Role of auditors in promoting investor confidence

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Overview

Stability and growth of an economy and financial markets are dependent upon trust among stakeholders. One cannot take trust for granted. External stakeholders, such as investors, creditors, and regulatory bodies, rely on audited financial statements to make informed decisions. Internal stakeholders, including management and boards of director's need insights into the efficiency and effectiveness of internal controls and risk management systems.

With the advent of new technologies, greater openness of the economy and faster transmission of information flows, it has become paramount to ensure credibility and confidence in the system. Misreporting may occur due to errors in the financial reporting process. Further, at times, being responsible for financial performance, management may also have some compulsions to misreport.

Auditing is thus very vital for having trust in financial information. It provides an independent and objective assessment of an organization's financial statements, internal controls and compliance with relevant laws and regulations. An independent challenge by the auditor during the audit process is an important safeguard against any misreporting and promoting investor confidence. High-quality financial reporting and a robust auditing profession are the bedrock of market capitalism.

Emerging trends of how auditors enhance confidence

We have noted several emerging trends through which auditors in today's era enhance confidence in the audit. This has changed both in terms of processes as well as the culture within the audit profession.

Focusing on Auditor Independence - The audit is perceived as a public good and hence stakeholders must have confidence in the auditor's independence. The objective of providing credibility to the financial statements cannot be met if the Stakeholders (Shareholders/ Regulators/ Prospective Investors/ Lenders all others) do not believe that there is full independence on the part of the auditor while providing their opinion. Hence, Auditors need to be independent both in form and in perception. Auditors need to demonstrate a high degree of professional skepticism, particularly in areas involving management judgement and assumptions, and in areas that are susceptible to fraudulent reporting. The readiness to challenge and ask probing questions about a company's transactions, processes, controls, reporting and governance practices greatly adds to the quality of audits. By building robust independence limitations, the auditors are demonstrating that they are unbiased in giving their opinions and can promote investor confidence.

Additional procedures on Non-GAAP measures- Investors today look not only to the financial statements but to a multitude of other information when making investment decisions including sustainability reports, environmental, social and corporate governance matters, and non-GAAP financial measures. Investors rely on key performance indicators because they find it a quick way to focus on an entity's performance. However, often this information is not consistent, comparable, reliable or well-disclosed. Further, investors are not clear on the nature and extent of auditor review involvement with that information. As per some studies, audited financial statements account for not more than 20%-25% per cent of the information an informed investor uses to make their decisions. The rest is generally from Management Discussion & Analysis, press releases, analyst calls with management and investor information packages which are generally not part of audit. When the auditor audits this information, whether as part of external audit or management audit, it helps in the investor confidence.

Enhanced focus on clear and transparent reporting – the audit report serves as the mode of communication between an auditor and the users of the financial statements. While the format of the audit report is generally prescribed by regulations, auditors have the mandate to describe the key audit areas of the audit that they focused on and the procedures performed in these areas, through their 'key audit matter' reporting. Further, auditors need to ensure that they call out any disagreements or concerns by appropriately modifying their audit reports either through qualifications or highlighting any going concern uncertainties in a timely manner. The Regulatory bodies in there review reports or oversight publications have also considered this as a significant aspect of whether the auditor has discharged its duties with sufficient care or not. When the audit report is clear and transparent, it helps in building investor confidence.