Company Auditing and the 'Expectations Gap
Changing Perceptions of the Auditor's Responsibility for Detecting and Reporting Fraud

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Abstract

In recent decades, the objectives of company auditing as perceived by auditors had changed considerably. Public perceptions, however, had not altered to the same extent, and an 'expectations gap' had developed. This gap was often obvious when a company collapsed after a fraud had taken place.

Since the 19th century, the prevailing view expressed by the professional accounting societies had been that the principal responsibility for the detection and reporting of fraud lay with the management, in the case of a company with directors. In recent decades, this view had been increasingly questioned particularly in U.S.A, United Kingdom and Canada following financial scandals. The 'expectation gap' had led to a sequence of events which had introduced changes in the auditor's responsibility.

The objective of this study was to carry out a critical review of previous work on the forces behind changes in perceptions of the auditor's role in detecting and reporting fraud, possible consequences that might have been vague understanding of the auditor's responsibility in detecting and the implications of recent legislations and other changes in the auditor's responsibility. These together with the 'expectations gap', had affected the concepts of confidentiality and reporting.

In particular, the study sought to determine the causes for changes in perception of the auditor's role with regard to fraud and to look into the implications of legislation and other events for company external auditors and their clients. The study also considered one possible consequence of the vague understanding of the auditor's responsibility for fraud.

The study started by describing the historical development of the audit function and the identification of the 'expectations gap'. It noted that audit developed in response to external needs of accountability, and fraud and error detection dominated as the main objective of audit in the early days of audit.

However, as business became large and more complex, and improvement in management standards resulted in improved information, error and fraud detection were gradually relegated to secondary objectives; the main reason probably being that detailed checking could be inefficient. This notwithstanding, it had been noted that since fraud and error detection dominated the early history of audit, it was not surprising to find some financial statements users still holding that the auditor's objective was to search for fraud. Such users were not aware of the fact that the auditor's role had changed from fraud and error detection to attestation for credibility of the financial statements.

The study then considered the consequences for auditing of the changes in perceptions. Important consequences foreseen by the auditing profession included a rise in audit fees as a result of detailed checking, higher administrative costs for compliance, and how all this affected the concept of confidentiality.

One probable consequence of the 'expectations gap' was the escalation in liability claims against audit firms. For some years, there had been a number of suggestions aimed at limiting the liability claims against audit firms. These suggestions had included changing the law to allow audit firms to operate as corporate bodies with limited liability, reviewing the procedure for awarding damages, and allowing the liability to be based on the figure for the audit fee.

While the law was unclear on the auditor's responsibility for fraud, there was still a strong belief that the auditor had a role to play in this respect. However, the accounting and auditing professions seemed reluctant to sanction any extension of the auditor's responsibility towards fraud.

The study also pointed out a number of challenges and limitations to the auditing profession. These included time constraint, impossibility of detailed checking, ignorance on the part of some financial statements users of the role of the auditor in detecting, deterring and reporting fraud, uncertainties in the accounting process, the use of sampling, presence of alternative acceptable accounting principles and the possibility of management committing a 'clever' fraud which may be difficult for the auditor to detect.