EXTRACT

SOURCE GLOBAL RESEARCH

October 2021

The Challenger Audit Brand: Can technology disrupt the audit market?

Introduction

In January 2019, we published our report 'The Challenger Audit Brand: Impossible or inevitable?', which looked at the extent to which the audit market was ripe for disruption, and in what form that could happen, underpinned by a survey of audit clients undertaken in 2018. We saw, at that time, an appetite from clients to divide the audit process up, potentially creating opportunities for technology-driven firms to enter the market in parts of the audit in which technology and increased automation can provide a step change in quality or cost.

In this report, we've revisited that analysis—especially in light of the extraordinary changes forced by COVID-19—to assess to what extent clients' views about the potential for disruption to the audit market have changed. We also wanted to understand further how clients think the market could be disrupted, and why we haven't seen as much change in the market since January 2019 as we might have expected.

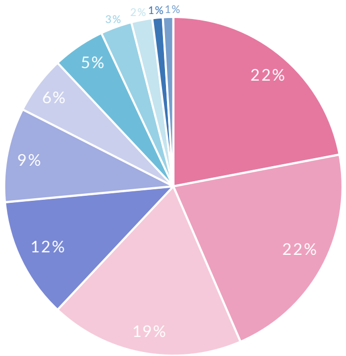
This report seeks to follow up on several issues:

- Are clients still largely happy with the state of the audit market and the quality of work from their auditors?
- Do clients believe in the intrinsic value of the external audit?
- What drives clients to change auditor?
- Is technology still a driver of change in audit, and in what ways do clients think it will change the audit process? In particular, are they still thinking of breaking up the audit process?
- Could technology change the way clients buy audit and create an opportunity for other types of firms?
- What impact has COVID had on the audit market: Do clients think firms have responded well to the crisis, and has it changed clients' attitude to technology?
- Why isn't the audit market changing, and what are the barriers for clients in breaking up the audit process?

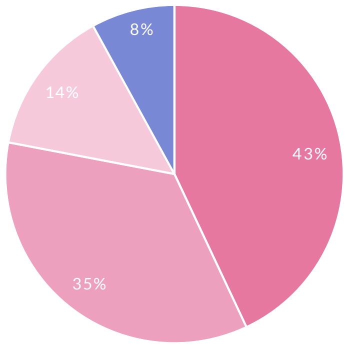
About our research

In July 2021, we surveyed 200 senior executives, 100 of whom were based in the US and 100 of whom were based in the UK. The sample was split evenly between mid-sized organisations (1,000-4,999 employees) and large ones (5,000+). Thirty-four percent of clients were from the financial services sector, with almost all of the rest of the sample from other parts of the private sector, and just 2% from the public sector. The sample focused on finance executives, although we also included CEOs and non-executives who were also on audit committees. All respondents had been involved in either selecting internal auditors, interacting with auditors during the audit, and/or discussing the external audit. We also made sure to look not just at clients of the Big Four, but the mid-tier too: Overall, 74% of those surveyed were audited by the Big Four. Our sample also covered a range of different lengths of relationship between client and auditor, although the vast majority had the same auditor in place for between three and 10 years.

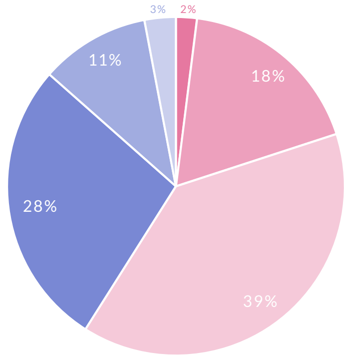
Split of respondents by current auditor



Split of respondents by job title



Split of respondents by length of relationship with current auditor



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How happy are clients with their auditors?

Clients remain largely satisfied with the quality of external audits

In our previous investigation into the audit market—and indeed in our intervening annual client perception studies of the audit market—we found that most clients were happy with the quality of work. Our research in October 2018 showed that 81% of clients were positive about audit quality. Despite the turmoil of the pandemic and the challenges of working remotely, clients are, if anything, even more positive, with 84% of clients telling us they think the quality of audit is high or very high. Clients are much more positive about the audit industry than the negative press coverage and the occasional gnashing from politicians and regulators would suggest.

Of course, not everyone is happy. Larger clients are less pleased than smaller clients, and the energy & resources and financial services sectors are the least positive, perhaps suggesting that satisfaction with external audits falls as organisations become more complex (and harder to audit). CEOs and CFOs are also more positive than senior finance executives and non-executive directors. Perhaps staff of lower seniority, who see more of the nitty gritty, have a better view of the messy reality that lies behind the sheen and so are less forgiving, while non-executive directors on audit committees with the power to choose who to work with are placing firms under greater scrutiny.

Not only are the vast majority of clients positive about the quality of audit, most are positive about the value for money they get from the audit. Despite grumblings in the media, few think audits actually destroy value. While a substantial portion do think of audit as transactional—they merely get what they pay for—this isn't dissimilar from other professional services. Clients understand the value of the external audit, and would still have one even if they weren't forced to.

Despite the dominance of the Big Four, only a small minority (12%) think there isn't enough competition to carry out an effective tendering process. While splitting up the Big Four could help encourage more innovation, and clients in the UK think the changes being pushed by the Financial Reporting Council (FRC)—the independent regulatory body for the audit and accounting industry—should improve things, clients appear to be largely happy with the status quo. Against that backdrop, it's difficult to see how new entrants can dislodge the established players.

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What causes clients to change firms?

Audit clients have traditionally been resistant to change

Historically, one key barrier to change in the audit industry has been the reluctance of clients themselves to change anything. It wasn't unknown for companies to have the same auditor for decades, or even over a century: Proctor & Gamble, for example, has used Deloitte and its predecessor firms since 1890. In the UK and Europe, regulation is now forcing clients to rotate auditors, while in the US there are rules requiring the audit partner (if not the firm) to rotate. This in itself may increase disruption and change in the industry, as clients are exposed to more firms and experience alternative approaches to delivering an audit.

However, aside from being forced to change, what else drives clients to change firms, and could this offer a clue as to how the industry might be disrupted? With most clients seemingly pretty happy with the status quo, it's difficult to see how the audit industry could be heavily disrupted. Disruption doesn't just require firms to change what they do; it requires clients to change their behaviour by demanding different things or changing who they buy from.

In particular, can technology motivate clients to change who they buy audit services from, and open the door to wider changes in the industry? Alternatively, could periodic audit scandals and other industry failings eventually push clients over the edge into doing things very differently?

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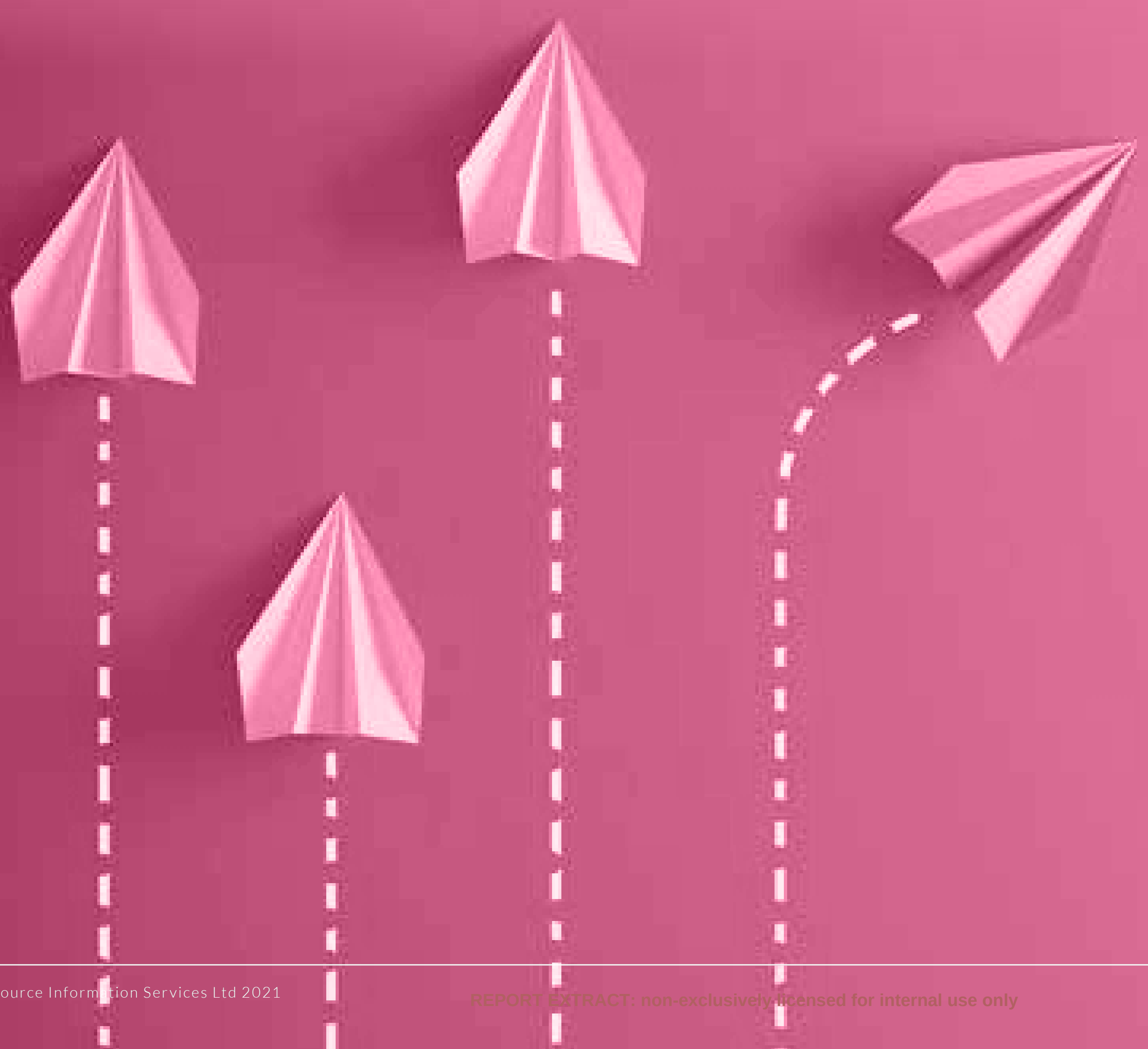
How is audit changing?



Does technology really have the potential to cause radical change in the audit industry? And which specific innovations would lead the way?

When thinking about the potential for disruption in the audit industry, technology seems like the most obvious driver (other than government intervention), as it has already disrupted so many other industries. However, it's difficult to see which particular technologies could drive that change. Not only that, it's not clear how disruptive technology will really be: The hunt for better technology may well be a key motivator to switch firms, but will it fundamentally change the industry?

In this section, we explore the extent to which clients think technology will change the industry, and what particular technologies could be at the forefront of that change.

4

How well have firms responded to COVID-19?

Could COVID act as a force for change in the audit industry?

Every part of the economy has been touched by the pandemic, whether positively, negatively, or a mix of both. In many areas, it's already proved to be a profound force for change, not just in terms of temporary fixes but in terms of a longer-lasting legacy. All crises create challenges but also opportunities, as we've seen previously with the Sarbanes-Oxley Act following the collapse of Arthur Andersen and various accounting scandals, and following the global financial crisis of 2007-2008. Crises force firms and clients to act differently, and we've seen professional services clients become more open to change and innovation as they come out of crises.

Crises also have a tendency to expose underlying weaknesses: Organisations that can muddle through business-as-usual challenges can fall apart when put under pressure. Meanwhile, organisations that have resilience built into their management and structure have a chance to shine. That can be revealing and have an impact on clients' perceptions and buying behaviour going forward.

We've asked clients about audit firms' response to COVID and the shift to remote working to understand the extent to which firms have responded well to the pandemic; what impact that's had on clients; and whether the crisis could act as an accelerant to disruption in the audit industry.

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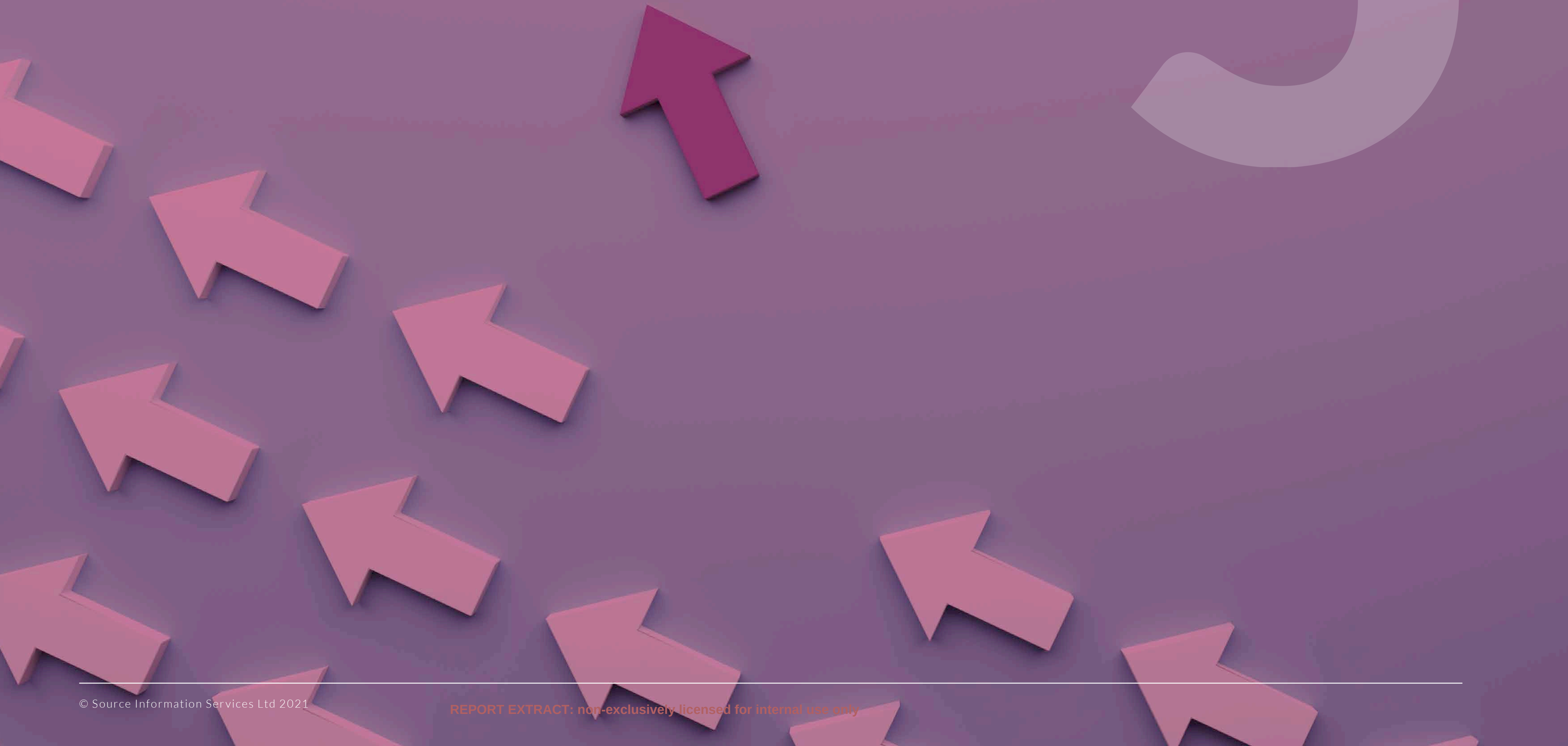
How is technology changing the way clients buy audit services?



Could disruption come from clients farming out parts of the audit process most amenable to technological change?

In our previous research, we argued that splitting up the audit process was unquestionably on clients' agenda, chiefly because of the growing potential to do more with data and automation and clients' assessment that audit firms weren't necessarily best placed to fulfil that potential. While the legal requirements of the external audit are well defined, what clients would like the audit to achieve beyond legal compliance is fuzzier and can change. And when those boundaries change, that creates opportunities for new competitors to carve out part of the audit process for themselves.

However, while a lot of our readers were excited by this particular conclusion, they told us they were sceptical about the extent to which newcomers were actually finding a foothold in the market. And if it wasn't happening yet, when might it start, and what might be the catalyst?

We were also curious to see if the pandemic had increased clients' appetite for change by helping them to see opportunities to do things differently and instilling a desire to innovate. Alternatively, we could also imagine that the ongoing uncertainty might have made the traditional audit more appealing—something that stays the same while everything else is in a state of flux.

6

Why isn't the audit market changing?

Why haven't things changed as much as we anticipated?

In 2019, we argued that clients' willingness to separate out the different components of the audit process, and thereby open up audit firms to competition from non-audit firms, would be the most important driver of disruption in the audit market and that technology firms would be the most likely beneficiaries of that shift. So why haven't we seen much change since we published that report? First, it's clear that clients still think highly of the quality of audit work, think there's still sufficient competition in the market, and have seen audit firms improve in their use of technology. On top of that, audit firms have had a good crisis. All of this taken together means there has been little incentive for clients to make a change.

Even so, many clients are still open to change, as reflected by the relatively high share of clients who still say they've been thinking about breaking up the audit process or are interested in alternative suppliers. To better understand why clients aren't driving change at the rate we anticipated, we asked if, perhaps, they think audit firms are changing enough on their own, what they see as the barriers to change, and what impact they think intervention from regulators and government could have on the audit market.

About the author

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Martin is a Senior Analyst at Source in our Client & Brand Insights team. He is an experienced writer and analyst specialising in client perceptions and helping professional services firms to understand how they are perceived in the market. Prior to joining Source, Martin spent more than 11 years as an economic and financial consultant in a variety of roles at FTI Consulting and LECG.

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Programme schedule for 2021

Reports 2021		Market Trends Programme	Client Perception Studies	Emerging Trends Programme
Q1	January	Forecasts for 2021 US GCC UK Nordics Canada	UK US	
	February		Germany Financial Services	
	March		Healthcare & Pharma GCC France	Buying and Selling
Q2	April	France DACH Australia Southern Europe	Nordics Energy & Resources Technology, Media & Telecoms	
	May		China Japan	Digital, Transformed?
	June			
Q3	July	China Benelux South America South East Asia India Japan Eastern Europe & Russia Africa Energy & Resources Financial Services		
	August		Perceptions of Risk Firms Perceptions of Tax Firms	Consulting's New Talent Crisis
	September		Perceptions of Audit Firms	
Q4	October	The Global Tax Advisory Market The Global Risk & Cybersecurity Services Market Healthcare & Pharma Technology, Media & Telecoms Consumer Products & Retail Planning for Growth in 2022		Building a Trusted Brand
	November			
	December			

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