The Future of Audit

A framework for debate

February 2019

pwc

This document aims to stimulate debate on the many important and complex issues surrounding the future of audit. It offers a framework for discussion among a wide range of stakeholders by posing a series of open questions.

It is not intended to address the specific questions around the structure of the industry that are the subject of public reviews – and on which PwC's positions have been captured in formal submissions – but rather to explore how the audit itself could evolve. Neither does it aim to provide answers or PwC's own views, but rather to summarise the key issues that need to be considered in order to design an audit that better serves the needs of society.

Through a programme of large events and small gatherings, in papers and online, PwC hopes to invite the views and perspectives of many people who have a stake in the effectiveness of audit – both to better inform the firm's own understanding and to share as a contribution to the broader public debate.

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Foreword

We are in a time of economic, political and technological upheaval. Expectations of all organisations are shifting rapidly. This is as true for our own sector as it is for the companies we work with. The audit profession is under great scrutiny and has become a subject of much commentary and challenge in the public arena. Reviews of the audit market have focused on auditor independence, competition and choice as well as the scope and quality of auditing. We're committed to working with policy setters on all the areas under review.

It’s clear that audit has not kept pace with society’s expectations. That’s why we believe there is an urgent need to explore how it needs to evolve for the future. Those of us in the audit profession must acknowledge that our current critics have raised valid concerns. More stakeholders than ever depend on the accuracy of financial reporting; shareholders rely on a far wider set of performance information than is included in the ‘back half’ of the annual report; and there is rising demand for auditors to give a more forward-looking assessment of an organisation’s health, whether in the public, private or the third sector. None of these areas are tackled in today’s statutory audit model.

Building and maintaining confidence in the audit matters: it plays a critical role in underpinning confidence and trust in business and the capital markets. This is important, not only to us as a leading firm in the sector, but also to the many stakeholders who rely on the assurance that the audit profession is here to provide. This, in turn, drives economic growth, trade and prosperity, both nationally and internationally.

At PwC, we have said publicly that we believe our sector is at a watershed moment, and we’re open to change. Auditing brings great value to society and we, as a profession, need to think about what this means for the audit of the future. This is why we have initiated a public discussion on what the audit could – and should – look like to better serve the interests of investors, and society more broadly.

We know there are no easy answers. There is no single remedy, or a single participant, that can resolve the challenge; it will require many different perspectives. Consequently, we want to engage with as many people around the country as possible, and we invite participation digitally as well as through face-to-face conversations. This will inform our own understanding and we will share publicly what we learn from these discussions. Our aim is twofold: we want to contribute to the debate, and also to work with others to develop a system that we can all be confident in.

We are committed to evolving the audit to ensure that stakeholders receive the independent assurance they need.

Kevin Ellis, Chairman and Senior Partner

Introduction

The UK has a reputation globally for having high standards for corporate reporting, auditing and governance. This is why I, and many others in my profession, have spent our working lives in the sector. Fundamentally, we believe in the truth and fairness of reporting; for the UK to remain a great place to do business, we need to have reporting people can rely on, and auditing is critical to that objective. However, recent high-profile corporate failures in the UK have put auditing and auditors in the spotlight.

We are proud of the audits that we perform. As auditors, our task is to help make sure that corporate reporting is true and fair. We treat any audit failure extremely seriously, and we are committed to improving the quality of our audits, both by focusing on the quality of our work today and by innovating to improve the audits of tomorrow.

The recent criticism of the profession highlights the need to do more. Whilst the audit has always evolved over time, the evidence is that the world has moved more quickly than the audit. In the profession, we are eager for change; we want the work we do each day to be as valuable and as useful as possible.

This is a complex, multi-faceted challenge, making it hard to grapple with. We think that a few big questions can provide a **framework for debate**, enabling a wide range of stakeholders to participate in shaping new solutions.

The world is changing fast around us and we believe the audit needs to evolve with changing expectations. My colleagues and I look forward to hearing the views and perspectives of many different stakeholders, and working collaboratively with others to respond to the challenges we face today to ensure that the audit of the future is fit for purpose.

Hemione Hudson, Head of Assurance

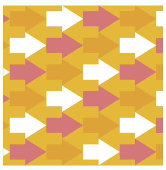
The Future of Audit – A framework for debate

Beyond historic information

- Would the audit be more valuable if it were more future-facing?
- Should it seek to stop companies failing?
- Should the focus continue to be on a binary ‘true and fair view’?
- Could it offer a more subjective judgement on significant business and financial risks?

Beyond shareholders

- Who should the audit be for?
- Should it still be carried out only on behalf of equity shareholders?
- Should a wider range of stakeholders be able to rely on the work of auditors?

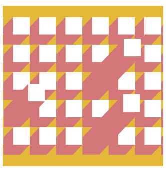


Beyond the financials

- What should the audit cover?
- Today, an audit opinion covers historical financial performance, but is assurance needed over other risks and non-financial information?

A different approach for big and small companies

- If audit expands in scope, does one size fit all?
- Should larger listed companies, arguably with the greatest level of public interest, face a greater degree of scrutiny than a smaller, owner-managed business?

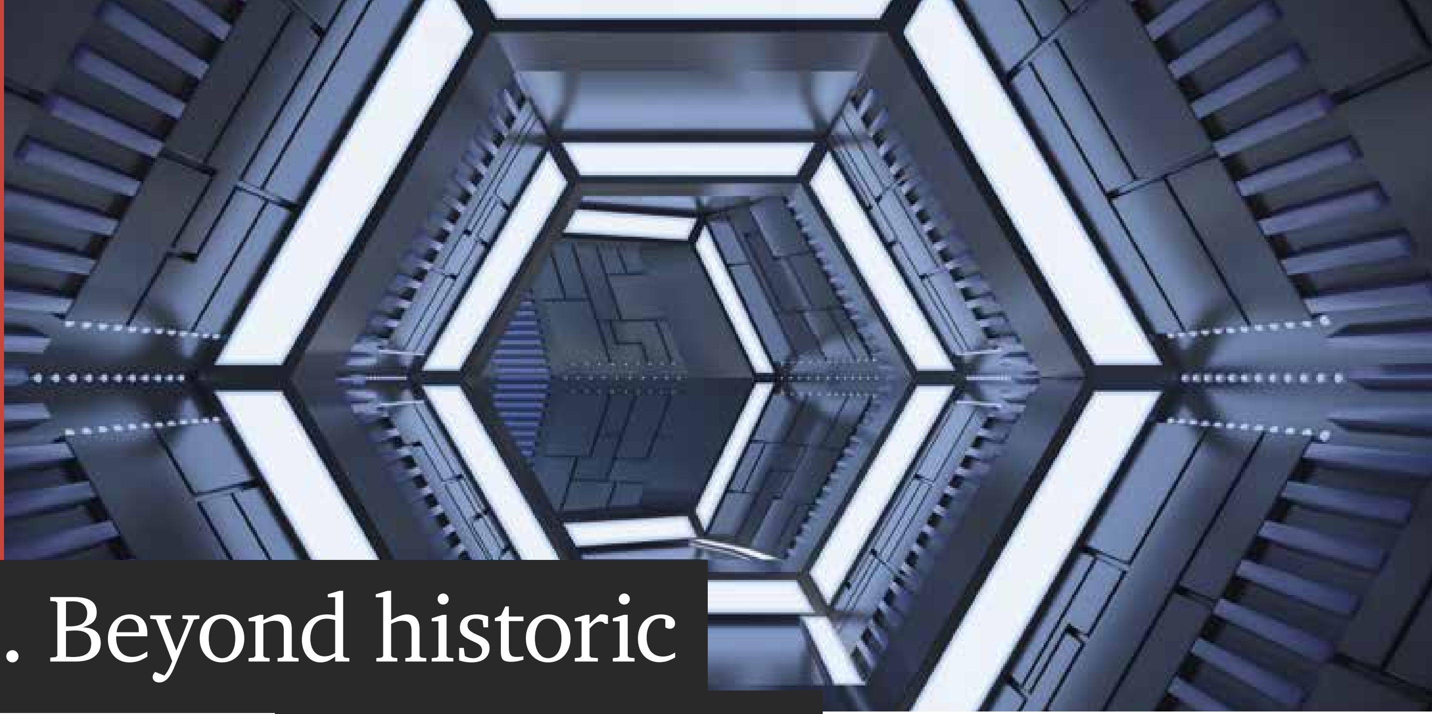


Technology reshaping audit

- How can technology enhance auditing?
- What are the possibilities for automated assurance and real-time analysis?
- In an automated audit, what will be the role for human judgement?

Driving audit quality

- Does everyone agree on what constitutes audit quality?
- How can it be observed?
- Can the profession ever eliminate all audit failures?



1. Beyond historic information

Would the audit be more valuable if it were more future-facing? Should it seek to stop companies failing? Should the focus continue to be on a binary 'true and fair view'? Could it offer a more subjective judgement on significant business and financial risks?

The collapse of prominent UK companies in recent years has led critics of the accounting profession to question whether auditing could do more to prevent corporate failure. If auditors have privileged access to a company's accounts and its management, surely they can more easily spot looming disasters, or at least flag up concerns about the direction of travel? At parliamentary hearings into the Carillion collapse, MPs repeatedly pressed its auditors to name the one thing they could have done to stop the company failing.

In some respects, the problem reflects a gap in understanding between what the public increasingly expects of auditors and what the statutory audit, enshrined in law, requires them to do. The statutory audit was designed to provide equity shareholders with reasonable assurance about a company's past performance; not to analyse its long-term viability. The aim is to decide whether historic accounts provide a 'true and fair view' of the company's financial performance and position on a specific date, and whether or not they have been materially misstated. So perhaps one way of addressing the expectation gap is to focus on promoting a better understanding of what audit is designed to do and question the assumption.

Even if there were a fool-proof way to predict which companies were at risk of going bust, it is far from clear that the economic interests of society would be best served by preventing all failing businesses from going under. It may even distract from the primary responsibility of a company's management to prevent failure.

Another way of addressing the expectation gap is to think about what could be done to change the design of the audit to bring it closer to what society seems to want. Would it be more valuable if the system were designed to be less focused simply on checking a company's past, and instead become more forward-looking: identifying potential risks and considering how well they are controlled? Could a reformed audit help stakeholders understand the risks inherent in a company's business model and so enable them to make better decisions?

One reason for thinking such changes might be possible is that auditors already learn a great deal about a company's future viability during the course of their work. The question is therefore about whether the system should be changed to allow auditors to share this insight by providing more subjective opinions.

Today's audit opinions are not subjective; they are based on a binary 'pass or fail' approach. Some stakeholders ask why auditors rarely qualify the accounts, with the perception being that, if the opinion is unqualified, the auditor isn't sufficiently questioning or challenging management. In practice, auditors give qualified opinions as a last resort once they have exhausted their efforts to work with management and the board to reach a true and fair view. Can this binary approach ever be sufficient to give an insight into the future viability of a company? Perhaps a wider range of 'graduated findings' could be included in the opinion to better reflect the auditor's perspective on each of the significant audit risks.

Of course, there are catches to this idea too. One danger is that even a limited warning about a company's future viability could quickly become a self-fulfilling prophecy – driving a company into the wall faster as creditors, customers and investors take flight. Others worry that subjective opinions could become too woolly to be useful, and that auditors would lose the ultimate sanction of a qualified opinion. Then there is a danger of false assurance – the risk of a new expectation gap emerging by implying that there is more certainty over the future than is possible. Furthermore, any meaningful increase to the level of comfort provided by the audit would also require additional work, and potentially increase the cost of an audit. Taking this route would make trust in the profession all the more important because still more would rely on the sound judgement of the auditing firms and even individual auditors.

Questions for further debate:

1. Would the level of comfort for stakeholders increase or decrease if audits became less binary and more subjective?
2. Could audit reports on future risks trigger a lack of external confidence in the company that becomes a self-fulfilling prophecy?
3. Should the auditor's report reveal more about the risks that they identified in private – or would that lead to a poorer dialogue with the management?

Case study – Beyond historic information: Assurance provided as part of an Initial Public Offering

During an Initial Public Offering (IPO) process, a company produces a prospectus including important information for potential investors. Reporting accountants (auditors, by another name) give a degree of assurance on the financial information included in the prospectus, following a similar model to the statutory audit approach.

However, reporting accountants often provide additional assurance as part of the IPO process, either publicly or behind the scenes. Assurance might be provided on future-looking measures, such as profit forecasts, or working capital projections, as well as on the accuracy of a wide range of non-financial information included in the prospectus.

This model provides a glimpse of how auditors could work differently in the future. The due diligence process carried out as part of the IPO is extensive, detailed and rigorous, requiring substantial levels of time and resource, and is typically much more expensive than an annual financial statement statutory audit but the additional assurance provided is also extensive and more forward looking.

2. Beyond shareholders

Who should the audit be for? Should it still be carried out only on behalf of equity shareholders? Should a wider range of stakeholders be able to rely on the work of auditors?

There has been renewed public debate about whether, in addition to a company's body of equity shareholders, a wider range of stakeholder interests should be taken into account during an audit. Employees, pensioners, customers, suppliers and public officials have been asking whether they too should be able to rely on the statutory audit to give them confidence in a company's financial statements. Concern about whether the public interest is sufficiently represented in the audit is prompting calls for a wholesale shake-up of how auditors are appointed.

Some view this as a red herring. It could be argued that all stakeholders have the same common need: to be sure a company's accounts can be relied upon. Under this reasoning, equity shareholders, creditors, pensioners or employees all have essentially the same expectations of what the auditor should be trying to achieve and no reframing of the audit itself is necessary. But it may be more complicated than that.

When the Joint Stock Companies Act of 1884 first laid the foundations of modern auditing – by requiring that directors report to shareholders via an audited financial statement – it was in response to a growing separation between the interests of owners and managers of businesses as the economy grew more sophisticated. It was a time when booming railway companies required external capital to grow. Investors needed the audit, as they do today, so they could rely on the information being given to them which explained what was being done with their investment. Today many more 'stakeholders' feel they have something at stake too.

While investor confidence in the soundness of a company may be aligned in principle with the assurance required by the other groups of people, in practice their specific concerns and interests may be divergent, creating a tension between different sets of expectations. Creditors, for example, might hope that audited financial statements would give early warning of a risk of default – whereas employees and equity shareholders might stand to lose out if the company no longer has access to lending suddenly. Responding to a series of distinct interests all through one audit could therefore prove more difficult than it sounds.

One current example illustrates the challenge: the impact of Carillion's collapse highlighted the knock-on consequences on customers, particularly in the public sector, where the company managed vital contracts in schools, hospitals and prisons. Yet highlighting to big customers the risks they may face could also have led to a rapid loss of confidence in the company, precipitating an even faster collapse. Trustees of pension funds have yet another perspective; with two-thirds of defined benefit pension schemes in the UK running at a deficit, according to the Pension Protection Fund, any increase in corporate failure rates could pose a systemic risk. When, how and to whom to flag prospective concerns is a matter of finely balanced judgement.

One suggestion that has emerged is to include more stakeholders in the process of appointing an auditor. But as the discussion above indicates, this could create new conflicts as different stakeholders jostle to prioritise their own concerns. An alternative would be to require audit committees to take heed of existing requirements in the Companies Act that already ask directors to take account of the interests of multiple stakeholders. That could prompt them to be explicit in setting an audit scope that was responsive to the needs of different sets of stakeholders.

Either way, an enhanced audit that is required to consider a wider range of risk factors may also end up costing more, with a whole new set of questions over who pays for that.

Finally, there is the question of liability. Increasing the number of stakeholders relying on the auditor's work could increase the risk of litigation, with the potential of making the audit market less attractive. A greater chance of being sued could lead to a more risk-averse approach, just when others are calling on auditors to be bolder.

Auditors are already required to work in the public interest but moves to more precisely define this concept will throw up plenty of tough choices.

Questions for further debate:

1. Does it matter who the audit is for, so long as it does its job?
2. Would the independent appointment of auditors help?
3. If we expand the audit to serve a wider variety of stakeholders, do we also expand the liability of auditors to those stakeholders and therefore make performing an audit riskier and costlier?

Case study – Beyond shareholders: A precedent in company law

Since the 2006 Companies Act, company directors have been required to 'have regard to' a broad range of stakeholder interests.

Through section 172, the act imposes on a director the duty to act in a way s/he considers would be most likely to promote the success of the company and in doing so have regard to the interests of employees, suppliers, customers and other stakeholders. In practice, this can require the promotion of social, environmental and corporate governance measures which may not necessarily be in the short-term financial interests of the equity shareholders.

3. Beyond the financials

What should the audit cover? Today, audit opinions cover historical financial performance, but is assurance needed over other risks and non-financial information?

The risks facing modern organisations are growing all the time, and some of those risks can threaten the viability of the business in ways which are just as consequential as financial performance. Who could have imagined a decade or two ago, for example, that cyber security breaches would be routinely exposing companies to such large and far-reaching privacy risks, regulatory pressures and operational dangers as they are today?

Corporate governance practices, social goals and environmental targets are viewed as ever more important by investors, who see these issues as increasingly integral to the value of the companies in their portfolios. But whether these non-financial factors are on climate reporting, human rights in the supply chain or the sustainable sourcing of goods, how are the claims of management about the resilience of the systems they put in place to manage such issues tested and assured? Of equal concern are the ethics and culture of a company – factors seen as key in preventing fraud and accounting irregularities; whilst external auditors would certainly be aware of these, they are not part of the formal audit scope.

Meanwhile, other financial information given to investors throughout the year, such as press releases and analyst presentations, are also not subject to external audit. Management statements in the front half of the annual report are reviewed for consistency with the auditor's understanding but are not subject to the same level of scrutiny as the formal financial statements in the back half of the report.

Expanding the scope of the audit to cover these types of areas would inevitably require a degree of customisation by sector, or even by company. Take, for example, the reserves data declared by major oil and gas companies. Or, in the banking industry, capital adequacy and liquidity ratios. Few investors would regard these factors as any less important than the figures on the company's balance sheet, so perhaps they too should be subject to external audit?

The audit profession is well placed to respond to demands to broaden the scope of the audit to cover more information, including operational risks, environmental and social metrics and other alternative performance measures. But the profession faces reputational risks of its own if it does so – any expansion in scope of the statutory audit could simply be seen as an excuse to increase fees. The prospect of increasing audit scope also underlines the benefits of maintaining a diverse range of specialist expertise within big professional services firms – something that could be jeopardised if audit practices were separated from their sister advisory businesses.

Finally, there is a question of making sure quality remains high across an increased range of topics. Subjecting the front half of the annual report to the same rigorous testing as the financial pages at the back would require a whole new approach and some wonder if this would mean developing a set of new, commonly-agreed, standards. Others argue it is maintaining the professional judgement of auditors, rather than technical standards, that will be most important.

Questions for further debate:

1. Should the audit go beyond financial information to cover environmental and social commitments and other aspects of corporate governance such as culture and boardroom quality?

2. Would the additional assurance be worth the extra cost?

3. Are there reliable and consistent ways to audit non-financial information in practice?

Case study – Beyond the financials: Sustainability reporting

Precedents already exist for the audit profession to give assurance over non-financial information. In response to growing environmental legislation, for example, many large companies monitor and report on their carbon emissions, and some commission assurance over that reporting. Internationally agreed assurance frameworks have been developed to underpin this type of work.

The stakeholders for environmental reporting are by their nature highly diverse: the regulators, environmental experts and customers who buy products and services on the basis of environmental performance. Commissioning third party assurance over environmental reporting has benefits for companies; it builds trust with those diverse stakeholders, it develops credibility both internally and externally, and gives access to feedback on the effectiveness of controls. Increasingly, shareholders are requiring companies to demonstrate their resilience on non-financial measures – which may lead to greater uptake of these forms of assurance.

4. A different approach for big and small companies

If audit expands in scope, does one size fit all? Should larger listed companies, arguably with the greatest level of public interest, face a greater degree of scrutiny than a smaller, owner-managed business?

As the previous questions demonstrate, there are plenty of calls to expand the scope of the audit, so that it covers a wider variety of risks and metrics. The need for this often focuses on the largest and most complex companies, but the requirements of multinationals and small or medium sized enterprises (SMEs) are not the same. Does substantially expanding the size and scope of the statutory audit risk unnecessarily burdening smaller companies?

All audits today follow the same framework of standards. But there are some differences in how audits are delivered – including the level of 'materiality' and whether the audit is balanced towards testing and relying on a company's controls or the detailed testing of data. There are also differences in the financial statements which are audited; although almost all UK companies are required to publish financial statements annually, the accounts of a large listed company will be vastly more complex and detailed in comparison to the accounts of a smaller and simple private company. This flexibility is designed to allow both corporate reporting, and auditing, to respond to the different characteristics of companies, including the level of public interest in an organisation. Nonetheless, from the point of view of many businesses, the overall regulatory compliance burden is still seen as too high.

Audit standard setters favour a long-established principle that 'an audit is an audit' and that, in the interests of consistency, there should not be a fundamentally different audit process applied to different sizes of entity. However, the principle of a single set of audit standards applicable to all entities has been questioned in the past, and is again under review at a global level, particularly in respect of the challenges to SMEs of the audit requirements. Some have suggested that the international audit standard setter (the IAASB) should write standards using a 'think small first' approach. Under this approach, requirements for small and less complex entities would be the starting point of the auditing standards, and additional requirements for larger, more complex entities would be added on top of that.

Others feel that owner-managed unlisted entities, regardless of size, should not be required to undergo a statutory audit because for such organisations there is no information asymmetry between the managers and the share capital providers. Similarly, some wonder whether there is value in auditing wholly-owned subsidiaries when their results are included within the audited consolidated results of the group.

In comparison, today's vast multinational organisations are increasingly complex and seem intrinsically to require a very different kind of audit to address their risk profile. The degree of assurance that society demands over systemically important companies arguably requires auditors with a huge range of specialist expertise and the highest levels of experienced professional judgement – a world away from what's needed for the routine audit of smaller firms.

Another big question is whether the increasing scope and complexity of auditing is best underpinned by more and more standards, or whether a new, more flexible, approach is needed. Detailed, prescriptive standards can inadvertently undermine audit quality rather than enhancing it by promoting a focus on compliance with the rules – a 'tick the box' mentality – which can supersede thoughtful application of professional judgement.

Perhaps if the standards were less prescriptive and relied even more on a principles-based approach, they could be applied differently to reflect the different sizes, complexities and circumstances of companies.

Questions for further debate:

1. Should the nature of an audit be determined by the size, complexity and nature of an audited entity?

2. Should the nature of an audit depend upon the public interest or potential impact on broader society if the company were to fail?

3. Does an expanded audit require more standards-setting or would a principles-based approach work better?

Case study – A different approach for big and small companies: Applying materiality thresholds

"Materiality" is the threshold at which financial information becomes relevant to the decision-making of the users of financial statements.

The auditor's opinion deals with the financial statements as a whole and therefore the auditor is not responsible for the detection of individual misstatements that are deemed too small to be material.

The size of the materiality threshold has a significant impact on the scale of information that falls within the scope of an audit, and the number of misstatements that may or may not be uncovered. The materiality threshold is ultimately the judgment of the auditor, and International Standards on Auditing (ISA (UK) 320) set out factors that may affect the materiality benchmark used, allowing the auditor to use their professional judgment in their application of materiality. This includes the nature of the entity, where the entity is in its life cycle, and the industry and economic environment in which the entity operates, allowing the auditor to be flexible in their application of materiality and enabling the benchmark and threshold to reflect the size, nature and potential risks. There are also qualitative aspects to materiality, i.e. an item which is small in the context of the financial statements could still be material (such as a related party transaction).

5. Technology reshaping auditing

How can technology enhance auditing? What are the possibilities for automated assurance and real-time analysis? In an automated audit, what will be the role for human judgement?

Technological innovation is moving at pace. Businesses are capturing increasingly vast volumes of information digitally, and new techniques are being developed to convert the non-digital to digital. This means that there is the possibility that with the right investment and forward-thinking regulation, real-time automated assurance of transactional data flows could become a reality. Instead of testing a small sample at a single point in time, there is the potential in the long run for constant, automated auditing.

Already, in recent years, there has been a huge advance in the technology which auditors use following significant investment by leading firms. Technology used in practice today ranges from Robotic Process Automation (RPA) applications which automate simple audit processes, to applications that use artificial intelligence to analyse an entire year's general ledger in the blink of an eye. Technology is also being used to convert unstructured data into structured, consumable data, a previous barrier for automating some audit areas.

New data analysis tools are allowing auditors to move from sample testing to evaluation of an entire population of transactions – flagging exceptions and areas of concern quickly.

These tools enable auditors to visualise the data in many different ways, such as by supplier, transaction date or amount – thereby increasing the chance of spotting trends or irregularities. The effectiveness of these tools is enhanced by the inclusion of external data – enabling auditors to make comparisons with peer group companies, for example, again enhancing the identification of anomalies. Many tools are now powered by machine learning, so that their audit effectiveness increases the more they are used. Together these innovations are set to radically transform both how the audit is delivered and possibly even the nature of the audit itself.

This technology is expensive and is currently being developed primarily by the large audit firms. It is changing both their own operational processes and their service offerings to clients. As a consequence, it presents a challenge for emerging players in the sector because it further increases the relative capacity of the leading firms and acts as a barrier to entry for smaller competitors. Some have asked whether, if there were a requirement to share such technology, it would serve to open up the industry or if, instead, it would disincentivise further investment in tech innovation.

As we look further into the future, we might also begin to ask whether audits in their current form will be needed at all. Theoretically, companies could install independently verified audit software and use that as a base for providing their own assurance to the outside world.

On the other hand, it is equally possible that these visions of how a technology-led future might unfold are distracting the profession from today's pressing issues of audit quality. The sceptics would say that the 'driverless' audit is many years away and may never actually happen – and that the profession is not answering the big questions of today that are most important to making the audit fit for purpose now.

While the delivery of tomorrow's audit may be different from today's, it seems unlikely that technology and the automated auditing of transaction flows will ever provide the full solution. So whatever the truth of technology's eventual promise, it seems important to remember that an audit will probably always include, at its heart, plenty of human judgements – and that will require trust in the audit firms responsible.

Questions for further debate:

1. Will real-time audit work in practice and is it desirable?
2. If automation is achieved at scale, what will be the human role for audit opinion and judgement?
3. How can the profession ensure there is trust in the technology 'black boxes'?

Case study – Technology reshaping auditing: Drone-assisted stock counts

One of the more unusual applications of new technology in the field of auditing relates to the use of drones to help quantify physical assets held by companies. In late 2018, PwC UK experimented with undertaking a stock count of coal reserves using a drone.

The machine, which was manufactured and operated by UK drone company QuestUAV, was used to capture over 300 images of the coal reserve at one of the UK's last remaining coal-fired power stations, Aberthaw, in South Wales, owned by one of Europe's largest energy firms, RWE. The images from the drone were used to create a point cloud 'digital twin' of the coal pile in order to measure its volume. The value of the coal was then calculated to within 99+% accuracy based on that volume measurement.

Though the figure used in the final audit was still calculated using the old-fashioned method of clambering over the coal piles with human stock counters, the experiment was carried out as part of a drive to harness emerging technologies to enhance audit quality and efficiency and transform the audit process.

6. Driving audit quality

Does everyone agree on what constitutes audit quality? How can it be observed? Can the profession ever eliminate all audit failures?

Confidence in the system of auditing in the UK has been dented by events over the last 18 months. Thousands of audits are successfully carried out every year and problems are rare. But this is a system that relies on trust. It matters to everyone – not least to the accountancy profession – that there is a relentless commitment to improving audit quality and an openness to reform.

It is not necessarily clear that everyone agrees on what constitutes a high-quality audit. Though a number of different stakeholders have sought to define audit quality, no single definition has emerged. Common elements include: “arriving at the right opinion”, “basing it on objective judgements” and “having gathered sufficient evidence”. It is notable that these elements are closely linked to the narrow audit product, rather than the broader role of audit in the corporate reporting ecosystem. Given that recent crises have led to a deterioration of trust in corporate reporting, it could be time to consider a broader definition of audit quality – successful audits could be those that restore trust in corporate reporting, enabling users to make better decisions.

The lack of a common definition can make the observation of audit quality challenging. Regulatory inspection results are often used as an indicator of audit quality. But these inspections are usually based on a review of completed audit documentation which, whilst important, can never capture the day-to-day reality of a challenging audit. Perhaps real-time reviews could give more insight?

As the profession works towards an ever-improving standard of audit quality, it’s also important to reflect on the ultimate objective. Despite the introduction of transformational audit technology, much of audit remains a human endeavour. Human auditors, however well trained, supervised and motivated, will always be at risk of making mistakes.

Responding to past mistakes has already prompted a lively debate over possible structural reforms to the sector, which are designed to address conflicts of interest and choice, as well as improving audit quality. Many different views have already been expressed on the merit of the recommended remedies, but the issue of what a “good” audit looks like has been largely missing from the conversation.

Why does this matter? Is developing a common understanding of audit quality just an interesting intellectual exercise? Some might argue that if agreement on a definition is reached, then work to improve audit quality will be more focused. Regulators could better observe the indicators of audit quality, and therefore direct their supervisory efforts more effectively. And a shared view of audit quality throughout the marketplace could increase the level of competition based on audit quality.

Questions for further debate:

1. Will different stakeholders ever agree on what constitutes a high quality audit?
2. How can the profession learn from past audit failures to make sure the same mistakes do not happen in future?
3. What is the right interplay between quality, competition and regulation?

Case Study – Driving audit quality: Sarbanes-Oxley reforms

In the wake of a series of UK specific corporate failures, it is easy to forget that the questions swirling around the audit industry are not new or unique to this country. Following the 2001 collapse of the Houston-based energy company, Enron, and other corporate failures including WorldCom and Tyco, the US auditing profession came under very similar scrutiny. Concerns about market concentration also ensued after Enron's collapse led to the demise of its auditor, Arthur Andersen.

The political backlash that followed in Washington led to sweeping federal reforms that were initially controversial but have been more recently acknowledged by some to have improved audit quality. The legislation sponsored by Democratic senator Paul Sarbanes and Republican congressman Michael Oxley contained significant sanctions for companies and audit firms who failed to comply.

As well as requiring companies to take responsibility for the quality of their own internal controls, the legislation established a new and powerful audit regulator, the Public Company Accounting Oversight Board (PCAOB) which has become a respected and feared institution in the industry.

Share your views

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futureofaudit@pwc.com
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