.”

4. Public interest professionals

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 nevertheless be uneasy. As one of our interviewees put it:

“Professions are where a vague degree of suspicion meets complicated respect.”

Interviewee

Public perceptions of the professions

Professional services have never been so pervasive. In the UK, for example, they grew by 3.4 percent in the decade to 2014. The professions also account for £15,849m of British trade in services, or over half of the total £29,194m and represent the largest single category of employment – 11.5 percent of total UK employment.⁹ But these buoyant figures mask changes and anxieties. Sub-contracted by society to represent the public good above personal gain, the professional was once seen by many as a trustee of the public interest. But there is a pervasive concern that since at least the 1980s, the professional’s expertise has significantly lost its value and the public trust that would once be taken for granted is now waning or new conditions are being attached.

Medical professionals are a case in point. Recent scandals notwithstanding, they are still amongst our most trusted professions.¹⁰ Most people believe that doctors act in the best interests of their patients and do not give advice that will maximise their own material rewards. This social regard varies with the structures that define the healthcare system; the fact that the UK’s NHS is still trusted helps, but as provision becomes more complex, so does trust.

Doctors’ status has been challenged in parts of the world where patients are able to access a widening range of self-help tools, information

9. Spada (2008), *The British professions today: the state of the sector*, Spada, www.ukipg.org.uk/executive_group_resources/spada-british-professions-today.pdf

10. Reader’s Digest (2013) Trusted Brands survey includes trust in professionals (www.rdtrustedbrands.com/about.shtml); the Edelman Trust Barometer reviews levels of trust internationally in business, government and professions (www.edelman.com). The most recent controversy over professional standards in healthcare has been subjected to review by Robert Francis QC, *Report of the Mid Staffordshire NHS Foundation Trust: Public Inquiry, Executive Summary* (2013), Stationery Office www.midstaffspublicinquiry.com/sites/default/files/report/Executive%20summary.pdf

Do professionalism's structures, disciplines and forms of accountability – internal and external – provide socially valuable assurance?

for self-diagnosis, and opportunities for peer discussions. Patients can also review performance data, sometimes for individual practitioners. Technology and education have democratised information and enabled patients to become more active partners in treatment decisions, challenge doctors' opinions and request the treatments that they themselves deem to be best.

People are better educated, better informed and used to making their own decisions, so why rely on professional knowledge and judgment? Do professionalism's structures, disciplines and forms of accountability – internal and external – provide socially valuable assurance? Certainly, in what Baroness O'Neill has termed an 'age of suspicion' the way professions are often called to account seems to be problematic.¹¹ The popular response to failures and abuses has been increased regulation (internal and external) – one consequence of which has been that professional behaviour has necessarily become more bureaucratic. It is a bitter irony – not lost on people whose experience of being audited has been one of irksome processes and demands – that today's audit profession is itself feeling burdened by red tape, distracted by tick-boxes.

"There is a subtle difference between this approach and the logic which defines 'red tape is bad. Audit is red tape; audit is therefore bad'."

Interviewee

The identification of audit with bureaucratized professionalism sets up a negative loop which makes it more and more difficult to attract entrants with diverse mindsets, high ideals and empathetic skills. Our interviews for this report revealed a weary sense of a profession whose motives are misunderstood.

Trust and respect are afforded most readily to professions with the least direct financial self-interest, and whose services are provided in a way that can be observed and understood by the wider public (on both counts, audit fares badly). 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, the dispositions and incentives with which people enter a profession are often reshaped and reformatted over time by the internal culture that persists within the professional community. The defined knowledge and expertise, the technical capacities, the ethical code, the aims and goals all define the culture and legitimise the expertise of the professionals. 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.

The profession as an institution also provides the script that articulates what a successful career is like in a given profession. The administration of a profession determines the relationships between its professionals, but also influences the nature of its relationship with its clients and the public.

11. Baroness Onora O'Neill (2002) op. cit.

Notoriously messy as a concept, the public interest is most often understood by what it is NOT

What is the public interest?

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 a public good; this is the case whether audit is being performed on a private corporate 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.

Notoriously messy as a concept, the public interest is most often understood by what it is NOT. We find it difficult to know as an entity itself: finding out what it is primarily 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.

Public interest is conceptualised most fruitfully as a process, not as an identifiable end point. As Denhardt and Denhardt argue,¹² it can be simultaneously seen as a state of being and an ongoing process. Its quality and significance are bound up in both the process 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 reflection and 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 potentially valuable vessels for reflection, but to explore the public interest they need to reach out and collaborate more widely. This may be by establishing formal cross-professional groups to review challenges and grey areas, or by bringing in lay reviewers to qualification processes. (In 2007, lay assessment was introduced for doctors undertaking speciality training in general practice and applying for membership of the Royal College of General Practitioners.) 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. Professions have been too quick to professionalise the maintenance of the public interest.

“If the interests of the public are to be well served, the activities involved in each of the areas of ‘public interest’, in the sense indicated, must be well done. This requires extraordinary dedication and training on the part of individuals engaged in those activities, as well as significant regulation of what they do. Because of the special knowledge such regulation requires, however, it must largely be regulation by others trained and immersed in that same activity. Special dedication, training, knowledge and self-regulation, when institutionalized in the appropriate respects, form a profession as a social entity.”

D. Willard¹³

The audit profession and the public interest

Embracing a definition of the public interest as an inherently public dialogue would be extremely challenging for the audit profession. It would

12. Janet Denhardt and Robert Denhardt (2011; 3rd Edition), *The new public service: serving not steering*, New York, M.E. Sharpe

13. Willard, D. *Professions and the Public Interest in American Life*, University of Southern California (2007)

mean taking responsibility and stepping away from the security provided by its rules and regulations. This could be uncomfortable.

To be credible it would have to involve a generous invitation to wider society and its peer professions 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. A senior figure in financial services has recently spoken of the need for a truth and reconciliation process in the aftermath of the financial crash. Whatever forms it takes, the initiative needs to come from the profession. As we heard from our interviews:

“We need to be seen to promote the public interest and not self-interest. Much of this is about perception but at present the audit profession often seems to quickly explain why something, such as the financial crisis, is not our fault.”

A major challenge for many professions is the commercial side of their activity. As noted earlier, audit faces particular challenges in this regard, as its relationships – often long-term – with the businesses it works for are characterised by an unusual combination of confidential analysis, public accountability and shared jeopardy.

The audit profession should aspire to be independent of commercial pressures and to be the servant of the public interest. Yet we have heard much public criticism of audit being dominated by big business; concerned with business interests first, followed by clients, with society in last place. In protecting their clients’ interests, accounting firms are criticised for avoiding social and environmental obligations. Critics also argue that firms need to demonstrate that they can be more transparent about the commercial pressures that exist within the firms and how they are managed. Too often, the interests of clients are seen as paramount regardless of the consequences for society, especially if the fee is right. Bigger organisations are more often in the public eye and are inevitably perceived as synonymous with the profession.

One solution offered in our interviews was to remove statutory audit entirely from the market:

“My views are that auditing of company accounts should not be provided by the market but rather is inherently a government function. The process whereby corporations selected their own company accounts inspector has an inherent conflict of interest built into it, which was a prime reason for so many banks not being audited properly prior to the 2008 crash.”

Interviewee

This was a minority view but could it address the problem of trust? Perhaps, but not necessarily. Successive governments have established regulatory inspection bodies, with responsibilities ranging from finance to social care. Some have stood the test of time, but many more have presided over scandals that have damaged their credibility and have seen them replaced.

A different approach to the problem of how independence and financial relationships could be tackled comes from the credit rating agencies, where commercial negotiations and fees are completely separated from the analytical work. Credit analysts do not know the correlation between the fees their company is being paid and the work that they do, and are not permitted to discuss these matters with rated companies. Yet an audit partner is both responsible for the audit quality and for the fee. Audit will need to consider similar separations and protections, if it is to secure the trust it needs to be a full partner in creating economic, social and environmental value.

Audit today appears to be in the worst of both worlds: unable to give a satisfactory account of financial disinterest; and unable to realise its potential value to the business it is reviewing. Field auditors have become more junior and less able to play the role of adviser or confidant; indeed, they are encouraged not to do so. They have little immediate awareness of their impact on the business, let alone their impact on wider society.

The audit profession as a public interest educator

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. As our interviews as part of this project underline, the core elements of a public interest conversation are actually very simple. People within and outside of businesses want accuracy of financial information, a clear narrative about performance, an understanding of why things are happening the way they are, and the risks ahead. The public also value assurances that companies act within the law, do not harm or unnecessarily pollute their environment, pay an appropriate amount of tax, behave ethically, treat their workers fairly, give good customer service, and do what they have promised.

We have suggested that 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 stakeholders within and outside the audited organisations 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 and environmental value. But 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 processes and products. Our interviewees acknowledged that there is still some way to go. For example, we heard that in the final audit report and audit opinion, auditors still struggle to find a language that can be understood by shareholders, let alone a language that engages and secures the trust of society more widely.

Exciting developments are underway that are shifting audit in the direction of more inclusive practices and a wider set of reckonings – including social and environmental value

5. An enlightening profession

The partnership between the RSA and AuditFutures started by asking what value audit could bring to society in the 21st century. This has been our central focus. We have recognised that there are controversial structural aspects of how audit as a business operates today, but have attempted to explore the possibilities of audit without being confined by its current institutions. Nevertheless, future institutions will have to look and behave quite differently in order to produce value in the way we have suggested. If they are to build trust through exemplary open learning and integrated inquiry in the public interest, the institutions will need to continue to adapt. This section, therefore, sets out some of the changes we would like to see. Most involve audit as a profession and a business sector taking the best of practice emerging in other professions, and moving towards business forms that draw on the best talent and incentivise innovation.

Leadership and collaboration

Step change in other fields has been initiated by people who recognise the need to change, 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 ecosystem their service operates in and they are willing to recognise and adapt to technological and social developments. Crucially, they do not construct solutions within their own institutions, but look to use partnerships.

“We need to think about audit as a collaborative activity rather than [activity] by the expert in the pinstripe suit.”

Interviewee

Collaboration works best when it involves sharing values and aspirations. Some of the most transformative instances of cross-professional work have brought people together from diverse backgrounds in order to face shared social and economic challenges. For example, buildings today are much more energy efficient in large part because architects, engineers, constructors and technology experts have come together with a shared purpose. The research that underpins many advances in science and

Technology should be in service of a public interest vision, rather than simply a tool for efficiency

medicine is rooted in multidisciplinary teams that establish a common framework and language for discovery and innovation.¹⁴

Audit leaders and innovators now have the technological tools to push collaboration in ambitious new directions, up to and including crowd-sourced Open Audit, for example. But the technology should be in service of a public interest vision, rather than simply a tool 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 learn from existing developments that can provide valuable lessons and models to adapt. For example, in the UK, doctors in the first two years after graduation are asked to perform an audit, which forms part of clinical governance and aims to ensure that patients receive the best quality of care. A 2008 *British Medical Journal* article suggests four key areas to improve the value of the audit:

- The audit needs support and collaboration to work
- The scope of the audit should concentrate on high-risk areas
- Data collection needs to be carried out to a high standard
- The aims of the audit and its findings need to be well communicated

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 tiers of authority will be disrupted, and with them, 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. Specialist staff may increasingly be necessary as it is unlikely that every auditor will be able to understand all the necessary issues – for example, complex financial instruments and how information is processed by computers. The structuring of audit teams to include individuals who have particular skills relevant to the risks may become increasingly important and this may mean accountancy and audit firms becoming more interdisciplinary, without losing the core value 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 firm in the future, able to capture and analyse the diverse information needed by businesses and society, may take the form of firms within firms, or a

¹⁴ Jill Trehwella (26 June 2009) “Multidisciplinary research: an essential driver for innovation”, GlobalHigherEd, <http://globalhighered.wordpress.com/2009/06/26/multidisciplinary-research-an-essential-driver-for-innovation>

platform enabled by modern technology to plug into talent, intelligence, and user-generated content wherever it can be accessed.

More than a technique for mass collaboration, crowdsourcing has become a fully fledged business model for some companies and sectors. Distributed, open innovation can be used to provide even the most technically demanding products or services. The successful pharmaceutical maker InnoCentive is a virtual firm whose employees work from locations around the world using remote-networking technologies.

As the boundaries of the firm become more permeable and elastic, many of the established privileges of scale will not apply. Does this mean that small audit firms will develop strategic advantages over large firms? Potentially. 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 their increasing organisational size and complexity, the increasing need for capital, and an increasing risk of litigation.

New organisational forms could be helpful in addressing some of the challenges and opportunities raised by this report. Innovation and ambition are sorely needed. But organisational change would also bring fresh challenges, including how to maintain reasonable assurances about quality of service to clients, and where to locate accountability in complex, multidisciplinary practices.

Innovation as the new default¹⁵

The audit profession has been accustomed to incremental change and consistent methodologies. It now has the chance to create a sea-change in practice through understanding and embracing open and social auditing, new technology, real-time auditing, co-creation with social enterprises, and crowdsourcing. These developments all provide opportunities for more direct contact with the wider stakeholders of the organisation being audited, opening up dialogue and access to information.

In many areas – and particularly when it comes to public services – the driver of change is a focus on what is produced with stakeholders. In many cases, a clearer focus on outcomes means ‘going back to the drawing board’ and redesigning how things are administered and delivered. This process needs to be expansive: exploring the whole ecosystem the service is delivered in, including technological and social developments. The development of services such as Skype have revolutionised the telecoms market. Online retailers such as Amazon have done the same in their industry. This meant being prepared to redesign from scratch, based on a detailed understanding of what their stakeholders were demanding, using changing technology as the enabler.

Audit would benefit from offering support to the most innovative parts of the economy, including those it has yet to develop strong relationships

15. For more discussion on the theme of innovation in auditing see Chapter 2 of Catasús, B., Hellman, N. and Humphrey, C. (2013) “Thinking Differently: Making Audit Innovation the New Practice Standard”, in *Revisiones Roll i Bolagsstyrningen*, SNS Förlag: Stockholm

with. The social enterprise sector has the fastest growth of all start-up company types in the UK.¹⁶ Over half of new graduates looking to start a new business want to use the social enterprise model.

The new audit 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 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. Rigour of course needs to be maintained in terms of specialist knowledge, but, in the long term, it is the learning skills of tomorrow's doctors, architects and accountants that will be critical.

We believe that education and training for audit should become much broader. To deliver a more enlightened profession, new skills, capabilities and attitudes will be essential, some of which may feel alien to professionals schooled in harder-edged disciplines:

“We’ve got to recognise that the real high-value work, ironically, may not fit within our classical cognitive framework, but may actually have an imaginative component.”

Interviewee

Empathy

“The stock of global empathy has to grow if we are to reach an agreement on [putting] the long-term needs of society ahead of short-term needs of individual businesses.”

Matthew Taylor¹⁷

If auditors are to become the relational professionals referred to in this report – trusted intermediaries who bring together stakeholders to ensure transparency and produce trust – they will need strong interpersonal skills, grounded in good emotional intelligence. This involves knowing one's self, being able to self-manage, being able to connect to others and being able to show empathy toward others.

Vulnerability

“Vulnerability is the birthplace of innovation, creativity and change.”

Brene Brown¹⁸

16. UKGov website 2013.

17. Matthew Taylor, *21st Century Enlightenment*, the RSA, (2010), <http://www.thersa.org/about-us/rsa-pamphlets/21st-century-enlightenment>

18. TED blog – Brene Brown <http://blog.ted.com/2012/03/02/vulnerability-is-the-birthplace-of-innovation-creativity-and-change-brene-brown-at-ted2012/>

The audit profession includes people of exceptional talent and energy.

In a profession that has become used to labouring under fears of liability, willingness to admit vulnerability could be powerful and disruptive. Ultimately it could nurture confidence and encourage trust between the profession and its stakeholders.

Philosophy and ethics

“Audit should rethink its role as a custodian of moral good.”

Lehman, 2013¹⁹

The success of our society has been dominated by three logics: the logic of science and technological progress, the logic of markets and the logic of bureaucracy. An enlightened professional needs to be able to introduce a stronger element of ethical reasoning.

Audit education is at a moral crossroads. In many universities, ethics courses have been replaced by more business case scenarios that illustrate how ethics, profit and sustainability can be combined.

Change will come from within

True reformation will only come from within, led by new leaders and the best and brightest. AuditFutures’ work with young auditors has found that they want change, and they want to prove that what they do is important.

Change is possible and the audit profession can rise to the challenge. But the scale of challenge should not be underestimated. Leadership will need to encourage truth and reconciliation, a co-designed and positive view of the future that all practitioners can aspire to. A mood that today is darkened by frustration and defeatism will need to shift to one energised by active engagement and bold exploration.

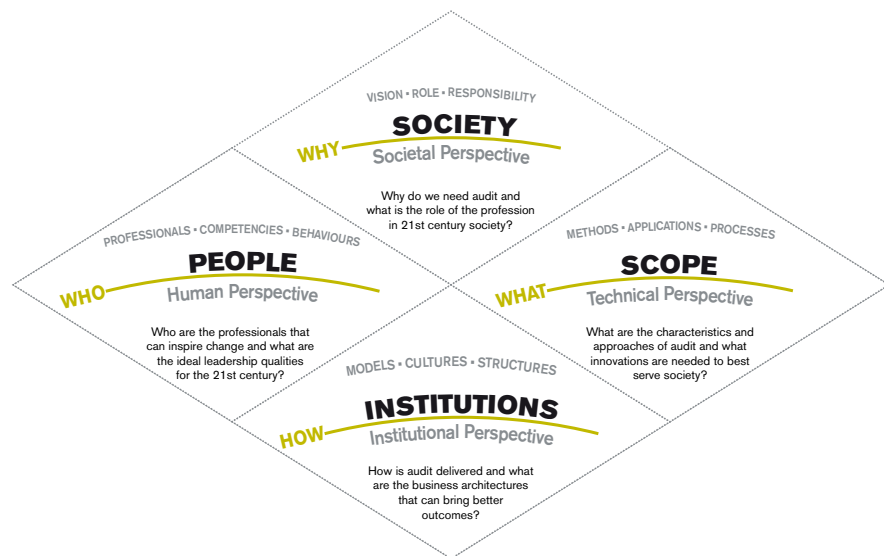
This paper argues that a self-imposed technical evolution will not be sufficient: what is needed is a transformation of the profession, led by the profession and focused on the public good.

¹⁹. Lehman, G. *Moral will, accounting and the phonemos*. Crit Perspect Account (2013), <http://dx.doi.org/10.1016/j.cpa.2013.10.004>

6. Beyond Groundhog Day

This report ties in with AuditFutures' systemic view of the future of the profession. Too many recent discussions in the profession have taken on a Groundhog Day dimension. By starting with individual areas rather than considering the whole system, discussions have simply repeated themselves. It is crucial to review all aspects of the audit profession's work and understand that they are not static but are dynamic and interdependent. AuditFutures has therefore developed a framework to help this broader thinking.

The model defines four dimensions: societal, institutional, technical and human. The theory of change underpinning it sees real change as possible through reflecting on all four areas at the same time.



Instead of a conclusion

This paper is a discussion piece and instead of a conclusion we would like to offer a group of challenges and provocations to maintain and encourage dialogue.

Society

- Should the mission of the audit profession be to create a trusting society that needs less formal auditing?
- What would Steve Jobs have made of the 'expectation gap'?

- Would a truth and reconciliation process enable audit and the financial sector to move on?
- Can auditors move to meet social expectations or should society be moving to accept what auditors regard as legitimate audit practice?

Scope

- How much confidence in the integrity, success, sustainability and social accountability of business is currently provided by audit? How much confidence is audit capable of providing?
- How does audit provide useful information at the speed demanded by modern businesses and society while guarding against the risks of short-termism?
- What purposes should be served by automation and new applications of information technology in audit?
- Should a financial statement audit be graded and differentiated, more like an Ofsted inspection, so as to provide a more complete picture?

People

- What makes a good auditor?
- How can audit broaden its interdisciplinary skills base while maintaining technical expertise?
- Will tomorrow's bright minds want to be auditors?
- Is recruitment from a wider socio-economic background essential to building trust?

Institutions

- How is it best to coordinate the multi-disciplinary demands on audit and nurture the requisite skill sets of auditors?
- Does audit have a legitimate place in the professional services firm of the future? What is the role for audit only firms? Or 'no audit' large firms? What can be learned from other professions that deliver independent advice and review services to clients?
- What of the relationship between professional bodies and leading professional firms? Can this change in ways that have a positive impact on audit futures?
- If audit becomes an integrated and collaborative review activity, drawing on interdisciplinary skills, will we need firms specialised in professional audit services?

In planning forms of audit for tomorrow's society, people, institutions and public expectations need to be well aligned. We could design a new audit product and recruit the ideal people to deliver it, but if we retain insufficiently adaptive institutions, and pitch these services to a market and a society that does not care about them, the future of audit is not bright. If our society and its markets want more from audit, but firms are not set up to deliver, and the right set of skills are not in place, then the future for the profession is not bright. If we have bright minds, smart structures and an ambitious and informed public, the future of audit should be bright.

For many years now, audit as a profession has been told what to do, or told others what it cannot do. Some changes have been imposed on it; others have been resisted or modified. In some cases the profession's own initiatives have been seen by some as too self-interested, or have jarred with traditional ideas of what auditing can or cannot do.

The spirit of this report is different. It encourages the profession to go beyond Groundhog Day and seize the initiative as the best way of repairing trust, sparking innovation and increasing the economic, social and environmental value it generates. We suggest that it aims high, not just by finding more efficient ways of doing what it does today, but by playing an active role in influencing the development of a society – and within that, an economy – that is better informed by the standards, skills and insights of audit.

The RSA: an enlightenment organisation committed to finding innovative practical solutions to today's social challenges. Through its ideas, research and 27,000-strong Fellowship it seeks to understand and enhance human capability so we can close the gap between today's reality and people's hopes for a better world.



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