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Audit Expectation Gap – Evidence in 21st Century

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Abstract:

Audit expectation gap has always been a captivating literature to study in the accounting and auditing philosophy. The first study on audit expectation gap was carried in 1974 and since then several literatures have been developing to identify the evidence of audit expectation gap in different responsibility centers of auditors proposing how to reduce the gap from different perspectives. As the scope of auditing is kind of defined by definitions, we tend to believe that the expectation gap must be reducing with the adoption of audit knowledge and practices over times which must be working from both the auditors' and users of financial statements' end. This paper aims to find out the evidence of audit expectation gap in the literatures concentrating majorly on the 21st century and summarizing the proposals made to reduce the existing expectation gap. Certain research gaps have been traced through the study of literatures which will create further avenues for the researchers of audit expectation gap to work on.

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Introduction:

There is a widespread belief that a person who has any interest in a company (shareholders, potential investors, take-over bidders, creditors, etc.) should be able to rely on its audited accounts as a guarantee of its solvency, propriety and business viability. Hence, if it transpires, without any warning that the company is in serious financial difficulty, it is widely felt that somebody should be made accountable for these financial disasters, and this somebody is always perceived to be the auditors (Godsell, 1992). While the role and responsibilities of the auditors have been passing through fundamental changes, especially after the debacles of the last few years, there is evidence from various studies that such a gap still exists (Yusuf, 2007). Whenever users of financial statements incur losses as a consequence of their misinterpretation of opinions expressed in the auditors' reports and their over-reliance on the audited statements for their decision making, value of the external audit is always questioned (Amir and Soon, 2003). Following the widely publicized Enron and WorldCom phenomena, several attempts have been made to modifying the duties, roles and responsibilities of auditors as a means to addressing the expectation gap. However, a large number of recent studies on the concept tended to focus on the characteristics of the gap relative to diverse circumstances, users and reporting implications (Joseph et al., 2015). This paper aims at summarizing the literatures on audit expectation gap focusing the development especially on the 21st century though this paper referred few literatures that are found important yet evident before 21st century. The paper has been organized with the following chronology: In the first section, it has discussed different Definitions of Audit Expectation Gap that are available in different audit literatures. Existence of Audit Expectation Gap in 21st Century has been attempted to trace in the next section. The findings of audit expectation gap and given suggestions have been summarized in the next three sections under the titles such as Effect of Audit Education in Audit Expectation Gap, Importance of Long-Form Audit Report and Other issues addressed in the literatures of 21st century.

Audit Expectation Gap (AEG):

According to the American Institute of Certified Public Accountants (AICPA) in 1992, the expectation gap could be defined as "the difference between what the public and financial statement users believe auditors are responsible for and what auditors themselves believe their responsibilities are. Independent audit of financial statements has long been associated with the role of assurance, from which the credibility of information presented by the management is, to a certain extent, guaranteed (Mohamed and Zauwiyah, 2004). The expectation gap exists when auditors and the public hold different beliefs about the auditors' duties and responsibilities and the messages conveyed by audit reports (Hian and E-Sah, 1998). Many authors have discussed the continuing gap between what the users of financial statements expect from the auditing profession and what the auditors define as their role in the assurance process (Yusuf, 2007). Fowzia Rehana (2010) defined Audit expectation gap As the difference between what auditors actually do and what third parties think auditors do or should do in conducting the audit practice. Kimberly et al. (2001) noted that the expectation gap has been presumed to be caused by the differing perceptions of the accounting profession and third parties regarding the profession's role, responsibilities, and related performance. Fran et al. (1999) expressed the expectation gap as the gap between what the public expects from the auditor and what the auditor perceives his or her role to be has exacerbated crises within the accounting profession. Porter (1988) identified two components of the audit expectation gap:

Reasonableness gap: The difference between what society expects auditors to achieve and what they can reasonably expect to accomplish.
Performance Gap: The difference between the responsibilities society reasonably expects of auditors and auditors' performance.

UK Essays (2013) claimed that the audit expectation gap is critical to the auditing profession because the greater the unfulfilled expectations from the public, the lower is the credibility, earning potential and prestige associated with the work of auditors. It further added that, the expectation gap is driven by two variables: the auditor's ability to detect fraud, and the auditor's efforts to detect fraud. An auditor may possess the skills to detect fraud, but might choose to take shortcuts or disregard obvious signs of potential fraud. Or, an auditor might use a variety of techniques, but lack the experience to effectively uncover red flags. Both scenarios will broaden the expectation gap.

Existence of Audit Expectation Gap in 21st century:
Considerable evidence of a gap exists between the expectations of users of financial statements and the accountancy profession as to the definitive scope and usefulness of an audit function (John & Silvia, 2014). Liggio (1974) introduced the term 'expectation gap' at the very first place. A plethora of researches were conducted world-wide to find out the existence of audit expectation gap and to recommend the ways to mitigate such expectation gap since then. Bailey et al. (1983), Nair and Rittenberg (1987), Kelly and Mohrweis (1989), Miller et al. (1990), Holt and Moizer (1990), Hanks (1992), Gay and Schelluch (1993), John et al. (1993), Christopher et al. (1993), Monroe and Woodliff (1994), Pierce and Kilcommins (1996) and Peter & Wendy (1996) showed the existence of audit expectation gap in different countries before 2000 which were discussed almost in the literature review based article on audit expectation gap titled 'The expectation gap in auditing' by Hian and E-Sah in 1998. This paper will illustrate the findings of such audit expectation gap in the 21st century. John and Stanley (2001) studied the investors' and auditors' perception of the expectation gap extending the prior researches involving different dimensions of the attest function. The study found higher expectation gap among investors than auditors and emphasized engagement of adequate steps to reduce this gap by the accounting profession. In 2001, Kimberly et al. measured the audit expectation gap among auditors, jurors and students in USA. The study found a huge divergence in perceptions of auditors and jurors regarding their expectations of the accounting profession. The study also claimed that accounting students were almost responding like practicing auditors. In the same year Peter et al. found the evidence of audit expectation gap in Singapore adopting a replication of a study by Schelluch. The study traced a wide audit expectation gap in the areas of auditors' responsibility for fraud prevention and detection, maintenance of accounting records, freedom of the entity from fraud, and auditor judgment in the selection of audit procedures. In 2002, Ian and Peter revealed that fund managers of UK were concerned of the audit expectations gap and were particularly concerned about the scope and responsibilities of the auditor, and monitoring of auditors' work. In 2003, Riazur and John published a research work on the expectation gap of public sector of Bangladesh. The interviewees' responses revealed important differences between the CAG auditors and the audit report users in such important areas as auditor accountability, auditor independence, auditor competence, truth and fairness of the reported information and the role of the performance audit. Mohamed and Zauwiyah (2004) found audit expectation gap in Malaysia whereas Z. Jun and Feng traced a wide audit expectation gap in China in the same year. In 2005, Riazur et al. again worked on the public sector audit

expectation gap in Bangladesh and found statistically significant differences in perceptions between 17 CAG auditors and the 15 members of the PAC on 13 of the 25 variables and between these 17 CAG auditors and nine representatives of the IFAs on 14 of these variables.
Dixon et al. (2006) worked on expectation gap in Egypt and found a significant expectation gap in the areas of auditor responsibilities for fraud prevention, maintenance of accounting records, and auditor judgment in the selection of audit procedures. In 2007, Yusuf studied in Lebanon to find out the evidence of audit expectation gap and addressed a reasonableness gap whereas Roszaini and Mohammad conducted the same survey in Saudi Arabia to find out audit expectation gap in the cultural context in 2007. The result indicated the 'performance gap' arising from four factors in the environment within which auditing is practiced: licensing policy, recruitment process, the political and legal structure, and dominant societal values.

In 2008, Philip Law conducted an empirical comparison of non-Big 4 and Big 4 auditors' perceptions of auditor independence which showcased that the provisions of NASs and high competition could have a negative influence on auditors' perceptions of independence. The result supported the agency theory that the agent (senior manager) may not always act in the best interests for the principal. The study however did not find any difference between Big 4 and non-Big 4 auditors' perceptions of the influence of NASs and competition on independence. Philip Law also had a work in the same year on auditors' perceptions of reasonable assurance in audit work and the effectiveness of the audit risk model where it was claimed that there were significant differences between the perceptions held by auditors of different ranks regarding reasonable assurance in audit work. Javed et al. (2009) found the existence of audit expectation gap in Bangladesh among auditors, bankers and students and concluded claiming positive correlation with audit education and narrower audit expectation gap. In 2010, Fowzia conducted the same survey in Bangladesh and concluded in the same manner which is identical to the findings of Javel et al. emphasizing more on audit course inclusion to mitigate the expectation gap. Amir and Soon (2013) showed the audit expectation gap adversely affecting the loan decision quality in Malaysia and indicated that knowledge/experience factors could significantly mitigate the audit expectation gap. In 2014, John and Silvia concluded that audit education has significant effect on AEG in Nigeria and called on the accountancy profession, educational institutions and regulators to initiate appropriate policy framework for increasing financial statement users' knowledge and awareness of the nature and limitations of an audit through broad-based audit education and enlightenment programs. Joseph et al. (2015) also evident the existence of audit expectation gap in Ghana. In 2018, Hudaib & Haniffa studied on audit expectation gap in Saudi Arabia and concluded that two macro factors viz. ideology and legal structure in the Saudi environment significantly affected audit perceptions gap.

Effect of Audit Education:
Bailey et al. (1983) and Epstein and Geiger (1994) talked about the importance of audit education in mitigating the audit expectation gap. They claimed that such adoption of audit education increased the understandings of the users hence created an epistemic justification on the roles and responsibilities of auditors resulting in reducing the audit expectation gap from the users' end. However, Epstein and Geiger (1994) also emphasized on re-examination of fundamental role of an audit in society by both the audit profession and financial users.
Gary and David (1993) tested the impact of audit education in shaping the students' perceptions on audit reports and auditors' responsibilities. Taking the audit course as a control variable, the study was conducted with two groups of final year under graduating

students – one is from accounting having auditing course done and the other is from marketing having no auditing course done. The study claimed a presence of huge impact of audit education in reducing the audit expectation gap. Pierce and Kilcommins (1996) surveyed 818 students dividing them into different groups having full audit course, a module of auditing or no auditing course. The result got surprising reduction at the .05 level in all the elements of the misunderstanding gap who took audit course or a module either. Fowzia Rehana (2010) conducted an empirical research on how audit education influence towards narrowing the audit expectation gap in Bangladesh. Three groups of students consisting one hundred students in each group were asked the same questions in the data collection stage. All the respondents were from private universities of Bangladesh. Among the three groups, one group did not take audit course yet, one group completed audit course and the another group completed both audit and advanced audit course. This study prepared 10 questions and assigned values for each question depending on the agreement of the international standards of auditing. It showed the difference between assigned values and respondent's values to find out the extent of audit expectation gap. Her finding shows that audit education in the university has positive correlation in narrowing the audit expectation gap.

Before Fowzia Rehana, Javed et al. conducted the same research in 2009 where they tried to find out the significance of audit education in audit expectation gap calculation in Bangladesh. They found a magnificent audit expectation gap among auditors, bankers and students specially in the audit responsibility segment. In the audit reliability section, the paper found a positive role of audit education in reducing audit expectation gap. The paper also claimed that the class room lectures on different corporate failures due to accounting scandals had created augmented enthusiast among the students resulting in creating few unreasonable expectations in audit responsibility. In 2014, John & Silvia conducted the same survey on role of audit education in Nigeria and revealed that exposure to a course on Auditing significantly enhanced the knowledge of students in the two experimental groups, and accordingly reduced their expectations on the scope, reliability and decision usefulness of audit function. The study however found no significant improvement in their perception of the key components based on industry work experience of the students. The paper, therefore, concluded that audit education has significant effect on AEG in Nigeria and calls on the accountancy profession, educational institutions and regulators to initiate appropriate policy framework for increasing financial statement users' knowledge and awareness of the nature and limitations of an audit through broad-based audit education and enlightenment programs.

Importance of Long Form Audit Report:

Several studies were conducted before 2000 which showed the importance of adoption of long-form of audit reports instead of short-form of audit reports by the companies to reduce the audit expectation gap. Nair and Rittenberg (1987), Kelly and Mohrweis (1989), Miller et al. (1990), Holt and Moizer (1990), Hanks (1992), Gay and Schelluch (1993) and Monroe and Woodliff (1994) claimed that introduction of long-form audit report and modification of words play a positive role in understanding the audit reports and users can have more useful and reliable decisions thereon. In 2001, Peter et al. measured audit expectation gap in Singapore and found the evidence of strong audit expectation gap where it concluded with the recommendation of adopting long form audit report instead of short form audit report to mitigate the audit expectation gap and enhance the decision making usefulness of the users.

However, In Hartherly et al.'s (1991, 1992) said that the perceptions of management's and auditors' responsibilities were not significantly influenced by the modified wording.

Other Issues:

Fran et al. (1999) proposed a two-part strategy to effect structural change of the auditor client environment. Part one of the strategy called for greater involvement of regulators in selecting the external auditor and requiring auditor rotation. Part two of the strategy proposed market-based instruments, audit failure permits and audit disaster futures, to deal with remaining audit risk. Keith et al. (2011) pointed out the difficulty in understanding the audit materiality by the stakeholders and traced mixed views as to whether the actual level of tolerable error should be disclosed. Kimberly (2015) developed the Assurance Gaps Model, which described expectations gaps in general, defining these holistic differences between users' and providers' perceptions of assurance services as assurance gaps. The model suggested that assurance gaps really had a number of components – expectations, evaluations of performance and disconfirmation – all of which impact users' satisfaction with the service. The magnitude of each of these components, as well as the emphasis placed on each one, is important in describing the nature of the gap. Roszaini and Mohammad (2007) indicated that the inclusion of Islamic principles in auditing standards and the code of ethics would help reduce the expectations gap that exists in Saudi Arabia. However, Ian and Peter (2002) concluded that accountancy foundation should provide greater independence to the investigation and disciplinary processes of the existing regulatory framework to go some way to narrowing the expectations gap

Auditing is increasingly difficult and challenging, with new rules and regulations encouraging, if not requiring, auditors to enhance their efforts to detect fraud during an audit. Unfortunately, these rules and regulations contain terms like "reasonable," "material," "professional scepticism," and "brainstorming," whose meanings vary in the minds of different auditors. Hasaan (2013) concluded that on careful analysis of this gap one of the reason that was critical in widening the gap is lack of understanding of different connected factors. And this is not only a lacking on part of users of financial statements but also the auditor sometimes. If efforts are invested in these areas, then expectations can be bridged to great extent. For example:

Users must understand why auditor can only provide reasonable assurance and not the absolute assurance and what are inherent limitations of the audit. Users must understand that general purpose financial statements are meant for general needs of users and even if they have been audited in a best way possible but it does not mean audited financial statements can help in any decision making situation. Users must realize that auditor's work is relative to circumstances that require use of judgment which may be wrong. Although auditor works diligently but it does not always mean if judgment is wrong then auditor is guilty of ignorance rather it will be assessed based on what auditor could possibly do and what he actually did. Although auditor and management is required to produce financial statements in a way that are easy to understand but users are also expected to have certain degree of relevant knowledge on how to use and interpret financial statements. Financial statements are not for everyone to read and act upon. For auditors to understand users' expectations they must arrange workshops or seminars so that users at least feel that they have been heard. Auditors must not rule out everything on the basis of lack of knowledge on part of users. Auditors must make audit reports easy to understand for the masses and avoid to great extent any technical jargon that can impair ordinary person's understanding who lack skillful insight of financial statements. Auditors are already providing less than absolute assurance so they must not leave any effort undone to maintain reasonable level of assurance by complying with the requirements of relevant auditing standards. For example, proper planning, appropriate understanding of entity to design further audit procedures, maintaining skeptic attitude, reducing sampling risk to appropriate level etc.

Conclusion:

The audit 'expectation gap' is a crucial issue associated with the independent auditing function and has significant implications on the development of auditing standards and practices (Jun & Feng, 2004). The importance of alignment between users' and providers' expectations of accounting services has long been recognized as paramount in the auditing profession (Kimberly et al., 2015). The auditing profession believes that the increase in litigation and criticism against the auditors can be attributed to the audit expectation gap (Lee et al., 2009). To recapitulate the literatures existed; this study offers few avenues where expectation gap study can still be conducted. In addition to audit education, general education knowledge can be another control variable to check the audit expectation gap. A pool of educated people from any discipline and uneducated people yet involved in the investment, business or job can be taken to find out the existence of audit expectation gap. Moreover, importance of the use of long-form audit report particularly in developing countries like Bangladesh where most of the share-holders invest being provoked by words of mouths needs to be reviewed by the researchers.

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