CHAPTER III
REVIEW OF LITERATURE

⇒ INTRODUCTION
⇒ SCOPE OF THE REVIEW
⇒ AUDITOR INDEPENDENCE
⇒ RESPONSIBILITIES OF AUDITORS AND DETECTION OF FRAUDS
⇒ AUDIT EXPECTATION GAP
⇒ EDUCATION AND AUDIT EXPECTATION GAP
⇒ THE INDIAN SCENE
⇒ CONCLUSION
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INTRODUCTION

The audit process should ensure faithful representation of economic events of a business enterprise and it should be in conformity with measurement process of accounting figures as envisaged in accounting standards. It is important to have notes and supplementary schedules in the audit reports to make financial statements understandable, reliable and comparable. However, the effective audit process is thwarted by the lack of independence of auditors and low level of fraud-proof audit process. As a result, audit expectation gap arises and it is influenced by various events in a business enterprise.

SCOPE OF THE REVIEW

In the background of various factors causing the audit expectation gap, the review of literature is presented below focusing on auditor independence; responsibilities of auditors and detection of frauds; audit expectation gap; education and audit expectation gap; and the research on audit expectation gap in India.

AUDITOR INDEPENDENCE

Auditor independence is an issue that has been debated since the birth of the profession. The global conception among users of accounts has always been quite rightly under threat. If one wants to place trust in the auditors report, it must be a precondition that the views expressed by the auditor are based on objectivity, which can only be achieved, if the auditor is independent of the client. Audit independence has been a significant issue in accounting literature for over forty years. This is often tested by statistical analysis of the relationship between audit fees, non-audit fees, qualified audit reports etc. There is a broad range of accounting literature that investigates whether the independence of the auditor has been actually impaired. 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 Treadway Commission [1987] with many
debates about the effect of management advisory services on the independence of the auditor. However, the views of natural shareholders have not been sought in much of this research.

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

Schulte [1965] specifically focused on non-audit services (NASs). Third parties (commercial loan officers and financial analysts) were asked whether management consulting seriously impaired CPA’s audit independence. There were great variations in views. It was found that 43 per cent did not think so (indeed 20 per cent indicated that their confidence in audit reports were thereby improved), 33 per cent did think so and the remaining 24 per cent were unsure.

Titard [1971] undertook a similar study, asking financial statement users on whether non-audit services (NASs) provision to audit clients ‘may result in CPA’s losing some of their audit independence’. The interesting feature of this study was that this same question was asked with respect to 33 specific types of services. Over 20 per cent of respondents answered in the affirmative to five types of service: mergers and acquisitions (32 per cent); executive recruitment (27 per cent); policy determination (27 per cent); personnel appraisal and/or selection (23 per cent); and executive and wage incentive plans (21 per cent). It was noticeable that no single item was checked by more than one-third of respondents, although 49 per cent answered ‘yes’ to an initial question asking about NAS generically. Respondents were also asked whether each service should be prohibited assuming separation of personnel. For the above five services, the percentage agreeing was between 10 per cent and 20 per cent.

Hartley and Ross [1972] did a large-scale survey of three groups: auditors, users and preparers of financial statements. Their study sought to overcome criticisms of the earlier studies by including definitions of key terms, examining the relative importance of NAS provision as a factor influencing independence in appearance and separating competency and independence.
issues. They found that only 6 per cent of all respondents ranked NAS provision as the top threat to independence (flexible accounting rules and economic dependence rank much more highly). In relation to specific services, the two greatest problem areas were recruitment of non-financial personnel and psychological testing. However, this perception of a lack of independence was often found to stem from a belief that the service was incompatible with the image of a CPA or that the CPA was not competent to perform it. Neither limiting NAS work as a percent of fees earned from a client nor disclosure of NAS fees in the financial statements was viewed as a satisfactory solution to the problem. These findings were inconsistent with Goldman and Barley’s [1974] argument that the provision of non-routine audit services could lead to greater auditor independence because the auditor’s value to a power over the client company increases.

Lavin [1976; 1977] presented respondents with 12 situations having been drawn from the SEC’s ASR NO. 126 and asking whether independence was impaired. Two of the situations concerned NAS provision by the auditor: the provision of accounting services and the maintenance of executive payroll (limited accounting services). The 1976 study compared the views of third parties and CPAs, while the 1977 study focused exclusively on third parties (financial analysts) but also asked whether the investment decision would be affected. A dichotomous, rather than continuous measure of independence was used. Just under 50 per cent of users believed that the provision of extensive accounting services would impair independence, with this falling to 37 per cent for more limited accounting services. The investment decision tended to be affected in cases where the auditor was not perceived as being independent.

Imhoff [1978], examining perceptions of auditor independence for situations where the auditor later went to work for the client, found that there were differences between CPAs in practice and users of financial statements. The users of financial statements were found to be more skeptical of auditor independence in this situation.

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

Firth [1980] examined 29 specific auditor-client relationships drawn from the ethical guidelines being proposed at the time. The parties were a random sample of chartered accountants (large-size firm of accountants, those working in other professional practices and those employed in commerce and industry), all major stockbrokers and investment managers (unit trusts, insurance companies, merchant banks) in the city of London and the loan officers of major banks and financial institutions. There were 369 questionnaires received out of 750 issued at the rate of 52 per cent. The provision of NAS was ranked low as a threat factor for the three chartered accountant groups, but moderately for the two user groups. The result showed that 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 independence and the importance thereof.

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

The study by Shockley [1981] was the first to use an experimental task method of investigation. He considered four factors, viz., (a) competition in the
audit market; (b) non-audit services (NAS); (c) audit firm size and (d) tenure. The study covered a survey of Big Eight partners; non-big eight partners; commercial loan officers and financial analysts. The study revealed that the most important threat to independence was NAS. This factor explained 3 per cent of the variance across all respondents. This marked considerable variation across groups, with financial analysts showing the highest figure at 9 per cent.

Reckers and Stagliano's [1981] study focused on NAS provision. They made use of data contained in ASR No. 250 disclosures (SEC, 1978) to construct 32 case survey questions based on varying levels of provision of five non-audit services. These were: acquisition search; pension and actuarial services; systems design; tax planning and tax preparation. The level of provision (as a percentage of audit cost) for each service was set between 3 per cent (no disclosure required) and 12 per cent (the level found to be seldom exceeded by companies in practice). Users were asked to indicate (on a continuous scale of 0 to 100) their degree of confidence that the auditor remained independent. The views of 'sophisticated' users (financial analysts) and 'naïve' users (MBA students) were compared. Interestingly, the less knowledgeable, less experienced group of study participants tended to express lower average confidence than the financial analysts on the auditor's independence. However, both groups displayed a high level of confidence in the CPA's ability to remain independent while performing NAS for fees upto and above the average level found in an examination of actual proxy disclosures. The authors concluded that the SEC's decision to require disclosure rather than prohibit NAS provision was appropriate.

Dykxhoorn and Sinning [1981] essentially replicated Lavin's [1976] study based on ASR 126 auditor-client relationships using German auditors as respondents. In relation to the provision of extensive accounting services, 58 per cent of German auditors felt that independence would be impaired compared to 64 per cent in Lavin's study. In relation to more limited accounting service provision. Almost 78 per cent of German auditors thought that the auditor's independence would not be impaired as against 59 per cent of US auditors in Lavin's study.
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: extensive accounting services, limited accounting services and EDP provision. Respondents were asked whether 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 per cent, 75 per cent and 94 per cent respectively. It was found that perceived investment decisions were affected.

NAS is the focus of Pany and Reckers' [1983] study. They asked corporate directors to make two judgements 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. 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 (7-point scale). The level of service incidence was manipulated for both the current year (10 per cent and 40 per cent of the year's audit fee) and the historical trend over the last five years (0 per cent, 10 per cent and 40 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 just significant. The approval likelihood for systems design (viewed as a less routine task that either tax preparation or acquisition review, giving rise to greater self-review threat) was much lower than for the other two services. The findings for independence perceptions mirrored those for approval likelihood. Independence perceptions declined as the level of both prior provision and current provision increased.

Pany and Reckers [1984] compared seven services: executive recruiting; actuarial services; purchase acquisition assistance; market feasibility studies; redesign of an accounting system; independent board of director recruiting; and client employment of firm employees. They failed to find a significant difference in perceptions of auditor independence across the different services.
Gul and Yap [1984] examined the views of auditors, managers and users (bankers and shareholders) in what was characterized as a developing country taking a case study of Malaysia. NAS provision was the focus of the study. Findings were based on responses from a maximum of 34 individuals in each group. Interestingly, 23 per cent of shareholders and 9 per cent of auditors believed that NAS provision increased their confidence in auditor independence and the disclosure of fees paid to the auditor for audit and for NAS would lead to a better understanding of the relationship between the auditor and the client. With 87 per cent of auditors agreeing with it and the percentage for the other three groups affirming the statement ranging between 55 per cent and 63 per cent.

Scheiner [1984] examined whether the introduction of NAS disclosure requirements by the SEC in 1978 influenced the amount of NAS purchased from the incumbent auditor (a decision made primarily by the client company). It was argued that there would have been little opportunity to make substantial changes in services in the first year of disclosure, so these base levels were compared with the following year. In addition to total NAS fees, eight categories of service were distinguished. No significant reduction in total NAS fees was observed and only one type of service (personnel services—the service attracting most criticism in relation to joint provision) showed a significant reduction.

McKinley, et al., [1985] used a between-subjects (i.e., non-repeated) design, which reduced the risk of ‘demand effects’, i.e., subjects seeing the purpose of the study and responding in the manner they thought was expected by the researcher. They examined the influence of three factors: CPA firm type (Big Eight/non-Big Eight); office size (large/medium) and prior provision of NAS (none or 30 per cent of audit fee). Loan officers were asked to make decisions whether to accept or reject a loan based on financial statements and to indicate their level of confidence (on a 10-point scale) in the reliability of financial statements and in the auditor’s independence. NAS provision did not affect any of the response variables, contrary to all prior research. This lack of significance suggests that demand effects may have caused the findings of prior research.
Knapp [1985] defined independence as ‘the auditor’s ability to resist client pressure’. He investigated the impact of four factors (including NAS provision at the level of 0 per cent and 40 per cent) on loan officers’ perceptions using a full factorial, repeated measures design. NAS provision was significant, but explained only two per cent of the variance in responses.

Corless and Parkers [1987] investigated the relationship between NAS and auditor independence. They attempted, using an experiment, to investigate auditors’ independence behavior rather than their independence perceptions. Auditors were asked to evaluate the client company’s internal control. They found no evidence that the fact of the auditor’s firm designing the client’s internal control system had a measurable impact on the client’s thought processes in his audit capacity. There was, in fact, some slight evidence of the opposite effect, i.e. a more critical stance.

Lindsy, et al., [1987] examined the impact of 15 auditor-client relationships on the perceptions of auditors, financial analysts and bankers. Four of the situations related to NAS provision. NAS provision at a level of 25-30 per cent of total client fees impaired independence for almost 50 per cent of both user groups and for less than 20 per cent of the auditors. Three specific types of service were considered: preparation of accounts; executive search; and accounting systems design. Of these, all three groups viewed accounting systems design as the smallest threat – less than 15 per cent of each group did not regard the auditor as independent. Both of the other two services led to between 23 per cent and 31 per cent of each user group regarding the auditor as dependent (the percentage for auditors being less than 10 per cent).

Pany and Reckers [1988] explored the effect of the magnitude of NAS (at the levels of 0 per cent, 25 per cent, 60 per cent and 90 per cent of the audit fee). They found that the level of 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 (including NAS provision, one of 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 higher confidence in auditors who provided NAS (consistent with the argument of Goldman and Barlev [1974], discussed above). The NAS factor explained 9 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 auditor independence, two of which related to NAS. The prohibition of executive search services to audit clients was one policy. Another was the requirement to disclose the nature of other services provided by the auditor. In relation to the former policy, the majority of Big Eight auditors and financial analysts disagreed (59 per cent and 58 per cent respectively), whereas only 37 per cent of non-Big Eight CPAs and 23 per cent of loan officers disagreed. In relation to the disclosure policy, the majority of Big Eight auditors and financial analysts disagreed (64 per cent), but the majority of all other groups agreed (83 per cent of financial analysts, 58 per cent of non-Big Eight CPAs and 88 per cent of loan officers. The numbers responding in each group were, however, very small (22 maximum).

Lindsay [1990] examined the impact of three contextual factors (audit firm size; competition; and NAS provision) on bankers, perceptions of auditors, ability to resist management pressure. A repeated measures design was used. NAS provision, while highly significant, explained only 1 per cent of the variance in bankers' responses. This cast some doubt upon the practical significance of joint provision on auditor independence perception.

Gul [1991] examined the impact of four variables (including NAS provision) on bankers' perceptions of auditors' ability to resist management pressure. The service involved was the design and installation of an accounting system, representing a significant proportion of the current audit fee. The NAS factor was significant and explained 3 per cent of the variance.

Agacer and Douphin [1991] conducted the first cross-country study of auditor independence perceptions. They considered the US, the Philippines and West Germany. Four variables were considered, including NAS provision and members of the accounting profession. A full factorial, repeated measures design was used. It was found that significant differences existed between the three countries, with West German respondents indicating
greatest concern regarding independence impairment and Philippine respondents indicating 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 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 subjects who then took on a role (seller, buyer or auditor) and interacted for multiple periods in one of 12 particular experimental markets. There was no indication that allowing joint service provisions by auditors adversely affected auditors' verification effort decisions for either service. Nor was there any indication that buyers perceived audit reports to be less credible because of joint provision.

The authors concluded that a prohibition on joint provision could have an 'adverse' effect on the market structure of the audit industry, since the efficient NAS rather than for audit services in the restricted market. The authors suggested that specialist firms would emerge. It was argued that this market structure effect could offset any benefits that the change might have on auditor's independence.

Panayiotis [1991] made a survey on the legal framework of auditor independence. The survey found that the more independent an auditor seemed to be the greater would be the confidence in his work and opinion. The law supported the auditors' independence by establishing the framework for future thinking by the interested parties with prevailing legal environment. He concluded that the maintenance of 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, which the public thought that the independence was endangered.

The empirical study by Humphrey [1991] with reference to England was an extension of the above studies and the main conclusions included expectations gap in auditors role in fraud detection; the extent of auditors'
responsibility to this party; the nature of balance sheet valuation; threats to auditors independence; and auditors ability to cope up with risk and uncertainty. He also adds “If any topic can be classified as going to the heart of the audit expectations debate, it is the issue of auditor independence.”

Humphrey et al., [1992] identified auditor independence as a key element of the audit expectations gap. The authors identified the main elements of the expectations gap: independence; whom auditors were responsible to; practical abilities; the commercial nature of auditing; and responsibility for detecting fraud

Lindsay’s [1992] study covered Australia and Canada. Four factors (including NAS provision at either 0 per cent or 40 percent of audit fee) were presented to expert users (analysts and bankers) in a full factorial, repeated measures design. The country effect was not found to be significant. NAS provision was a significant factor in explaining responses, accounting for 3 per cent of the variance for analysts and 2 per cent for the bankers.

García-Benau and Humphrey [1992] investigated the expectation gap in both the UK and Spain. Auditors, finance directors and users were asked, inter alia, whether 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.

Sikka et al., [1992] identified 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 DTI”. Placing his arguments on reducing audit expectation gap, he recommended one of the steps to be taken by the profession to reduce the expectation gap was reform relating to auditor independence.

Barlett [1993] examined the view of loan officers and CPAs in relation to 10 situations, five of which relate to NAS provision respondents were asked to indicate on a continuous scale of 100 (completely independent) to 0 (not independent at all), how independent they felt the CPA was. The situation where only auditing services were presented serves as a benchmark. The four NAS considered were design of accounting systems; executive search
and hiring of CEO; acquisition investigation; and assistance with accounting decisions. Benchmarks scores were 89 and 94 for loan officers and CPAs, respectively. For both the groups, the provision of executive search resulted in the lowest independence scores (54 for loan officers and 75 for CPAs), while assistance with accounting decisions resulted in the highest scores (71 for loan officers and 84 for CPAs). Only the fact of provision (at some level) rather than the magnitude of the NAS provision was considered in this study.

Teoh and Lim [1996] used a factorial ANOVA with repeated measures design. Five factors were investigated, including NAS>50 per cent audit fee. At this time, Malaysia was described as a newly industrialized economy. The level of confidence in the auditor was elicited from both auditors (n=69) and accountants in industry (n=33). NAS provision was the second most important factor explaining 7 per cent of the variance in responses.

Davidson and Emby [1996], in addition to providing a review of prior studies, focused on the impact of NAS provision on individual perceptions and decision, on the impact if NAS provision on individual perceptions and decision, surveys auditors on the impact of internal control systems design on audit assessments. Their findings supported those of Coreless and Parker [1987] in that auditors did not appear to be biased towards a more favorable assessment when they assessed systems designed by their firm’s systems group (although in some cases the opposite effect was observed).

Emby and Davidson [1997] conducted an experiment using auditors to examine the impact of four factors (including NAS provision) on auditor’s ability to resist management pressure in a dispute over the disclosure of a contingent claim. They found that auditors were more likely to insist on disclosure when they provided the client with NAS.

Barlett [1997] examined perceptions of auditor independence in five different scenarios involving potential conflicts of interest. Case four involved the provision of NAS (specifically porches investigation audit that gives rise to a self-review threat and pressure from management to violate GAAP). Seventy-six CPAs and forty-eight bankers were participated. 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 auditor’s views regarding 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 audit judgments. Of the 897 respondents, 12.3 per cent felt that such an influence occurred.

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

Hussey [1999] asked UK finance directors about a range of issues concerning the familiarity threat and auditor independence. One question asked whether auditors should be allowed to undertake other than audit work for the same client. The majority agreed that joint provision should be allowed, however 20 per cent of independent public respondents disagreed, compared to 13 per cent of private company respondents.

The Beattie et al., [1988; 1999] study examined a large set of 45 economic and regulatory factors that could impair or enhance auditor independence, using questionnaire 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 users with second rank and for preparers with sixth rank. It was ranked as twelfth for auditors. At a level of 50 per cent of audit fee, the corresponding threat rankings were firth, tenth and seventeenth and at the level of 25 per cent of audit fee they dropped to fourteenth, eighteenth and twentieth ranks. 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 occurred 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 of 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 a questionnaire survey. Respondents were asked whether the independence of the auditor decreased if NAS were provided in five different circumstances, with responses being given on a 5-point agree-disagree scale. Sixty-nine percent agreed that joint provision using the same personnel reduced independence, whereas only 24 per cent agreed when separate departments were used. Only 16 per cent agreed that NAS provision to non-audit clients only reduced independence and only 16 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. joint provision enhanced auditor independence.

Kornish and Levine [2000], a survey commissioned by the ISB indicated that respondents believed that the evolution of audit firms into consulting fields was logical and the provision of most consulting services was not likely to create real problem of independence.

Jenkins and Krawezyk [2000] is the recent US study and it focuses on the impact of joint NAS provision. Both the materiality of the NAS fee (material or nominal –40 per cent and 3 per cent respectively) and the type of NAS performed (actuarial services; internal audit outsourcing; legal services; and software training were varied, 323 investors and auditors took part. This study founds that joint provision had a positive effect on participant’s perceptions of auditor independence, with the influence being strongest for Big-Five auditors. It was also found that investors favored disclosure of the amount of NAS and audit fees regardless of their level, whereas auditors favored disclosure only if NAS exceeded a specified threshold.

Contrary to the concerns that fee dependency impairs auditor independence, Reynolds and Francis [2002] found evidence consistent with auditors increasing their independence in response to greater financial dependence. Specifically, they found that relatively larger audit clients-those for which the auditor was expected to have the greatest financial dependence-
tended to report significantly lower discretionary accruals when compared with smaller clients. The authors conjectured that this was because the reputation and litigation damages associated with audit failure were likely to be greater for larger clients, providing incentives for 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 that financial dependency impaired auditor independence.

This study also suggested that market-based institutional incentives such as reputation loss and litigation costs promote auditor independence and outweigh 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 had 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 involving moral hazard, 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. The authors assumed that the owner hires an auditor to produce information used in contracting with the manager. Thus the auditor was also an agent and was modeled as such.

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 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 et al., [2002] found no association.

It is believed that auditor’s responsibility and independence are crucial issues underlying the independent auditing function and has significant implications on the development of auditing standards and practices. In this
regard, a survey taken up by Lin [2004] in China with respect to audit objectives, auditor’s obligation to detect and reporting 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 governmental control or intervention and moving towards self-regulation of the profession. This study has a limitation in the sense that it should cast light on understanding of the institutional setting and updated development of independent audits in China and may also serve as an annotation to the recent accounting reform debates in the western world.

Myers [2005] perceive that audit independence is fundamental to the credibility of the profession. The audit independence can be viewed from two angles: (i) Actual independence is the achievement of actual freedom from bias, personal interest, prior commitment to an interest, or susceptibility to undue influence or pressure; and (ii) Perceived independence is the belief of financial report users that actual independence has been achieved.

This study investigated the views of natural shareholders regarding the role of the effects on independence due to the audit firm also providing non-audit services to their audit client. A total of 615 questionnaires were received with an overall response rate of 37.5 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 the independence of auditors and audit firm reputation were tested. Both were believed to add credibility to the auditors’ report. Further discussion involved shareholder perception of audit independence in three separate instances: audit firm receiving substantial consultancy fees; the auditor holding shares in the audit client and the same auditor had been retained for over seven years. Shareholder opinions revealed that 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 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 suggest that natural shareholders place a strong reliance on regulatory matters such as the accounting standards and the corporation's law 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 adequate regulation of the capital market. Thirdly, their study would serve to educate users and auditors about the contextual factors surrounding the role of auditor as well as the possible threats and enhancements factors affecting auditor independence. The survey instrument was divided into two sections: section one dealt with demographic factors and section two focused on 39 audit-related issues categorized under a number of generic factors. The sampling respondents identified comprised several groups such as auditors, financial directors, credit managers, investment analysts, fund managers, shareholders and government departments. The sample respondents comprised 66 auditors and 148 users. The findings of the study revealed that economic dependence of 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 negatively affect perceptions of auditor independence.

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 indicates that NAS provision impairs independence perceptions for at least a significant proportion of respondents, others suggest that independence perceptions are either unaffected or enhanced and yet other studies show that decisions can be unaffected even if independence perceptions are negatively affected.
This type of study suffers from a number of limitations. Non-response bias is one limitation. However, arguably a more serious threat to the validity of the findings of these studies is the risk of demand effect, whereby respondents can see the focus of the research and respond in the manner they think is expected by the researcher. This is a particular danger in experimental, case-based studies that utilize a ‘within-subjects’ design rather than a ‘between-subjects’ design (i.e. a repeated measures design) as many of the early studies do.

RESPONSIBILITIES OF AUDITORS AND DETECTION OF FRAUDS

The responsibility of auditors is ‘an amalgamation of public policy consideration’ [Chung, 1995] as a result of the deregulation movement demands for the profession to protect the public interest has grown rapidly. In addition, business operations have become much more complex owing to 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’ 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 auditor’s 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 society’s need over time, the debate has enabled the profession to realize ‘a duty to continuously assess auditing standards 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 auditor’s responsibility for fraud detection, has made continuing efforts to revise 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 studies relating to responsibilities of auditors, compared to those available on auditor independence, the audit expectation gap or the components of audit expectation gap. Many studies in audit expectation gap have identified responsibilities of auditors as one of the factors causing audit expectation gap. The following paragraphs bring out the important aspects pertaining to responsibilities of auditors based on some of the important studies available on the same. Those studies have also been the outcome of research conducted in developed countries of the world.

The responsibilities of auditors and the expectation gap always go together. The expectation gap is due to 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 management who bear a legal obligation for truthful financial reporting [Nair and Rittenberg, [1987]; Goldberg, [1988]; CICA, [1988]; Martens and McEnore, [1991]; 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 fraud and error have shown their construction to be dependent on the reactions and lobbying efforts of the audit profession [Humphrey, 1991]. In similar manner, Humphery et al., [1993] noted that auditor's responsibilities concerning fraud have been a recurrent problem as it is clear that public's expectations on this issue is not satisfied.

Robinson and Lyttle [1991] showed 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 fraud as one of their duties. Given that some auditors misunderstand their responsibilities it is not surprising that some users are confused.

Auditors have an existing duty to detect material theft of corporate assets by non-managerial employees, which escapes the internal control net, but providing the report such theft to the company's management 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 auditor's legal liability [O'Sullivan, 1993; Tidewell and Abrams, 1996].

Another remarkable study on auditor's 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 following areas: disclosure, internal control, fraud, and illegal operations.

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

Monroe and Woodliff [1993] examined the effect 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 responsibility and management had less responsibility for the prevention and detection of fraud, and safeguarding assets. But, at the end of semester the auditing students believed that auditors assume a much lower level of responsibility, but there was little change in the marketing students beliefs.

Guy and Sullivan [1998] made an overview on issue of the nine new standards of Auditing Standards Board. An issue was raised in America about the responsibilities of auditors for uncovering fraud and illegal acts and whether they had taken enough steps for evaluating going concern, by members of congress, financial writers, judges and members of leading accounting firms. In 1987, the ASB issued for comment 10 exposure drafts of
professional standards. After reviewing nearly 1200 comment letters, the ASB approved issuance of nine new statements on auditing standards. The expectations gap statements on auditing standards are grouped under four statements, such as (i) Detection of fraud and illegal acts, (ii) More effective audits, (iii) Improved external communications and (iv) Improved internal communications.

The authors expect the above changes in auditing standards, because the profession has a duty to continually assess auditing standards in light of the expectations, concerns and criticisms of others. Based on such an assessment and after extensive deliberation and careful study, the ASB approved these nine new standards. The authors conclude that if the existing audit expectation gap is to narrow. The new standards should bring the auditor's responsibility and performance closer to public expectations.

Lin and Chen [2004] found that the beneficiaries believed the auditors were responsible for the truthfulness and reliability of financial statements, detecting and reporting errors and frauds, liable for fraudulent or misleading information contained in prospectus disclosure and disclose in the audit report the uncovered frauds, inefficiency or irregularities. The empirical study showed that there were significant differences between the perception of beneficiaries and auditors. This shows that the auditors have more responsibility than the management.

Fadzly [2004] identified the responsibilities of auditors as one of the factor in the areas, which could cause gap between auditors and investors. In his study, he formulated eight statements on responsibility such as the issues of fraud detection and prevention, accounts and financial statements preparation, auditor's objectivity, internal control, scope of auditor's legal responsibility and auditor's culpability in fraud-related business failure. Here, Fadzly used Mann-Whitney U test to find the perception between the auditors and users, the result showed that there were significant difference in all statements except for auditors' objectivity. The study proved that the users believed that auditors were responsible for all the above said statements. The largest extent of difference was found in the responsibility to prepare financial statements. Brokers and investors expected auditors to prepare financial
statement instead of management (directors). For remaining statements, moderate ratings were given by the users.

The study made by Dixon et. al., [2006] in Egypt focused on seven statements of responsibilities like 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. It showed the auditors were responsible in most of the areas.

The results of experiments by Jamal et al., [1995] and Zimbleman (1997) suggested that focusing specifically on fraud detection might result in enhanced ability to detect fraud. These studies focused on the planning and review stages. It was observed that the attention to qualitative aspects of misstatements indicative of potential fraud might be subordinated in the normal audit context invited the question as to whether a specific “fraud audit” would be valuable, especially in situations involving heightened risk of fraud.

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 at the beginning of the semester that auditors were more responsible to detect fraud 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 for detecting fraud by assigning the group mean value of 2.1.

Mancio [1997] brought out clearly auditor’s responsibility towards detecting any kind of fraud. He quoted SAS 82 to clarify the same and states that the auditor was not responsible for detection of fraud. According to him, the auditor’s responsibility related to the detection of material misstatements caused by fraud 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 are free of material misstatements, whether caused by error or fraud. He also brings out how a financial statement audit
differs from a fraud audit. A fraud audit is 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 for appropriate guidance.

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Garrick [2004] opined that at the heart of any program to prevent fraud was the 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 auditability: The weight attached to each of these elements will vary depending on the resource being protected and the threat. Regarding 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 fraud, Garrick suggests the designing of a fraud awareness program targeting 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 fraud or other irregularities

Neil (2004) feels that to protect its reputation a company should first come clean about fraud and then clean up the mess. He opines that 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 a lack of financial integrity has to be treated by senior managers as a serious threat to reputation.

While conducting an empirical study of audit expectation gap in China, Lin and Chen [2004] found substantial differences between Chinese audit beneficiaries and auditors in perceptions of auditors’ obligation to detect and report fraud. There was a wide gap between the beneficiaries and auditors in this regard that was supported by the there group mean of 4.22 and 2.83 respectively with the expectation gap of 1.39. It showed that detection of fraud was one of the important functions of an auditor.

Fadzly et al., [2004] of Malaysia and Dixon et al., [2006] of Egypt, did similar studies about fraud detection. They were of the opinion 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 fraud highlights that the fraud is an important component of audit expectation gap. And fraud 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 fraud no doubt their responsibilities towards fraud detection is unavoidable in the course of his discharge of his duties. Lastly, the above studies clearly reveal that the auditors’ responsibility is mainly in preparing financial statements.

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 on audit expectation gap amongst different sections of the society. Most of the studies ascertain the auditors’ and the public’s view of the roles and responsibilities of auditors through the use of questionnaire 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 the auditors’ and the public’s view of the roles and responsibilities of auditors through the use of questionnaire surveys. 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 material errors, irregularities and illegal acts. They attempted to establish whether there were any differences in the perceptions regarding 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 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.

In a similar context, Low [1980] examined the expectation gap in Australia. The extent of auditors’ detection and disclosure responsibilities concerning 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 objective 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.

Jennings et al., [1991] asserted that auditor liability depended on the attitudes of judicial litigants towards the auditing profession.

In a slightly different perspective and in an attempt to contemplate how an expectation gap could have legal implications for the profession, Lowe [1994] compared the perceptions of auditors and judicial litigants regarding their expectations of the auditing profession. It was found that an expectation gap exists between the auditors and judicial litigants and that judges systematically expect more from auditors than auditors believed they provide.

Similarly, Maria et al., [1992] made a comparative analysis of the nature of the audit expectations gap in Britain and Spain. The paper begins by 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 expectations 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 further 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 debate on the audit expectations 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 properly the nature and extent of audit work and responsibilities. The expectations gap in Britain is portrayed very much as an ignorance gap.

This study suggested some ways of reducing the expectation gap. They are: (i) tighter ethical guidelines, (ii) mandatory auditor rotation, (iii) the establishment of audit committees, (iv) state auditing boards, (v) banning of auditors from providing management consultancy services to audit clients, and (vi) broadening of the groups to whom auditors can be held responsible.

In the UK, Humphrey et al., [1993] examined the expectation gap by ascertaining the perceptions of individuals of audit expectations issue through the use of a questionnaire survey comprising a series of mini-cases. The issues investigated include the following: What is and should be the prohibitions and regulations placed on audit firms? And what decisions could auditors are expected to make? The respondents included 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 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 risk and uncertainty).

Chandler et al., [1993] looked at 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 perception 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.

Cameron [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 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.

Porter [1993] conducted an empirical study in New Zealand to test the postulated structure of the audit expectation-performance gap and to establish the composition and extent of the gap and its constituent parts, using a mail survey. This study was conducted in 1989 to ascertain the opinions of auditor's interest groups in New Zealand regarding auditors' existing duties, the standard of performance of these duties and the duties that auditors should perform.

It was hypothesized that society meant the population at large, inclusive of auditees, and users of financial statements, but exclusive of auditors. The study covered two interested groups in their research, viz., financial community comprising of auditors, auditees and audit beneficiaries comprising of auditors, officers of public companies, financial analysts, auditing academics, lawyers, financial journalists and members of the general public. The findings from the survey revealed that 50 percent of the gap was attributable to deficient standards 34 percent from society holding unreasonable expectations of auditors and 16 percent from perceived substandard performance by auditors.

This was because of lack of knowledge about the existing duties of auditors by the interest groups. It was also found that the major reason for the
audit expectation perception gap was deficient standards, unreasonable expectation from different users and the sub-standard performance of auditors.

This empirical research helped in 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 Jager [1993] studied the audit expectation gap in the Republic of South Africa and found three areas (independence of auditors; role of auditors, in particular relating to fraud and going-concern issues; and compulsory audit of small owner-managed companies) in which expectation gaps existed between auditors and non-auditors. McInnes [1994] reviewed the findings of Gloeck and Jager and found the existence of audit expectation gap.

Epstein and Geiger [1994] discussed 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 perception of the type and level of assurances believed or desired to be provided by auditors. The data for the study was collected through a national survey conducted on investors representing individuals from all the 50 states of United States to gather information on various aspects of financial reporting issues. Two separate questions were asked to investors, viz., what level of assurances they believed auditors should provide for detecting material misstatements as a result of error and as a result of fraud. The researchers anticipated a typical response of reasonable assurance. However, investors held auditors to a much higher level of assurance. Over 70 percent of investors believed that auditors should be held to absolute assurance standard for detection of fraud higher than that for detection of errors both of which exceeded current professional standards. Hence the results of this study bring out the fact that there exists audit expectation gap and the profession's perception that an
audit should provide a higher level of assurance of financial statement accuracy. The study also concluded that the majority of investors expect an audit absolute assurance that the financial statements were free of all types of material misstatements.

Monroe et al., [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 audit reports. The data for the study was 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 auditors. The major areas of differences in perceptions studied in this research included responsibility factor, prospects factor and reliability factor. 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 was to be decreased.

Chung [1995] examined how varied levels of confidence of auditors resulted in audit expectation gap and the inadequacy of which led to inadequate performance by auditors. He was of the opinion that the auditor's confidence was not a contributor to the audit expectation gap. An over-confident auditor may be dangerous as over confidence might result in
inefficient audit. The objective of the auditor is to make the most accurate (correct) decision possible after considering all the facts. Anyone who suffers a financial loss as a result might sue an auditor who expressed an inaccurate opinion on a set of financial statements that he 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 time to make decisions.

The survey was conducted on 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' 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 (calibration is 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, there was seen to be a tendency towards under-confidence. 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 may expose them to. 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 [1996] found that the expectations gap detected in prior research studies dealing with auditor 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 expectations gap continued to exist after the introduction of the long-form audit report in relation to financial statement reliability. This finding indicated the continued difficulties being experienced by users in understanding audited financial statements. The study also indicated that users were generally unhappy with the role played by the auditing profession particularly with respect to 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 demands, which can often pull the auditor in opposite directions. This has been explored by Hoskov [1998] who made a survey on the expectation gap between 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’ 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 error 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 error as material i.e. whether they thought this would influence the decisions, which users reach on the basis of the financial statement. The survey was based on four examples of publicly listed companies, all of which were assume 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.

Noordin's [1999] study is important for two reasons: Firstly, the result of this study might affect the process of setting auditing standard. 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 auditor's 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. This results in forcing the auditors to deliver a report in more clear terms that helps in reducing 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 auditor's report. It was found that knowledgeable users placed less responsibility on auditor than less knowledgeable users. He concluded that education on audit amongst users to be 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 auditor 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 auditor's responsibilities on (i) omission and misstatement reporting, (ii) detecting all fraud and errors, (iii) fraud prevention and (iv) 100 per cent examination in 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., [1999] examined 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 from the Singapore telephone directory. Hundred persons were selected from each group. The response rates achieved were: 35 per cent for auditors, 26 per cent for bankers and 36 per cent for investors. They applied Mann-Whitney U-test to find significant differences between the auditors and non-auditors (bankers and investors). They selected 16 areas under three heads 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 of the existence of a moderate gap. Out of sixteen areas, a significant area of gap was concerned with the auditors responsible for detecting all frauds and the auditors not responsible for preventing fraud. In addition, there was evidence that investors believed that auditors had some responsibility for ensuring an entity of sound internal controls.

Hian [2000] studied 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 questionnaire listing 13 possible companies audit objectives and was administered to auditors and non-auditors (500 each). The response rates for auditors and non-auditors were 50.40 percent and 47.00 per cent respectively and the overall response rate was 48.70 percent. To examine statistically, the gap between auditors and non-auditors, t-test, ANOVA and Student-Newman-Keuls’ (SNK) multiple comparison tests were performed. The results showed that auditors perceived significantly more strongly than non-auditors in giving a true and fair opinion and providing aid and advice on accounting matters were important. On the other hand, non-auditors perceived significantly more strongly than the auditors with regard to detecting and preventing 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 company audit objectives exists between 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 perception; and (ii) identifying the extent of gap with regard to 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 fraud; and (vi) the group most effective for preventing and detecting fraud.

Primary data was collected using questionnaire from 150 auditors and an equal number of individuals selected at random (43.33 per cent responded).

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

The study suggested that the auditor profession should take more proactive stance like (i) greater responsibility for educating the public on the role
of auditors; (ii) extending the auditor’s responsibilities to match users’ expectations, regarding the prevention and detection of fraud and; (iii) ensure 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 auditors’ and investors’ perceptions on the expectation gap in the United States. The study surveyed 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 23.4 per cent and 29.40 per cent respectively. The data was analyzed using descriptive statistics such as group means and standard deviations and two-tailed t-tests were applied to arrive at the 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 employee fraud; and (vi) the firm had not engaged in illegal operations.

The findings of the study in conjunction with the expectation that all items were important to investors and creditors were disclosed indicated that investors did not concur with the Panel to 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.

Hudaib [2002] conducted a survey on audit perception gap in Saudi Arabia. He conducted a survey using a combination of mail questionnaires and semi-structured interviews. He found that the ideology and legal structure in the Saudi environment significantly affected audit perceptions 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. Auditors were not happy with the misconceptions attached to these two roles. Similarly, the various user groups also revealed their dissatisfaction on the current performance of these roles by the auditors. The profession is forcefully governed by their religious code of ethics. Auditors felt that they were lacking the capability in handling cases under both systems such as secular and shariah. But users wanted auditors to be involved in detection of fraud 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 forcing the implementations of such rules without proper consultation with the practitioners created a gap in perceptions in Saudi Arabia. Tension between Saudi Organization Certified Public Accountants (SOCPA) and other parties interested in role of auditing too created a gap. Thus the competing ideologies of western economic rationality v/s Islamic rationality and their legal systems resulted in an uncomfortable relationship between the auditors and users.

“The Expectation Gap Revisited” was a study made by Schullch et al., [2002] of Monash University on the recommendations made by 1994 and 1996 expectations reports. These reports were the outcome of joint efforts made by the two professional accounting bodies, viz., 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 “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 proactively address the expectation gap issue and stimulate widespread discussion among all sections of the society on the same. The 1996 Report was based on these public submissions and seminars. This report was to advice the two
accounting bodies on the best way of progressing the various issues raised in the research study.

According to these two accounting bodies, the expectation gap was attributed to a number of different causes, viz., (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; 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 and these 100 recommendations were not implemented, but at that time, the 1996 Report was released. 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 research 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 as under: (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 gaps issues that considers the impact on all parties affected; (iii) the need for a concerted effort by all parties affected to satisfactorily resolve certain expectation gap issues; (iv) the need for regulatory support to implement measures to reduce the problem; (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 did not necessarily mitigate the expectation gap; and (vii) the need to be vigilant and monitor expectation gap issues over time in line with changes in social expectations.

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

For the controlled experiment, reading material was 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 auditor’s responsibilities to accounts and financial statements and internal control and fraud. 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 would only learn about financial audit and during their second trimester would learn about audit expectation gap. The results indicated that after reading the brochure there were no significant differences in students’ and auditors’ expectations.

The study addressed the expectation gap through auditor’s responsibilities, reliability of audit, and usefulness of audited financial statements. Auditor’s responsibility addressed the issue of fraud detection and prevention, accounts and financial statements preparation, auditor’s objectivity, internal control, scope of auditor’s legal responsibility and auditor’s culpability in fraud-related business failure. The empirical result indicated significant differences in all responsibility areas except for auditor was unbiased and objective between the auditors and users (broker, banker and investor).

Statements on reliability dealt with the issues of audited financial statement being true and fair, the extent of assurance provided by audit, fraud within the audited entity, auditor’s trustworthiness and audit report’s effectiveness in communicating the extent of assurance and audit work performed. The empirical result indicated that there were no significant differences in beliefs between the auditors and users except financial statements, which give a true and fair view. It showed less extent difference belief between the auditors and users than in the responsibility statements.

Three statements on usefulness pertaining to the use of 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 difference between the auditors and users except performance monitoring.

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

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

A mail survey was conducted to collect data from audit beneficiaries (investors, creditors, government officials, business management, and academics) and public practitioners by distributing 800 questionnaires. The overall response rate was 24.80 percent. The data was analyzed using descriptive statistics, such as group means, standard deviation and independent sample t-tests. The result 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 government controls in the economy, made independent audits provided by public accountants to have much more important in the Chinese economy.

There was an expectation gap with respect to objectives of auditing function, auditor’s obligation to detect and reporting frauds or irregularities, and third-party liability of auditors and the impact of government sponsorship on the credibility of audit services. Auditors and audit beneficiaries were dissatisfied with the present status of auditor independence in China. They concluded that much must be done to improve 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 society’s reasonable or unreasonable expectations. And this resulted in undermining the confidence in the auditing profession. The objectives of this study were investigating 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 survey by means of a questionnaire containing 51 suggestive responsibilities of auditors were conducted. The findings of the study showed that the extent of gap was very less i.e., less than 2.00 percent. But contribution of gap's 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 New Zealand. It was found that in the United Kingdom expectations were more from auditors. Hence the reasonableness gap was wider in the United Kingdom than in New Zealand. Regarding deficient standards, the gap was more in New Zealand than in the United Kingdom. The deficient performance gap was almost similar in both the countries.

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

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

Dixon et al., [2006] investigated the expectation gap between auditors and financial statement users in Egypt. The study confirmed the existence of an expectation gap in the nature of the audit function, the perceived performance of auditors, their duties and role, their independence and the non-audit services. The data for the study was collected through
questionnaire. The questionnaire was divided into two sections. The first section contained demographic factors 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 to each group and the overall response rate was 37.00 per cent. Mann-Whitney U-Test was applied to find significant differences between the three respondents groups form three factors. The three factors analyzed being responsibility factors, reliability factor and usefulness factors.

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

Statements on reliability dealt with issues of the extent of assurance provided by audit, accounting policies, audited financial statements being true and fair, fraud within the audited entity and audit reports effectiveness in communicating the extent of audit work performed. The results indicated that there were significant difference between auditors and users excepting the extent of assurance provided by audit and audit reports effectiveness in communicating the extent of audit work performed.

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

On the whole, the literature survey on the perceptions of nature of audit expectation gap revealed that perceptual differences did exist between auditors and various users group regarding audit profession as a whole.
EDUCATION AND AUDIT EXPECTATION GAP

In majority of the studies the authors suggest that educating the public about the objects of an audit, 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 in narrowing the audit expectation gap.

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

There were significant differences between auditors and students who had not completed an auditing course, about auditor’s/reviewer’s responsibilities, the reliability of audited/reviewed financial information and the decision usefulness of audited/reviewed financial statements. But 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] examined the effect of education on students’ perceptions about the meaning of audit reports, duties and responsibilities of auditors. They examined the effects of professional education on undergraduate auditing students’ beliefs about the messages communicated through audit reports through a questionnaire that was administered to two groups of students at the beginning and end of the semester and to auditors. The first group consisted of final year undergraduate accounting students enrolled in their first auditing unit and the second group consisted of marketing students not enrolled in the auditing unit.

99
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 fraud, and safeguarding assets. But at the end of semester, the auditing students believed that auditors assumed a much lower level of responsibility, but there was little change in the beliefs of marketing students.

When reliability factor was considered, there were significant differences between both groups of undergraduates and auditors. 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. But at the end of semester, the auditing students believed that financial information were reliable. Regarding the future prospects, both student groups held similar beliefs to auditors at the beginning of the semester. But at the end of the semester, auditing students' view changed significantly towards the belief that audit reports implied nothing about the future viability of the firm. Hence the results suggest that education may be an effective approach to narrow the expectation gap. However the study added that further research is needed to reveal the quantity and content of public education required to educate financial information users about the nature of auditing.

Pierce et al., [1996] examined the effect of education on 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 investigated in this study were (i) duties; (ii) ethical and legislative framework; (iii) liability; and (iv) audit report. A survey questionnaire was completed by five different groups of students at the start of the academic year and again at the end of that 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 were 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 of the regulations governing 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 improvements 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 auditors and undergraduate business students. Responses from the students were collected before and after they completed auditing coursework. The students' perceptions were closer to auditors after they completed the coursework, particularly about the roles and responsibilities of auditors, but signs of the expectations gap remained in areas pertaining to fraud. However, the extent of the gap was lower than 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.

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

Similarly, the impact of audit education on perceptions of deficient auditors' performance 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
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, viz., auditor duties relating to fraud and auditor duties relating to going concern. The objectives of the study were (i) to investigate the impact of audit education on the deficient performance gap; and (ii) to investigate the impact of audit education on perceptions of deficient auditor performance when threats to auditor performance seemed to exist.

A survey questionnaire comprising two parts (one part for each objective) was used to collect data on the impact of audit education on perceptions of auditor performance. Data was collected from three groups of students, each of which was exposed to varying levels of audit education. 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 auditor performance compared to those classes who had received less audit education.

The major finding of the study was that audit education appeared to create greater skepticism regarding the performance of existing duties by auditors. Perceptions of deficient auditor performance increased 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 a different and contradicting finding when compared to the findings of 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 create perceptions of deficient auditor performance.
Uday [1989] in his outstanding article presented at the Eleventh Western India Regional Conference held in Bombay, India during January 1989 presented some of the malaises afflicting auditing professions in contemporary India. He was of the opinion that what people in the accountancy profession perceived to be their role as auditors was lawfully short of what society expected us to do in that role. Everybody, whether it was a shareholder or a prospective investor, labor leader or a creditor expected corporate financial statements included in the annual report to cater to his specific information needs. And they expected the same from the auditors more than from anybody else. The author opined that one of the most popular misconceptions among the users of financial statements was their widespread belief that the auditor’s primary duty was detection of frauds and many also believed that it was the auditor who provided the figures and he was responsible for preparing the balance sheet. But there were misunderstandings about the role of auditors by the general public. The author argued that the responsibility of preparing the balance sheet lied with the management and with the auditor.

Hence the author concluded that it was essential in the interest of maintaining the reputation and projecting proper image about the role and character of auditors’ profession that a review and reappraisal should be made of their function.

Singh [2004] observed that most current functions did not encompass enough of the expertise or the range of risk-based information and financial analysis that today’s banks required to thrive in fiercely bought market. He observed if the auditor was using yesterday’s approach in today’s bank then expectation gap widened and the result would be the loss of opportunity. He lists the causes for expectation gap as follows: (i) Auditors merely fill the information required in the reporting formats in a mechanical way and objective analysis is not done; (ii) Focus is only on identification and rectification and not to stop recurrence controls; (iii) 100% verification of vouchers is not carried out; (iv) Auditors should be vigilant, objective and analytical in approach; (v) Quality of credit assessment is lacking; (vi) System related issues are not commented upon; (vii) Critical analysis of the quality of
Bridging of unreasonable expectation gap is possible by way of effective and continuous communication with the concerned parties by sending questionnaire on the expectation to all concerned followed by a brainstorming session and then formulating adequate strategies. Listed below are a few suggestions to bridge the gap. (i) Concurrent auditors traditional testing of control activities should include two additional components that are derived from the way management runs a business; control environment and risk assessment. In future, concurrent auditors can’t just audit control activities they will have to play a key role in identifying areas to improve risk management process; (ii) Good auditing and accounting skills are unlikely, in themselves, to be enough when dealing with banking transactions and practices; (iii) Acquire at least working knowledge of IT auditing. (iv) Understanding of foreign exchange business, financial instruments and risks arising there from needs improvement; (v) More senior level involvement; (vi) The Support of specialist training and technical back up; (vii) To be in touch with the market practices; (viii) To have updated knowledge of relevant legislatures regulation and circulars issued by the Bank; (ix) To be aware of emerging business issues; (x) In addition to tests of details focus should also be given on analytical procedures and (xi) Change in mindset up-by banks as well as auditor.

The following extracts from a debate under the title ‘Frauds in Public Sector Banks’ in the Rajya Sabha on April 27, 2000 reflects the expectation of the parliament: (i) Day-by-day the depositors are losing their money because of various frauds in nationalized banks; (ii) A number of cases have been registered against the nationalized banks; (iii) There is a need to review the concurrent audit; (iv) Some of the expectations as highlighted above can be classified as unreasonable expectation gap; (v) Whether we like it or not all concerned people expect concurrent auditors not only to detect frauds but also to prevent it; (vi) The existing scope of the concurrent audit in view of
changed international practices in order to ascertain what is unreasonable expectation and what are the ways to minimize overall expectation gap; (vii) The concurrent audit effectively is an internal audit though carried out on a continuous basis and the objective here is to minimize the time between the independent examination and the happening of financial transactions; (viii) RBI has made it mandatory to all the banks to implement Risk management system; (ix) Risk-based auditing is more efficient, because it directs audits at the high-risk areas, as opposed to financial areas, which may not represent such a great risk and it also reduces the risk of over-auditing; (x) Auditors are under attack around the world for not doing enough in the war against frauds; and (xi) The perception of the society is “Better audit less fraud” to bridge this expectation gap continuous communication with the concerned people is the need of the hour.

Salehi and Gowda [2006] made a study about audit expectation gap. This was the first study conducted in India. However, they covered only the concepts of audit expectation gap made by a few researchers. They viewed the expectation gap as the result of deficiencies in auditor, lower auditor independence, unscientific audit process, laxity in regulatory mechanism and apathy of the society towards audit importance at large. Even though there were many studies made in various parts of the world, they didn’t highlight any empirical evidences on the problem on audit expectation gap.

On the whole, the audit expectation gap in India has not been researched thoroughly, or even a modest attempt has not been made. However, there seems to be a general awareness on the role of audit, which is always perceived negatively in the country. The research coverage of various dimensions will go a long way in making audit a deliberate instrument of public policy to find a solution to the all-pervasive corruption imbroglio of Indian subcontinent. Hence the present study aims at achieving a modest attempt on audit expectation gap in India.

CONCLUSION

The review of literature shows that extensive studies were carried out in a few countries on audit expectation gap. The empirical researches conducted so far mainly focus on auditor independence, responsibilities of
auditors, audit expectation gap, role and responsibilities of auditor in detection and prevention of frauds, impact of non-audit services on independence, and the impact of audit education on audit expectation gap through experimental designs. The studies highlight that expectation gap exists in almost all countries like Singapore, Australia, China, Bangladesh, Denmark, Ireland, England and other countries. As auditing is gaining much importance in recent times, investors are becoming more intelligent and they expect auditors to protect their interest and expect the financial statements produced by the auditors guide them to right investment strategies. However, no comprehensive study has been conducted in India to examine the existence and the extent of audit expectation gap. As India is catching up with the global developments, it has become necessary to take up an explorative study on audit expectation gap. An initiation is attempted on the audit expectation gap in India in this present study.