CHAPTER III
REVIEW OF LITERATURE

INTRODUCTION

It is widely accepted that corporate auditing is an essential part of good management and suitable corporate governance and the success of a business heavily depends upon its financial position which is attested by its auditor. The auditor evaluates the correctness of financial statements and issues the audit report that becomes beneficial only when it contains reliable information [Committee on Basic Auditing Concepts, 1978; Commission of the European Committee, 2002]. If the users do not believe that an auditor is independent of the company where he is working, they will have little confidence in his work. It is wildly believed that auditors cannot present true and correct views, if there is an absence of auditor independence. It is also held that audit expectation gap is a function of responsibilities of auditors and the remedy lies in the right education imparted to the relevant groups in the financial reporting environment.

SCOPE OF THE REVIEW

Related to the various factors causing the audit expectation gap, the review of literature is presented below focusing on the auditor independence, the responsibilities of auditors, the audit expectation gap, and the education and audit expectation gap.

AUDITOR INDEPENDENCE

Emphasizing the crucial role of auditor independence in reducing the expectation gap, Humphrey [1991] observes; “If any topic can be classified as going to the heart of the audit expectation debate, it is the issue of auditor independence.” Further, Humphrey et al. [1992] identified the main elements of the expectation gap to be audit independence, audit skills, commercial nature of auditing and responsibility to detect frauds. Sikka et al. [1992] opined that independence was the main cause to reduce the expectation gap. He stated: “As a first step towards reducing the expectation gap, auditing standards and hence audit objectives should be shaped by open, democratic, accountable bodies, independent of the accountancy profession and the

Department of Trade Industry (DTI). On reducing the audit expectation gap, he recommended that the profession reduce the expectation gap by reforming the auditor independence.

High quality independent audits are used as a monitoring and bonding mechanism to alleviate the agency costs [Defond, 1992; Fan and Wong, 2005; Francis and Wilson, 1988]. In addition, the high quality auditors bring in greater credibility and better quality on financial statements [Khurana and Rama, 2004; Teoh and Wong, 1993]. If one wishes to place trust in the auditors' report, it must be a pre-condition that the views expressed by the auditor be based on objectivity, which can only be achieved when the auditor is independent of the client. The independent audit fills an essential role for the investing public and creditors by giving assurance as to the reliability of financial statements. Users of the financial statements must perceive auditors as independent professionals who exercise an objective and impartial judgment on all the issues brought to their attention. The perception is aided when the users also perceive that auditors have neither mutual nor conflicting interests with their audit clients. However, the issue of independence becomes more complicated when external auditing, internal auditing, and management consulting services are concurrently performed by the same accounting firm for the client. The users believe that an audit firm should not provide any management advisory services to its clients. However, auditors and accountants have traditionally tended to disagree strongly with this suggestion, whereas financial directors, investment analysts and bankers have weakly disagreed [Humphrey et al., 1993]. It is unbelievable that the auditor can offer the managerial consultation to the management on a fee basis and still appear completely independent to alert the intelligent outsiders [Mautz and Sharaf, 1986]. Majority of the perceived independence research has emanated from the United States, where there have been two government commissions, viz., the Cohen Commission [1978] and the Tread-way Commission [1987] with many debates on the effects of management advisory services on the independence of an auditor. However, the views of natural shareholders have not been sought in much of this research.

Reiter and Williams [2004] explained the way the accounting profession presented its notion on independence by characterizing accountants as professionals in these words; the professionals sought to convince their public that auditors were independent in fact, even though they may not be independent in appearance. Independence, in fact, referred to the true state of objectivity of the auditor.

There exists a large body of empirical evidence concerning the impact of various economic, regulatory and non-audit service factors on the perceptions of auditor independence. The following are the empirical evidences on auditor independence, which has been largely impaired by the non-audit services along with other factors.

Schulte [1965] discussed the non-audit services. Third parties (commercial loan officers and financial analysts) were asked whether the management consulting seriously impaired CPA's audit independence. There were great variations in their views. It was found that 43.00 per cent did not think so- indeed 20 per cent indicated that their confidence in audit reports was thereby improved), 33.00 per cent did think so, and the remaining 24.00 per cent were unsure.

Hartley and Ross [1972] conducted a large-scale survey among three groups (auditors, users and preparers of financial statements). Their study sought to overcome the criticisms of the earlier studies by including definitions of the key terms, examining the relative importance of NAS provision as a factor influencing the independence in appearance and separating the competence and independence issues. They found that only 6.00 per cent of all respondents ranked the NAS provision as the top threat to the independence; however, the flexible accounting rules and economic dependence ranked much higher. In relation to the specific services, the two greatest problems were the recruitment of non-financial personnel and the psychological testing. Nevertheless, the perception of the lack of independence was often found stemming from the belief that the service was incompatible with the image of a CPA or that the CPA was not competent to perform it. Neither limiting the NAS work as a percentage of fees earned from a client nor disclosure of NAS fees in the financial statements was viewed as a satisfactory solution to the problem.

Pany et al. [1980] discussed the effects of gift discounts and client size on the perceived auditor independence. The objective of this study was to report the results of an empirical investigation of factors, which influenced the actual and/or perceived auditor independence. In the study, three independent variables were manipulated: (i) the purchase discount or gift, (ii) the size of purchase discount or gift, and (iii) the client size. Their report suggested that gifts and discount of even a minimal amount significantly affected the users' perceptions of auditor independence, but the effects of the client size were not significant. This study also highlighted that less confidence in the auditor independence was expressed for the audits of large clients. Concerning the gifts, the larger the gift size, the less independent, as the respondents believed for each of the levels surveyed including 'No gift, $3, $40, and $125, the auditor was.

Lacy [1990] examined the effects of investment by the CPA partners and client principals on the perception of auditor independence. Specifically examined were the effects of a joint investment by a CPA partner and a client's Chief Financial Officer (CFO) in a limited partnership unrelated to the audit client, and a direct investment by a CPA in a client company. The results showed an inconsistency between the respondents' perception of risk of losing the independence and the AICPA independence rules. The respondents were more concerned about the certain joint investments, which were acceptable under the AICPA rules, than they were about small percentage, financially immaterial direct investments which were unacceptable under the AICPA rules. The CPAs perceived that the risk of losing the independence when there was a direct ownership of stock by a CPA was greater than that of any other group who perceived the risk to be.

Firth [1980], in his survey, distributed 750 questionnaires and received 369 completed questionnaires, the response rate being 52.00 per cent of the total. He examined 29 specific auditor-client relationships drawn from the ethical guidelines being proposed at the time. The participants were a random sample of chartered accountants (large-size firm of accountants working in other professional practices and those employed in commerce and industry), all major stockbrokers and investment managers (unit trusts, insurance companies, and merchant banks) in London and the loan officers of major banks and financial institutions. The provision of the NAS was ranked low as a threat factor for the three chartered accountant groups, but moderate for the other two user groups. The results showed that the lack of auditor independence was perceived to impair investment and lending decisions and this supported the 'traditional' view of the importance of auditor independence. It was also found that there were significant differences between the various groups of respondents regarding what constituted the independence and its importance.

Firth [1981] discussed the eight specific auditor-client relationships contained in the UK ethical guidelines of the time. He asked the bank lenders to make a loan decision based on the financial statements prepared in the context of one of these relationship situations. Two among the eight situations concerned the joint NAS provision: accounting services and consulting services. It was found that significantly lower loan responses were given than if there had been no joint service provision in both situations.

Dopuch et al. [2003] found that the disclosure of non-audit services reduced the accuracy of investors' beliefs in auditors' independence, when the independence in appearance was inconsistent with the true independence. In other words, a significant positive relationship between the non-audit service fees and audit fees was reported in a number of studies [Mc Meeking et al., 2002].

Firth [2002] developed a test to examine whether relatively high NASs were associated with the clean audit opinions, assuming that the higher frequency of clean audit opinions indicated impaired independence. He found a significant positive relationship between the NAS fees and the incidence of clean audit reports. He implied that the auditors, who also provided the audit clients NASs, might have impaired the independence and were more inclined to give a clean audit opinion. Firth's evidence was consistent with an impairment of independence due to the NASs.

Dykxhoorn and Sinning [1982] asked two groups of German users (loan officers and financial analysts) about a series of auditor-client relationships. Three relationships concerned NAS provision: the extensive accounting services, the limited accounting services and the EDP provision. The respondents were asked whether the independence was impaired or not, and whether the relationship had a positive or negative impact upon the lending/investment decision. The percentages considering that auditors remained independent were 63.00 per cent, 75.00 per cent, and 94.00 per cent in case of the extensive accounting services, the limited accounting services and the EDP provision respectively. It was found that the perceived investment decisions were affected.

Pany and Reckers' [1983] study focused on the non-audit services. They asked some corporate directors to make two judgments in relation to three services under a variety of conditions. The three services examined were: tax preparation, acquisition review, and systems design. These three services were believed to present self-review threats of increasing magnitude. The directors were asked whether they would vote in favor of engaging the auditor to perform the service and whether they thought the auditor could remain independent (Seven-point scale). The level of service rendering was manipulated for both the current year (10.00 per cent and 40.00 per cent of the year's audit fee) and the historical trend over the last five years (0.00 per cent, 10.00 per cent and 40.00 per cent of the year's audit fee).

Both the types of services and the magnitude of the current proposal were highly significant factors, while the magnitude of past services was only significant. The approval likelihood for system design- viewed as a less routine task than either tax preparation or acquisition review giving rise to a greater self-review threat was much lower than that of the other two services. The findings for the independence perceptions mirrored those obtained for the approval likelihood. The independence perceptions declined as the level of both prior provision and current provision increased.

Gul and Yap [1984] surveyed the views of auditors, managers and users (bankers and shareholders) on NAS provision taking Malaysia as the case study. The findings were based on the responses from a maximum of 34.00 per cent of individuals in each group. Interestingly, 23.00 per cent of the shareholders and 9.00 per cent of the auditors believed that the NAS provision increased their confidence in auditor independence, and the disclosure of fees paid to the auditor for the audit and for the NAS would lead to a better understanding of the relationship between the auditor and the client. With 87.00 per cent of the auditors agreeing with the NAS provision and the percentage for the other three groups confirmed the statement ranging between 55.00 per cent and 63.00 per cent.

Knapp [1985, 1987] defined independence as ‘the auditor’s ability to resist client pressure.’ He investigated the impact of four factors (i.e., NAS provision at the level of 0.00 per cent and 40.00 per cent) on loan officers’ perceptions using a full factorial, repeated measure design. The NAS provision was significant, but it accounted for only two per cent of the variance in responses.

Pany and Reckers [1988] explored the effects of the magnitude of NAS- at the levels of 0.00 per cent, 25.00 per cent, 60.00 per cent and 90.00 per cent of the audit fee. They found that the level of the NAS influenced only two of the requested 15 decisions (a loan decision and a 12-month investment safety decision).

Gul [1989] examined the impact of five factors (i.e., the NAS provision, one of the three factors treated as a repeated measure) on bankers’ confidence in the auditor’s independence. The impact of NAS was significant but not in the expected direction since bankers had a higher confidence in the auditors who provided NAS- consistent with the argument of Goldman and Barley [1974] discussed above. The NAS factor accounted for 9.00 per cent of the variance.

Schleifer and Shockley [1990] examined users’ and auditors’ reactions (agree, undecided or disagree) to a range of policies designed to enhance the auditor independence, two of which related to NAS. The audit clients being prevented from receiving the executive search services was one policy. The next policy was the requirement to disclose the nature of other services provided by the auditor. Majority of Big Eight auditors and financial analysts disagreed with the former policy and their percentages stood at 59.00 per cent and 58.00 per cent respectively. The majority of Big Eight auditors and financial analysts (64.00 per cent) disagreed with the disclosure policy, but the majority of all other groups agreed (83.00 per cent of financial analysts, 58.00 per cent of the non-Big Eight CPAs and 88.00 per cent of loan officers). The number of respondents in each group was, however, very small at 22.

Lindsay [1990] analyzed the impact of three contextual factors (audit firm size, competition, and NAS provision) on bankers' perceptions of auditors and their ability to resist the management pressure. A repeated measure design was used. The NAS provision, while highly significant, explained only 1.00 per cent of the variance in bankers' responses. This cast some doubt upon the practical significance of the joint provision on auditor independence perception.

Agacer and Doupnik [1991] made the first transnational study of auditor independence perceptions taking the US, Philippines and West Germany. Four variables were considered (the NAS provision and the members of the accounting profession). A full factorial, repeated measure design was used. It was found that significant differences existed between the three countries, with West German respondents indicating the greatest concern regarding the independence impairment and Philippine respondents indicating the least concern. These findings were explained in terms of cultural differences.

Dopuch and King [1991] used experimental market to investigate the impact of NAS provision on the auditors' independence. They compared market outcomes under two different rules (joint provision by auditor allowed or not). These were referred to as non-restricted and restricted markets. The markets' setting and general market procedures were explained to the subjects who then took on a role (seller, buyer or auditor) and interacted for multiple periods in one of the 12 particular experimental markets. There was no indication that allowing joint service provisions by the auditors adversely affected their verification effort decisions for either type of service, nor was there any indication that buyers perceived the audit reports to be less credible because of the joint provision. The authors concluded that a prohibition on the joint provision could have an 'adverse' effect on the market structure of the audit industry since the efficient NAS and not the audit services were restricted to the market. The authors suggested that specialist firms emerge. It was argued that this market structure effect could offset any benefits that the change might have on the auditors' independence.

Panayioris [1991] conducted a survey on the legal framework of auditor independence. It was found that the more independent an auditor was, the greater the confidence he had in his work and opinion. The auditors' independence was also supported by the law establishing the framework for the future thinking by the interested parties with prevailing legal environment. He concluded that the maintenance of the auditor independence was very important for the users of the financial statements. However, after the implementation of the eighth directive, this framework probably would change and take the form of more rules and regulations. The professional bodies were able, through the ethical guidelines, to enhance their independence by issuing and enforcing standards in all the areas, by which the public thought that the independence was endangered.

A survey was conducted by Canning and Gwilliam [1999] among the 196 respondents who were academics, corporate lenders, investment managers and financial analysts. The results showed that 68.90 per cent of respondents strongly believed that provision of NAS decreased the level of auditor independence.

Shokley [1981] examined the perception of CPAs and financial statements' users with respect to the independence of public accounting. The subject considered the impact of four variables on the risk that the independence of an audit might became impaired: competition for an audit client; provision of MAS; size of audit firm; and audit firm's tenure.

The results showed that the audit firms operating in highly competitive environment, firms providing MAS, and smaller audit firms were perceived as having higher risk of losing independence. For all respondents, competition was ranked the most important, which had significant impact on perception of independence followed by size, and MAS. The results also showed that the tenure did not have significant impact on independence.

Frankel et al. [2001] provided empirical evidence on the effects of non-audit services provision on the auditor independence and whether the market values the fee disclosure. The authors collected fee information from 4000 proxies filed with the SEC between February and June 2001. A significant negative market reaction was found with respect to the firms with the highest unexpected non-audit service fees. The authors concluded that the provision of non-audit services could threaten the auditor independence.

A survey was conducted by Abu Bakar et al. [2005] among 116 loan officers in Malaysia. The results showed that 75.60 per cent of the respondents indicated that the size of the audit firm did affect the auditor independence and 74.40 per cent of them mentioned that the level of competition in the audit service market influenced the auditor independence. Furthermore, the results indicated that the provision of MAS had a negative effect on the auditor independence in Malaysia.

Another survey was conducted by Quik and Rasmussen [2005] regarding the non-audit services, especially MAS in Denmark. The participants were 151 auditors, 140 directors, 146 bank loan officers, 124 shareholders and 117 business journalists. The results of this study showed that most subject groups believed that the provision of advisory services by the auditors to the clients reduced the trust held in an auditor's independence. In other words, 39.90 per cent of directors, 50.50 per cent of bank loan officers, 69.20 per cent of shareholders and 81.10 per cent of business journalists believed that the provision of advisory services by the auditors to the same clients impaired the audit independence; 85.60 per cent of auditors did not agree with them. In this research the authors postulated that separation of audit firm consulting staff from the auditing staff might increase the audit independence. The results of this study showed that 44.40 per cent of directors, 38.40 per cent of bank loan officers, 49.40 per cent of shareholders and 56.90 per cent of business journalists strongly agreed that the separation of such services increased the audit independence; 66.70 per cent of the auditors strongly disagreed with other participants on this matter.

Lindsay [1992] surveyed the perceptions of financial community in Australia and Canada on auditor-client conflict resolution. Four factors- NAS provision at either 0.00 per cent or 40.00 per cent of audit fee- were presented to the expert users (analysts and bankers) in a full factorial, repeated measure design. The country effect was not found to be significant. The NAS provision was a significant factor in explaining the responses, accounting for 3.00 per cent of the variance for the analysts and 2.00 per cent for the bankers.

Garcia-Benau and Humphrey [1992] investigated the expectation gap in both UK and Spain. Auditors, finance directors and users were asked whether the audit firms should not provide NAS to their audit clients. In both countries, the average response was close to neutral for all groups except UK auditors who expressed strong disagreement.

Emby and Davidson [1997], in addition to providing a review of prior studies, focused on the impact of the NAS provision on individual perceptions and decisions, and the impact of NAS provision on individual perceptions and decision. Their findings supported those of Coreless and Parker [1987] in that the auditors did not appear to be biased towards a more favorable assessment when they assessed the systems designed by their firm's system group and in some cases the opposite effect was observed.

Barlett [1997] examined the perceptions of auditor independence in five different scenarios involving potential conflicts of interest. Case four involved the provision of NAS (specifically investigation of the audit that gives rise to a self-review threat and pressure from the management to violate GAAP). Seventy-six CPAs and forty-eight bankers participated in this study. Over half of the bankers felt that the auditor would compromise his independence, compared to 69 per cent of CPAs who felt that they would not.

Engle and Sincich [1998] explored auditors' views regarding the violations of the AICPA's Code of Professional Conduct Rule 101. Fifteen independence-related ethical violations were identified, including the risk that NAS inappropriately influenced the audit judgments. Of the 897 respondents, 12.30 per cent felt that such an influence was felt.

Lennox [1999] examined the voluntary disclosure of NAS fees in the period immediately before the requirement became effective in UK and after the requirement was announced. Examination of the UK companies during 1988-94 suggested that if NAS fees were disclosed, the provision of such services would appear to strengthen independence, consistent with the arguments of Goldman and Barley [1974].

Hussey [1999] asked some UK finance directors about a range of issues concerning the familiarity threat and auditor independence. One question was whether the auditors should be allowed to undertake to do other than audit work for the same client. The majority agreed that the joint provision should be allowed; however, 20.00 per cent of the independent public respondents disagreed, compared to 13.00 per cent of private company respondents.

The Beattie et al. [1988] study examined a large set of 45 economic and regulatory factors that could impair or enhance the auditor independence, using surveys of UK audit partners, finance directors and financial journalists. A high level of NAS (> 100 per cent of audit fee) ranked among the top threat factors for the users with the second rank and for the preparers with the sixth rank. It was ranked as the twelfth for the auditors. At a level of 50.00 per cent of audit fee, the corresponding threat rankings were the fifth, tenth and seventeenth and at the level of 25.00 per cent of audit fee they dropped to the fourteenth, eighteenth and twentieth. The NAS fees also increased economic dependence generally, and all groups ranked various measures of economic dependence among the top threat factors.

Lowe et al. [1999] examined the implications of various internal audit-outsourcing arrangements. Based on a survey of 177 loan officers, they found that the highest ratings of auditor independence were given when the company's CPA firm used separate staff members to perform the internal auditing services, with the overall effect of such joint provision being positive.

It is important to mention that Canning and Gwilliam's [1999] work is the only Irish study on the auditor independence perceptions. It focused on the impact of joint NAS provision. A total of 148 corporate lenders, investment managers and financial analysts took part in the survey. The respondents were asked whether the independence of the auditor decreased, if the NASs were provided in five different circumstances, with responses being given on a 5-point agree-disagree scale. Sixty-nine per cent agreed that joint provision using the same personnel reduced the independence, whereas only 24.00 per cent agreed when separate departments were used. Only 16.00 per cent agreed that the NAS provision to non-audit clients only reduced independence and only 16.00 per cent agreed that joint provision to all clients combined with full disclosure reduced independence. Twelve per cent agreed that non-provision of NAS decreased independence, i.e., the joint provision enhanced auditor independence.

Jenkins and Krawezyk [2000] is the recent US study that focuses on the impact of the joint NAS provision. Both the materiality of the NAS fee (material or nominal–40.00 per cent and 3.00 per cent respectively) and the type of the NAS performed (actuarial services, internal audit outsourcing, legal services, and software training) varied where 323 investors and auditors took part. This study found that the joint provision had a positive effect on the participants' perceptions of auditor independence, with the influence being the strongest for the Big-Five auditors. It was also found that investors favored the disclosure of the amount of NAS and audit fees regardless of their level; whereas auditors favored the disclosure only if the NASs exceeded a specified threshold.

Contrary to the concerns that fee dependency impairs auditor independence, Reynolds and Francis [2002] found evidence consistent with the auditors increasing their independence in response to greater financial dependence. Specifically, they found that relatively larger audit clients- those on whom the auditor was expected to have the greatest financial dependence- tended to report significantly lower discretionary accruals when compared with smaller clients. The authors maintained that this was because the reputation and litigation damages from the audit failure were likely to be greater for the larger clients, providing incentives to the auditors to be more conservative. In addition, they also found no evidence that auditors were more lenient in issuing going concern reports to larger clients. Thus Reynolds and Francis found no evidence indicating that financial dependency impaired the auditor independence.

This study also showed that market-based institutional incentives such as reputation loss and litigation costs promoted auditor independence and outweighed the economic dependency created by higher fees. They felt that the essence of auditing was verification. Hence a rich model for auditing should contain something to verify. In the absence of verification, management received incentives to misrepresent the financial condition of the firm. These incentives arose because the financial reports were used to evaluate management's performance, which was costly to observe directly.

This study suggested that modeling auditing in a decision setting involved moral hazards, with agency theory providing a natural basis for the model. Agency theory models the contractual relationship between a principal and an agent, which in this case consists of the owner-principal and the manager-agent relationship. The authors assumed that the owner hires an auditor to produce information used in contracting with the manager. Thus the auditor was both an agent and a model as such.

A survey was conducted by Dewing and Russell [2002] among 13 accountants and 17 non-accountants, whose results showed significant expectation gap between two parties. In this research, key concerns identified by respondents were auditor independence, responsibilities for fraud and going concern, monitoring and discipline of auditors.

Frankel et al. [2002] used recent SEC-mandated disclosures to investigate the share price reaction to the announcement of higher than expected non-audit fees. This required the specification of a model of expected fees. Although a negative association was found, suggesting that investors interpreted the provision as an evidence of auditor impairment, the statistical significance of this finding was sensitive to the specification of the non-audit fees model. In a replication using a similar dataset, Ashbaugh-Skaif et al. [2002] found no relationship.

It is believed that auditor's responsibility and independence are crucial issues underlying the independent auditing function and have significant implications on the development of auditing standards and practices. A survey was taken up by Lin and Chen [2004] in China with respect to the audit objectives, auditors' obligation to detect and report frauds, and third party liability of auditors. The study evidenced the emergence of the expectation gap in China and the majority of audit independence by reducing the governmental control or intervention and moving towards self-regulation of the profession. This study had a limitation in that it should cast light on the understanding of the institutional setting and updated development of independent audits in China and might also serve as an annotation to the recent accounting reform debates in the western world.

Myers [2005] investigated the views of natural shareholders regarding the role of effects on independence due to the audit firm's providing the non-audit services to their audit clients. A total of 615 questionnaires were received with an overall response rate of 37.50 per cent. Shareholders were asked whether they agreed that the independent audit enabled them to rely on financial information of profits, dividend yield/payout ratios and assets/liabilities. The responses of shareholders generally confirmed that the independent audit was important in their use of financial accounting information. Similarly, the reliability factors for the audit report of auditors' independence and audit firm's reputation were tested. Both were believed to add credibility to the auditors' report. Further discussion involved shareholders' perceptions of audit independence in three separate instances, where the audit firm had received substantial consultancy fees and the auditor had acquired shares from the audit clients while the same auditor had been retained for over seven years. Shareholders' opinions revealed that the auditor independence was perceived to have been impaired by the substantial consultancy fees paid, but to a lesser extent by share ownership. Long-term audit contracts were not perceived to impair the auditor independence. This study also refutes the idea that auditors could maintain their independence when receiving substantial consultancy fees. Overall, the findings of this research suggested that natural shareholders placed a strong reliance on regulatory matters such as the accounting standards and the corporation's laws for accounting information.

Alleyne et al. [2006] investigated the appearance standard by empirically exploring both auditors and users' perceptions of auditor independence in Barbados. Firstly, the study contributed to the existing body of knowledge in terms of providing a better understanding of the nature of auditor independence in small developing countries. Secondly, this study could inform policy makers, governments and professional accounting bodies as to how auditor independence policies and frameworks could be structured to ensure an adequate regulation of the capital market. Thirdly, their study would serve to educate the users and auditors for the contextual factors surrounding the role of auditor as well as the possible threats and enhancement factors affecting the auditor independence. The survey instrument was divided into two sections: section one dealt with the demographic information, and section two focused on 39 audit-related issues categorized under a number of generic factors. The sample respondents consisted of auditors (66), and users (148). The findings of the study revealed that economic dependence of an auditor on the client, the provision of non-audit services, high competition, small firm size, being a sole practitioner, lengthy tenure and the size and closeness of Barbadian society were found to affect the perceptions of the auditor independence negatively.

Sajadi and Ebrahimimand [2005] elicited 98 Iranian Certified Public Accountants' viewpoints on the factors increasing auditors' independence. The objective of the study was to identify the factors which increased/would increase the auditors' independence. The results showed that the factors such as audit committee, client size, the size and experience of audit firms increased the auditors' independence, and other factors, namely, competition among the auditing firms decreased the auditors' independence.

A survey was carried out by Sajadi and Naseh [2003] in Iran regarding the effectiveness of certified auditing of financial statements among 51 managers. The conclusion was that independent auditors would be effective in the detection and reduction of illicit acts and offences as well as the exercise of precise appraisal of bases used in accounting estimates. However, such auditing would not serve the purpose of improving internal control system reducing the likelihood of errors omission.

The study by Mojtahedzadeh and Aghaei [2005] focused on the factors influencing independent audit quality. The study covered the perceptions of 90 investors, 71 creditors, and 92 auditors in Iran selected on the basis of random sampling. The study showed that the investors and the creditors strongly believed that any other services affected auditor independence.

Another survey was carried out by Hassas-Yeganeh and Khaleghi [2004] in Iran regarding the attest function of the independent auditors and the respondents included auditors and investors. The results indicated that there was an expectation gap between the auditors and users on the attest function of the independent auditors.

The results also showed that there were significant differences between the auditors and users regarding the reliability of the audited financial statements and the comparability of the audited financial statements. The users believed that if the audited financial statements were re-audited by others, they would show a different picture.

To conclude, majority of the studies on the impact of NAS provision on auditor independence perceptions offer somewhat conflicting and inconclusive results. While the majority of them indicate that the NAS provision impairs the independence perceptions for, at least, a large number of respondents, others suggest that the independence perceptions are either unaffected or enhanced. Yet, other studies show that decisions can escape the effects even if independence perceptions are negatively affected.

RESPONSIBILITIES OF AUDITORS

The concept of audit responsibility entails ‘an amalgamation of public policy consideration’ [Chung, 1995]. In addition, business operations have become much more complex owing to the global competition and large-scale industrial restructuring. The investing public has increasingly relied on auditors to monitor and assure the reliability of financial reporting. The ‘expectation gap’ has emerged as the profession has failed to react [Gwilliam, 1992; Francis, 1994]. As posited by Power [1998], the ‘expectation gap’ is derived for a loose coupling between the idealization of auditing and the actual audit practices. However, the ‘expectation gap’ in relation to the auditors’ responsibility is mainly a time lag effect.

The responsibility debate has positively affected the development of auditing standards and practices in the developed world. By identifying the society’s needs over time, the debate has enabled the profession to realize ‘a duty to asses auditing standards continuously in light of the expectations, concerns and criticisms of others and develop new standards to bring the auditors’ responsibility and performance closer to public expectation’ [Porter, 1996]. In the USA, the AICPA, though reluctant to extend auditors’ responsibility for fraud detection, has made continuing efforts to revise the auditing standards in the last two decades to accommodate changing public expectations [Dye, 1993; Kinney and Nelson, 1996; Barnett et al., 1998;

Reinstein and Coursen, 1999]. Similar efforts have been made in the UK and other countries [Pong and Whittington, 1994; Porter, 1996; Innes et al., 1997].

Less literature is available on the studies relating the responsibilities of auditors, compared to those available on the auditor independence, and the audit expectation gap or the components of audit expectation gap. Many studies on audit expectation gap have identified the responsibilities of auditors as one of the factors causing the audit expectation gap.

The responsibilities of auditors and the expectation gap always go together. The expectation gap is due to the over-expectations of the auditing function. The profession has challenged this viewpoint on the grounds that audits are designed to assure the conformity of financial statements with GAAP, and fraud prevention and detection should be the responsibility of managers who bear a legal obligation for truthful financial reporting [Nair and Rittenberg [1987]; Goldberg [1988]; CICA [1988]; McEnore and Martens [1991]; and Chapman [1992].

Auditors have long been asked to detect errors or frauds [Brief, 1975]. The history of the development of the auditor's responsibilities concerning the detecting and reporting of frauds and errors have shown their construction to be dependent on the reactions and lobbying efforts of the audit profession [Humphrey, 1991]. Similarly, Humphrey et al. [1993] noted that auditors' responsibilities concerning frauds have been a recurrent problem as it is clear that public's expectations on this issue are not satisfied.

Robinson and Lyttle [1991] opined not only that the audit expectations gap was widest in this area, but also that almost half of the auditors studied considered the detection of frauds as one of their duties. Given that some auditors misunderstand their responsibilities, it is not surprising that some users are confused.

Auditors have a duty to detect material theft of corporate assets taken away by non-managerial employees whose wrongfulness escapes the internal control net, but they provide the company's management with the report such as theft that is generally where their responsibility ends [Porter, 1990].

The profession's continuing attempts to avoid fraud detection responsibility were motivated to protect its self-interest in order to deflect public pressure and reduce auditors' legal liability [O'Sullivan, 1993; Tidewell and Abrams, 1996].

Humphrey et al. [1992] conducted a survey in October 1991 and March 1991 to gather evidence on opinions and perceptions on auditing from a wide variety of groups. These groups consisted of auditors, financial directors, investment analysts, bankers and financial journalists. Their survey found that there were significant differences relating to the auditors' role. Generally, the auditors saw themselves as more restricted than other groups. One interesting aspect was that 71.00 per cent of auditors disagreed that the balance sheet provided a fair presentation of the company's financial position, while 58.00 per cent of financial directors and 81.00 per cent of users felt otherwise. It was concluded that this might suggest that in addition to the expectation gap there was also a financial reporting gap.

Another remarkable study on auditors' responsibilities involving various dimensions of the attest function was made by McEnroe et al. [2001], who found that investors had higher expectations for various facts and assurances of the audit than did auditors in the areas of disclosure, internal control, frauds, and illegal operations.

The literature explored with respect to the responsibility of auditors brings out that one of the major responsibilities of an auditor is detection of frauds. The literature survey also evinces the fact that any discussion about auditors' responsibility centers on his responsibilities towards the detection of frauds in spite of the fact it has been relegated to the second place. In addition, SAS 82 also specifies clearly that it is not the responsibility of an auditor to detect and prevent errors and frauds, but the users of financial statements still perceive the major responsibility as only the detection of frauds. There is also a lot of information supporting this viewpoint as any amendment to the existing auditing standards or the inclusion of any new provisions centering on the prevention and detection of frauds as the responsibility of auditors.

Monroe and Woodliff [1993] surveyed the effects of education on students' perceptions about the responsibilities of auditors. It was found that there were no differences between auditing and marketing students at the beginning of the semester about auditors' responsibilities. They believed that auditors had more responsibilities, and management had less responsibility for the prevention and detection of frauds and the safeguarding of assets. However, at the end of the semester, the auditing students believed that auditors assumed a much lower level of responsibility, but there was little change in the marketing students' beliefs.

Guy and Sullivan [1998] made study of the nine new standards of Auditing Standards Board. The authors concluded that if the existing audit expectation gap was to narrow, the new standards should bring the auditors' responsibilities and performance closer to public expectations.

Makkawi and Schick [2003] suggested two approaches that auditors should adopt to aid the fraud detection. First, they argued that auditors needed to 'audit smarter' because they operated in a fixed fee environment, which limited the fees that clients were willing to pay. This can be accomplished by the need for auditors to be more aware of the context in which the audit occurs, and the fact that the nature and concentration of fraud varies by industry. Second, the authors suggested that auditors exercised greater skepticism and rigorous assessment of management's integrity.

Lin and Chen [2004] opined that the users believed that the auditors were responsible for the truthfulness and reliability of financial statements, detection and reporting of errors and frauds, fraudulent or misleading information contained in the prospectus disclosure. They also perceived that the auditors should disclose in the audit report the uncovered frauds, inefficiency or irregularities. The empirical study showed that there were significant differences between the perceptions of users and auditors.

Frank et al. [2001] conducted a survey among 100 auditors, 100 jurors and 100 accounting students from the Mid-Atlantic University in the USA. The study focused on audit knowledge, audit role, and general attitudes toward the profession of the respondents groups.

In this survey participants were asked to respond the items in the scale with endpoints of 0 (strongly disagree) to 10 (strongly agree). The results indicated that the participating groups had different degrees of variability in their responses, with jurors generally having the most variability. Therefore, the authors conducted the Kruskal-Wallis test to examine the differences between and among the three groups. The results revealed a large divergence in perceptions among auditors, jurors, and students regarding their expectations of the accounting profession. The participating groups' responses were significantly different for each attitudinal question of the three above mentioned dimensions. For all dimensions, jurors' responses were significantly different from either students or auditors'.

Almer and Brody [2002] conducted an experiment to examine 57 auditors and 69 bankers' interpretations of the phrase substantial doubt, and the entity's ability to continue as a going concern used in an audit opinion. They found that auditors and bankers had a different understanding of the phrase, and so there was a significant gap in perception between the auditors and the bankers.

Koh and Woo [2001] investigated the audit expectation gap between 302 auditors and 246 managers and found a significant gap, with management expecting more than auditors in the areas of preventing and detecting fraud, illegal acts, errors and guaranteeing the accuracy of financial reports. The expectation gap between the two groups was mitigated as managers became more knowledgeable about audits and had longer tenures.

The study by Abdel-Qader [2002] on the role of auditors in detecting illegal acts in Jordan revealed that a significant gap existed in respondents groups consisting of external auditors, academics, shareholders, internal auditors and finance managers. The external auditors did not feel that they were responsible to detect the illegal acts, while 40.00 per cent of the academics, 28.60 per cent of the shareholders, 60.00 per cent of the internal auditors, and 47.80 per cent of the financial managers strongly agreed that the external auditors should be responsible for detecting the illegal acts; however, the researcher concluded that all of the participants strongly agreed that management should be responsible for detecting all frauds.

Desira and Baldacchino [2005] conducted a thorough study on the expectation gap in Malta based on the perceptions of auditors and jurors. The results revealed that there were significant differences between the two groups related mainly to the auditors' responsibility for various issues, from frauds to the security of a company's internal control structure. Furthermore, the results showed significant differences in the area of prevention and detection of frauds and material misstatements.

Fadzly and Ahmad [2004] surveyed the responsibilities of auditors as one of the factors in the areas, which could cause a gap(s) between auditors and investors. In their study, they formulated eight statements on the responsibility such as the issues of fraud detection and prevention, account and financial statements preparation, auditors' objectivity, internal control, scope of auditors' legal responsibility and auditors' culpability in fraud-related business failure. The researchers used the Mann-Whitney U test to find the auditors and users' perceptions of the expectation gap. The results showed that there were significant differences in all the statements except for the auditors' objectivity. The study proved that the users believed the auditors were responsible for all the above mentioned statements. The largest extent of difference was found in the responsibility to prepare the financial statements. Brokers and investors expected the auditors, not the directors, to prepare financial statements. For the remaining statements, moderate ratings were given by the users.

Low [1984] conducted two surveys amongst the auditors and analysts in Singapore and Australia. The results showed that significant differences in perceptions were found in areas pertaining to the extent of assurance over fraud detection and the reliability of information presented in the audited financial statements in both the countries.

Dixon et al. [2006] conducted a survey on auditors' responsibility in Egypt focusing on seven statements of responsibilities such as the issue of fraud detection and prevention, internal control, scope of auditors' legal responsibility, financial statement preparation, auditors' objectivity and audit procedures. The results of the empirical study indicated that there were significant differences in all responsibility statements except for financial statement preparation. The auditors as well as the users were in agreement and had strong beliefs that management must have responsibility for producing financial statements. And the users believed that auditors were responsible in the remaining areas

Jamal et al. [1995] and Zimbleman [1997] evidenced that focusing specifically on fraud detection might result in enhanced ability to detect frauds.

Monroe and Woodliff [1993] found that the beliefs about responsibilities of the auditors for the detection of fraud were significantly different. Auditing and marketing students believed that at the beginning of the semester the auditors were more responsible to detect frauds by assigning the group mean of 3.9 and 4.3 respectively. After the course, auditing students believed that auditors assumed less and management more responsibility to detect frauds by assigning the group mean-value of 2.1.

Mancio [1997] clearly brought out the auditors' responsibility towards detecting any kind of frauds. He quoted SAS 82 to clarify the same and stated that the auditor was not responsible for the detection of frauds. According to him, the auditors' responsibility related the detection of material misstatements caused by frauds and was not directed to the detection of fraudulent activity *per se*. Thus the auditor of financial statements must obtain responsible assurance that the statements were free of material misstatements, whether caused by errors or frauds. He also discussed how a financial statement audit differed from a fraud audit. A fraud audit is a separate engagement from a financial statement audit conducted in accordance with GAAS. The fraud audit typically is a consulting service; the accountant should refer to the AICPA statements on standards for consulting services and for appropriate guidance.

McEnroe and Martens [2002] extended the prior research by directly comparing audit partners and investors' perceptions of auditors' responsibilities involving various dimensions of the attest function. This study surveyed the public accountants and individual investors to obtain their perceptions of the extent to which an expectation gap existed in several dimensions of the attest function. The investors were surveyed because they were the main users of the financial statements and were the most appropriate subjects to be employed as the representatives of the public and financial statement users. Audit partners were included as the group on the other side of the expectation gap. The research was conducted over a decade after the release of the expectation gap SAS No. 82 [AICPA, 1996]. They found that an expectation gap existed. The investors had higher expectations for various facets and/or assurances of the audit than did the auditors in the following areas: disclosure, internal control, frauds, and illegal operations. It was also discovered that the investors expected the auditors to act as ‘public watchdogs’

Garrick [2004] opined that at the heart of any program to prevent frauds was an effective, efficient and secure management of information in any form. Information is a key asset and is the product of people interacting with processing systems, technology and raw data. According to him, protection may include one or more of the following elements: confidentiality, integrity, availability, accountability and potentiality of being auditable: The weight attached to each of these elements will vary depending on the resource being protected and the threat. Regarding the fraud detection, Garrick is of the opinion that detection aims to identify losses or attempts to cause loss at the earliest possible opportunity and limit the amount of capital wastage.

In order to prevent and detect frauds, Garrick suggests the designing of a fraud awareness program targeting the critical fraud issues that can achieve early changes in staff awareness and culture. Fraud awareness and change management programs use the full range of modern multimedia, sales and marketing and communications concepts to deliver messages in a refreshing and innovative manner. Similar techniques are recommended for this program to ensure maximum impact and value to ensure appropriate training to enable staff to prevent, detect and where appropriate, correct frauds or other irregularities.

Boyd and Ethics [2004] feel that a company should first come clean about frauds and then clean up the mess to protect its reputation. He opines that a fraud is an assault on trust and reputation. If not well handled, the damage to a company’s reputation—either from the fraud or the way a suspected fraud is managed by senior managers—can be as profound as the impact on the company’s bottom line. In the current environment, any suspicion of fraud or public allegation of lack of a financial integrity has to be treated by senior managers as a serious threat to reputation.

The studies by Fadzly and Ahmad [2004] and Dixon et al. [2006] on audit expectation gap in Malaysia and Egypt did similar studies about fraud detection revealed that fraud prevention was also one of the areas where the expectation gap was likely to exist. The expectation gap was found to be particularly wide on the issue of the auditor's responsibilities for fraud prevention and detection.

The above literature survey on frauds highlights that fraud is an important component of an audit expectation gap, and it is perpetrated in many ways at different levels. The literature survey also evinces the fact that though it is not the primary responsibility of an auditor to detect and prevent frauds, their responsibilities towards fraud detection are unavoidable in the course of his discharge of his duties.

A survey was carried out by Nikkhah-Azad and Mojtahedzadeh [1991] regarding the independent auditors' responsibilities in Iran. The participants were 43 Investors, 100 Financial Managers, 105 Creditors, 60 Tax Officers, 50 Stockbrokers, and 70 Independent Auditors. The objective of the study was to ascertain the dimensions of independent auditors' responsibilities in Iran among these participants.

In this study, the authors identified 25 areas of the auditors' responsibilities each of which formed one research hypothesis. The results showed that 17 of 25 hypotheses were accepted, maintaining that 17 areas of the responsibilities were more important than the rest:

a. responsibility of auditors to give an independent opinion,
b. responsibility of independent auditors related to the companies' going concern,
c. responsibility of auditors to evaluate financial control structure,
d. responsibility of auditors to report the inefficiency of financial control structure,
e. responsibility to evaluate the management structure,
f. responsibility to report the inefficiency of management controls,
g. responsibility to detect the illegal acts,
h. responsibility to detect frauds,
i. responsibility to report the overriding of regulations,
j. responsibility to recognize the GAAP competence,
k. responsibility to identify the audit procedures,
l. assessment of the rationality of accounting methods,
m. assessment and evaluation of client firms based on their short time as well as long time goals,
n. assessment of reasonability of accounting estimations,
o. responsibility of auditors towards society,

p. responsibility of auditors towards the fairness of financial information, and
q. responsibility of auditors to evaluate the firm's activities.

A very thorough survey was conducted by Beelde et al. [1999] among the auditors, bankers, and managers in Belgium, whose results showed that there were significant differences between auditors, bankers, and managers' perceptions in several fields. The significant gap was found regarding the responsibility of auditors towards the detection of frauds and errors. Eighty-nine per cent of the auditors felt that they were good at detection of errors, but other parties believed otherwise. Furthermore, the results showed that there were significant differences among the respondent groups regarding the auditing process, auditors' liability, and prohibitory rules and regulations for the auditors.

The study conducted by Sidani [2007] directly touched upon the expectance gap, on which the researcher attempted to identify it in the areas of audit knowledge, auditors' role, and general attitude towards the profession. The participants were 87 auditors and 81 non-auditors. The results showed significant differences regarding the auditors' responsibility, auditors' liability among the participants. Non-auditors believed that the auditors should have more responsibility for financial statements. In addition, the results showed that there was a significant difference in the perceptions of an auditors' role pertaining to fraud detection.

Meanwhile, Ratliff and Reding [2002] that third parties and auditors accepted new responsibilities in a new environment because of changing environment. Hence auditors of the 21st century must be prepared to 'audit' virtually everything operations (including control systems), performance, information and information systems, legal compliance, financial statements, fraud, environmental reporting and performance, and quality. Chandler et al. [1993] found the various aspects of the development of the audit function in the UK and sought to explore the nature of auditors' responsibilities and the public's perceptions of the auditors' role. The study showed that audit objectives and practices tended to follow external events and that the profession encountered great difficulty in reconciling public expectations with the practicalities of auditing. It also suggested that general confusion over the role of auditors existed to such an extent that it was difficult even for the profession to reach agreement on the main purpose of company auditing and the message to be sent to the investing public. Further, Comeron [1993] explored the relationship between public accountants and their small business clients in New Zealand by seeking the opinions of public accountants, small business and associated third parties (bankers, business consultants and enterprise agencies) with respect to the roles that the auditors were expected to perform and those that they actually performed. The results revealed that the three groups expected the auditors to provide compliance services, give accounting-related advice, show concern for clients' financial health, actively seek out client problems and give general business advice. Auditors were perceived as actually providing all of the services expected of them except the service of actively seeking out client problems. In relation to the other functions, the actual performance of chartered accountants was generally perceived to fall below the expected levels.

In this background, the responsibilities of an auditor are listed below:

- analytical and critical thinking skills,
- an efficient method to gain an adequate understanding of any individual audit clients, organization, or system,
- new concepts, principles, and techniques of internal control,
- an awareness and understanding of risk and opportunity related to both the audit clients and the auditors,
- development of general and specific audit objectives for any audit project,
- selection, collection (using a broad array of audit procedures), evaluation, and documentation of audit evidence, including the use of statistical and non-statistical induction,
- reporting audit results in a variety of formats to a variety of recipients,
- audit follow-up,
- professional ethics, and
- audit-technology applicable across a variety of types of audit reports.

In addition, auditors must understand the concepts of auditor independence and objectivity as the concepts related to different types of audits by different types of auditors. They must fully understand cost and materiality implications of risk, opportunity, and audit evidence.

AUDIT EXPECTATION GAP

Over the last two decades, the Anglo Saxon world has experienced a spate of corporate failures such as financial scandals and audit failures, which have placed the audit agenda of the accounting profession, regulators and the public [Dewing and Russel, 2002]. Given the recent financial reporting scandals (Enron, WorldCom, Parmalat, etc.), financial reporting and audit practice are once again at a crossroad. These conditions may be widening the audit expectation gap.

The studies on audit expectation gap bring out the nature of audit expectation gap prevailing in different countries of the world. These studies bring out the differences in perceptions of the audit expectation gap amongst the different sections of the society. Most of the studies ascertain the auditors and the public's views of the roles and responsibilities of auditors through the use of surveys.

The foundations for research in audit expectation gap were laid down in the seminal works of Lee [1970] and Beck [1974], who investigated the duties which auditors were expected to perform. Most of the studies ascertain that the auditors and the public's views of the roles and responsibilities of auditors can be obtained through the questionnaires. Liggio [1974a] visualized the changing role of auditors at the initial stages. Then, he pioneered the concept of audit expectation gap [Liggio, 1974b].

In the USA, Baron et al. [1977] examined the extent of auditors' detection responsibilities with respect to the material errors, irregularities and illegal acts. They attempted to establish whether there were any differences in the perceptions regarding the auditors' detection and disclosure duties between the auditors and users of accounting reports- financial analysts, bank loan officers and corporate financial managers. They found that auditors and users of accounting reports had significantly different beliefs and preferences on the extent of auditors' responsibilities for detecting and disclosing the irregularities and illegal acts. In particular, users held auditors to be more responsible for detecting and disclosing irregularities and illegal acts than the auditors believed themselves to be.

Low [1980] examined the expectation gap in Australia. The extent of auditors' detection and disclosure responsibilities concerning the errors, irregularities and illegal acts as perceived by auditors and a non-auditor group was investigated. It was found that both groups differed significantly in their perceptions of the extent of auditors' detection and disclosure responsibilities and that an expectation gap existed between the two groups. This finding is consistent with that of Beck [1974], who reported that shareholders had higher expectations of auditors than what most auditors would consider reasonable.

Low et al. [1988] examined the extent of the expectation gap between auditors and financial analysts on the objectives of a company audit taking the case study of Singapore. The results indicated that both groups perceived the traditional objectives of the audit (i.e. expressing an opinion on financial statements) as one of the primary audit objectives. However, besides this objective, respondents possessed an array of beliefs as to what they considered as audit objectives. Financial analysts perceived an audit as setting a seal on the accuracy of the financial accounts of the company. Further, their perceptions of fraud prevention and detection responsibilities of auditors were more demanding than those that the auditors believed they themselves should possess.

Low [1994] compared the perceptions of auditors and judicial litigants regarding their expectations of the auditing profession. It was found that an expectation gap existed between the auditors and judicial litigants and that judges systematically expected more from auditors than auditors believed they provided.

Maria et al. [1992] made a comparative analysis of the nature of the audit expectation gap in Britain and Spain. The paper begins with analyzing the changing nature of the auditing services market in Spain revealing the dominance of some of the Big-Six large multinational accounting firms and the striking absence of any significant discussion concerning the audit expectation gap.

Traditionally, auditing has not been extensively practiced in Spain. The absence of legislation of any specification concerning filing and publication of annual financial statements, and the predominance of small family owned companies were other factors negating any voluntaristic drive to audit. The implementation of a number of pieces of legislation from the 1960s onwards gave some momentum to the practice of auditing.

The situation is different in Britain. Even though Britain has experienced greater debates on the audit expectation gap, it is argued that the British and Spanish positions are related through the dominant belief that the audit function can deliver what is expected of it 'if only' the appropriate system can be established.

In Britain, concerns are shown towards standardizing audit practice enabling people to understand the nature and extent of audit work and responsibilities properly. The expectations gap in Britain is portrayed very much as an ignorance gap.

This study suggested reducing the expectation gap through tighter ethical guidelines, mandatory auditor rotation, the establishment of audit committees, state auditing boards, banning of auditors from providing management consultancy services to audit clients, and broadening of the groups to whom auditors can be held responsible.

Humphrey et al. [1992] conducted a survey to gather evidence on opinions and perceptions of auditing from a wide variety of groups. These groups consisted of auditors, financial directors, investment analysts, bankers and financial journalists. The survey found that there was no significant difference in perceptions concerning whether accounts should comply with the company laws or accepted accounting practices, but there were significant differences relating the auditors' roles. Generally, the auditors saw themselves as more restricted than other groups. One interesting aspect to note was that 71 per cent of auditors disagreed that the balance sheet provided a fair presentation of the company financial position, while 58 per cent of financial directors and 81 per cent of users felt the other way round.

In another survey, Humphrey et al. [1993] examined the expectation gap in UK by ascertaining the perceptions of individuals of audit expectations issue through the use of a questionnaire comprising a series of mini-cases.

The questions of what the prohibitions and regulations were/should be placed on audit firms and what decisions auditors were expected to make were investigated. The respondents included the chartered accountants in public practice, corporate finance directors, investments analysts, bank lending officers and financial journalists. The survey revealed a significant difference between auditors and the respondents- representing some of the main participants in the company's financial report process- in their views on the nature of auditing. The results confirmed that an audit expectation gap existed, specifically in areas such as the nature of the audit function and the perceived performance of auditors. The critical components of the expectation gap were found to include auditors' fraud detection role, the extent of auditors' responsibilities to third parties, the nature of balance sheet valuations, the strength of and continuing threats to auditors' independence, and aspects of the conduct of audit work (e.g. auditors' ability to cope with the risk and uncertainty).

Porter [1993] investigated the audit expectation gap In New Zealand by breaking the gap into two parts: the performance gap and the reasonableness gap. She conducted the research using a mail survey sent to two groups affected by the work of external auditors. The two groups were (1) the 'financial community' groups, including auditors, firm offices, financial analysts, and auditing academics, and (2) the general public groups, including lawyers, financial journalists, and members of the general public. She used the Wilcoxon Sined-Ranks test to determine whether generalization could be made from the survey results, and the Mann-Whitney test to test for significant differences in opinions between the two groups. From the results of her study, Porter identified that more than 20.00 per cent of the general public perceived the auditors should perform ten duties but they were identified by the financial community as not cost effective and/or economical for the auditors to perform. These duties included reporting to the regulatory authorities and disclosing in the audit report the theft of company assets by non-managerial employees, guaranteeing that the audited firm was solvent and the audited financial statements were accurate, detecting and disclosing in the audit report the illegal acts not directly affecting the company's accounts, reporting the breaches of tax laws to the tax authorities, examining and reporting the fairness of the non-financial information and the efficiency and effectiveness of the firm's management, and verifying every transaction of the audited firm.

This empirical research helped the researcher with identifying various components of audit expectation gap, which constituted reasonableness, deficient standards and deficient performance. It also provided the means to estimate the relative contribution of the duties to their respective components and of the components to the overall gap between society's expectations of auditors and auditors' perceived performance.

Gloeck and De Jager [1993] measured audit expectation gap in the Republic of South Africa using three areas (independence of auditors, role of auditors, in particular relating the fraud and going-concern issues, and compulsory audit of small owner-managed companies). The participants of this survey were investors and auditors, in which the survey revealed that there was an audit expectation gap and that there were three main areas of concern: the lack of independence of auditors, uncertainties regarding the role of auditors particularly in regard with the fraud and going-concern issues, and dissatisfaction with the compulsory audit of small owner-managed companies. Almost 60 per cent of financially knowledgeable respondents were of the opinion that the auditor was strongly influenced by the management of the company which he or she audit.

McInnes [1994] reviewed the findings of Gloeck and De Jager and found the existence of audit expectation gap.

Epstein and Geiger [1994] opined on the shift in auditing profession in terms of its basic functions and the primary audit objectives from the investors' perspective. The researchers observed that CPAs as professionals must continually assess public reaction to their stated role in financial reporting as well as in determining the public's perceptions of the type and level of assurances believed or desired to be provided by auditors. The data for the study were collected through a national survey conducted among the investors representing individuals from all the 50 states of the United States to gather information on various aspects of financial reporting issues. Two separate questions were asked of investors: what level of assurance they believed auditors should provide to detect material misstatements as a result of errors and frauds. The researchers anticipated a typical response of reasonable assurance. However, investors held auditors to a much higher level of assurance. The survey asked what level of assurance the auditors felt the investors should provide in detecting material misstatements as a result of errors and frauds. The results are presented in Table 3.1.

TABLE 3.1
FINDING OF EPSTIEN AND GIGER

Investors Perception of Audit Assurance		
Statement	Error	Fraud
No assurance necessary	1.67%	2.51%
Reasonable assurance	51.05%	26.36%
Absolute assurance	47.28%	71.13%

Source: Epstein and Geiger [1994: *64*].

These findings certainly suggest that an expectation gap exists between what auditors and investors perceive as the level of assurance that should ideally be provided by the auditors.

Epstein and Hill [1995] elaborated on the findings of Epstein and Geiger [1994] concerning the expectation gap. They found that less sophisticated investors were more likely to expect absolute assurance than more sophisticated investors, although a large percentage of both types of investors expect absolute assurance. This study implied that the unsophisticated investors expected a higher amount of assurance concerning the misstatements due to the errors than the sophisticated investors. However, the auditors found no significant differences due to frauds; an overwhelming number of both types of investors, namely, sophisticated and unsophisticated, wanted an absolute assurance against this type of misstatement. Epstein and Hill [1995] concluded that:

1. Investors expected greater amount of assurance concerning the frauds and errors than the auditors could provide.
2. There seemed to be a general lack of understanding concerning the differences in the auditors' ability to detect a misstatement due to the frauds and errors.

3. Investors did not grasp the difficulty of detecting material misstatements due to the frauds or the cost of doing so.

Based on these findings, they made two suggestions: A) auditors need to educate the public about the difficulties and costs related to detecting frauds, and B) auditors need to increase both the quality and quantity of their audit services in an effort to provide the investors with a greater level of assurance.

Monroe and Woodliff [1994] conducted a classical study on the audit expectation gap taking the case study of Australia. The study aimed at identifying the differences between financial report users and auditors about their perceptions of the messages communicated through the audit reports. The data for the study were collected through a mailed questionnaire administered to auditors, accountants, creditors, directors, shareholders and students. The questionnaire directly addressed the existence and nature of the audit expectation gap. The research instrument used for the study carried semantic differential scales for different categories of the respondents stated above.

The results of the study suggested that there were significant differences between old reports and new reports, which were significant to the auditors. The major areas of differences in perceptions studied in this research included the responsibility, prospect and reliability factors. It was found that (i) the modified wording in the new reports had a significant impact on beliefs about the nature of an audit and auditors and management, (ii) the modified wording eliminated some of the differences but also created some new differences between auditors and various user groups, and (iii) the differences in perceptions were much smaller for sophisticated users than naive users.

The research also suggested that educating the users was one of the approaches to raise the sophistication level of users to reduce the differences in perceptions. Further, the research indicated that wording changes did change beliefs about the messages communicated through audit reports. In other words, audit report wording should become more specific if the gap were to be decreased.

Chung [1995] surveyed on how varied levels of auditors' confidence resulted in an audit expectation gap and the inadequacy of which led to inadequate performance by auditors. He was of the opinion that the auditors' confidence was not a contributor to the audit expectation gap. An over-confident auditor may be dangerous as over confidence might result in an inefficient audit. The objective of the auditor was to make the most accurate decision possible after considering all the facts. Anyone who suffers a financial loss as a result might sue an auditor who expresses an inaccurate opinion on a set of financial statements that he has examined. In addition to making accurate decisions, the confidence of the auditor in his decision was also important. If auditors were over-confident, this might reduce the value of their audit opinions and the effectiveness of the profession. If they were under-confident, they might take longer to make decisions.

The survey was conducted between two groups of auditors from the Big-Six public accounting firms in the United States. In the first administration of the experiment, thirty two auditors were selected based on availability, willingness to participate and on the condition that they had at least two years of experience. In the second administration, twenty six auditors were selected on the same basis. These two groups received training before undertaking the experiment. The first group of auditors showed a mixture of under-confidence and good calibration (the relationship between confidence in one's decision and the accuracy of the decision), whereas the second group showed a mixture of good calibration and over-confidence. When the results of the two groups were aggregated and analyzed, a tendency towards under-confidence was witnessed. While this was not as dangerous as being over-confident, there were still implications for the profession. The reasons for the inefficiency and under-confidence of auditors were (i) the conservative nature of the training they received, (ii) their past experiences, and (iii) the legal liability that any negligence they may expose. However, the author expressed his concern that it was better to be inefficient than ineffective.

The study also suggested that if one could understand the relationship between audit decision confidence and audit decision accuracy, it would increase one's understanding of the audit expectation gap. The profession in general and the audit firms in particular can direct their training programs towards making auditors better calibrated.

Schelluch and Green [1996] found that the expectations gap detected in prior research studies dealing with auditors' responsibilities appeared to be reduced over time with the introduction of the long-form audit report. Differences in beliefs between auditors and users (company secretaries and shareholders) appeared to be reduced in areas specifically addressed in the wording of the expanded report. However, the expectation gap continued to exist after the introduction of the long-form audit report in relation to the financial statement reliability. This finding indicated the continued difficulties being experienced by users in understanding the audited financial statements. The study also indicated that users were generally unhappy with the role played by the auditing profession particularly with respect to the auditor independence and the level of value (i.e. credibility) added to the financial statements from the auditing process.

Another area that is less explored when one studies audit expectation gap is the concept of materiality. In ISA No. 25 (subject matter 320), audit materiality is defined as follows: Information is material if its omission or misstatement could influence the economic decision of user point rather than being a primary qualitative characteristic which information must have if it is to be useful.

This definition of materiality in auditing is due to a demand for efficiency on the one hand and credibility on the other, which can often draw the auditor in opposite directions. This has been explored by Hojskov [1998] who surveyed the expectation gap between the users and auditors with reference to Denmark. The participants in the survey were 13 financial analysts, who represented professional investors/advisors, and 11 State authorized public accountants 'Danish CPAs' of listed companies. The financial analysts were all involved in share analysis and had on an average six years of experience in this area. Participants had only limited, but varied knowledge of the topic prior to the survey, but this grew during the course of the survey. The survey was based on the same survey questions for both financial analysts and auditors. Financial analysts were asked whether the errors must be considered material for their share price recommendations, i.e.

whether they thought the price would be influenced. Auditors were asked whether after assessing the financial statements they regarded the errors as material i.e. whether they thought this would influence the decisions, which users make on the basis of the financial statement. The survey was based on four examples of publicly listed companies, all of which were assumed to be known to the participants.

It was confirmed that the two groups in Denmark had no knowledge of each other's materiality levels. Hence Hozskov's conclusions indicated the need for standards at least for auditors in order to ensure a degree of uniformity.

Lowe and Pany [1993] surveyed auditors and potential jurors to test for differences in expectations concerning the auditor's role, knowledge of the audit process, and general attitudes toward the audit profession. The jurors' subjects were drawn from a municipal juror pool. The auditors were participants in a two-week audit training seminar for the senior. The researchers used an eight-question survey scale to test perceptions, which the subjects answered using an eleven point scale (0 to 10) anchored at 'strongly disagree' and 'strongly agree'. The authors found large differences between the two groups in the areas of responsibility for the financial statement information, the necessity for sampling transactions, and the auditors as an insurer against large stockholders' losses, a public watch dog and an active pursuer for fraud.

Noordin's [1999] study is important for two reasons. Firstly, the result of this study might affect the process of setting auditing standards, that is, either the existing standards must be modified or new audit standards must be framed. This was because of the fact that an auditor's report was the only medium of communication that included the auditors' opinion regarding their audit work and their final opinion regarding the financial statements audited. Hence, in this sense, it is important to study the degree of usefulness of an auditor's report. These results in forcing the auditors to deliver a report in clearer terms that help reduce the expectation gap. Secondly, the results of his study are expected to affect the audit academic environment, and educating users regarding the knowledge of audit and auditors' report is essential so that users understand the essence of audit as well as the utility of an auditor's report. It was found that knowledgeable users placed less responsibility on auditor than less knowledgeable users. He concluded that educating the audit users was an effective approach to narrow down the expectation gap.

The study was conducted with three main objectives: (i) to examine the existence of expectation gap between auditors and users in Malaysia, (ii) to ascertain the effectiveness of an auditor's report as a communication medium between auditors and users, and (iii) to understand in which area the users expect the most in order to overcome the gap.

The study clearly indicated the presence of a wide expectation gap in Malaysia. The expectation gap was found wide particularly on the issues of the auditors' responsibilities on (i) omission and misstatement reporting, (ii) detecting all frauds and errors, (iii) fraud prevention, and (iv) 100 per cent examination of the audit procedures. To a lesser extent, an expectation gap was also found on (i) audited financial statements in an annual report, (ii) soundness of internal control, (iii) using the work of other auditor or expert, and (iv) producing the financial statements. This study also revealed that users who were having knowledge about the responsibilities and duties placed less responsibility on auditor than less knowledgeable users.

Best et al. [2001] examined the evidence in support of the long form audit report for audit expectation gap in Singapore. The study extended research on the audit expectation gap in Singapore by surveying auditors, bankers and investors. A total of 300 persons were randomly selected form the Singapore telephone directory. One hundred people were selected from each group. The response rates achieved were 35.00 per cent for auditors, 26.00 per cent for bankers and 36.00 per cent for investors. They applied the Mann-Whitney U-test to find significant differences between the auditors and non-auditors (bankers and investors). They selected 16 areas under three headings, namely, (i) responsibility, (ii) reliability, and (iii) decision usefulness statements.

The study provided some insight into the nature and extent of the audit expectation gap in Singapore. Evidence was found confirming the existence of a moderate gap. Out of sixteen areas, a significant area of gap concerned the auditors responsible only for detecting all frauds and the auditors not responsible for preventing them. In addition, there was evidence that investors believed that auditors had some responsibility for ensuring an entity of sound internal controls.

Chye [2000] surveyed the audit expectation gap in Singapore with reference to a company's audit objectives. The study examined whether an audit expectation gap existed between auditors and non-auditors in Singapore with respect to the objectives of a company audit. The survey was conducted through a questionnaire listing 13 possible companies' audit objectives, and it was administered to auditors and non-auditors (500+500 individuals). The response rates for auditors and non-auditors were 50.40 per cent and 47.00 per cent respectively, and the overall response rate was 48.70 per cent. To examine the gap between auditors and non-auditors statistically, T-test, ANOVA and Student-Newman-Kenls' (SNK) multiple comparison tests were given. The results showed that the auditors perceived the gap significantly more strongly than the non-auditors in giving a true and fair opinion and providing aid and advice on accounting matters that were important. On the other hand, non-auditors better perceived the detecting and preventing of errors, fraud or illegal acts, satisfaction of the requirements of authorities, and ensuring the accuracy of financial accounts.

It was evidenced that an audit expectation gap with respect to the company audit objectives existed between the auditors and non-auditors. The non-auditors placed a significantly greater demand on audits and auditors than what auditors themselves perceived their roles and responsibilities to be.

Martinis et al. [2000] made an examination of the audit expectation gap in Singapore. The main objectives of their study were (i) to examine the extent to which lower levels of user cognizance of the role, objectives and limitations of an audit were associated with unreasonable audit expectations and perceptions, and (ii) to identify the extent of the gap with regard to the expectations and perceptions about the duties and responsibilities of auditors, fraud prevention and detection.

The extent of the audit expectation gap was measured by comparing non-auditors' expectations and perceptions regarding the role, objectives, and limitations of an audit with auditors' responses reflecting audit reality as prescribed in the profession's auditing standards. Audit expectation gap issues identified in this study were (i) the usefulness of audited financial statements for decision-making activities, (ii) the nature of an auditor's work, (iii) the duties and responsibilities of an auditor, (iv) the meanings of an 'unqualified' audit report, (v) the group responsible for preventing and detecting frauds, and (vi) the group most effective for preventing and detecting frauds.

Primary data were collected through the administration of a questionnaire from among 150 auditors and an equal number of individuals randomly selected (43.33 per cent responded).

On analyzing the data, it was found that the lower levels of cognizance were significantly associated with the unreasonable expectations and perceptions of the audit function, and the audit expectation gap was not directly influenced or constrained by political, legal, economic or social factors. The audit expectation gap was prevalent among the non-auditor respondents with relatively little business work experience, and non-graduates.

The study suggested that the auditor profession to take more pro-active stance (e.g. a greater responsibility for educating the public on the role of auditors, the extension of the auditors' responsibilities to match users' expectations regarding the prevention and detection of frauds, and the ensuring of the continual existence and monitoring of audit quality, particularly as related to the minimization of corporate collapses resulting from business failure. The authors concluded that the audit expectation gap, although impractical, should be significantly reduced, if impossible to eliminate.

McEnroe et al. [2001] conducted a study on the auditors and investors' perceptions on the expectation gap in the United States. The study surveyed the public accountants and individual investors to obtain their perceptions on the extent to which an expectation gap did exist in various dimensions of the attest function.

Audit partners from the 66 largest public accounting firms and investors from the American Association of Individual Investors (AAII) were chosen for the study and the sample size stood at 500 each. The response rate was 23.40 per cent and 29.40 per cent respectively. The data were analyzed via the descriptive statistics such as group means, standard deviations and two-tailed t-tests that were applied to achieve significant values. The results revealed that an expectation gap existed in the following areas: (i) every item of importance to investors and creditors had been reported or disclosed, (ii) auditors had been 'public watch dogs', (iii) the internal controls were effective, (iv) the financial statements were free from misstatements resulting from management fraud, (v) the financial statements were free of misstatements intended to hide the employees' frauds, and (vi) the firm had not engaged in illegal operations.

The findings of the study in relation to the expectation that all items were important to investors and creditors were disclosed, and they indicated that investors did not concur with the Panel on the Public Oversight Board (POB) that the public was not the auditor's true client. The appropriate action to reduce these expectations might be in the public education.

Hudaib [2002] conducted a survey on audit perception gap in Saudi Arabia. He did so by using a combination of mail questionnaires and semi-structured interviews. He found that the ideology and legal structure in the Saudi environment significantly affected the audit perception gap.

In Saudi Arabia, there are two roles of an auditor, namely, acting as a judge and adhering to the current code of ethics included in the official documents. The auditors were not happy with the misconceptions attached to these two roles. Similarly, the various user groups also revealed their dissatisfaction with the current performance of these roles by the auditors. The profession is forcefully governed by their religious code of ethics. The auditors felt that they were lacking the capability in handling the cases under both systems of Secularism and Shari'ah. However, the users wanted the auditors to be involved in the detection of frauds because of the increasing number of companies in recent years experiencing losses resulting from frauds and mismanagement.

This study also highlighted that the practice of 'cherry-picking' regulations from western developed countries and the implementations of such rules without proper consultation with the practitioners created a gap in perceptions of Saudi Arabians. The tension between the Saudi Organization Certified Public Accountants (SOCPA) and other parties interested in the role of auditing too created a gap. Thus, the competing ideologies of western economic rationality vs. the Islamic rationality and their legal systems resulted in an uncomfortable relationship between the auditors and users.

'The Expectation Gap Revisited' was a study carried out by Schullch and Guy [2002] of Monash University on the recommendations made by the 1994 and 1996 expectation reports. These reports were the outcome of joint efforts made by the two professional accounting bodies, namely, CPA Australia and the Institute of Chartered Accountants in Australia. They undertook an extensive analysis and review of the 'expectation gap' at both local and international level. The 1994 report was entitled 'A Research Study on Financial Reporting and Auditing-Bridging the Expectation Gap', and the 1996 report was entitled 'the Report of the Financial Reporting and Auditing Expectation Gap Taskforce to the Joint Standing Committee.' The 1994 report was the first comprehensive attempt by Australian professional accounting bodies to address the expectation gap issue proactively and stimulate the widespread discussion among all the sections of the society on the same. The 1996 Report was based on these public submissions and seminars. This report was to advise the two accounting bodies in the best way to progress the various issues raised in the study.

According to these two accounting bodies, the expectation gap was attributed to a number of different causes, namely, (I) the probabilistic nature of auditing, (ii) the ignorance, naivety, misunderstanding and unreasonable expectations of non-auditors about the audit function, (iii) the evaluation of audit performance based upon information or data not available to the auditor at the time the audit was completed, (iv) the evolutionary development of audit responsibilities, which creates time lags in responding to changing expectations, (v) corporate crises which lead to new expectations and accountability requirements, and/or (vi) the profession attempting to control the direction and outcome of the expectation gap debate to maintain the status quo.

The 1994 Report made 100 recommendations which were not implemented, but it was released then. Though both the reports suffered from many limitations, a review of submissions to the joint working party provided some insight about the potential reasons for the lack of support for the study recommendations. Many of the recommendations were still incomplete while others required on–going action. These results highlighted a number of important implications that needed further consideration: (i) the diversity of the expectation gap issues and the impact of these issues on different parties, (ii) the need to adopt a strategic approach to the resolution of expectation gap issues that consider the impact on all the parties affected, (iii) the need for a concerted effort by all the parties affected to resolve the certain expectation gap issues satisfactorily, (iv) the need for a regulatory support to implement measures to reduce the problems, (v) the need to consider many expectation gap issues over time rather than at one point in time, (vi) the lack of support for an issue that did not necessarily mitigate the expectation gap, and (vii) the need to be vigilant and to monitor the expectation gap issues over time in line with the changes of social expectations.

Fadzly and Ahmad [2004] examined the perceptions on 'what the auditors were doing' by comparing their and the users' perceptions in Malaysia. The study was comprised of two parts. In the first part, the respondents' opinions and beliefs on the audit functions were accumulated to find the proofs of expectation gap. In the second part, a controlled experiment was used on investors to find the effects of the reading materials on the respondents' expectations.

For the controlled experiment, the reading materials were developed in the form of a brochure. It contained information about the audit functions and specifically addressed the issues that were susceptible to misconceptions among the users such as auditors' responsibilities towards the accounts, financial statements, the internal control and frauds. One hundred undergraduate students were selected and the questionnaire was administered to them twice over a period of four months, where the brochure was given only during the second survey. The students were in the first trimester of their senior year when they would only learn about the financial audit, and, during their second trimester, they would learn about the audit expectation gap. The results indicated that after reading the brochure there were no significant differences in the students and auditors' expectations.

The study addressed the expectation gap through the auditors' responsibilities, reliability of audit, and usefulness of audited financial statements. The auditors' responsibility addressed the issue of fraud detection and prevention, accounts and financial statements preparation, auditors' objectivity, internal control, scope of auditors' legal responsibility and their culpability in fraud-related business failure. The empirical results indicated some significant differences in all the responsibilities except for the fact that the auditor was unbiased and objective among the auditors and users (brokers, bankers and investors).

Statements on reliability dealt with the issues of the audited financial statements to see if they were true and fair, the extent of assurance provided by the audit, fraud within the audited entity, the auditors' trustworthiness and the effectiveness of audit reports in communicating the extent of assurance and audit work performed. The empirical results indicated that there were no significant differences in beliefs between the auditors and users except in the financial statements, which gave a true and fair view.

Three statements on usefulness pertained to the use of the audited financial statements in decision-making, performance monitoring and assessing whether the entity was well managed. The empirical result indicated that there were no significant differences between the auditors and users except in their performance monitoring.

The results of the study showed a wider expectation gap on the issue of the auditor's responsibility and a lesser expectation gap with respect to the reliability and usefulness of the audit.

Lin and Chen [2004] conducted an empirical study on audit expectation gap in China. The study investigated the rise of expectation gap and related the auditing issues under business and auditing environment in the country. The study obtained substantial proofs on the emergence of 'audit expectation gap' in China, with respect to the audit objectives, auditors' obligation to detect and report fraud, auditor independence and third party liability of auditors.

A mail survey was conducted to collect data from the audit beneficiaries (investors, creditors, government officials, business management, and academics) and public practitioners by distributing 800 questionnaires. The overall response rate was 24.80 per cent. The data were analyzed through descriptive statistics, such as group means, standard deviation and independent sample t-tests. The results revealed that the independent audit function would enhance the truthfulness and reliability of financial statements and play a positive role in the Chinese economy. Declining in the government's controlling the economy caused the independent audits provided by the public accountants to be much more important in the Chinese economy.

There was an expectation gap with respect to the objectives of auditing function, auditors' obligation to detect and report frauds or irregularities, third-party liability of auditors, and the impact of governmental sponsorship on the credibility of the audit services. The auditors and audit beneficiaries were dissatisfied with the present status of auditor independence in China. They concluded that much must be done to improve the public accounting practices in China to bridge the expectation gap.

Vinten [2005] conducted a study on audit expectation gap. According to him, the auditors failed to meet the society's reasonable or unreasonable expectations, which resulted in undermining the confidence in the auditing profession. The objectives of this study were to investigate the structure, composition and extent of the audit expectation gap in England and New Zealand in 1989 and in 1999. A cross-cultural study and a longitudinal study through a survey containing 51 suggestive responsibilities of auditors were conducted. The findings of the study showed that the extent of gap was much less (i.e. less than 2.00 per cent). However, the conditions of gap-components differed quite markedly in the two countries. In the United Kingdom, reasonableness, deficient standards, and deficient performance gaps constituted 50.00 per cent, 42.00 per cent and 8.00 per cent respectively, whereas in New Zealand they constituted 41.00 per cent, 53.00 per cent and 6.00 per cent respectively. In 1989 in New Zealand, the above gaps constituted 31.00 per cent, 58.00 per cent and 11.00 per cent respectively.

From the above results, it was learnt that there was greater incidence of corporate scandals in the United Kingdom when compared to that in New Zealand. It was found that in the United Kingdom, expectations from the auditors were higher. Hence the reasonableness gap was wider in the United Kingdom than in New Zealand. Regarding the deficient standards, the gap was wider in New Zealand than in the United Kingdom. The deficient performance gap was almost similar in both of the countries.

The study suggested the following measures to reduce the gap: (i) strengthening the monitoring of auditors' performance, (ii) improving the quality control in audit firms, (iii) enhancing the education of auditing practitioners, (iv) introducing new auditing standards, and (v) educating the society about the audit function and work of the auditor.

The findings of this report provided some insight into the society's expectations of auditors, the perceived standard of their work and the extent to which these expectations were not being fulfilled. The findings give recommendations on how auditors might better satisfy a society's expectations by narrowing the gap.

McEnroe et al. [2001] conducted a study on the auditors and investors' perceptions on the expectation gap in the United States. The study surveyed the public accountants and individual investors to obtain their perceptions on the extent to which an expectation gap did exist in various dimensions of the attest function.

Audit partners from the 66 largest public accounting firms and investors from the American Association of Individual Investors (AAII) were chosen for the study and the sample size stood at 500 each. The response rate was 23.40 per cent and 29.40 per cent respectively. The data were analyzed through the descriptive statistics such as group means, standard deviations and two-tailed t-tests. The results revealed that an expectation gap existed in the following areas: (i) every item of importance to investors and creditors had been reported or disclosed, (ii) auditors had been 'public watch dogs', (iii) the internal controls were effective, (iv) the financial statements were free from misstatements resulting from the management frauds, (v) the financial statements were free of misstatements intended to hide the employee frauds, and (vi) the firm had not engaged in illegal operations.

The findings of the study in relation to the expectation that all items were important to the investors and creditors which were disclosed indicated that the investors did not concur with the Panel on the Public Oversight Board (POB) that the public was not the auditor's true client. The appropriate action to reduce these expectations might be in public education.

Dixon et al. [2006] opined that the expectation gap between the auditors and financial statement users in Egypt was disappointing. The study confirmed an expectation gap in the nature of the audit function, the perceived performance of auditors, their duties and roles, their independence and the non-audit services. The data for the study were collected through a questionnaire that was divided into two sections. The first section contained demographic information, and the second section contained 16 statements under three factors like responsibility, reliability and decision usefulness. The survey participants of the study were auditors, bankers and investors (general public, financial analysts and brokers). 100 questionnaires were distributed among each group and the overall response rate was 37.00 per cent. The Mann-Whitney U-Test was applied to see if there were any significant differences between the three respondent groups touching upon the three factors of responsibility, reliability and usefulness.

With regard to auditors' responsibility, seven statements concerning the issues of fraud detection and prevention, internal control, scope of auditor's legal responsibility, financial statement preparation, auditors' objectivity and audit procedures were all taken into consideration. The results indicated that there were significant differences between the auditors and users (bankers and investors) except for the statement that the auditor was not responsible for preventing fraud.

The statements on reliability dealt with the issues of the extent of assurance provided by the audit, accounting policies, audited financial statements (to find out their accuracy), frauds within the audited entity and audit report effectiveness in communicating the extent of audit work performed. The results indicated that there were significant differences between the auditors and users excepting the extent of assurance provided by the audit and audit report effectiveness in communicating the extent of audit work performed.

In usefulness of the audited financial statements, three statements were used, namely, the audited financial statements in decision making, and, performance monitoring, and assessing whether the entity was well managed. The study indicated that there were no significant differences between the auditors and users in the statements excepting the performance monitoring. The results of the study showed a wider expectation gap on the issue of the auditors' responsibility and a lesser expectation gap with respect to the reliability and usefulness of audit.

On the whole, the literature survey on the perceptions of the audit expectation gap nature revealed that perceptional differences did exist between auditors and various user groups regarding the audit profession as a whole.

A survey was conducted by Altwaijri [2006] regarding the expectation gap related to the internal auditors in Saudi Arabia. The data were collected through both telephone and face-to face interviews, whose participants were the academic staff, corporate managers, directors of internal audit departments, external auditors, governmental, and accounting bodies. The results revealed that several gaps existed among Saudi Arabia corporate auditors: (i) the gap between what corporate management believed the external auditors did when performing the independent audit and what their real task was, the gap between how the corporate management was expected to value its internal auditing and how the management appreciated its internal auditing in reality; (ii)the gap between how the audit clients within the corporate perceived the internal auditors and what the internal auditors real job was; (iii) the gap between what the business sector required the internal auditors and what internal auditors real requirement of qualification and background were, and (iv) the gap between the scope of the internal auditing as expected by the professional standards and what the internal auditors were really doing.

Swamy [2007] highlighted the dimensions constituting the broad spectrum of audit expectation gap in India: responsibility of external auditors; role of auditors; profession commitment; obligations of auditors; deficiency levels of audit; audit effectiveness, and auditor independence. The audit effectiveness was assigned the highest actual mean value of 3.17 and auditor independence the least actual mean value of 1.81 and their respective ranks were at 1st and 7th. The other dimensions were found to fall in between these two dimensions. The role of auditors, professional commitment, responsibility of external auditors, deficiency in audit levels and obligation of auditors were found to have the actual mean values of 3.01, 3.00, 2.92, 2.65 and 2.29 respectively with 2nd, 3rd, 4th, 5th and 6th ranks respectively.

The highest expectation related the professional commitment with the mean value of 4.19 which was followed by the role of auditors (4.15), audit effectiveness (4.09), responsibilities of external auditors (4.04), deficient audit levels (3.80), obligations of auditors (3.04) and auditor independence (2.84) with their respective ranks of 2nd, 3rd, 4th, 5th, 6th, and 7th respectively.

TABLE 3.2
RANKING OF DIMENSIONAL PERCEPTION: SWAMY'S FINDINGS

Sl. No.	**Areas**	**Actual**		**Expected**		**Gap**	
		Mean	**Rank**	**Mean**	**Rank**	**Mean Diff.**	**Rank**
(i)	Responsibility of External Auditors	2.92	IV	4.04	IV	-1.12	IV
(ii)	Role of Auditors	3.01	II	4.15	II	-1.14	III
(iii)	Profession Commitment	3.00	III	4.19	I	-1.19	I
(iv)	Obligations of Auditors	2.29	VI	3.04	VI	-0.75	VII
(v)	Deficiency Levels of Audit	2.65	V	3.80	V	-1.15	II
(vi)	Audit Effectiveness	3.17	I	4.09	III	-0.92	VI
(vii)	Auditor Independence and Economic considerations	1.81	VII	2.84	VII	-1.03	V

Source: Swamy, [2007].

It was observed that the highest expectation gap evidenced with regard to the professional commitment with the expectation gap of 1.19 and the least expectation gap related the obligations of auditor with 0.75. In between these two extremities of gaps, the deficient level of audit (-1.15), the role of auditors (-1.14), the responsibilities of external auditor (-1.12), the auditor independence (-1.03) and the obligations of auditors (-0.75) were assigned the ranks of 2nd, 3rd, 4th, 5th and 6th respectively.

The status of the universe presents an overview of the perceptions of 225 respondents on ninety-four statements related to the audit expectation gap. The actual level of perceptions on the audit effectiveness stood at the mean value of 2.82 representing the effectiveness of audit process at 56.40 per cent only. However, the respondents expected that this level of effectiveness should rise to the mean value level of 3.88, which represented the effectiveness of 77.60 per cent. On the whole, the expectation gap in terms of mean value stood at 1.06 representing a gap of 21.20 per cent of audit effectiveness. To conclude, the audit effectiveness was found to be at a moderate level and the challenge lies in increasing the level of effectiveness to a higher level so that the credibility in audit function will increase to bring objectivity into the corporate financial reporting.

TABLE 3.3
STATUS OF THE UNIVERSE: SWAMY'S FINDINGS

Areas	Actual Mean Value	Expected Mean Value	Audit Expectation Gap
All Ninety-four Statements	2.82	3.88	-1.06

Source: Swamy, [2007].

EDUCATION AND AUDIT EXPECTATION GAP

In the majority of the studies, the researches maintain that educating the public about the objectives of an audit and the auditors' role and responsibilities will help to narrow the audit expectation gap. Hence, an attempt has been made in the present study to survey the literature available on the impact of education on narrowing the audit expectation gap.

A study on the effects of education on students' perceptions of the relative responsibilities of auditors and management and the reliability and decision usefulness of the audited and reviewed financial statements was conducted by Gay and Sullivan [1988]. The survey was carried out among a group of auditors and three groups of students (second year financial accounting students at the beginning of the first semester, and third year auditing students at the beginning of the second semester (pre-auditing) and at the end of the semester (post-auditing)). They also analyzed the results by using the Mann-Whitney U-tests of comparison among the groups and between review and audit reports within each group. The results revealed that there was evidence of an expectation gap between the auditors and undergraduate commerce students in relation to both audits and review engagements.

There were significant differences between the auditors and students who had not completed an auditing course, auditors/reviewers' responsibilities, the reliability of audited/reviewed financial information, and the decision usefulness of the audited/reviewed financial statements. However, after completing their auditing course, the beliefs changed significantly. The results indicated that education might be an effective way to reduce the expectation gap.

Monroe and Woodliff [1993] opined that the effects of education on the students' perceptions about the meaning of audit reports, duties and responsibilities of auditors, which examined the effects of professional education on the undergraduate the auditing students' beliefs about the messages communicated through the audit reports through a questionnaire that was administered to two groups of students at the beginning and end of the semester and to auditors were strange. The first group consisted of final year undergraduate accounting students taking their auditing unit one and the second group consisted of marketing students who had not taken that unit. It was found that there were no differences between auditing and marketing students at the beginning of the semester about auditors' responsibilities. They believed that auditors had more responsibility and management had less responsibility for the prevention and detection of frauds, and safeguarding the assets. However, at the end of semester, the auditing students believed that auditors assumed a much lower level of responsibility, but there was little change in marketing students' beliefs.

Concerning the reliability factor, there were significant differences between both groups of undergraduates and auditors' viewpoints. The students believed at the beginning that the reports indicating financial information were less reliable than did auditors. This supported the existence of an expectation gap. However, at the end of the semester, the auditing students believed that financial information was reliable. Regarding the prospects, both student groups held similar beliefs the same beliefs as did the auditors at the beginning of the semester; yet, at the end of the semester, auditing students' views changed significantly towards the belief that audit reports implied nothing about the future viability of the firm. Hence, the results implied that education was an effective approach to narrow the expectation gap. However, the study added that further research was needed to reveal the quantity and content of public education required to educate financial information users about the nature of auditing.

In another study, Monroe and Woodliff [1994] reported that differences in perceptions between sophisticated users and auditors were smaller than those of unsophisticated users (in particular, shareholders and students) and auditors. Again they suggested education as a means to increase the sophistication level of user groups in order to reduce the audit expectation gap.

Pierce et al. [1996] examined the effects of education on the audit expectation gap in Great Britain. The study focused on the user-misunderstanding gap and the extent to which this gap could be narrowed through the provision of auditing education. The elements of user misunderstandings were investigated in this study: (i) duties, (ii) ethical and legislative framework, (iii) liability, and (iv) audit report. A survey was completed by five different groups of students at the start of the academic year and again at the end of the same year. The total number of completed responses received from the survey conducted at the start of the year and at the end of the year was 428 and 390 respectively. The statements in the questionnaire were designed on the elements of user -misunderstanding. The study revealed that the users who studied auditing showed evidence of a significant improvement in their understanding. However, the findings showed no improvement in understanding the regulations governing the auditor independence even by the auditing group. The central finding was that there was a significant reduction in misunderstanding of audit regulations by those students who had studied either a full course or a single module in auditing. Although other students achieved significant improvement in some specific areas, changes in their overall levels of understanding were considerably less than those achieved by the groups who studied auditing.

Gramling and Schatzberg [1996] conducted a survey among the auditors and undergraduate business students. Responses from the students were collected before and after they completed the auditing coursework. The students' perceptions were closer to those of the auditors after they completed the coursework, particularly about the roles and responsibilities of auditors, but signs of the expectation gap remained in areas pertaining to frauds. However, the gap was smaller than that before the students were about to start the audit coursework. Hence, audit education could still be considered as an effective way to reduce the expectation gap.

Ferguson et al. [2000] found that Canadian co-operative students had pre-scores on an expectation gap instrument that were closer to the practicing auditors than the pre-scores of Australian non-co-operative students, which they attributed to experience.

There were significant differences between the auditors and students who had not completed an auditing course about the auditors' responsibilities, the reliability of the audited financial information, and the decision usefulness of the audited or reviewed financial statements. After completing their course, the auditing students believed that the auditors assumed less responsibility for the soundness of internal control, maintaining accounting records, preventing and detecting frauds; management assumed more responsibility for producing financial statements; the auditor/reviewer was more independent; and the auditor/reviewer exercised more judgment in the selection of procedures than they did at the beginning of the course. These changes were in the direction of the auditors' beliefs indicating significant reduction in the expectation gap in relation to auditors or reviewers' responsibilities.

After finishing the auditing course, students believed to a greater extent that the auditor agreed with the accounting policies, and to a lesser extent that the entity was free from frauds. These changes were in the direction of auditors' beliefs indicating significant reduction in the expectation gap in relation to the reliability of the audited or reviewed financial statements. However, the auditors still had a significantly stronger belief that the audited financial statements gave a true and fair view and believed a significantly higher level of assurance was provided by the audit. All groups believed that an audit provided such a higher level of assurance that there were no material errors as in a review.

After the auditing course, students believed to a greater extent that reviewed financial statements were useful for monitoring the performance and making decisions. These changes were in the direction of auditors' beliefs indicating significant reduction in the expectation gap in relation to the usefulness of the reviewed financial statements. However, the students still believed that the limited or incomplete audit/review report meant that the entity was well managed.

The results indicated that education might be an effective way to reduce the expectation gap. However, several differences in expectations still existed. Also, it must be remembered that it may not be practical to expect all participants to undertake the equivalent of an undergraduate auditing course. However, the importance of the accounting bodies retaining auditing as a prescribed subject for accreditation purposes for undergraduate tertiary degrees to help ensure that members of the accounting profession did not have misconceptions about the audit function was emphasized.

The study by Hussain [2003] regarding the expectation gap in Oman focused on auditors and the auditing process; auditors' role with respect to the audited financial statements; auditors' role with respect to the audited company; and auditors' responsibility towards the owners and creditors.

The questionnaire was administered among 35 students before taking auditing and after finishing it at Sultan Qaboos University in Oman. The results of this study showed that there were significant differences between the students before and after taking the course. It means the students before studying the subject were expecting highly from the auditors, while the same students after studying the subject had lower expectation from the auditors; therefore, education may reduce some degree of audit expectation gap.

The study by Siddiqui and Nasreen [2004] focused on identifying the existence of an audit expectation gap in Bangladesh. Students of accounting were chosen as a knowledgeable representative group of the society. Mail questionnaires were sent to the professional accountants and university accounting students. The questionnaire consisted of statements regarding three aspects (audit responsibility, audit reliability and decision usefulness of audited financial statements). The mean responses of the two groups were then compared. The audit expectation gap was found in all of the three aspects: perceptual differences being widest in the area of auditor responsibility. The findings of this study were indicative of a much wider expectation gap between auditors and other societal groups in Bangladesh as these clusters possess lesser knowledge in auditing than do the students of accounting.

Chowdhury and Innes [1998] conducted the study on audit expectation gap in Bangladesh. This interview-based research explored whether or not an audit expectations gap existed in the public sector of Bangladesh between public sector auditors, members of the public accounts committee in the parliament and international funding agencies. The interviewees' responses revealed important differences between the public sector 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. It was found that auditors in the public sector provide information of mainly financial and compliance nature. However, users were more interested in management performance related information. Users believed that the reports were too long and irrelevant. The study also reveled that auditors believed that through their efforts, public interest was being protected, which was contradicted by the users. In the issue of audit independence, the government auditors believed that they were reasonably free from external influence. However, users believed that independence was hampered because of budgetary and administrative control by the Government, poor salary structure and status of public sector auditors, and auditor competence. The users groups expressed their dissatisfactions over the lack of auditing skills and training facilities. The study also identified a number of causes for such an expectation gap, namely independence from the ministry; absence of formal communications; scope of performance audit; format and contents of report; auditor's competence; objectives of audited entities; and timeliness of reporting. The study acknowledged that a number of perceived causes of the audit expectation gap were common to both the public and private sectors, such as fraud detection and auditor independence.

Similarly, a study on the impact of audit education on the perceptions of deficient auditors' performance was conducted by Boyle et al. [2005] to support the role that audit education can play in the reduction of the audit expectation gap. This study attempted to see whether exposure to auditing modules influenced the students' perceptions of the performance of duties by auditors. According to these authors, there was a lack of sufficient evidence available regarding the impact of audit education on the deficient performance gap. The study identified two areas of deficient performance, namely, auditor duties relating the frauds and auditor duties relating the going concern. The objectives of the study were to investigate the impact of audit education on the deficient performance gap and to investigate the impact of audit education on the perceptions of deficient auditor performance when threats to auditor performance seemed to exist.

A survey comprising two parts (one part for each objective) was used to collect data on the impact of audit education on the perceptions of auditors' performance. The data were collected from three groups of students, each of whom was exposed to varying levels of audit education. The results indicated that there was a significant difference in perceptions of deficient performance between those who had received a full year or module of auditing and those who had not. It was also found that those classes with more audit education perceived audit independence threats to have a greater adverse effect on auditors' performance compared to those classes who had received less audit education.

The major finding of the study was that the audit education appeared to create greater skepticism regarding the performance of existing duties by auditors. The perceptions of a deficient auditor performance augmented significantly for those students who were exposed to the greatest amount of audit education. The extent to which the deficient performance gap widened was directly related to the amount of audit education received. The authors justified this being as a different and contradicting finding when compared to the findings of the previous studies. The authors concluded that if the audit environment was perceived to be free from the various threats, then there was no reason to suggest that audit education would creates perceptions of deficient auditor performance.

CONCLUSION

The review of literature on the audit expectation gap strongly supports the existence of ‘a gap.’ These expectation gaps are found to exist based on the perceptions of auditors *per se,* investors, lenders, financial analysts and society everywhere in the world between the auditors as conceptualized by [Salehi and Gowda, 2006]. As auditing has been gaining much importance in recent times, stakeholders are becoming more intelligent and they expect auditors to protect their interests and expect the financial statements produced by the auditors lead them to right decisions. To reduce such a gap, the suggestion of what Titard et al. [2004] call it ‘audit education’ in colleges and universities will go a long way and also lower levels of corporate scandals, which are rampant the world over. Lastly, such a move to reduce audit expectation gap is certain to herald a new era of corporate governance and ethics.