BRIDGING THE GAP: STAKEHOLDER EXPECTATIONS VS. AUDITOR RESPONSIBILITIES

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"Auditing is serious business, stay away from it, if you can't meet the expectation gap"
– ICAI President Debashish Mishra

Auditing is a powerful tool to bolster the stakeholders' confidence with the results of business operations, many expectations are influenced by the role played by the auditors. Right from scope to assurance, stakeholders shall be familiarized with the responsibilities of the auditors in the true sense. In absence of which, a gap comes into existence, which could lead to distrust and lack of reliance by the stakeholders' on the audited financial statements. In this article, I have brought into facets certain important aspects, like expectations of stakeholders, expectation gaps and Auditors roles and responsibilities and how the expectations gap be minimised.

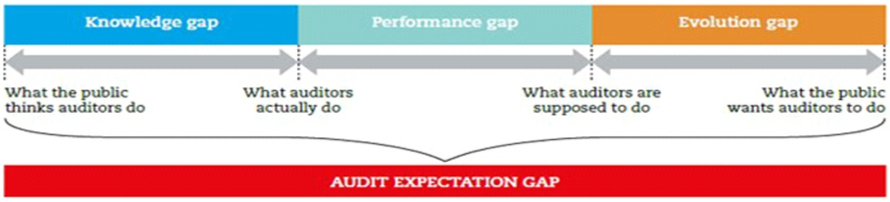
Some common expectations of the stakeholders are-

1. Complete Reliability on the audited financial statements of the entity.
2. Prevention and detection of all Frauds. Eg: Violence Child Labour (Being a non-financial reporting related flag however posing ethical and morale reporting needs)
3. Design, implementation and maintenance of operating effectiveness of internal controls, including those controls, which don't correspond to financial reporting framework, Eg: Employee attendance is not the responsibility of auditor.
4. Assess the creditworthiness of the company for their investment decisions.
5. Compliance with legal and regulatory matters, including laws not covered by financial reporting.
6. Maintaining transparency of all data, even sensitive public information.
7. Maintaining public trust to ensure there are no scandals or red flags.

Expectation gap illustrations –

Last week, Deloitte resigned as auditor of the Adani Group's port company while the company run by Gautam Adani said the auditor wanted a wider scope in the role of accounting whereas auditors resigned on the grounds of limitations on the scope of audit. Earlier in June Deloitte also resigned from Byju's and PWC resigned from Paytm on the similar grounds of gap between the client and the auditor. Following illustrations are examples of the gap that arises on common grounds.

- Knowledge gap – Lack of expert knowledge on general audit scope and coverage, specifically those as per the standard of auditing, issued by the ICAI.
- Performance gap –difference between the types of tasks that the public believes, which the auditor is required to perform and the level of work that auditing standards require.
- Liability gap: misunderstandings regarding an auditor's legal liability, as in the case of detecting fraudulent activity.
- Evolution gap: Stakeholders expectation do not match despite of agreed terms of engagement with the Company.



Auditor's Roles and Responsibilities:

1. Examine Financial Statements: The primary responsibility of a statutory auditor is to examine the company's financial statements, including the balance sheet, income statement, cash flow statement, and statement of changes in equity, to ensure their accuracy and compliance with the accounting standards and regulations (GAAP, Ind AS, etc.).

2. Express an Opinion: After conducting the audit, the auditor is required to express an opinion on whether the financial statements give a true and fair view of the company's financial position and performance.

3. Evaluate Internal Controls: Auditors assess the company's internal controls pertaining to financial statements and accounting procedures, to determine their adequacy in preventing and detecting errors and fraud. It goes without saying that the Auditors are not expected to assess all internal controls, only those in the scope of audit.

4. Assess Going Concern: Auditors evaluate whether the company is a going concern, meaning it can continue its operations for the foreseeable future. This aspect is increasing over the period, as many corporate entities have gone for insolvency proceedings and the stakeholders are not informed on timely basis. It goes without saying that by commenting on this aspect of the Company, the Auditor is NOT giving a guarantee given by auditors on the going concern, but only a test of irregularities in the normal course of business.

5. Detect Fraud and Irregularities: Auditors are responsible for detecting material misstatements due to fraud or error. They perform procedures to identify irregularities and fraudulent activities. However, the primary responsibility of fraud detection is still in the hands of management of the Company.

6. Professional Skepticism: Auditors are required to approach their work with professional skepticism, maintaining an attitude of questioning and critical assessment to uncover potential issues.

7. Independence: Auditors need to be independent to the engagement so as to avoid bias and maintain the professional standards in the audit performed. There are various safeguards to independence, as provided under the Companies Act 2013, which ensures that the auditor's independence is maintained.

Additional, as per SA 200 auditing suffers from inherent limitations and *the auditor is not expected to and cannot, reduce the audit risk to zero and cannot therefore obtain absolute assurance that the financial statements are free from material misstatements due to fraud or error. And thus audit refers to having a reasonable assurance on the true and fair view of financial statements.*

However, an Auditor can be held liable –

- Liability for Negligence: If the Auditor fails to exercise reasonable care and skill while performing the audit, resulting in incorrect or misleading financial statements, they may be held liable for negligence. Widely known Satyam Scam being a prime example.

- Liability for Fraud Detection: Auditors may be held liable, if they fail to detect material fraud during the audit that could have been reasonably expected to be identified.

- Failure to perform audit as per SA: Auditors have a professional duty to perform their work in accordance with applicable auditing standards. Failure to do so can result in professional liability.

How to manage the GAP?

In continuation of the above example of Deloitte, it is noted that communicating the practical unconvincing and impossibilities give stake holders and insight as to not refer to the audited Financials due to imposed restrictions. Clear communications of the results expected by client and auditors as per SA 220 and SA 580 (written representations by management) allows the auditor to rely on statements given by management and deal with the discrepancies accordingly.

Audit report also highlight's management as well as Auditor's responsibilities giving a detailed clarity on the GAP and miscommunication that can be avoided or mitigated. Managing the expectation gap is an ongoing discussion in the industry, but there are some ways to help close it. It's helpful to look at both the knowledge and performance components of this gap.

1. Educate the stakeholders about an auditor's specific responsibilities.
2. Writing a letter of engagement helps spell this out before the audit process begins as per the agreed terms.
3. Overall, clear communication is the best way to close the expectation gap.

As we conclude this insightful discussion on "Bridging the Gap: Stakeholder Expectations vs. Auditor Responsibilities," it's clear that the relationship between auditors and stakeholders is a critical one, shaping the integrity and transparency of financial reporting. In closing, let us remember that the collaborative efforts of auditors and stakeholders contribute to the trust and confidence that underpin financial markets. By acknowledging each other's roles and limitations, we can work together to bridge the gap between expectations and responsibilities, ultimately strengthening the foundation of economic growth and stability.

Lasty I'd like to close by quoting Larry Sawyer *" For every Operation audited, know the mission, the purpose and the reason of being."*