

Shadows on the wall of the cave

Plato's image of human existence – that we do not see reality but are locked in chains in a cave and are only able to view a shadow play on the wall, illuminated by the flickering light of a fire and unable even to imagine the pleasure of leaving the cave and seeing daylight and real life – is not a popular one these days. We are so very confident in the reality of our current existence, and the gaudy pleasures it brings, that the image seems just as much a tarnished historical artefact as a battered shard of pottery from the same era.

It is still a useful image in some ways, however. Often as a shareholder, we feel like the people trapped in the cave, seeing corporate performance and behaviour only darkly. Except that we are well aware that there is a world of light out there somewhere and we are constantly hoping that a little more of that light will enter the cave. Work on improving disclosure standards is a constant effort for engaged shareholders, both at the individual company level and also with national and international regulators.

The image seems particularly relevant with regards to auditing. We as shareholders pay for audits and yet we see almost nothing of substance from them. This is even less acceptable given that while shareholders pay and are in fact the client for which the auditors work, the profession instead tends to call the audited companies their clients – despite the fact that auditors need to maintain their independence from them. The typical Auditor's Report, and these are pretty standard documents across the world, is a defensive one, focusing more on what the auditor does not do than on what the auditor has done. The descriptions of the activities in an audit are wholly boilerplate and are more designed to lower shareholder expectations of what might come from an audit than to offer real value in themselves. This is all driven by a fear of litigation. The result is that the Auditor's Report is generally not worthy of the name: in almost all cases only the final sentence amounts to a report on what has been revealed through the audit work, and this amounts to a simple tick or cross. It does the profession a disservice.

We are told that a great deal lies behind that simple tick or cross; we are told that many accounts are improved through the audit process and that the threat of gaining a cross from the auditors has helped win significant changes which enable the ticks to be in the vast majority. But we, locked in chains in a cave, looking in a single direction, see only the simple shadow of a tick or a cross projected on the wall.

There must be an opportunity for more to happen, for more daylight to enter into this relationship.



This is why we are excited by the recent consideration of IOSCO, the global grouping of securities regulators, of the issue of auditor reports – a rare example of a regulator stepping across regulatory boundaries and discussing moves to join up securities disclosure rules, accounting standards and auditing guidelines. IOSCO recently closed a consultation on auditor reporting where it asked very wide questions – not least 'Is the standard audit report useful to investors?' – and opened the door to a refreshed approach.

Our answer to the direct question was that the standard audit report is not useful at present and we urged reforms to make it more so by including additional company-specific information. We welcomed IOSCO's use of the new UK reporting standard – which we helped write – as an exemplar. This UK standard itself reflects work at the Audit Quality Forum in which we actively participated. But we recognise that auditors cannot move alone in this respect: generally, they need better disclosure from the audit committee and from management on which they are then able to comment. In our response to IOSCO we encouraged better disclosure from these two groups, particularly about key areas of accounting and auditing judgement, key assumptions embedded in reporting and how they oversee risk.

It is because we need better disclosure from companies before we can insist on better reporting from auditors that the involvement of IOSCO is so important: it is the securities regulators which can set higher standards for corporate disclosure. We hope that there will be stronger cooperation between the securities regulators, accounting standards setters and audit regulators: only if this occurs will financial reporting be designed to be auditable, and only then will the overall structure provide confidence to investors.

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Much of the intent of Plato's image is a rebuke to his fellow Athenians for having tried and imprisoned Plato's great teacher Socrates – a process that led Socrates to commit suicide. Implicit in it is the arrogance that only a few people – Socrates himself, and by implication Plato as well – attain freedom through their intellects and escape the cave that most humanity is trapped in, and that because of their limited perspective other humans cannot comprehend these more enlightened few.

We hope that the auditing profession is not trapped by a similarly arrogant presumption that the value of its work is recognised and guaranteed forever simply because regulators currently require most accounts to be audited. The contrary is true: the auditing profession must demonstrate its worth to the market on an ongoing basis, in order to convince investors that its role in assisting market confidence is a cost-effective one. That is particularly the case when the profession continues to push for limitations to its own liability without talking about improvements to quality and improvements to the way it reports on its work to investors. Shareholders which continue to know they are seeing only shadows on the wall of the cave will not bless further protections for a profession which works solely in the shadows. We need a little more daylight to penetrate this cave.

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