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In order to assess the future of the auditing profession in perspective, one has to first judge where the profession is at present. This effort will be further strengthened if we look at the past of auditing and its origins. The need for auditing was felt when the agency concept in business arose. The entrepreneurs who were trading or were engaged in crafts, or were doing manufacturing with their own funds, did not really need to present periodic financial statements to others. However, as society got more complicated and business evolved into different forms, and grew in size, a system developed by which investors gave their money to an entrepreneur to run an entity on their behalf, bankers started lending money to businesses and the government as a stakeholder started collecting taxes. Therefore, a need arose for greater accountability. Such accountability was created by bringing in a structure of laws. But it was also created by the development of an institutional set up as it was felt that greater assurance was needed - an assurance that the financial statements as produced by the entrepreneurs, as agents, who were also accountable to the Revenue authorities for a share of their profits by way of tax had been examined by an independent outside agency. These independent outsiders were auditors. Therefore, auditing evolved as a service to give reasonable assurance about financial statements. Auditing did not evolve out of legislation. Auditing evolved because of a social contract that those who were handing over their money to others for use in business needed an extra layer of assurance and accountability for the use of their money.

This is the origin of the auditing profession. The profession started getting organized in the 19th century and firms of auditors started rendering service. In its initial years the auditing profession was not very strictly monitored by the regulators. It had developed a form of self regulation which is continuing even today.

As businesses have grown in size and complexity and have gone multinational, as shareholder and lenders have poured in very large sums of money to run giant companies, the demands on the auditing profession have increased and the auditing profession has strived to meet these expectations. The question however arises whether the auditing profession has kept pace with what has happened in the business environment, with what has happened in the global economic scenario or whether the auditing profession needs to reinvent itself. To answer this question, one has to closely look at what is happening in the auditing profession.

The first feature to stand out for the auditing profession is a unique characteristic of the profession – the manner is which the rendering of service is concentrated. There are a handful of auditing firms which control the audit services rendered around the world. Statistics shows that in the UK, 100% of the FTSE companies (these are the largest listed companies in the UK) are audited by only four auditors. 92.4% of the FTSE 350 companies (this includes the next largest companies in size) in the UK are audited by the Big Four auditors. In the US in a survey carried out in 2020 of the Fortune 500 companies out of 457 top companies that were examined it was found that all of them were audited by the Big Four firms. In India the statistics for 2018-19 suggests that the companies that make up 75% of the market capitalization in the stock exchanges are audited by the Big Four firms. This is a unique feature of the auditing profession. The other professions – medicine, advertising, legal, IT, architecture, – are not characterized by this concentration. This level of concentration of service providers among only four firms has to be kept in mind in order to understand the present situation of the auditing profession and the future direction.

If we look at how auditors have performed and especially look at the performance of auditors in large audits, which it is well understood are done by only by a handful of auditors, it is found that there have been recurring audit failures. The world was shaken by the failure of Enron. But did that bring a fundamental change in the profession? The answer is no. The Enron scandal took place in 2001. There have been audit failures in WorldCom (2002), there have been audit failures in Tyco (2002), there have been audit failures in Health South (2003), there have been audit failures in Freddie Mac (2003), there have been audit failures in AIG (2005), there have been audit failures in Lehman Brothers (2008), there was the Bernie Madoff scandal (2008) and in India we had the Satyam episode in 2009. All these have been failures of large dimension. The world has also been shaken by audit failures in Parmalat, Qwest, Global Crossing. The list is really too long and the length of the list itself is scandalous. All these audits failures have continued unabated. In popular journalism, these are called scandals, accounting scandals --- but in effect these are failures of the auditor to understand the financial statements and to issue an appropriate assurance report for corporates which have not been presenting their financial statements properly.

Unfortunately for the corporate world, as well as for the auditing profession, there has been a spike in audit failures in recent years. If we look at the UK we shall find that Patisserie Valerie had a fraud in their accounts, there was a black hole of £94 million, which a major firm of auditors could not detect. If we look at Carillion, the large builder, we find that four major audit firms had earned more than £72 million in fees from this company in the 10 years before it failed. When it failed, there was a job loss of more than 2300 persons and there was a black hole of £845 million in the accounts. The auditor had failed to identify "terminal failings in risk management and financial controls or too readily ignored them". If we look at Conviviality, the auditors did not sound any alarms. However, the profit warnings said that profits had dropped because of a "spreadsheet arithmetic error." If we look at Rolls Royce, we find that it paid a penalty of £ 671 million pounds to settle prosecution in a corruption case and an investigation was opened into the conduct of this audit by a major firm. If we look at the Mitie group it had to take an £88.3 million financial hit. However, the auditors had not sounded any alarms. If we look at British Home Stores, which was purchased by a new promoter for £200 million pounds in 2000 and was sold for only one pound in the year 2016, the closure of which led to 11,000 jobs lost and a pension deficit of £571 million, the auditors had kept strangely quiet. There are other instances like Ted Baker, Quindell, etc, which have similar stories to tell. Apart from this dismal scenario, in just one country, the failures of Wirecard in Germany, the proceedings against the auditor by the Singapore oil trader Hin Leong Trading Limited are further examples of audit failures across the world. In the USA, a century old company like General Electric, in which one major firm had continued as an auditor for over 100 years $22 billion of non cash charges cropped up and GE's market value fell by over $200 billion over two years. I could go on giving such examples -- Nikola in US, Direct Lending LLC in US, the Gupta scandal in S. Africa, Luckin Coffee in China, Wells Fargo in US, problems of a major firm in Bermuda, Mexico and in Oman, problems in Cooperative Bank PLC, problems in Lloyd Syndicate etc. This could go on and on and on.

For the process of peer review, done in the US, the PCAOB carried out a subsequent study of peer reviewed firms and found major deficiencies in the process of peer review. Whereas the peer reviewers had given 99% of the 100 biggest firms as getting pass rate, the PCAOB found that 25% +firms had serious deficiencies and in the biggest 20 firms, the deficiency rate was between zero to 80%.

The findings from the review of audit quality done by the regulators are also significant. The PCAOB 2019 report in the US found that in the audits done by the Big Four firms, there were serious deficiencies. One Big Four firm had serious deficiencies in 20% of the audits they carried out. The second one had 23.6%. The third one had 27.3%. And the fourth Big Four firm had deficiencies as high as in 50% of their audits. In the December 2020 report published by PCAOB, it was seen that 30% of all audits of the Big Four firms had significant deficiencies. In the UK, the situation is not much better. The CEO of a major audit firm stated in 2019 that it was not his firm's job to uncover fraud. He stated "we are not looking at fraud, we are not looking at the future, we are not giving a statement that the accounts are correct". When the regulators carried out a review of the audits done by this firm, it was found that in the last five years, more than 25% of the audits carried out by this firm needed "significant improvements". It is further revealed that only 75% of the samples of audits drawn from among Britain's 350 largest listed companies for the year ended December 2017 met quality standards. The regulators said "At a time when the future of the audit sector is under the microscope, the latest audit quality results are not acceptable. The most common failure was the auditors failure to challenge management sufficiently".

Let us look at the position in India. The question of audit failures in India has come to the forefront after the National Company Law Tribunal has started sending companies into liquidation or effecting change in management. The process was kickstarted in 2017 when twelve large companies were sent to the National Company Law Tribunal at the behest of RBI. Since then, the process of referring sick companies to the NCLT has continued till it was brought to a halt because of the pandemic and the NCLT has been using its powers either to carry out a resolution process by change of promoters or by sending the company into liquidation. The results of the reference to NCLT of these companies has been an eye opener. It has found that banks which had lent to these companies on the strength of the security, on the strength of the asset values had to take an average loss of 60% when these cases were either resolved or when the company went into liquidation. The February 2021 report which updates such figures stated that the debt recovery rate up to September 2020 was only 20.9% out of total claims of Rs. 10.48 lakh crores. The realization amount was Rs 2.2 lakh crores, What do these figures reveal? It reveals that the value of assets based on which the companies carried on operations, the value of assets based on which the bankers lent money, the value of assets based on which creditors extended credit were not worth the figures at which they were carried in the financial statements. This reveals that when the companies stopped generating cash, the alternative model of asset pricing as envisioned in the Accounting Standards were not followed. This is a massive audit failure in India. Till January 2020, 823 companies were sent for liquidation under the NCLT process. Only 6.67% of admitted claims were realized. This is something which has brought to light the fact that the Accounting Standards were not being followed for asset valuation and the auditing standards were not being adhered to by the auditors. In many of these companies, even when the going concern issue was flagged, asset valuation was not corrected.

In India we have also had major audit failures in the NBFC sector. Two large NBFC have collapsed and the regulators are looking at the role played by the auditors.

This spate of audit failures across the world has sensitized the corporate world to the fact that there are inherent deficiencies in the audit process as it is carried out today. Many views have been expressed, many surveys have been conducted and a kind of consensus has emerged about what the current deficiencies are. The Chairman of the Competition and Markets Authority in the UK in a statement that has created the backdrop for all these views and findings on these deficiencies. has said “People’s livelihoods, savings and pensions all depend on the auditors job being done to a higher standard. But too many fall short -- more than a quarter of big company audits are considered substandard by the regulator. This cannot be allowed to continue”. The various specific issues and deficiencies which have been identified in debates and surveys across the world are:

* The samples checked by the auditors are too small.
* Auditors are not capable of using sophisticated technologies for data gathering and analysis in large auditee organisations.
* Auditors are incapable of leveraging analytics into actionable insights and use the conclusions to challenge management assumptions.
* Auditors do not engage in assessing risks and evaluating risk management practices.
* Disclosures on Key Audit Matters are not effective in creating transparency about how auditors arrive at audit conclusions and what the learnings from the audit process were on the state of the organization.

In a speech given on 16 November 2016, the then Chairman of IFAC stated:

- ❖ The auditor should understand the business of the auditee and the value it is supposed to create.
- ❖ The auditor must have much greater amount of professional skepticism and they should critically challenge management assumptions to a much higher degree.
- ❖ The auditors have not yet adapted to the digital age.

There have been also findings that the audit function will not improve unless the auditors automate their audit procedures to a much greater degree, unless they are able to comment on financial statements which are more predictive and unless audits are done in such a manner so that data is validated on a real time basis throughout the year.

However, the biggest question which has been raised is of auditor independence. When a single firm or a single conglomerate of firms renders non-audit and audit services to the same client or to the same group of clients, when it is seen that the non-audit services are more lucrative, when it is found that there is clear cross subsidasation of the audit services by the non-audit services, the question arises, can the auditor be truly independent? The crux of the matter is the auditor becomes dependent on the client and becomes incapable of exercising an independent opinion.

Questions have also been raised about the auditors' adaptation to increasing digitalization of the corporates. It is possible today for the auditor by using data mining techniques and analytical techniques to examine all of the data generated by the client. The question therefore arises, why should the auditor only give reasonable assurance? Why should the auditor not be able to give complete assurance?

Questions also has been raised about the auditors' present reluctance to face the issue of fraud squarely. If the auditor does not take responsibility for uncovering fraud, the basic utility of audit comes into question.

There is also the issue of language of the audit report. The language is to a great extent unchanged for over a century and the summary of observations ends with "true and fair" with or without an emphasis of matter or ends with a modified opinion. Adverse opinions and disclaimers are very rare. Laymen ask, "Why is the auditor not being forthright in expressing an opinion on the affairs of the company? Is he hiding behind verbiage"? The views on the language of the audit report can best be expressed poetically which follows:

The Accountant's Report

We have audited the balance sheet and here is our report:

The cash is overstated, the cashier being short;

The customers' receivables are very much past due,

If there are any good ones there are very, very few;

The inventories are out of date and practically junk,

And the method of their pricing is very largely bunk;

According to our figures the enterprise is wrecked…..

But subject to these comments, the balance sheet's correct.

The suggestions on and criticisms of the audit profession have also led to increased scrutiny of the way the auditing profession is organized. This scrutiny reveals certain facts. Firstly, because of the concentration of services by a handful of firms, there is obvious lack of choice and the firms at the top are really indistinguishable from one another. Secondly, the gap between the top four firms and the next 20 which follow them are very large. The next 20 firms if aggregated will not add up to the size of one of the top four. Obviously, the situation below the next 20 is even worse. As a result of this distortion, firms which could be an alternative to the Big Four have not been able to build up capacity, or attract talent. They have not been able to create a convincing story that they can position themselves as an alternative. Thirdly, self regulation of the profession has failed to a great extent. There has been uninterrupted self regulation for more than 150 years. This has failed and the regulators and the Governments are increasingly taking a proactive role in the affairs of the profession.

There is also on the other hand, what the auditors have to say. They say that the expectations from the audit profession are too high. They say that it is the expectation gap which is working against them. And it is not in their mandate to meet the expectations that society at large has from them. The auditors say that they are underpaid and have to bear rising costs. The auditors are saying that while the risks and accountability are being increased, while the auditee organisations are getting more complex, their audit fees remain unchanged. The auditors say that there is a lopsided management- auditor power equation and the auditors are the least powerful among the various corporate stakeholders. All these issues, however get overshadowed by one issue that the auditors do not wish to grapple with. And that is the issue whether the audit mandate as it is framed today is sufficient. The heart of the issue is if the auditor continues to do what he is doing today limiting the scope of his assurance services to a great extent does it meet the needs of today's economy? Will the social contract which created this assurance service survive?

All the above has led to a move to reform the auditing profession. India has set up the NFRA which has assumed major powers in laying down standards and in regulating the profession in various ways. The Reserve Bank of India is taking proactive step in overhauling the systems of audit of banks and or NBFCs including private sector entities.

Major reforms are underway in the UK. It is possible that the efforts being made in the UK will determine the way auditing profession will go.

A review was done of the Financial Reporting Council of UK by Sir John Kingman in December 2018. In the report it was stated that:

“There continues to be a difference between public perception about the auditors’ ability to detect financial statement fraud and the auditors’ responsibility relating to fraud under the existing professional standards.

Users of corporate financial information also point to a gap between the information they believe is needed to make informed investment and fiduciary decisions and what is available to them through the entity’s audited financial statements or other publicly available information.”

The report also has major recommendations on how the regulator should monitor audit quality.

This was followed by a Statutory Audit Services Market Study by the Competition and Markets Authority published in April 2019. Its recommendations included split between the audit and non audit business of major firms, greater regulatory oversight of the committees that run the selection process of auditors. There was another report by the UK Government by a Select Committee entitled the “Future of Audit” report. This report highlighted the conflict of interest arising from the rendering of non-audit services by the auditors affecting auditor independence. It quoted the CEO of the Institute of Chartered Accounts of England and Wales saying that there was “a palpable crisis in public trust” in the audit profession which required “fundamental change if trust was to be regained “

The report recommended auditors reporting compulsorily how they have investigated potential fraud, strengthening the audit of and reporting on going concern assumption and viability statement, auditors being compulsorily asked to make a presentation at the AGM to show how they have challenged management and exercised professional scepticism to underpin the audit opinion. Based on the findings of these Committees and based on independent reviews Sir

Donald Brydon, the former Chairman of the London Stock Exchange published in December 2019 a comprehensive review of the auditing function and the audit profession.

The review started most emphatically by saying, “Starting point of this report is audit is not good enough.”

It then went on to say: “Audit is not broken but it has lost his way.”

The report proposed a new definition of auditing:

“The purpose of an audit is to help and maintain deserved confidence in a company, in its directors and in the information for which they have responsibility to report including the financial statements. Such a purpose should reinforce audit as a public interest function that demonstrates more than just compliance with laws and rules.”

It pointed out how auditors were shying away from giving information to shareholders. It stated: “In hiding behind the need only to confirm and verify, many auditors have failed to grasp the opportunity to make their reports more informative. Many do take this opportunity in private, communicating well beyond the narrow confines of auditing statements, when reporting to audit committees, but not to shareholders.”

It pointed out major areas in which auditing needed to change. These were:

- There needs to be a fundamental shift in definition and approach to ensure that the auditor informs as well as confirm and verify. This will mean sometimes going beyond the information contained in the statements of the director.

- A new reporting duty should be cast on directors to set out the actions they have taken each year to prevent and detect material fraud. The auditors are to comment on the discharge of this duty by the directors.

There was major thrust on auditors being required to provide more information. The report stated:

- The standard verbiage of an auditors' opinion says absolutely nothing to the effect that auditor is providing assurance that the financial statements are providing decision useful information.
- Auditing should provide information that is useful to present and potential investors, lenders, creditors and other users in making rational investment, credit and other decisions and assessments about the company.
- Auditors should be free to include original information materially useful to a wide range of users in their audit report and at the AGM and not be confined to commenting on what has already been stated by the directors.

The principles of corporate auditing should include a statement that auditors act in the public interest and have regard to the users of their report beyond solely those of the shareholders.

The report also questioned the use of the term "true and fair". It stated:

"There is a challenge in using "true and fair" as a descriptor of financial reporting given that corporate accounting increasingly involves the use of estimates and judgments. Together with the fact that the audit intends to provide assurance that the company accounts are free of misstatements, it is difficult to see how either directors or the auditor can communicate effectively that modern company accounts are true."

In the recommendation part the report called for setting up of a new profession of auditors. It stated: “Auditing is too important to be left to be an adjunct of another profession. It should be an independent profession in its own right. At present, it is an adjunct of the accounting profession. Audit would not be just part of an accounting landscape, nor necessarily the purview of accountants alone. Accountants may be professional auditors but the definition of an auditor needs to be redrawn and accountants need not be the only professional auditors. There will be different levels of assurance given by different auditors depending on the field of activity covered and the brief given to the auditor by the audit committee. The profession should encompass all corporate auditors including the statutory auditor of the financial statements and auditors of other corporate information, for example, information covering cyber scrutiny or related to environmental measures. Some of the corporate auditors may come from traditional audit firms but others may come from new specialist audit entities”.

The report was harsh on the tendency to blame the expectation gap to answer criticisms levelled at auditors. It stated: “Many talk about the expectation gap. We have to add a performance gap, a knowledge gap, an evolution gap, a hindsight gap, a quality gap, a misperception gap, a methodology gap. Also an education gap and a delivery gap. This focus on the expectation gap is a distraction. Either audit is helping to reinforce confidence in business or it is not. What is required is better audit delivered by professionals in a more understanding framework”.

It is clear therefore that widespread reforms in the auditing profession have started in the UK. The British Parliament has taken on record these suggestions and legislative changes are on their way.

In the light of all the developments in the auditing professions three trends are clearly visible:

- The process of audit needs major reforms across the globe. Audits cannot continue the way they are being done today. If the present quality issues in audits persist -- these really not being quality issues, but systemic flaws in the auditing profession -- the social mandate which created the auditing profession will break down.
- The resulting reforms will lead to a redefinition of the audit function and changing the mandate of the auditor.
- Increasing digitalization and the large volumes of data which are being generated by corporates will permanently change the way auditors carry out their work.

In the light of the above trends, what are the predictions for the future? How does one see the future of auditing? My predictions will be:

- The era of self regulation of the auditing profession is gone forever. The auditing profession was for over a century regulated and governed by respective Institutes in their countries, by international standard setters which are associations and committees made up by these self regulators. Their mandate is now losing force. Organizations like the Institute of Chartered Accountants in India are fast losing their relevance in regulating the auditing profession and will continue to do so.
- Regulators and Governments will step into this vacuum. They will increasingly take on the role of monitoring of audit quality and will take action if audit quality is found lacking. It is inevitable that regulators and governments will interfere in the appointment of auditors. In India, the Reserve Bank of India has already made a

beginning by issuing new regulations for appointment of auditors in banks and NBFCs and more of this is likely to happen.

- Entities that do not require audit mandatorily will see little utility in audits and will opt out of the auditing system. The financial statements of these entities will no longer be audited. This is already happening around the globe. And a move has now been initiated in India to exempt smaller companies from audits.
- Audit reports will be much more informative than they are today. Audit reports will have to give information to the public at large which will help in taking decisions about the company. The disclosure of Key Audit Matters is just the beginning. Auditors will have to disclose much greater information on the affairs of the auditee, the way the entities are run, the outlook for the future and the process by which the audit was carried out. Such information will be beyond the information disclosed by directors.
- Audit reports will have to cover non financial areas as well. ESG reporting has started across the world, Auditors will have to cover the disclosures made in such reporting in their assurance services. Cybersecurity will also be another area for coverage by the auditors. This will require audit teams to be made up by not only accountants, but also with experts from other disciplines.
- A very major change in the way audits are done will be brought about by increasing digitalization of corporates. The volume of data being continuously generated on a day to day basis by the auditee entities is enormous. Much of the time of the auditor goes in validation of this data. My prediction is that sooner or later, the continuous validation of this data will no longer be the prerogative of the auditors, but will be handed over to specialized IT service companies. Today data is being generated in such a way that it can be sent into the cloud, data aggregators can put the data in a form that it can be readily

analyzed and there is no reason for such data to be put up for examination only at the time of periodic audits and reviews. My prediction is this all data being generated by the corporates will be validated on real time basis by specialized agencies. And their findings will be relied on by the auditors as the work of an outside expert in order to form a judgment on the financial statements and other matters, on which the auditors have to issue a report. This will enable auditors to give much more than “reasonable” assurance which they are giving today. Much of the work done by the auditors today goes into data validation. This work will shrink. Auditors will be free to apply their minds on judging appropriateness of accounting policies, in judging the adequacy of disclosures, in choosing relevant information to be disclosed and in forming an opinion on the presentation of financial statements. It is therefore my prediction that the auditing profession will be split. And much of the work which is being done by auditors today will go out of the auditing profession, and will go to specialized agencies.

- Auditors will no longer be able to get away by saying that they are not responsible for frauds and errors. The testing of systems which prevent such frauds and errors, the detection of frauds and errors will be very much a part of the auditing mandate.

These are my predictions for the future of auditing. As businesses evolve, their needs will change and the social mandate which was drawn up many years back will necessarily undergo transformation.