Defining the Audit of the Future

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Traditionally, auditors have opined on historical financial results and select areas of internal controls and compliance. As a part of this process, auditors have relied on management representations in many areas and worked on the assumption that the primary purpose of the audit is not to detect underlying frauds. Further, while auditors have looked at assumptions around the ability of the company to continue as a going concern, this responsibility has been somewhat restricted by the auditing standards.

Over the last few years, there has been a growing feeling, both in India and globally, that as gatekeepers for maintaining the integrity of corporate reporting, auditors could and should do more. This has also, at times, resulted in a gap between what auditors are responsible for, and what stakeholders expect from them. While there is a case to deal with this expectation gap through increased communication and awareness, this may not be enough. What may be required is to redefine the Audit of the Future to ensure that auditors play their critical part in maintaining and enhancing the integrity of the financial markets and the economy at large.

Getting the basics right

At a fundamental level, auditors need to demonstrate independence from management, and a heightened sense of professional skepticism – both in form and substance. This would require a change in mindset whereby the 'client' of the auditor is not just the management or the Audit Committee, but the entire wider group of stakeholders comprising investors, lenders, employees, regulators, and other relevant market participants. Auditors would need to ensure that the culture within their organizations recognizes that performing high-quality audits is their primary objective and that auditors are accountable to this wider set of stakeholders. Further, auditors would need to invest appropriately in talent and tools to achieve this basic objective.

Enhancing the scope of the audit

Given that several stakeholders now expect auditors to detect frauds (particularly the large ones) and to highlight risks around corporate failure, there is an urgent need for a discussion to determine how the scope of an audit can be enhanced to achieve these objectives. Investors, lenders, regulators, and auditors all have an important role to play in the debate, and in determining the enhanced scope.

Evolving with changes in corporate reporting

The focus of corporate reporting is changing from just financial reporting to more holistic and integrated reporting. Companies are increasingly communicating with their stakeholders in the areas of 'Environmental, Social and Governance' (ESG) considerations and non-GAAP Key Performance Indicators.

ESG considerations such as environmental pollution, human rights, green technology, and carbon footprint are of interest to wide range of users, including non-shareholders. Many companies are disclosing their ESG goals and their journey in their corporate reports. Currently, there are different frameworks available for this reporting with a growing emphasis towards standardization. For example, efforts are being made in this area through the work of the IFRS Foundation towards forming a new International Sustainability Standards Board, which would develop globally accepted sustainability standards.

Many companies also present non-GAAP information around Key Performance Indicators in their corporate reports and investor presentations, as it provides supplemental information to the financial reporting and disclosures. These measures help in communicating a company's business story or medium to long-term strategy.

Investors and stakeholders expect that all such disclosures should be transparent, accurate and fair. Also, they need to be presented consistently and provide comparability. Currently, for the most part, investors and other stakeholders end up relying on information disclosed by the company in these critical areas without any independent verification. Given the increasing importance of these disclosures, auditors would need to step-up to provide assurance in this area. This is likely to enhance the trust and confidence in such information. As a step in this direction, in April 2021, the International Auditing and Assurance Standards Board issued guidance on 'Extended External Reporting' which marks a significant development in supporting assurance for such disclosures.

Embracing technology

Companies and the world at large have digitized at a scorching pace. This digital transformation is pervasive and cuts across almost all areas of a company's operation. This requires a significant shift in the use of technology by auditors. It is impossible for auditors to perform high-quality audits using the same approach and tools that they used in the past. Auditors would need to invest significantly not just on basic auditing tools and workflows, but more advanced auditing technology. Through use of technology tools auditors can move away from the traditional way of auditing based on selecting samples, to auditing entire populations of transactions to identify exceptions. Similarly, use of Data & Analytics and process mining tools can identify outlier transactions that require greater scrutiny by the auditor. While auditors have historically relied on information from within the organization, technology can also enable auditors to leverage information available outside the organization such as external signals or data points, including those on social media, as a part of the audit process. At the next level, new technologies such as cognitive and Artificial Intelligence can also be leveraged. It is likely that audit firms will rely on a combination of internal skills and external alliances (including with start-up technology companies) to bring this to life.

Boards and management would expect auditors to leverage technology, not just to provide a higher level of assurance, but also to make the audit more efficient, and to provide deeper insights. Further, regulators would also come to expect auditors to have deployed technology and analytics tools to enhance coverage and increase the effectiveness of audits.

Developing a more diversified talent pool

Historically, audit firms have attracted and deployed qualified chartered accountants or professionals with similar qualifications. Going forward, to meet the enhanced expectations and responsibilities, this talent pool would need to get more diversified. For example, an audit firm would need forensic & ESG resources to better address fraud detection and provide an assurance on ESG disclosures respectively. Similarly, given the pervasive use of technology and analytics, audit firms would need to attract and deploy technology professionals, including data scientists and resources with knowledge and experience of emerging technologies.

Given the war for talent, audit firms would need to ensure that through a focus on extreme automation along with use of delivery centers (where routine audit processes can be streamlined), experienced audit field staff is able to focus on areas that are more complex, require the use of judgment and involve management interaction. This is required to ensure that qualified professionals find the audit profession fulfilling and attractive.

Finally, this talent pool would need to be geared to not just perform a technically high-quality audit, but also to communicate effectively with the diverse set of stakeholders that the auditor will serve.

Conclusion

Given the importance of the audit function to the financial markets and the broader economy, it is critical that all relevant stakeholders – auditors, regulators, investors, management, Boards, and society at large, accelerate the debate on the Audit of the Future, and initiate the required changes. Regulators, investors, and auditors need to take the lead to facilitate the required regulatory changes. In the interim, progressive companies need to consider voluntarily subjecting disclosures to extended assurance, and audit firms should step-up their investments in technology, talent, and in building the right culture. This is essential to maintaining the integrity of corporate reporting, trust in the financial system, and relevance of the external audit function.