CHAPTER I
INTRODUCTION

THE PROLOGUE

There has been a paradigm shift in the structure of business organizations in the sense that small entities employing a handful of family members have transformed into vast multinational companies staffed by thousands of employees. Such growth has been made possible by mobilizing financial resources from many thousands of small investors through the financial markets and credit granting by the financial institutions to the growing companies.

As companies have grown in size, their management has passed from shareholder-owner to small groups of professional managers. However, this gigantic growth of company has been accompanied by the increasing separation of ownership interests and management functions. As a consequence, a need has arisen for company managers to report to the organizations, owners and other providers of funds such as banks and other lenders on the financial aspects of their activities.

In this process of accounting, there is a gap between the managements of enterprises and end-users of published financial reports, regarding their authentication, reliability and correctness of financial reporting. The link between shareholders and lenders on one hand and management on the other is established through financial statements, which need auditing with the assurance that they are reliable and credible through authentication based on professional code of ethic regulation.

In nutshell, the auditor plays a centrifugal as well as a centripetal role in the accounting world. The primary function of external auditors is to attest to the fairness of the financial statements of a company [Gibbins and Mason, 1988; Rulund and Lindblom, 1992]. Audited financial statements are used by different users for various purposes. For example, creditors and shareholders may rely upon audited financial statements to obtain view of the financial resulting of a company to guide their investment decision [Merchant, 1985]. Audited financial statements are also important to the management of a company, since the information that they contain is used by owners and/or
board of directors to evaluate, and often to compensate its officers [Murphy, 1985; Scott et al., 1993; Lambert and Larcker, 1987]. The divergence between external user's and management's use of financial information in an inherent conflict over financial information results in an inherent conflict over financial statement presentation. In other words, the agency theory will arise in general to the auditor's role is the resolution of this inherent conflict of preference for financial statement information [Gaa, 1991]. Society requires the auditors resolve this conflict to the benefit of the external users of financial statements [Beaver and Demske, 1974; Gaa, 1993; May and Sundem, 1976].

According to Chandler et al. [1993], the need for external auditors is a response to agency problem and the audit functions as a mechanism to attest to the accountability and stewardship of company management to reduce the possibility of innocent mistakes and deliberate misstatements such as fraud and management manipulation.

Adams and Evans [2004], observe that there is much debate about whether social, ethical and sustainability accounts and reports should be audited, and about the quality and usefulness of audit or assurance statements published in the reports which we have to date. Assurance statements should address the questions: Does this report give an account of the company and its performance on which readers can rely? Is the report complete, accurate, honest and balanced in its portrayal of the organization? Audit is concerned with the way an organization performance has been reported. Stakeholders should be able to rely on the information in audited reports in making their decisions about investments, products and services, employment where to live and other issues that may affect them directly. However, because of the recent scandals at national and international dimensions the credibility of audit practice became undermined. In addition these scandals had severely damaged the business section. At the bankruptcy of World Com, 40% of employee plans consisted of World Com stock. When the company went bankrupt, employees lost $775 million in interest benefits [Jacobius, 2002]. The events of scandals not only caused an erosion of confidence in the capital market but also created what Whittington and Pany [2004: 10] call a “crises of credibility” for the accounting profession. A profession that was once highly regarded and whose members were one of
the most credible was now shrouded by mistrust and skepticism. Raiborn and Schorg [2004] describe the growing distrust in the auditing profession as “a cancer that is metastasising”. With the demise of Enron, over $70 billion of investors’ money and 4500 jobs were lost [Elkind and Mclean, 2006]. Arthur Andersen, Enron external auditor, was charged with obstruction of justice related to the destruction of Enron documents [Berkowitz, 2002]. Surprisingly, accountants who were highly regarded for maintaining high ethical standards were accused of participating in criminal behavior. Auditors who were once held in high were now viewed as ineffective and complacent [Beasely and Hermanson, 2004]. Furthermore, after those scandals a fundamental change in the way audits are performed was needed to win back the public’s trust [Tackett et al., 2004].

AUDIT EXPECTATION GAP

Many users misunderstand the nature of the attest function, especially in the context of an unqualified opinion. Some users believe that an unqualified opinion means that the entity has foolproof financial reporting. Some feel that the auditor should not only provide an audit opinion, but also interpret the financial statements in such a manner that the user could evaluate whether to invest in the entity. There are also users who expect auditors to perform some of the audit procedures while performing the attest function like penetrating into company affairs, engaging in management surveillance and detecting illegal acts and/or fraud on the part of management. It is these high expectations on the part of users of financial statements that create a gap between auditors’ and users’ expectations of the audit function. In addition, the users also place the responsibility for narrowing the gap on auditors and others involved in preparing and presenting financial statements.

Various studies have confirmed the existence of the audit expectation gap. Prior literature in audit expectation gap evinces that the expectations gap between auditors and financial statement users has existed for the past hundred years. The audit expectation gap has become a topic of considerable interest world wide, for research in general, and in the advanced countries like the U.S, the U.K, New Zealand, Germany and Singapore in particular for the
last thirty years. This is due to the occurrence of series of corporate failures, financial scandals and audit failures in these advanced countries and their subsequent impact on other countries’ audit profession. The literature available on audit expectation gap and related matters evinces the extent to which the auditing environment has become litigious.

The widespread criticism of and litigation against auditors indicates that there is a gap between society’s expectations of auditors and auditor’s performance as perceived by society. The majority of research studies indicate that the audit expectation gap is mainly due to users’ reasonable expectations of audits as well their as unrealistic perceptions of the audit profession’s performance. According to these studies, the differences may be attributable to users’ misunderstanding of what is reasonably expected from an audit, and of the actual quality of the audit work. Although a number of explanations for the existence and persistence of the audit expectation gap appear in the literature, references to users’ misunderstandings of the role, objectives and limitations of an audit, inadequate audit standards and deficient auditor performance capture the main essence of its causes. This results in users’ dissatisfaction with auditor’s performance that undermines confidence in the auditing profession and the external audit function.

BACKGROUND OF THE STUDY

Research indicates that financial statement users and auditors have substantially different perceptions regarding the role of the auditor. This difference is referred to as the audit expectation gap. There are several factors that cause the public’s expectation to differ from actual performance of auditors.

Porter [1990, 1993] separates these differences into two categories: those that are within the control of the profession to correct the gap called the performance gap and those that are called the reasonableness gap. The reasonableness gap reflects societal expectations that may not be reasonable in relation to the professional expertise of auditors. The reasonableness gap can be addressed by public education.

In attempting to address this portion of the audit expectation performance gap, the profession has modified the language in audit reports
to reflect that management has primary responsibility for the preparation of financial statements. The performance gap reflects the gap between the duties that can be reasonably expected of auditors and the performance of auditors as perceived by the public. Two deficiencies contribute to the performance gap: deficient standards and deficient performance.

Deficient standards cause a performance gap when there is a difference between auditor responsibilities as promulgated by professional standards and the expectations of financial statement users. Improving the congruency between promulgated standards and public expectations is expected to reduce the “deficient standards” component of the audit expectation performance gap.

Deficient performance is the difference between auditors’ existing duties and the perceived actual performance of auditors by the society. This is the only area of the expectation gap that is within the personal control of the auditor. Violations of any of the Generally Accepted Auditing Standards (GAAS) would constitute deficient performance.

THE PROBLEM

The many interrelated problems that face the accounting profession are symptoms of more generic phenomenon best referred to as expectation gap. In its most limiting presence, an expectation gap exists whenever a dispute arises between an auditor and a non-auditor over either the nature of or the quality of audit performance. The American Institute of Certified public Accountants (AICPA) responded to the increased public concern over the auditor’s role by establishing The Commission on Auditors’ Responsibilities (The Cohen Commission) in 1974. This Commission was charged to: develop conclusions and recommendations regarding the appropriate responsibilities of independent auditors. It should consider whether a gap exists between what the public expects or needs and what auditors can and should reasonably expect to accomplish. If such gap does exist, it needs to determine how disparity can be resolved [Cohen Commission, 1978]. After four years of existence, the Cohen Commission issued its final report which contained the following conclusions about expectations gap:
1. A gap does exist between users’ expectations and auditors’ performance.
2. Users appear to have reasonable expectations of the abilities of auditors and of the assurances they can give.
3. Although users’ expectations are generally reasonable, many users appear to misunderstand the role of the auditor and the nature of the service he offers.
4. The burden of narrowing the gap between performance and expectations fall primarily on auditors and other parties involved in the preparation and presentation of financial information [Cohen Commission, 1978].

The Cohen Commission’s conclusions were based upon an unsystematic approach which relied heavily upon evidence provided by surveys and public testimony which lack scientific appeal. So, more research should be taken in this matter.

Furthermore, in a market economy, information providing through financial statements is critical in making choices. But reporting enterprise produces the accounting data in financial statements and hence additional steps are necessary to establish their reliability. Independent auditors are professional experts entrusted with the mandatory responsibility of stamping the reliability of financial statements through an independent professional opinion on the fairness of presentation of the financial statements. Because of the flexibility permitted by Generally Accepted Accounting Principles (GAAP) and the many judgments and estimates necessary to prepare financial statements, the subjectivity in measurement and valuation is likely to arise. The impact of this flexibility has been evidenced in many studies: Archibald [1967]; Neumann [1968]; Bird [1969]; Cushing [1969]; Myers [1969]; Simpson [1969]; Baskin [1972] and Kaplan et al. [1972] in the sense that firms have a tendency to make changes in the policies and procedures so as to produce a favorable effect on the reported income and earnings per share. Since the auditor is virtually by the management, it is likely that the auditor is prone not to give qualified opinion, adverse opinion or disclaimer of opinion, but the unqualified opinion. This situation fails the very objective of audit function and the problem has paved way for audit expectation gap.
ACCOUNTING AND AUDITING IN IRAN

Accounting and auditing are playing very important role in Iran. According to Keramaty [1993] independent public accountants and auditors play important role in Iran because: (i) They can be good tax advisers for government; (ii) Their services reduce the government office work; (iii) Their services increase investment information in securities; and (iv) Their services provide reliable information for national economic and financing institutes.

The idea of auditing the economic enterprises in Iran was first propounded in Commercial Law in 1933. In the articles of this law pertaining to the companies, it had been ordained that the general assembly of each company had to select one or more inspectors from among the share holders or else to audit all the accounting affairs, deeds and records of the general situation of the company and its financial statements which had been fixed by the board of directors and to hand in an account to the general assembly of share holders during the succeeding year [Commercial Law, Act No 61, 1933]. Although the general assembly of the companies was mandated to select one or more inspectors, the audit was not discharged in its real meaning and it is still being neglected [Gaviandam, 2003].

The professional backdrop of accounting and auditing profession in Iran are presented under the following three categories: (i) Professional Associations; (ii) Private Audit Institutions; and (iii) Audit Organization.

(i) Professional Associations:

The professional associations in Iran themselves can be studied under the following groups. (a) Association of Testified Accountants; (b) Iranian Society of Certified Public Accountants; (c) Iranian Association of Certified Public Accountants; and (d) Iranian Accounting Association.

(a) Association of Testified Accountants:

Employing accountants’ services in auditing taxes was first propounded in the Income Tax Act in 1949. It regulated that whenever the association of testified accountants was established in the country, the Ministry of Finance and Economy was required to warmly admit the results of its accountants
having audited the balance sheets or accounts of the merchants or companies; hence, there was no need to audit the general taxpayers’ books [Tax Law, Act 33, 1956]. Despite the explicit mandate of this law, no practical measure to develop and regulate such professional accounting reference was taken. In the Tax Act of 1956, the same was repeated, and, to enforce it, a respective regulation, in 1961, was compiled and approved by then Finance Minister. The statute of the testified accountants was prepared in 1963 by a number of prominent individuals with designations of financial directors, auditors, and financial consultants who enjoyed a long professional experience. However, this Association was dissolved after sometime.

(b) Iranian Society of Certified Public Accountants (ISCPA):

The turning point to professionally recognize auditing in Iran was the result of passing Direct Tax Act in 1966. Chapter 7 of this act required that the Society of Certified Accountants be established in order to identify and introduce certified accountants, provide required facilities to improve knowledge of accounting and pave the proper ground for compilation and supervision of principles and standards. The regulation concerned with the specific manner of selecting efficient accountants was approved in 1967, and the Society’s Statute was regulated in 1970; hence, the selected accountants undertook to see to taxes, ledgers and books, income and loss statements and taxpayers’ balance sheets.

Parallel to the measures to develop professional accounting to make use of the specialized accountants’ services in tax accounting, the amendment of Commercial Law approved in 1968 required all public companies to attach the Certified Accountants’ commentary report onto their income and loss statements and balance sheets. The Certified Accountants, too, were required to not only comment on the companies’ financial statements but also certify and approve them, which were prepared by the board of directors illustrating the financial situation of the company. Hence, auditing the public companies was propounded in Commercial Law; however, it was pondered that legal inspection and auditing could be distinct and separable.
Besides the Tax Act passed in 1966 and the partial amendment of Commercial Law in 1968 and different regulations as: Act of Establishing Iran's Central Insurance; Act of Establishing Tehran's Bonds and Securities Exchange; Act of Cooperatives; Regulations, Manual and Approvals concerning different governmental and public bodies; Investigating the accounts of Internal and External Insurance Companies and Agencies; Auditing the accounts of Companies Admitted to the Exchange; Selecting reliable audit institutes of exchange and finally making use of Certified Accountants' services for the cooperatives were all considered as a legal assignment [Molkaraye, 2003]. Approving this act induced not only the private bodies but also the governmental and public organizations to largely employ the services of known audit bodies and Certified Accountants operating in the field.

In 1980, a bill to partially amend a portion of the Direct Tax Act got all the articles pertaining to the Certified Accountants eliminated by the Revolutionary Council, and, as a result, the Certified Accountants’ Society was dissolved. In Articles 61 and 116, the terms ‘Certified Accountants and Audit Bodies (Institutions)’ were changed into ‘Accountants Recognized by Ministry of Finance and Economy’. Therefore, by virtue of Direct Tax Act, only the investigation carried out by those accountants recognized by Ministry of Finance and Economy was to be admitted.

A large number of graduates from foreign countries who were not recognized qualified enough to join the Certified Accountants’ Society decided to establish a professional committee composed of graduates from England and Wales’ Association of Certified (Expert) Accountants. Propounding this case and limiting the society to only those graduates from other countries induced lots of complaints and dissatisfaction among the civil graduates.

In 1972, Iranian Expert Accountants’ Society with 34 founding members of whom 13 had completed their studies in other countries was founded. Having been legally registered, the Society's public meeting participants elected the late Mahdi Sammie speaker of the High Council. However, the final registration was confirmed in 1974. Hence, with the existence of two professional accounting societies, that is, the Certified
Accountants’ Society that had originated in 1966 from the Tax Act, and Iranian Expert Accountants’ Society established by the specialized accountants, the profession of accounting stepped into different evolved a dynamic accounting profession.

ISCPA is the only non-governmental association of accountants in Iran. It was established in 1972 by a group of Iranian founding members who were members of the UK accounting institutes, with the object of promoting the accounting profession in Iran and it has continued its activities uninterrupted ever since.

A major field of activity of ISCPA is training and educating different groups of accountants and auditors at various levels, as well as the executive managers who are the main users of the accounting information system in public and private sector.

According to Article No. 1, the objectives of ISCPA is expansion and securing independence of the accounting and auditing profession, together with creating suitable conditions and opportunities for achieving and development of ethical self–esteem among accountants as well as providing the means for codification and prevalence of the trade’s norms and regulations and increasing level of professional knowledge and expertise among individuals together with greater involvement of qualified persons, aimed at obtaining efficacy and competence in accounting and auditing services. The Iranian Institute of Certified Accountants is hereby established along the lines of the present Articles of Associations.

c) Iranian Association of Certified Public Accountants (IACPA):

By formation of Accounting Organization in 1987, the case of auditing the accounts of companies and financial institutions, founding professional accountancy system, the how of formation and limits of nongovernmental audit practices had been left undetermined? To satisfy this need, ‘the Act of enjoying the specialized and professional services of recognized accountants as Certified Accountants’ was passed through the Majlis (Islamic Consultative Assembly) in 1993. This act authorized the government to financially monitor production, commercial and service corporations and make sure that their
financial statements were reliable and correct enough to maintain public interests. Hence, it was persuaded to employ the specialized and professional services of the recognized accountants in the following: (a) Legally auditing and investigating the accounts of companies admitted to or applied for Admission to Bonds and Securities Exchanges; (b) Auditing, non-sharing/non-stock companies and profit as well as non-profit institutions; (c) Legally auditing and investigating the companies and institutions included in parts a and b of Article 7 of legal statute of auditing body approved in 1987; and (d) Auditing taxes of natural and legal people.

In 1995, ‘ Regulation of Assessing Certified Accountants’ Competence and Selecting them’- a case included in the note of Act 1, was approved by the Cabinet, and subsequently a committee to assess the Certified Accountants’ competency was set up and introduced by the Minister of Finance and Economy.

In early 1996, upon enforcing the regulation of assessing the Certified Accountants’ competence, the Ministry of Finance and Economy assigned a mission of ten members, 7 of whom were from the assessing group and 3 from other accountants, as the first Certified Accountants to produce a comprehensive statute and introduce it to the Cabinet for approval in a six month period. This statute was produced in due time, and in September 1999 it was handed in to the Cabinet.

Based on the first note of Article 5 of Iranian Association of Certified Accountants, the manual of electing the High Council had, according to the Founding Board’s suggestion, to be approved by the Minister of Finance and Economy. The approving of this manual in 2000 paved the way to found ‘Iranian Society of Certified Accountants” and High Council election.

The first general assembly of Iranian Society of Certified Accountants was held on September 11, 2001 by the Council’s members’ suggestion. In this session, the High council members were, elected directly through the Society’s vote, elected and practically they commenced their activities.
(d) Iranian Accounting Association:

Iran Accounting Association was founded in 1997 with an intention of improving knowledge, research and function of accounting, but its operation, with a delay of six years, started in 2003. The members of this society are inclusive of university faculty members, graduates and researchers in accounting and other fields.

(ii) Private Audit Institutions:

Private audit institutions were first established in Iran by the graduates from Association of Certified Accountants (British and Wales). The first private audit institution was registered by the late Foaad Majzoob, and thence after the late Parviz Nabavi started to cooperate with Coopers Brother Institution in Iran; afterwards, he became a partner in Coopers and Lybrand Audit Institution, and finally he founded Coopers & Nabavi Audit Corporation. The late Sajjadi Nezhad, Shahrookh Behram and British partner Trans John Guru launched ‘Exact Auditing Institute’ in 1966.

Through selecting the second group of Certified Accountants in 1969, the first audit institute called Institute of Expert Accountants, whose partners were from among the internal graduates, was established by Reza Miraftabzadeh. Simultaneously, other institutes such as the Mysterious Audit Institute by Behrooz Vaghti, Pars Audit Institute by cooperate group of Esmail Erfani and Hoshang Ghazvini, Amin Audit Institute by cooperation of Ahmad Fatemi and Manoochehr Malekian and Iran Audit Institute by partnership of Sadiq Beheshti Zadeh, and agencies of known and well-established audit institutes such as Veini Mary by cooperation of Nasrollah Mokhtar and Price Water House were all launched. In the succeeding years, internal and overseas graduates in accounting launched other institutes to offer professional accounting services. Furthermore, some great international accounting institutes, especially eight big institutes (Big Eight) took actions to establish their agencies or to cooperate, in any possible way with Iranian Accounting Institutes.

Leaving out Chapter 7 of 1966 Direct Tax Act by the Revolutionary Council in 1980 caused the Society of Certified Accountants and
consequently the private audit institutes to be dissolved. After the establishment of Society of Iranian Certified Accountants in 2001, numerous audit institutes based on executive Regulation of Audit Bodies discussed in Article 27 of Statutes of Iranian Certified Accountants' Society were formed. They introduced professional services in accounting and were monitored by the Society of Iranian Certified Accountants.

(iii) Audit Organization:

Due to the escalating increase of governmental financial institutions and companies, and development of different institutes by the government, the Audit Company, whose shares totally belonged to the government itself, was established to audit accounts of all companies affiliated to Water and Power Ministry. However, since this company, in practice, was included in the list of organizations governed by Ministry of Finance, it was made responsible to audit most of governmental companies.

Islamic Revolution of Iran in 1979 resulted in electing governmental managers for some companies, expropriating companies belonging to a number of capitalists affiliated to the past Shah's Regimen and nationalizing some of the industrial entities. Proprietorship of public economical entities necessitated the formation of institutes to audit the accounts of the national economic or expropriated companies and entities, and formation of audit institutes of National Industries and Planning Organization, Foundation of the Oppressed and Martyr's Foundation was necessitated from 1980 to 1983.

The case of merging the audit bodies of public division was propounded in 1983, and law of founding the audit organization was approved. By approving the statutes of the Audit Organization in 1987, public audit bodies merged and the Audit Organization was established.

In the Certified Statutes and Act of Audit Organization, the responsibilities of Certified Inspector and audit affairs of all agencies and apparatuses, which were under the public proprietorship, were ceded to the Audit Organization. Furthermore, the Audit Organization was recognized as a specialized and official reference to compile principles, and regulations of accounting and auditing. Hence, for the first time, legal inspection tasks and
audit were in practice consolidated, and an organization to audit the financial institutions of public division and an official reference to compile principles and standards of accounting and auditing were ordained.

After the Islamic revolution of Iran in 1979, according to a bill ratified by the Revolutionary Council, many enterprises were confiscated or came under direct supervision of Government. To audit and perform statutory examination of these enterprises, three audit firms were established in the public sector, i.e., Nationalized Industries and Plan Organization Audit Firm in 1980, Mostazafan Foundation Audit Firm in 1981, Shahed Audit Firm in 1983.

In 1983 an act was ratified by the Parliament, to merge and embody these three audit firms together with Audit Company (established in 1971 to audit government corporations) to establish Audit Organization. Audit Organization's by-laws were also approved by the Parliament in 1987 and the Organization was established as a legal entity with financial independence, affiliated to the Ministry of Economic Affairs and Finance to follow those audit firms functions and pursue the activities legislated in the Organization's Act and by-laws.

Audit Organization's by-laws were revised and approved by the Council of Ministers in 2003 to comply with the Article 4 of the Third Economic, Social and Cultural Development Plan and the Organization's legal status changed to State Owned Limited Company.

The Organization's main objectives are: (i) To provide government with basic needs in the field of auditing and specialized financial services for state owned and government supervised entities; (ii) To set Accounting and Auditing Standards and Professional Ethics in compliance with Islamic Rules as well; and (iii) To conduct research in scientific and practical methods of accounting to enhance accountancy compatible with country's needs.

The Board of Governors comprises of Minister of Economic Affairs and Finance as chairman, Head of Management and Planning Organization, Minister of Petroleum, Minister of Industries and Mines and Minister of Commerce. The Board sets policies of the Organization; approves plans, manuals and financial statements of the Organization; and appoints members
of the Board of Executives Accounting and Auditing Standards and also the Board of Governors should approve the Organization's Code of Ethics and its disciplinary rules.

The Board of Executives comprises of Chairman and Chief Executive Officer of the Organization and four or six expert accountants, all appointed by the Board of Governors. The Board is responsible for planning, organizing, preparing manuals, managing and execution of programs. Each Board member directs and supervises a part of the Organization's activities. Exposure drafts of accounting and auditing standards should be reviewed and confirmed by the Board of Executives before submission to the Board of Governors.

High Supervisory Council comprises of three expert accountants appointed by the Board of Governors and is responsible for continuous supervision of the Audit Organization's activities, review of internal control system, statutory examination of the Organization's financial statements and reporting its findings to the Board of Governors and where appropriate to the regulatory bodies.

In fulfilling its main function to audit and statutory examination of state owned companies in 2003-04, Audit Organization has audited banks; insurance companies; oil, gas and petrochemical companies; regional water and power corporations; post, telegraph and telephone companies; and steel, tobacco and many other large corporations. Social Security Organization, Mostazafan and Janbazan Foundation, Shahid Foundation, and 15th Khordad Foundation and their affiliated companies are another major group of entities audited by the Organization. Investment companies and other enterprises controlled by banking system are also among those entities audited by the Organization. Audit Organization is also among those few audit firms certified by Stock Exchange Organization and 165 listed companies are audited by the Organization in 2003-04. Since its inception several auditing standards have been issued and Figure 1.1 presents the list of these standards and also the projects in process.
FIGURE 1.1
AUDITING STANDARDS: APPROVED AND PROJECTS IN PROCESS

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Iran Audit Organization [2007].
NEED FOR THE STUDY

It is evidenced historically that the focus of audit is on detection of fraud as evidenced in the studies of Pixley [1881]; Dicksee [1892]; Cutforth [1914]; Brown [1962]; Flint [1971]; and Lee [1979]. The possible solution for mitigating fraud is perceived to be conclusion audit. However, Baron et al. [1977] observe that users hold auditors more responsible for detection of fraud and disclosure of it than auditors believe. Epstein and Geiger [1994] states that the users of financial statements not only seek higher levels of assurance by stating that they need ‘correct’ financial statements instead of these statements based on true and fair view.

Another dimension of the problem has been the scope of audit. It is suggested that the auditor is not expected to verify every transaction and Pixley [1922:444] sums up argument in these words “…an auditor is not necessarily expected to verify every transaction. Indeed, in the vast majority of cases, such a procedure would be a practical impossibility; and he is entitled to rely on the system on internal check in force in a business, the subject of which is to reduce to minimum the possibility of fraud or errors in the accountants. In the same fashion, Lee [1979:161] argues that there is no need for audit absolute assurance because of (i) Companies were getting bigger, and the auditor could not be expected to deal with the sheer volume of material that was available; (ii) The time and cost of checking everything were now out of the question because of the increasing size of companies; and (iii) Company managements were accepting some measuring of responsibility for the detection of fraud and errors.

However, nowadays the main purpose of auditing is to add credibility to the financial statements prepared by an organization, therefore the key elements of responsibilities are identified to be the following:(i) The organization’s management, not the auditor, is responsible for maintaining accounting records and preparing the financial statements;(ii) Management, not the auditor, is responsible for maintaining a system of internal controls to prevent or detect errors or irregularities; (iii) An audit does not examine every transaction of agency, as this would be prohibitively expensive and time consuming. Rather the audit comprises a combination of a sample of transactions for all items in the financial statements that are considered
material or high risk in nature. These are items that, if materially misstated as a result of an error or fraud, could adversely affect the decision-making process of users of financial statements; and (iv) An audit opinion does not provide a guarantee of absolute accuracy in the financial statements; it provides users of those statements with reasonable assurance that they are free of material error.

At the start of the twentieth century, audit practice was developing an appreciation for the importance of internal control systems, moving towards sampling to test selected financial transactions rather than performing a detailed verification of all transactions. An audit opinion does not express a view on the adequacy of the organization system of internal control or the efficiency and effectiveness with which management conducts its affairs, nor does it guarantee the organization's future viability. Therefore there are differences between auditors and third parties on auditor responsibilities for so-called expectation gap.

According to Noordin [1999], expectation gap occurs when there are differences between what the public expects from the auditor and what the auditor actually provides. The users of auditing services have different expectations. On the one hand, they believe that auditors must assume more responsibility than examining and attesting the true and fairness of financial statements and in the other they also expect that they should protect their own professional interests through detecting and reporting frauds or irregularities. However, it is an irony that the auditors are of the opinion that it is the responsibility of the management, who bear a legal obligation for truthful financial reporting. According to Koh [2000], an audit expectation gap with respect to company audit objectives exists between auditors and non-auditors and that the latter place a significantly greater demand on audits and auditors than what auditors themselves perceive their roles and responsibilities to be.

In the present scenario, the audit philosophy needs a re-examination. It is apt to quote Epstein and Geiger [1994], who note that the fundamental role of an audit in society must be re-examined by both the audit profession and financial statement users and they must all agree to close the gap. To close this gap, the two suggested alternatives have come from Ryan Commission [1992], which suggests educating financial statement users and
Sweeney and Roberts [1977] who demand a change in the audit philosophy and system to meet user expectation.

The review of literature on audit environment and audit expectation gap reveals that the audit function is under great pressure from different forces requiring a new look at audit philosophy itself*. Understanding the gravity of the problem, the International Auditing Practices Committee of the International Federation of Accountants has issued 29 auditing standards, which delineate the various dimensions of audit from the viewpoint of objectives, audit principles and audit procedures covering internal audit, external audit, management audit and efficiency audit [Evans et al., 1994]. Added to this, the Auditing Standards Board of AICPA has issued statements on audit expectation gap through Statements on Auditing Standards (SASs). With these developments, the audit expectation gap still persists in the accounting world. The review of literature also reveals that, till today, studies on the audit expectation gap have been conducted primarily in the developed and western countries such as the USA, the UK, Australia and New Zealand. Less number of studies of this kind has been conducted in Asian countries like China, Bangladesh, Saudi Arabia and Singapore. In totality, audit is almost a neglected area of research in many Asian countries including Iran. Hence the present study is useful and novel. However, in order to understand the role of audit in the emerging scenario at the international level and to bridge the gap in research on audit expectation gap, especially in Iran, the present study is found to be more appropriate and relevant.

*Chapter III, pp. 75-131.
OBJECTIVES OF THE STUDY

The present study has been carried out with the following objectives:

(i) To analyze financial reporting environment and the concept of audit expectation gap;
(ii) To measure the effectiveness level, expectation level and expectation gap in the audit process;
(iii) To analyze the emerging role of auditors in the audit process;
(iv) To identity the source and magnitude of audit expectation gap;
(v) To measure the perceptions of auditors, investors, financial analysts and educated public towards audit expectation gap; and
(vi) To offer suggestions to improve the quality of financial reporting and also of audit quality.

HYPOTHESES FOR THE STUDY

According to the above objectives the hypotheses of this research are as follows

(i) Auditors perceive lower audit expectation gap than the other groups;
(ii) Investors perceive a higher level of audit expectation gap than financial analysts and educated public;
(iii) Reasonableness gap is higher than performance gap;
(iv) Deficient performance gap is higher than deficient standards gap;
(v) Auditor responsibility causes higher expectation gap than the other components of audit process;
(vi) Auditors perceive lower deficient standards gap in all components of audit process;
(vii) Investors perceive the highest level of audit expectation gap in all components of audit process;
(viii) Deficient performance is perceived at a higher than deficient standards in performance gap in all components of audit process;
(ix) Deficient performance is caused more by auditor independence and audit ethics than by auditor responsibility and financial reporting commitment;
(x) Audit effectiveness causes higher level of performance gap than other components of audit expectation gap; and

(xi) Lower the expectation gap in auditor independence, lower the audit expectation gap.

RESEARCH METHODOLOGY

There are two kinds of data that can be collected for a study. Primary data are data that the researcher gathers for a defined purpose and secondary data are data that have been collected by others for another purpose. Since it is cost efficient and easier to use data that already exists, secondary data are first used in a study. The usage of secondary data gives the researcher the possibility to read existing material on the subject and to receive a view of the existing models and theories concerning the subject.

The data for the present study has been collected from both primary and secondary sources. Secondary data was collected from various textbooks, journals, reports, magazines, dailies and has also been collected from web sources using the popular search engines like Google, yahoo and powerful databases such as Emerald, Ebsco and Elsevier. Primary data on corporate audit expectation gap was collected from auditors and third parties being sample respondents of the study.

The main method of research on the audit expectations gap has been the questionnaire using a Likert’s scale [Beasley, 1996]. Survey-based empirical studies fail to conduct deeper analysis of the reasons behind the expectations gap; therefore, Five-point likert’s scale questionnaire instrument was employed in this research while the questionnaire consisted of two sections. The first section contained data relating to demographic variables of the sample respondents and the second section contained the perceptions of sample respondents on the actual level of audit effectiveness and the expected level of audit effectiveness. The respondents were required to tick their perceptual levels on five-point Likert’s scale with ‘5’ as strongly agree, ‘4’ as agree, ‘3’ as moderately agree, ‘2’ as disagree and ‘1’ as strongly disagree for both the actual level and the expected level. Sufficient space was provided for giving comments and suggestions at the end of the questionnaire. The detailed research methodology has been presented.
under: (i) The Questionnaire; (ii) Identification of Respondent Groups; (iii) Analytical Techniques; (iv) Operational Definitions; and (v) Porter’s Model.

(i) The Questionnaire:

The questionnaire was designed to ensure that the precise data required would be collected from respondents to achieve the objectives of the present study. The items in this questionnaire were essentially identified after having reviewed the literature on the problem. The items have face validity, as the concepts to be measured are clearly specified in each question. In this regard Bailey [1978:58] states: “If the measure clearly measures another concept then obviously it does not have face validity. However, if the item does not seem to be measuring any recognizable concept other than the one it is supposed to be measuring, the instrument can be said to have face validity.” In this study, the questions have high face validity in addition to being developed from the auditing literature and thereof are based on clear and familiar concepts.

These pre-test steps for questionnaire were followed. A rough pilot questionnaire was developed. Concepts were discussed and debated and wordings were changed as necessary. The order of some of the statements was also changed. Some questions were eliminated because they appeared redundant. Consequently some additional statements were added. In reviewing the statements, some statements were felt to contain more than one concept. So in those cases the statements were revised into separate statements to allow for different responses to each concept.

The second phase of the pre-test was the administration of the revised survey to respondents, who were informed that this was a pre-test and specifically asked about questionnaire. Feedback was revised on the effect of the original format. This revised survey was gone over carefully and revisions were made before the final administration of the final questionnaire. At last the final questionnaire was carefully translated into Persian language because majority of people in Iran talked in Persian and they were poor in English.

As set out in Figure 1.2, the questionnaire consisted of five dimensions on audit expectation gap, viz., auditor responsibility, audit ethics, financial reporting commitment and auditor independence. Each of these above
dimensions was subdivided into components, which in turn consisted of individual statements on audit expectation gap to be responded by the sample respondents. As a result, the questionnaire consisted of five dimensions, 24 components and 80 statements.

![Figure 1.2: Bird's Eyeview of the Questionnaire](image)

<table>
<thead>
<tr>
<th>Sl. No.</th>
<th>Dimensions</th>
<th>Components</th>
<th>Statements</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Auditor Responsibility</td>
<td>4</td>
<td>13</td>
</tr>
<tr>
<td>2</td>
<td>Audit Ethics</td>
<td>6</td>
<td>18</td>
</tr>
<tr>
<td>3</td>
<td>Financial Reporting Commitments</td>
<td>10</td>
<td>31</td>
</tr>
<tr>
<td>4</td>
<td>Audit Effectiveness</td>
<td>3</td>
<td>13</td>
</tr>
<tr>
<td>5</td>
<td>Auditor Independence</td>
<td>1</td>
<td>5</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td></td>
<td><strong>24</strong></td>
<td><strong>80</strong></td>
</tr>
</tbody>
</table>

(ii) Identification of Respondent Groups:

There are a number of identifiable groups involved in, or impacted by, the audit process. These are constituencies or stakeholders. Mitroff [1983] defined stakeholders as: “…all those interest groups, parties, actors, claimants and institutions- both internal and external to the corporation- that exert a hold on it. That is, stakeholders are all those parties who either affect or who are affected by a corporation’s actions, behaviors and policies [Mitroff, 1983: 4]. This can also be used as a definition of constituencies [Tsui, 1984]. AAA [1973:7] noted user groups are as, “stockholders, creditors, customers, governmental agencies and the public”. Lee [1977:103] listed users are as: “shareholders/ investors, lenders, creditors, employees, trade unions, government, financial analysis, customers, and the public at large”. It has identified eleven different publics:

Owners and managers of small businesses and medium-sized business, top executives of large corporation, audit committee members of large corporations, board of directors, seniors bank officers who are credit grantors, attorneys knowledgeable about financial affairs, key aides to members of congress, leading members of the media dealing with financial affairs, leading academics in accounting and related field, and top security analysts [Louis Harris and Associations, 1986].
Wallace [1986:4] in an auditing text notes that audited statements are familiar to investors, creditors and government officials, as they appear in the annual reports of all companies regulated by the Securities and Exchange Commission (SEC) and with the financial statements of many municipalities, privately owned corporations, partnerships and nonprofit enterprises. This study examines a number of groups that were identified from the accounting and auditing literatures which are as follows: auditors, investors, financial analysts and public. All members of those groups have at least bachelor degree in accounting or related fields. The present study adopts the Wallace approach in identifying the sample group.

The sample respondents were chosen from Tehran city the capital of Iran, as this city has a larger number of investors in equity capital of Iranian corporate sector and traders in stock exchanges of the country on one hand and a large number of auditors working as professionals in the city. The total number of sample respondents chosen for the study was 2400 consisting of 600 auditors, 600 investors, and 600 financial analysts and from 600 educated public. The selection of 600 auditors was based on every fourth member from the alphabetically arranged names of chartered accountants enrolled in the Iranian audit organization. The selection of the 600 investors and 600 financial analysts was made by personally contacting them on their arrival to do the business in Tehran Stock Exchange (TSE). 600 members of educated public randomly selected who got at least bachelor degree in accounting or related fields while they were neither auditors, nor investors, and financial analysts, identifying the investors by oral questions on whether they invested frequently or regularly through initial public offerings. Such visits to TES took place between March 2006 and June 2006. Out of 2400 questionnaires administered to both the groups of respondents, through personal contact, only 848 completed questionnaires were returned with an overall responses rate of 35.33 per cent. The number of responses from the auditor group stood at 227 forming 37.83 per cent response rate, 214 from investor group forming the response rate of 35.67 per cent, 201 from financial analysts group forming the response rate of 33.5 per cent and 206 from educated public group forming the response rate of 34.33 per cent.
Figure 1.3 shows the total number of questionnaires distributed, returned and response rate.

**FIGURE 1.3**

**QUESTIONNAIRE DISTRIBUTION AND RESPONSE RATE**

<table>
<thead>
<tr>
<th>Target Groups</th>
<th>Distributed</th>
<th>Returned</th>
<th>Response Rate Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Auditors (Chartered Accountants)</td>
<td>600</td>
<td>227</td>
<td>37.83</td>
</tr>
<tr>
<td>Investors (Shareholders)</td>
<td>600</td>
<td>214</td>
<td>35.67</td>
</tr>
<tr>
<td>Financial analysts</td>
<td>600</td>
<td>201</td>
<td>33.5</td>
</tr>
<tr>
<td>Educated Public</td>
<td>600</td>
<td>206</td>
<td>34.33</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>2400</strong></td>
<td><strong>848</strong></td>
<td><strong>35.33</strong></td>
</tr>
</tbody>
</table>

Source: Field Survey.

(iii) Analytical Techniques

The primary data required for the present study has been collected from auditors, investors, financial analysts and public, residing in Tehran city capital of Iran. Structured questionnaire was developed for collecting data from sample respondents on their perceptions about the Audit Expectation Gap.

This study uses various non-parametric statistics for analyzing data. In the view of the fact, when the underlying assumptions are violated it is necessary to use the powerful non-parametric procedures. The non-additively of ordinal scales make them mathematically inappropriate for the calculations used in the parametric analyses. The questionnaire solicited responses for the actual level and the expected level on five-point Likert’s scale. After having calculated the weighted points, the mean values for actual level and expected level were calculated. The expectation gap was determined by taking the difference between the actual mean value and expected mean value. The expectation gap, measured as a difference between the actual mean value and the expected mean value was found to have both positive values for positive statements and negative values for negative statements. Irrespective of the nature of these expectation gaps in terms of positive and negative values, both of them were considered as expectation gaps.
The study is subdivided into two stages: (i) The first stage is universal analysis between all participants regarding the actual level of audit function, dimension and expectation levels which as mentioned before for analyzing data non-parametric statistical tools are used, and the Wilcoxon Signed Rank Test is being applied in this part of thesis, which are necessary for analyzing this part of thesis according to previous researcher (Porter, 1993 in New Zealand). (ii) In the second stage, the perceptions of various groups are presented and this analysis is widely adopted in the studies of Monroe and Woodliff [1993 &1994] in Australia; Best et al. [2001] in Singapore; Dewing and Russell [2002] in the UK; Schelluch and Gay [2002] in Australia; Fadzly and Ahmad [2004] in Malaysia; Chowdhury et al. [2005] in Bangladesh; Desira and Baldacchino [2005] in Malta; Boyle and Canning [2005] in Ireland; and Dixon et al. [2006] in Egypt employing Mann-Whitney U test. Considerable use was made of the Statistical Package for Social Sciences (SPSS) programme 14.0.

The scope of analysis of empirical research includes profile analysis and audit expectation gap. The analysis and interpretation of the study covering these dimensions have been presented below.

(iv) Operational Definitions:

In carrying out the study, the independent variables were defined, wherever necessary. The following variables were identified as having the effect on the structural distribution of respondents: (a) Age Status; (b) Qualification Status; (c) Audit Knowledge; (d) Audit Experience; (e) Equity Investment Status; (f) Reading of Annual Corporate Reports Habits; (g) Importance of Audit Report; (h) Belief Status in Auditor’s Report; (i) Belief Status in Financial Statements; (j) Belief Status in Company Profile; and (k) Belief Status in Directors’ Profile.

(a) Age Status:

Based on age, the respondents were classified into youth and adults. Youth were defined as those having attained the age of 35 years or less than 35 years. Adults were defined as those having attained more than 35 years.
(b) Qualification Status:

Based on qualification status, the respondents were classified into three categories, namely, graduate, postgraduate and PhD in accounting or related fields.

(c) Audit Knowledge:

The respondents were classified into literates and illiterates. The literates were defined as those having an exposure to auditing course at the university level or at any other level. And the illiterates were defined as those having no such exposure at all.

(d) Audit Experience:

From the viewpoint of audit experience, the respondents were also classified into experienced group and inexperienced group. All respondents who had at least the audit experience for 3 years were defined as experienced group and who those had no experience or less than three years’ experience were defined as inexperienced group.

(e) Equity Investment Status:

Based on the equity investment participation by the respondents, they were classified into two groups, investor group and non-investor group. The investor group included the respondents, who had invested in Iranian companies and the non-investor group included the respondents, who had not invested in companies in Iranian companies.

(f) Reading of Annual Corporate Report:

Based on the reading habit of annual corporate reports, the respondents were classified into regular readers and occasional readers based on their response to the item in the structured questionnaire.

(g) Importance of Audit Report:

The respondents were asked about audit importance in corporate sector on a five-point scale and the respondents were classified into high-importance group and low-importance group. The respondents having assigned the weighted points of 5, 4 and 3 were categorized under the high-
importance group and the respondents having assigned the weighted points of 2 and 1 were categorized under the low-importance group.

(h) Belief Status in Auditors’ Reports:

The respondents were classified into high-believers and low-believers based on the weighted points assigned by them. The respondents having assigned the weighted points of 5, 4 and 3 were categorized as high-believers and the respondents having assigned the weighted points of 2 and 1 were categorized as low-believers.

(i) Belief Status in Financial Statements:

The respondents were classified into high-believers and low-believers based on the weighted points assigned by them from the viewpoint of belief the reposed in financial statements. The respondents having assigned the weighted points of 5, 4 and 3 were categorized as high-believers and the respondents having assigned the weighted points of 2 and 1 were categorized as low-believers.

(j) Belief Status in Company Profile:

The respondents were classified into high-believers and low-believers based on the responses towards the importance on the company profile. The high-believers were defined as those having rated the given item with weighted points of 5, 4 or 3. The low-believers were defined as those having assigned the weighted points of 2 or less than 2 to the financial statements.

(k) Belief Status in Directors’ Profile:

The respondents were classified into high-believers and low-believers based on the responses towards the importance to the director’s profile. The high-believers were defined as those having rated the given items with weighted points of 5 or 4. The low-believers were defined as those having assigned the weighted points of 2 or less than 2 to the different items in financial statements.

(v) Porter’s Model:

The present study uses the Porter’s model [1993: 50] to measure the audit expectation gap in Iran. According to her, the audit expectation
performance gap is defined as the gap between society’s expectation of auditors and auditor’s performance, as perceived by the society. The Porter’s model has been briefly explained under (a) The Components of the Model; (b) Illustrating the Model.

(a) The Components of the Model:

Given the definition, the analysis indicates that the gap has two major components: (1) A gap between what society expects auditors to achieve and what they can reasonably be expected to accomplish (designated as reasonableness gap), and (2) A gap between what society can reasonably expect auditors to accomplish and what they are perceived to achieve (designated performance gap). This may be subdivided into: (a) a gap between the duties, which can reasonably be expected of auditors and auditors’ existing duties as defined by the law and professional promulgations (‘deficient standards’); and (b) a gap between the expected standard of performance of auditors’ existing duties and auditors’ perceived performance, as expected and perceived by society (‘deficient performance’).

An overview of these deficiencies in audit, also known as audit expectation gap, is depicted in the following Figure 1.4

FIGURE 1.4
STRUCTURE OF THE AUDIT EXPECTATION PERFORMANCE GAP

Perceived Performance of Auditors ← Audit Expectation-Performance Gap → Society’s Expectations of Auditors

Performance Gap ← Deficient Performance → Auditors’ Existing Duties

Deficient Standards ← Unreasonable Expectations → Duties Reasonably Expected from Auditors

1 Duties defined by the law and professional promulgations
2 Duties, which are cost-beneficial for auditors to perform.

Source: Porter [1993: 50].
Illustrating Porter's Model:

Figure 1.5 highlights the Porter's Model of audit expectation gap, which consists of a comparison between the perceptions of actual and expected levels of audit by auditors and the society with the levels measured in terms of mean values. The figure presents the determination of audit expectation gap comprising of reasonableness gap and performance gap, the later consisting of deficient standards and deficient performance based on hypothetical mean values.

<table>
<thead>
<tr>
<th>Respondents</th>
<th>Actual Level</th>
<th>Expected level</th>
</tr>
</thead>
<tbody>
<tr>
<td>Auditors</td>
<td>3.03 (A)</td>
<td>3.10 (B)</td>
</tr>
<tr>
<td>Society</td>
<td>2.61 (C)</td>
<td>3.24 (D)</td>
</tr>
</tbody>
</table>

Source: Own

Figure 1.6 briefly summarizes the simplified version of calculating the different expectation gaps based on the Porter's Model.

**Figure 1.6**

DETERMINATION OF GAPS

\[
\begin{align*}
A.E.G1 &= \text{Social Expectation } - \text{Social Rating} \\
(1) \text{ R.G2 } &= \text{Social Expectation } - \text{Auditors’ Expectation} \\
(2) \text{ P.G3 } &= \text{Social Rating } - \text{Auditors’ Expectation} \\
(2.1) \text{ D.S4 } &= \text{Auditors’ Rating } - \text{Auditors’ Expectation} \\
(2.2) \text{ D.P5 } &= \text{Social Rating } - \text{Auditors’ Rating}
\end{align*}
\]

Note1: Audit Expectation Gap; Note2: Reasonableness Gap; Note3: Performance Gap; Note4: Deficient Standards; and Note5: Deficient Performance.

Based on the information given in Figure 1.5 and 1.6, the values of expectation gaps are presented in Figure 1.7.

**Figure 1.7**

QUANTIFYING AUDIT EXPECTATION GAP

<table>
<thead>
<tr>
<th>Total of Gap</th>
<th>Mean Values Considered</th>
<th>Level of Gap</th>
</tr>
</thead>
<tbody>
<tr>
<td>A.E.G.</td>
<td>C Minus D</td>
<td>-0.63</td>
</tr>
<tr>
<td>(1) R.G.</td>
<td>D Minus B</td>
<td>-0.14</td>
</tr>
<tr>
<td>(2) P.G.</td>
<td>C Minus B</td>
<td>-0.49</td>
</tr>
<tr>
<td>(2.1)D.S.</td>
<td>A Minus B</td>
<td>-0.07</td>
</tr>
<tr>
<td>(2.2)D.P.</td>
<td>C Minus A</td>
<td>-0.42</td>
</tr>
</tbody>
</table>

Source: Figures 1.5 and 1.6.
LOCALE OF THE STUDY

The sample respondents for the present study were chosen from Tehran City; the capital of Iran, which has a high level of confluence of professionals and users of accounting information, and this locale, is assumed to represent Iranian ethos in totality.

LIMITATIONS OF THE STUDY

The following were the limitations of the study:

(i) The study was based on the perceptions of selected auditors and third parties of Tehran city only. Hence broader conclusions could not be established;

(ii) The sample of investors was only 214 and this number was too small when compared to the large number of investors in the country. Hence the conclusions drawn from the study could not be generalized;

(iii) The non-inclusion of institutional investors for the study limited the broader scope of analysis;

(iv) Majority of the sample respondent auditors were not conducting company audit, because of the domination of the big auditing firms and hence the perceptions might not reflect the real position of the corporate audit process; and

(v) The study focused on the perceptional differences in expectation gap from the viewpoint of auditors and third parties only and the perceptional differences based on age, occupation, investment portfolio, reading habit and belief level could not be conducted as the study would have become unwieldy.

CHAPTERIZATION

The present study has been arranged in five chapters comprising of Introduction, Theoretical Issues in Auditing, Review of Literature, Data Analysis and Interpretation and Summary of Conclusions and Suggestions. At the end of thesis, Frequency distribution tables and the Questionnaire used for the present study have been presented in Annexure I and II.

Chapter I introduces the study with a brief description of the problem. It brings out the rationale for conducting the present study identifying the
research gap. It states the objectives of the study and the hypotheses set for attaining the same. It includes the research methodology used in the present study for data analysis and interpretation along with operational definitions. It also summarizes the present scenario of auditing and accounting in Iran. It also specifies the locale of the study and the conceptual definitions of some of the key terms used in the present study. The chapter concludes with chapter scheme of the present study.

Chapter II presents an overview of theoretical issues in auditing with a focus on concept and evolution of audit, auditor independence and audit expectation gap.

Chapter III entails 'Review of Literature' focusing on the empirical research on auditor independence, responsibilities of auditors and audit expectation gap.

Chapter IV entitled 'Data Analysis and Interpretation' deals with empirical research covering five dimensions of audit expectation gap, twenty-four components of the dimensions with eighty statements included in these components.

Chapter V entitled 'Summary of Conclusions and Suggestions' covers the analysis and interpretation of data along with the testing of hypothesis and future course of research.