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RESEARCH ARTICLE

AUDITING EXPECTATION GAPS: ARE SHAREHOLDERS ASKING FOR TOO MUCH ON QUALITY?

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ABSTRACT

This is a theoretical discourse of the misconception and discrepancy between auditors' responsibilities on the one hand and shareholders, society and stakeholder's perception of their responsibilities on the other. The study is aimed at assessing the duties expected to be performed by the auditors and the perception of their duties by the stakeholders. This study aimed at assessing the duties expected to be performed by auditors and prospects of shareholders on the responsibilities, which are expected to be carried out. For this study, interview data from a KPMG study and other published data from literature were analyzed to determine auditors' duties and the stakeholders' perception of same. From the analysis carried out that shareholders expected an audit report to be a high quality reporting and to convey a clean bill of health. This is contrary to the statutory requirement of an audit. The study further shows shareholders expectation of what an audit report should be has a great impact on the audit exercise.

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INTRODUCTION

Are shareholders really asking for too much, considering the goings-on in the business world, discovered scandals, window dressing, earnings management and a host of other outrages? One might ask whether the International Standards on Auditing's (ISA) definition of audit as "an independent examination and expression of professional opinion on the financial statement of an enterprise by an appointed auditor in pursuance of that appointment and in compliance with any relevant statutory obligation" is still a fit for purpose considering that a difference exit in prospect between the shareholders perception of the outcome of an audit exercise and the statutory task of the auditors. 'Expectation gap' is a term commonly used to describe the situation whereby a difference in prospect exists between a group with certain expertise and a group which relies upon that expertise (Higson, 2003). The term has been used not only in the accounting literature but also in other fields of study such as business. It explains the perceptions of the information systems industry regarding the academic preparation of graduates (Rezaee and Rily, 2010). Singh (2004) expresses that the disparities in relation to various issues associated with corporate environmental reporting, the conflict between auditors and the public over preferred meanings of the nature, objectives and outcomes of an audit, the breach in bank sas well as between the transaction-audit approach that evolved during the industrial age and the information age Higson (2003) are evidence of financial reporting expectation gaps questioning the shareholders perception of value for money or fitness for purpose. Shareholders expectation of an auditor's report is that it will be a clean bill of health (Olowookere, 2005), thus most shareholders' expectations towards auditors are an over estimation of what they should be. Expectation gap is, therefore, the gap between the auditor's actual standard of performance and shareholders expectations of such (Lee, Azham &Ali, 2008). In line with such expectations, Percy (2007) highlightedperceived outcome of an audit exercise to include having a right account, being a going concern, guarding against fraud and error, acting within the law, being competently managed, as well as adopting a responsible attitude to environmental and societal matters. Ojo (2009)posits that shareholders and even other users of the financial statement also misunderstand the nature of the attestation function, especially in the context of an unqualified opinion. Ojo (2009)further shared that some users believe that an unqualified opinion means that the entity has full proof of financial reporting. While others look forward to the auditor who would not only provide an audit opinion but also interpret the financial statements in such a manner that users could evaluate whether to invest in the entity or not. Likewise, some shareholder believes that auditors need to perform other audit

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penetrating into company affairs, engaging in management surveillance and detecting illegal acts and/or fraud on the part of management to give value for money. Adetunji (2014) opines that when defining expectation of shareholders on any paid services, value for money should be guaranteed because irrespective of auditors view it is believed that he that plays the piper dictates tune.. Therefore, the expectation of shareholder is important and the gap to their needs must be filled. Likewise, Hallinger (2012) expressed that the consistency, conformity, fitness for purpose definitions may be associated with shareholder's perception, particularly in process. Though, Nykiel (2007) defined 'fitness for purpose' as 'conformity to predetermined objectives or standards' while Ajibolade (2008) also revealed that the fitness for purpose definition of quality is a major prevailing view of quality amongst accounting academics in Australia. An audit expectation gap, therefore, exists, particularly regarding the following issues: fraud detection and prevention, responsibility for internal controls, responsibility for the maintenance of accounting records, the auditors' use of judgment regarding the selection of audit procedures and the level of assurance given by the audit report. In addition, the shareholders also place the responsibility for narrowing the gap on auditors and others involved in preparing and presenting financial statements. It is these high expectations on the part of users of financial statements that create a gap between auditors' and shareholders' expectations of the audit function. Thus, this study shed light into auditing expectation gaps and shareholders view of such in line with discussion on value for money or fitness of purpose.

MATERIALS AND METHODS

Auditors' View of the Value of Audit: In a report published by KPMG partners, it was stated that "all felt that audit still has relevance and value. This value mainly derives from confirmation over historic financial information, as shown by the resulting reduction in the cost of capital. The KPMG partners'report also affirmed that audit quality has been improving since the Enron collapse. The financial crisis has put renewed focus to push these improvements along, but it is basically furthering an agenda that was already well underway" (KPMG, 2014)

Audit Expectation Gap and Shareholders' Perception: Various studies (Salehi, Nagilo, Mansoury &Azary, 2010; Lim, 2011; Akl, 2013) affirmed the existence of the audit expectation gap. Prior literature(Rezaee & Riley, 2010) evinced that the expectations gap between auditors and shareholders existed for the past hundred years. Hallinger (2012) explains that the audit expectation gap has become a topic of considerable interest for research and particularly, in advanced countries like the United States of America, United Kingdom, New Zealand, Germany, Singapore, Malaysia, India, and Iran for the last thirty years. This is due to the occurrence of a series of corporate failures, financial scandals,and audit failures and their subsequent impact on other countries' audit profession. Researchby Lim (2011) shows that quality of financial reports is of primary concern not only to shareholders but to the entire society due to its impact on economic decisions made by various stakeholders. However, the misunderstanding between the auditor's perception of corporate financial reporting and what shareholders expect has been a recurring issue in the auditing literature and has often been referred to as *the expectation gap*. Extensive research carried out by Johnsonand Christensen (2016) indicated that the reason for the expectation gap is that the role of auditors is poorly understood. Yet, European Commission (2010) shared that shareholders cannot be totally blamed as auditing is a complicated subject that is not easily comprehended by those who have limited knowledge and exposure in auditing. The audit expectation gap has a long history since there is widespread concern aboutthe expectation gap between the auditing profession and the shareholders. The term *expectation gap* was first applied to auditing by Hallinger (2012) and since then, the evidence has increasingly indicated the existence of auditing expectation gap (Appah, 2010). In fact, there is a gap between what the public expects and what they actually get (Solomon, 2010). In the last decade, the auditing profession has been the focus of attention, particularly because of some well-spread corporate collapses. KPMG (2014) reported that a person who has interest in a company such as shareholders, potential investors, take-over bidders,and creditors should be able to rely on company audited accounts as a surety of its solvency and business viability. Knowing the need for business viability, without any warning that the company is in serious financial difficulty, shareholders feel that someone should be made accountable for this financial disaster, and it is always perceived to be the auditors. This delusion by the shareholders resulted in the legal liability crisis faced by the accounting profession (Akl, 2013). Any entity worldwide relies on two very important and integral components, accounting and auditing. The former one tracks all transactions of the firm and provides information through financial reporting, while audit is performed to indicate the correctness of this track and to establish the validity and reliability of information. The purpose of the audit is to enhance the degree of confidence of intended users of the financial statements by the expression of opinion on whether the financial statements are prepared, in all material respects, in accordance with applicable financial reporting framework (IASB, 2010).

The role of auditors in the financial statement has been and will continue to be an important issue for the auditing profession. According to UK Corporate Governance Codes (2016), auditing practice has undergone various important developmental stages. In a debate by Rezaee and Riley(2010), they claimed that during the early 1990s, the use ofauditors for detection of fraud was the primary purpose of external financial audit. Lim (2011)also claimed that auditing practice turned out to be more related to enhancing role, with special focus on integrity and credibility of the information provided in financial statements; while Akl, (2013) opined that, besides enhancing the credibility of financial statements, auditors nowadays are providing other services such as reporting on irregularities, identifying business risks, and management consulting on internal controls. In other words, auditors are supposed to bridge the communication between the managers of the company and final users of published financial reports through authentication, reliability,and correctness of financial reporting (IASB, 2010). KPMG (2014) mentioned that financial statements no longer give insight into companies' changing fortunes,auditors, therefore, must evolve themselves in order to remain relevant as a profession. Jubb, Rittenberg, Johnstone, and Gramling (2012) noted that the existence of an auditor's perception on financial reporting quality is now more significant in comparison to what other stakeholders perceive to be the assessment of certain grey areas. Akl (2013)reported that audit expectation gap exists mainly because of the subjective nature of terms and concepts in auditing such as the true and fair view, reasonableness, materiality, adequacy, reliability,and relevance which are not defined precisely in the accounting and auditing standards but are left for the auditor' judgment. Creswell (2014) added that it is also influenced by the dynamic objective of auditing and role of auditors, where contextual factors such as socio-economic environments, critical historical events, courts or even technological developments play an important role.

Johnson and Christensen (2016) further brokedown the gaps related to the audit process into categories. There is a "**n**ormative Gap**"** that encompasses both the role of the auditor (meaning the scope of the assurance or other services being engaged) and the responsibilities of the auditor to provide certain levels of assurance over the information within that scope. Some surveys (Johnson, and Christensen, 2016) demonstrate that there remains a gap between what market participants think an audit **should** be versus what an audit is required to be going by applicable standards and applicable laws and regulations. Part of this gap may exist because of a difference between investors' information need and the level of confidence that investors want versus what is required for the particular assurance service. In a conclusion by Creswell (2014),she escalated that another element of the audit expectations gap concerns the interpretation of what the existing auditing standards require auditors to do or to communicate to the user about the audit process or results. When there is a difference in interpretation of the existing audit standard requirements and the assurance that is conveyed by the auditor's report by stakeholders and market participants, it referred to as an **"**Interpretative Gap". Also, the audit expectations gap relating to the information needs of stakeholders and market participants about the audit and the outcome of the audit as well as the nature and extent of the audit procedures performed and the quality of the audit, is referred to as the audit **"**Information Gap"**.**

As debated by Appah (2010)audit is a "credence good", a good or service for which consumers find it difficult or impossible to ascertain its utility or quality, even after its use. Currently, the quality of an individual audit that investors are relying on is unknown to those investors. Although progress has been made among regulators and audit firms in exploring "Audit Quality Indicators," mechanisms for defining and measuring audit quality in terms of its fitness for purpose to provide a high level of transparency around audit quality remain elusive. In a report by KPMG (2014), the five KPMG partners who were interviewed on the "auditing model and the profession" noted that organizinga quarterly investor conference calls at times may shed more light on the way companies are growing than the financial statements. Thus, the audit profession must widen the scope of the information that it offers in order to provide assurance to the investor community; and to meet other stakeholders' requirements regarding audit quality.

Society's failure to understand Auditor's duties: For nearly four decades, Chandler and Edwards (1996) noted that there has been a mismatch between society's expectations of auditors and auditors' performance. They also indicated that the gap resulted from three main causes; society having unreasonable expectations of auditors, auditors not meeting society's reasonable expectations of them and society being discontented with the standard of auditor's performance of some of the responsibilities they are required to perform by law, regulations or professional promulgations (Porter, 1993). The findings of these studies suggested that while society's unreasonable expectations of auditors are increasing, auditors must improve in meeting society's reasonable expectations of them and bring the performance of their responsibilities to an acceptable level. However, studies conducted in countries such as China and Saudi Arabia indicated that society's expectations of auditors and its perceptions of their performance (and, hence, the extent and composition of the audit expectation gap) may be significantly affected by institutional and cultural factors. Efforts made by the auditing profession to narrow the audit expectation gap, globally or in individual countries, will need to recognize the impact of these and similar factors. It was also found that Society's failure to understand the auditor's role in relation to the detection and reporting of fraud is considered the most important cause of the expectations gap. Humphrey, Moizer,and Turley (1992) noted that fraud has been an important element in the debate on audit expectations throughout the history of the statutory audit. The trustworthiness of auditors is being questioned in many countries and is evidenced by criticisms and litigations against auditors (Porter, 1993). Audit expectation gap contributes partly to these litigations and criticisms against auditors. One major criticism was that the auditors were unable to detect and report frauds, causing bankruptcy costs. Thus, shareholders misperceptions are the major cause of the legal liability crisis facing the accounting profession.

Perception of Audit between Public and Auditor's: In 1988, the Canadian Institute of Chartered Accountants (CICA) established a Commission (the Macdonald Commission) to study the public's expectations of audits. Like earlier studies, the Commission found that amongst its respondents (including the financial community group), there was substantial misunderstanding about the role of the auditor. Humphrey, Moizer, and Turley (1993) conducted a survey in the UK to investigate the opinions of auditors, *auditees* and financial statement users about auditors and their work. Findings from the study revealed that the opinions of the auditor group differed markedly from those of the finance directors and financial statement users. The largest difference relates to the assertion: *too much is expected of auditors by the investing community* (Humphrey, Moizer& Turley, 1993). Significant differences were also evident in respect of the assertions: a*uditors do not understand the problems of business*and *auditors should report to shareholders on management efficiency*.

While the auditors and, to a lesser extent, the accountants disagreed with the statements, the finance directors and financial statement users conveyed their agreement. However, the auditors disagreed with the notion that they should report on management's efficiency, but they agreed (as did the other groups) that they should identify ways to improve management efficiency. Linand Chen (2004) investigated the audit expectation gap in China by means of a survey of auditors and audit beneficiaries (investors, shareholders, creditors, government officials, business management and academics). They found that the auditors and audit beneficiaries agreed that there is a need to increase auditors' independence, nevertheless the groups' opinions differed in respect to the objectives of a financial statement audit, auditors' responsibility to detect fraud and third-party liability of auditors. Whereasthe auditors strongly agreed that the objective of a financial statement audit is to ensure the financial statements are presented in a true and fair manner, the audit beneficiaries indicated that they expect the objectives of an audit to include detecting and reporting fraud, other corporate irregularities, and management inefficiencies. The audit beneficiaries also expressed the view that auditors should be liable for third party losses caused by their negligence or failure to perform their responsibilities properly. Perhaps not surprisingly, the auditors disagreed with this proposition thus bringing about significant differences between auditors' opinion and the interest groups' view of the audit.

Summary and Conclusion

This study investigated the expectation gaps of the users of financial statement (in particular, shareholders) and their perception of the auditing assignment in line with its quality. The problem of audit expectation gap arose, not so much from a decline in standards of performance, but due to the facts that the role of auditors is poorly understood because of the failure to recognize significant changes in the environment wherein the companies operate. In other words, the audit expectation gap is a function of the complication and misunderstanding of nature, purpose,and capacities of an audit task. Shareholders alone cannot be censored for the existence of the audit expectation gap, as auditing is a complicated matter that may not be easily comprehended by those who paid for the service a situation that negates concept of the importance of value for money. Shareholders (the owners of the business), management and auditors are thus expected to come to a compromise of what auditing responsibilities should be and the correct ways to measure such performance.

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