

AUDIT EXPECTATION GAP: CAUSES AND POSSIBLE SOLUTIONS

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Abstract: The auditing profession believes the increase of litigation and criticism against the auditors can be contributed to the audit expectation gap. The audit expectation gap is defined as the difference between what the public expects from an audit and what audit profession accepts the audit objective to be. The audit expectation gap is critical to the auditing profession because the greater the unfulfilled expectations from the public, the lower is the credibility, earning potential and prestige associated with the work of auditors. The objectives of the paper are two-fold. Firstly, it attempts to uncover the causes of an audit expectation gap. Secondly, it reviews the possible solutions in narrowing the gap. This paper aims to provide an insight into issues of the audit expectation gap which in turn enable the audit profession and the profession's regulatory bodies to take effective steps in narrowing the audit expectation gap.

Keywords : Auditing, Audit Expectation Gap

1. Introduction

For decades the auditing profession has been troubled with high level of litigations and accusations. Such problems have reached an unprecedented level as a result of the spectacular fall of well publicized corporations like Enron and WorldCom (Porter & Gowthorpe, 2004). The increase in criticism and litigation against auditors shows that “modern auditing is in a period of serious turmoil and doubt” (Lee, 1977, p. 105) and that auditors are also facing “a liability and a credibility crisis” (Russell, 1986, p. 58). According to Power (1993, p. 292), “when innocent parties suffer losses as a result of fraud or the economic collapses of apparently healthy companies, institutional processes of blame allocation are set in motion”. The editorial comment in the September 1990 issue of *Accountancy* (the journal of the Institute of Chartered Accountants in England and Wales cited in Humphrey et al. 1992, p. 137) urged the media to stop blaming auditors as business failures have nothing to do with the standards of auditing. In line with this, Almer and Brody (2002) asserted that a business failure is always interpreted as an audit failure in spite of the level of procedures and tests performed by auditors. They further claimed that an auditor can carry out his audits in accordance with the generally accepted auditing standards and still be found negligent in not preventing risks to financial statement users. Hence, it is shown that the nature and objectives of auditing have been perceived differently by the users and these misperceptions are known as the “audit expectation gap”.

Sikka et al. (1998, p. 299) highlighted that the audit expectation gap is a detrimental issue to the auditing profession as “the greater the gap of expectations, the lower is the credibility, earning potential and prestige associated with the auditors' work”. They also claim that the audit expectation gap is harmful to the public, investors and politicians as, in a capitalist economy, the process of wealth creation and political stability depend heavily upon the confidence in the processes of accountability. An external audit of financial statements is considered to be an important part as auditing adds credibility to these financial statements. Hence, to mitigate the litigation and accusation against the auditors; and, more importantly, to restore public confidence in the financial reporting process and audit functions, the audit expectation gap should be eliminated, if not significantly reduced.

The aims of the paper are two-fold. Firstly, it attempts to uncover the causes of an audit expectation gap. Secondly, it reviews the possible solutions in narrowing the gap. It is hoped that such an attempt will provide some valuable insights into the audit expectation gap.

The rest of this paper is structured whereby section two reviews the factors which contribute towards the existence of an audit expectation gap. Section three evaluates some of the suggested solutions to reduce the expectation gap. Finally, section four provides the overall conclusion of this paper

2. Factors Contributing To The Expectation Gap

A review of the literature identifies various causes which contribute to the existence of an audit expectation gap. This section attempts to do more than merely outline the causes but rather to provide an in-depth evaluation and discussion on the matter. It is hoped that such an attempt will present the audit expectation gap problems in a more objective and meaningful manner.

2.1 The complicated nature of an audit function

The general public's poor understanding of the complicated audit function is likely to contribute towards the existence of an audit expectation gap (e.g. Baron et al, 1977; Campbell & Michenzi, 1987, Ellis & Selley, 1988). According to Lee and Azham (2008), the complexity of auditing could be due to the fact that the objective of auditing and the role of auditors have always been a dynamic rather than a static one. This is because they are highly influenced by contextual factors such as the socio-economic environment of a particular period, the critical historical events that have taken place (e.g. the collapsed of big corporations), the verdict of the courts, and technological developments (e.g. advancement of computing systems and CAATs). Therefore, any major changes in these contextual factors are likely to cause a change in the auditing function as well as the role of auditors.

The complicated nature of an audit function can also be seen by a change in the auditing paradigm over the years. According to Leung et al. (2004) the audit practice for the past centuries had undergone various evolutions. For example in the mid 1800s to early 1900s an auditing function can be regarded as "traditional conformance role of auditing" as the role of auditors was mainly concerned with ensuring the correctness of accounts and detecting frauds and errors. Over the past 30 years or so, the auditor played an "enhancing role" by enhancing the integrity and credibility of the financial information. Boynton and Johnson (2005) are of the opinion that present-day auditing is not restricted in enhancing the credibility of the financial statement, but also to provide value-added services, such as reporting on irregularities, identifying business risks and advising management on the internal control environment. However, as pointed out by Leung et al. (2004), following extensive reforms in various countries as a result of the collapse of big corporations such as Enron and WorldCom, it is expected that the role of auditors will converge i.e. refocusing on the public interest, redefining audit relationship, ensuring integrity of financial reports, separation of non-audit function and other advisory services. The audit methods have reverted to the basics i.e. risk attention, fraud awareness, objectivity and independence, and increase attention on the needs of financial statement users. In view of the substantial changes to the audit practice over the years, it is not surprising that the public has failed to recognize the essence of an audit. In addition, the lack of understanding among members of the public

may be due to the subjective nature of terms and concepts in auditing such as the true and fair view, reasonable, materiality, adequacy, reliability and relevance (Humphrey, 1997). For instance, the term “true and fair” in the audit reports are not explained in detail to ease the understanding of the users. It is also important to note that most of these terms and concepts are not defined in the Accounting and Auditing Standards. As such, auditors are required to exercise their judgment while applying them in the course of the audit. Given the complicated nature of auditing and the objective of an audit, confusion is likely to exist among those who have limited knowledge and exposure in auditing.

2.2 Conflicting role of auditors

According to Gloeck and Jager (1993) conflict of interest arising from the provision of “non-audit services” for audit clients contributes a great deal to the expectation gap. Leung et al (2007) pointed out that presently accounting firms have diversified by providing a wide range of services and products which include engagements for risk assessment, business performance measurement, information reliability systems, electronic commerce and health and elder care performance measurement. A survey conducted by Institutional Analysis of the top 100 Australian Companies on non-audit services in 2002 showed that 27 of the 58 respondents disclosed the nature and amount of payments they received from their auditors for providing such services. The results of the survey are summarized in Table 1.

A similar situation also existed in the United States of America where accountants have become increasingly dependent on consulting. The *International Accounting Bulletin* cited in Byrnes et al (2002) revealed that in 1993, 31% of the

Table 1: Non - audit services received by respondents of Top 100 companies in 2002

Category of non-audit services	Number of companies reporting (27/58)	Average payment to audit firm
Taxation planning and advice	27	\$935,810
Due diligence services	16	\$754,078
Strategic consulting	7	\$1,618,821
Accounting and bookkeeping	7	\$601,714
Statutory and regulatory compliance services	5	\$531,800
Information technology services and advice	5	\$531,800
Miscellaneous	19	\$606,212

Source: T Watts, *Non-audit fees Survey: A Review of the Non-audit Services Performed by the Auditors of the ASX Top 100 from 1992-2002*, Intuitional Analysis, Melbourne, November 2002, p. 19 (cited in Leung et al., 2007, p. 39)

auditing industry's fees came from consultancy. By 1999, that amount has increased to 51%. In 2001, for instance, PricewaterhouseCoopers earned only 40% of its worldwide fees from auditing, 29% came from management consulting and most of

the rest from tax and corporate finance work. Cited also in Brynes et al, 2002 is a study of 563 companies conducted by Bailey from the University of Illinois' in 2001 where it was found that on average, for every dollar of audit fees, clients paid their independent accountants, \$2.69 was for non-audit services. Bailey found that Puget Energy, based in Bellevue, Washington, had the greatest imbalance, paying PricewaterhouseCoopers only \$534,000 for its audit, but over \$17 million in consulting fees. Marriott International Inc. had a similar imbalance. It paid Andersen just over \$1 million for its audit, but more than \$30 million for information technology and other services.

In view of the provision of extra services to the audit clients, auditors are playing multiple roles at the same time i.e. (i) as an advisor to the management; and (ii) as an independent attester to the shareholders. Hence, auditors are likely to be in a conflicting position because shareholders expect the auditor to identify and report all problems with the financial statements while management expects the auditors to ignore financial statement manipulation (Koo and Sim, 1999). Hence, auditors are placed in "multi-role, multi expectation situations" (Davidson, 1975, p.7). Rizzo et al. (1970) regards such conflict of interest as "Inter-sender role conflict" where an individual occupies two or more position simultaneously which give rise to opposing expectations, conflicting policies, needs and incompatible criteria.

Research [e.g. Johnson, 1988; and English 1989] found that the auditors' role conflict is seen to have negative implications on the auditor's independence and their ability to perform a just audit. This is because if the auditor tries to be obstinately ethical in a situation of conflict, management may seek to replace the auditor for a more cooperative one. Consequently, the auditor may buckle under management's pressure, resulting in a compromise of auditor independence. Hence, given the lucrative remuneration from the "non- audit services", auditors may be perceived to have acted in a manner that is unfavorable to the public in order to protect their self-interest i.e. to secure their income from the provision of non-audit services. As a result, auditors are likely to be seen as not fulfilling their regulatory role of providing independent assurance to stakeholders and the general public on the relevance and reliability of financial statements issued by public corporations (Hendrickson, 1998).

2.3 Hindsight evaluation of auditors' performance

Shaked and Sutton (1982) claimed that the accusation crisis of the auditing profession may be due to the fact that society does not have the ability to evaluate the quality of an audit and the performance of the auditors. This is because the quality of an audit is difficult to determine as the public cannot differentiate between the quality of one audit versus another. Furthermore, they also asserted that the measure of audit quality comes from subsequent events that demonstrate that an

audit was not performed at an acceptable level for a particular engagement. Humphrey et al (1992) are of the opinion that this hindsight evaluation of auditors is deemed to be unfair as the perceived quality of the auditors has been judged using the benefit of knowledge after the event has taken place to argue that auditors are not performing adequately. The accusation against auditors through hindsight evaluation is evident in the following quotation of the executive vice-president of the AICPA, Olson (1993, p.9): *As long as investors suffer losses from a sudden and drastic drop in earnings or the bankruptcy of a corporation which was widely regarded as a good investment, our profession is going to be criticized in the new media. And since such situations are not likely to disappear completely, we ought to become more mature in our reactions to criticisms and recognize that this is an inescapable part of our life*

Given the significant amount of negative publicities against auditors, the hindsight method of evaluation is likely to bring about an impression that auditors may not have performed their work diligently. However, the blame should not be put on the auditors' shoulder alone when a bankruptcy of a corporation is reported in the media. This is because there are many reasons that may cause the fall of a corporation. These reasons, among others, could be: mismanagement; bad strategic decisions, industry downturns, competition, and poor oversight by boards of directors or fraud by senior managements (Phelan & Villareal, 2006). Hourguebie (2004, p.59), the CEO of Ernst & Young has highlighted that it is important to distinguish between a "business failure" and an "audit failure" as a business failure is always interpreted as an audit failure in spite of the level of procedures and tests performed by the auditor. Lee and Azham (2008) argued that auditors could have performed the required duties but yet failed to prevent the financial scandals. Hence, it is shown that the quality of an audit and the performance of auditors have been perceived differently by the users and these misperceptions are likely to give rise to an audit expectation gap.

2.4 Time lag in responding to changing expectations

Humphrey et al. (1992) pointed out that an expectation gap may occur as a result of time lags between the accounting profession identifying and responding to continually changing and expanding public expectations. Tricker (1982) argued that corporate crises lead to new expectations and requirements of accountability which in turn lead to new demands on the audit function and eventually to changes in auditing standards and practice. Ticker (1982) noted that issuance of accounting standards is particularly evident during periods of major crises in the corporate sector. This in turn suggests that the accounting profession is gradually and constructively responding to the changing expectations of society (Humphrey et al 1992). Such assertion can be validated through the actions taken by the AICPA

Auditing Standards Board as a result of the financial scandals in the 80's. In response to the high litigations against the auditing profession, the AICPA Auditing Standards Board produced a series of new statements on auditing standards (known as "expectation gap" standards), covering issues such as the detection of fraud and illegal acts, the assessment of internal controls and audit reporting (Guy & Sullivan, 1988). These standards were issued with the aim of improving the quality of an audit by extending the duties of auditors. Even though efforts have been taken to mitigate the accusation against auditors and to provide remedies in satisfying the requirement of the public, it is accepted that the accounting profession could still be criticized by the public for failing to react and evolve rapidly enough to keep pace with the changing business and social environment (Humphrey 1997). This is because it can be observed that actions are only taken by the relevant authorities after critical events such as major financial scandals occurred. Hence, the auditing profession has taken a rather retrospective approach in ensuring auditors' performance. As such, this is evident that there is a time lag for the auditing profession to live up to the expectations of the public.

2.5 Self-regulation process of the auditing profession

The auditing profession, like many other professions, operates under a self-regulatory framework (Humphrey et al. 1992). Shaked and Sutton (1981) highlighted that the rationale for self-regulation by a profession is premised on the ground that service quality may be maintained through self-regulation when the consumers (i.e. audit beneficiaries) are unable to measure the audit quality themselves. Byington and Sutton (1991, 316) claimed that the consequence of self-regulation is the creation of licencing boards and other government regulations that restrict practices of the profession and hence create rents that arise from a professional monopoly which controls the minimum acceptable level of service quality and entry into the profession. The weakness of self regulation was also highlighted by the following remark of Humphrey et al. (1992, p. 138): *The audit profession is not regarded as selfless, neutral body, responding diligently to the changing dictates and expectations of society. Rather, it is seen in a more proactive, economically interested light, needing to maintain the appearance of independent, highly technically competent individuals in order to defend and advance its members' interest. Symbolic traits of independence, trustworthiness, altruism and expertise are viewed as professional mystiques that together with the existence of a professional monopoly of labour give rise to a mutually dependent relationship with the state and serve to enhance the remuneration of members of the profession.*

In a similar vein, Shaked and Sutton (1981) claimed that the potential problem that may exist with a professional monopoly is lack of incentive to provide a service at a level of quality that exceeds the minimum level that the public will

accept. This implies that auditors are likely to compromise the audit quality at the expense of the clients by limiting their auditing work in order to maximize their personal interests. As a result, it is likely that auditors may have fallen short of the "expected performance". Such assertion is empirically supported by various studies found in different countries. Evidences of deficient performance of auditors are

Table 2: Deficient Performance of auditors

Porter (1993)	Porter and Gowthorpe (2004)	Lee et al. (2007)
<ul style="list-style-type: none"> - Detect theft of corporate assets by non-managerial employees. - Detect theft of corporate assets by company directors/senior management. - Disclose in the audit report deliberate distortion of financial information. - Disclose in the audit report misappropriation of company assets by company directors/senior management. - Detect illegal acts by company officials which directly affect the company's accounts. - Express doubts in the audit report about the company's continued existence. - Disclose in the audit report illegal acts which directly affect company's accounts 	<ul style="list-style-type: none"> - Disclose in the audit report doubt about auditee's continued existence. - Detect theft of a material amount of the auditee's assets by its directors/senior management - Detect theft of a material amount of the auditee's asset by non-managerial employees. - In the absence of regulated industry duty, report to an appropriate authority illegal acts by auditee officials. - Detect illegal act by auditee officials which directly impact on the auditee's financial statements. - Disclose in the audit report deliberate distortion of the auditee's financial statements. - In absence of a regulated industry duty, report to an appropriate authority, embezzlement of auditee's assets by directors/senior management. 	<ul style="list-style-type: none"> - Detect deliberate distortion of the figures in the company's financial statements. - Report privately to a regulatory authority: theft has been committed by non-managerial employees. • company directors/senior management has misappropriated company assets. • information presented in the financial statements has been deliberately distorted. • suspicious circumstances are encountered in the audit suggesting that theft or deliberate distortion of financial information may have occurred in the company - Disclose in the published auditor's report: <ul style="list-style-type: none"> • company director/senior management have misappropriated company assets. • information presented in the financial statements has been deliberately distorted.illegal acts committed by the company's management which directly impact on the company's accounts.

found, among others, in the research of Porter (1993) in New Zealand; Porter and Gowthorpe (2004) in the UK and Lee et al. (2007) in Malaysia. Their findings revealed that auditors are perceived to have underperformed in their various duties. These duties are summarized in the following table 2: In addition to the above, the allegation against the disciplinary process under the self-regulation framework can be seen from the following quotations of Mitchell (1990) and Witten (1990): *The profession's disciplinary procedures are even more feudal. Occasionally, in secret meetings, from which its own membership, press and public are excluded, it suspends some individuals from membership....And what about the big fish? To date, no partner from any major firm has ever been barred from practice by the Institute, even though the same firm has been criticized by the DTI inspectors again and again...The Institute is completely dominated by the interests of major firms and their financial might (Mitchell, 1990, p. 21). The disciplinary process has to be more open in a profession based on self-regulation. Washing hands quietly in back rooms doesn't cut it anymore (Witten, 1990, p.28)*

In view of the flaws in the disciplinary process of the self-regulatory framework, it is not surprising that auditors are motivated only to deliver a minimum level of service quality to their clients. However, this is likely to be in contrast with the expectation of the public as they may expect auditors to provide a good auditing service and to have better accountability of their performance. Hence, it is believed that the process of self-regulation and its attendant factors contributes materially to enlarging the expectation gap (Gloeck and Jager 1993).

2.6 The ignorance, naivety and unreasonable expectation of non-auditors

Humphrey et al. (1993) had associated the problem of expectation gap problems with the misconception of the nature, purpose and capacities of an audit function. The ignorance and naivety of the public are likely to cause unreasonable expectations being imposed on the duties of the auditors. The unreasonable expectations of the public are revealed in the following comment of the AICPA secretary in 1939 in the aftermath of the McKesson Robbins scandal: *We find that the public believed that the certified public accountant was an infallible superman; that the signature of a CPA invariably meant that everything was perfect; that it was unnecessary to read the accountant's certificate or the financial statements to which it was appended as long as the three major letters were in evidence... ..Whether through its own fault or not, the accounting profession seems to have been oversold. Its limitations have been overlooked, while its abilities have been emphasized. Now the public has been somewhat shocked to find that even auditors can be fooled by clever criminals. (quoted in Miller, 1986, p.35)*

According to Lee and Azham (2008) unreasonable expectation of auditors may have harmful implications on the audit profession as the public may not be able

to recognize the contribution of auditors to society and hence this may undermine the value of the audit function. Lee and Azham (2008) also argued that since the public is the free raider of audit service, it is important to distinguish between "reasonable" and "unreasonable" expectations of auditors. This is because the unreasonable expectations of auditors do not warrant further work of auditors as such duties may not be cost-beneficial for auditors to perform them. Therefore, attention should be given to the duties that are considered to be reasonable expectation of auditors. Studies for example, Porter (1993); Porter and Gowthorpe

Table 3: Unreasonable expectations on the duties of auditors

Porter (1993)	Porter and Gowthorpe (2004)	Lee et al. (2007)
<ul style="list-style-type: none"> - Guarantee financial statements are accurate. - Report breaches to tax laws to IRD - Guarantee auditee company is solvent - Report to a regulatory authority theft of corporate assets by non-managerial employees. - Disclose in audit report theft of corporate assets by non-managerial employees. - Detect illegal acts by company officials which do not directly impact on company's accounts. - Disclose in audit report illegal acts which do not directly impact on company's accounts. - Examine & report on fairness of non-financial information. - Examine & report on efficiency & effectiveness of company's management - Verify every transaction of auditee company 	<ul style="list-style-type: none"> - Guarantee financial statements are accurate. - Guarantee auditee is financially sound. - Report breaches of tax law to Inland Revenue Department. - In the absence of regulated industry duty to do so, report to an appropriate authority, theft of auditee's assets by non-managerial employees. - Disclose in the audit report theft of auditee's assets by non-managerial employees. - Detect illegal acts by auditee's official which only indirectly impact on the auditee's financial statements. - Disclose in the audit report illegal acts by auditee's financial statements. - Disclose in the audit report illegal acts by auditee's officials which only indirectly impact on the organisations financial statements. - Examine and report (in audit report) on reliability of financial information presented in auditee's annual report. - Examine and report (in the audit report) on the efficiency and effectiveness of auditee's management and administrative. 	<ul style="list-style-type: none"> - To prepare the company's financial statements. - To guarantee the complete accuracy of audited financial statements - To verify every accounting transaction. - To prevent fraud and errors in the company. - To detect all fraud and errors in the company. - To plan the accounting and internal control system

(2004) and Lee et al. (2007) have analyzed the nature and composition of the expectation gap among the auditors and non-auditors. These studies revealed that the following duties as shown in Table 3 are considered to be “unreasonable” expectations of the auditor:

It is also important to note that the public is the raider of an audit function hence the public may insist that auditors carry out those duties that are not cost-beneficial for auditors to perform. Thus, unreasonable expectation of the auditors cannot be avoided so long as the public are not required to bear the cost of an audit function. Hence it can be concluded that the existence of an audit expectation gap may be due to unreasonable expectations of auditors.

3. Solutions For Audit Expectation Gap

In view of the detrimental effects of the audit expectation gap on the financial reporting and auditing process, researchers and auditing professional bodies have conducted various studies to identify effective methods in narrowing the audit expectation gap. The aim of this section is to review some of the methods suggested in reducing the audit expectation gap.

3.1 Education

A number of studies (e.g. Bailey et al., 1994; Monroe & Woodliff, 1993; Gramling, et al., 1996) have revealed that the audit expectation gap can be narrowed through education. Monroe and Woodliff (1993) and Gramling et al. (1996) conducted a similar study in Australia and the USA to examine the effect of education on students' perceptions of the meaning of audit reports and the responsibilities and duties of auditors. Monroe and Woodliff (1993) administered the research instrument to two groups of students (final-auditing students and final-year marketing students) at the beginning and end of a semester and to auditors. The findings showed that the auditing students' beliefs about auditors' responsibilities and reliability of financial information changed significantly over the semester. At the end of the semester, the auditing students believed that auditors assumed a much lower level of responsibility; that financial information was reliable and that less assurance was placed on the company's future prospects than that conveyed by the audit report. In contrast, the marketing students' responses changed on only a few scales across the three factors and were not in a consistent direction. A similar study was conducted by Gramling et al. (1996) in the US. The study examined the perceptions of students on the roles and responsibilities of auditors in the auditing process. Data was obtained before and after the completion of a university level auditing course. In addition, professional auditors' perceptions on the same issues were also obtained with the intention of examining whether those with actual audit experience viewed the role of auditing and the nature of the auditing process

differently from those who had primarily received auditing-related education. The study found that the expectation gap between auditors and students exists but on a lesser extent after the students have completed their auditing course. This may suggest that the students have gained better understanding regarding some components of the auditing process and the roles and responsibilities of auditors. Other empirical studies, for example, Bailey et al. (1983) and Epstein and Geiger (1994) found that the more educated users tend to place lesser responsibilities on the auditors as compared to those less knowledgeable users. These studies also found the more educated users are less likely to seek assurance from the auditor.

It is important to note that education may not be a practical way to address problems of the audit expectation gap because it is not possible to educate the public through formal education since they may neither have attended universities nor done any auditing courses in the colleges or universities. Furthermore as pointed out Darnill (1991) pointed out, it is less possible to educate the public through mass communication as auditing is viewed as complex, and does not lend itself to gross simplification. Hence, mass communication on the role of the auditors will be an inappropriate means to reduce the audit expectation gap Darnill (1991) also claimed that there exists a general lack of public interest in the work of the auditors. Therefore, the public may choose not to pay attention to any information given to them with regards to the role of the auditors. Thus, the public may still remain ignorant on this issue

3.2 Expanded audit report

Empirical studies have been conducted in the USA, the UK and Australia to examine whether using an expanded audit report is effective in reducing an audit expectation gap. A survey conducted by Nair and Rittenberg (1987) in the USA revealed that an expanded audit report changes the users' perceptions with regard to the responsibilities of the auditors. Likewise, Gay and Schelluch (1993) found that audit reports based on the revised Statement of Auditing AUP3 (i.e. an expanded audit report) in Australia significantly improved users' perceptions of the purpose of an audit, the audit procedures, as well as the responsibilities of the directors for the financial report. A similar study on the revised AUP3 conducted by Monroe and Woodliff (1994) confirmed the previous findings of Gay and Schelluch (1993). Overall, the Australian findings are generally similar to the previous studies in the USA (Kelly & Mohrweis, 1989; Miller et al., 1990) and the UK (Hatherly et al., 1991) that longform audit reports improve and clarify users' perceptions of the auditor's roles and responsibilities in the financial reporting process. These studies provide evidence that an expanded audit report can be used as a way to reduce the audit expectation gap. This is because it provides a better understanding of the nature, scope and extent of an audit; as well as the roles and responsibilities of the

auditors and the management. The auditors, however, are less motivated to provide additional explanation in the audit report on issues, for example, the purpose of an audit, the audit procedures and the responsibilities of the directors for the financial report given the fact that these additional information are not required by the statutory requirement of ISA 700 "The Auditors' Report on Financial Statements". As a result, it may not be possible to improve the understanding of the users through this suggested method unless there is a change in the requirement of ISAs.

3.3 Structured audit methodologies

It is believed that the audit expectation gap is likely to reduce when the public is satisfied with the auditors' performance. Koh and Woo (1998) asserted that the use of more structured methodologies in the course of an audit helps to improve the auditors' performance. Purvis (1987) examined the usefulness of adopting structured and semi-structured methodologies of data collection in the audit assignment. His study revealed that the use of structured and semi-structured audit procedures in the course of an audit may not necessarily be beneficial to the audit firms. This is because using such methods of data collection may have both functional and dysfunctional effects on an audit assignment. Boritz et al. (1987) concurred with Purvis (1987). Boritz et al. (1987) claimed that structured audit methodologies may not lead to greater consensus among audit firms. Overall, it can be seen that, there is no consensus among the studies on the effectiveness of this method in reducing the audit expectation gap.

It may not be feasible to use a standardized method of data collection in the course of an audit in view of the differences in size of the audit firms and audit clients. The approach to audit a client depends on factors such as the nature and environment of the business, as well as the volume of transactions in the business. Hence, it may not be cost-beneficial to have a set of structured and semi-structured audit programme across audit firms. Therefore this proposed method is unlikely to be practical.

3.4 Expansion of auditors' responsibilities and enhancement of auditors' performance

Research (Humphrey et al. 1993; Knutson, 1994 and O'Malley, 1993) has suggested that audit expectation gap can be reduced by expanding the existing duties and responsibilities of the auditors. Similarly, The Institute of Chartered Accountants in Australia (ICAA), in their report 'Financial Report Audit: Meeting The Market Expectation' (2003) recommended that the audit profession should expand the scope of audit so that the services provided by the auditors are able to meet the demand of the public. The ICAA report explained that, in view the high litigation and accusation against the auditing profession, encouragement should be given to

promote the evolution of expanded audit services. The expansion of the scope of audit includes those core audit services and extended audit services. The core audit services relate to internal control, fraud and evaluation of going concerns. The extended audit services include business risk, management discussion and analysis, quality of accounting policies, corporate governance, continuous disclosure, performance audits and continuous audits (*ICAA*, p. 6).

Humphrey et al. (1993) claimed that the perceived quality of an audit can be improved through the following two ways: i) to establish an independent office to oversee the appointment of auditors and to regulate the audit fees; and ii) to expand the statutory duties of the auditors. In line with Humphrey et al. (1993), O' Malley (1993) is of the opinion that imposing additional responsibilities on auditors may help to mitigate the audit expectation gap as the expectation of the public is likely to be met when additional services are provided to them. According to him, the expansion of the auditors' duties should include: i) compliance reporting; ii) evaluation of internal control system; iii) direct reporting by auditors to regulators; iv) fraud detection; and v) involvement of auditors in interim financial information.

Expansion of auditors' responsibilities is likely to be a good way in meeting the expectation of the public. However, the cost of such services should be considered. Since the public is free raider of such services, the cost of these additional services needs to be borne by the company. Thus, the company may be reluctant to engage the services of auditors unless they become a statutory requirement in Malaysia or the benefit of engaging such services outweigh the cost.

In addition, the competency of auditors in providing additional services needs to be considered closely. For example, auditors may fail to evaluate the going concern of the business as they may lack the relevant experience in performing such duty. This is mainly because such duty is not part of the present statutory duties. Hence, the auditors' expertise in such area is in question. Furthermore, the going concern of a business will be subject to unavoidable business risks due to changes in the overall economic condition of the country. Therefore, the feasibility of expanding the auditors' responsibilities needs to be evaluated on a case-to-case basis in order to ensure that the auditors have the ability to perform these additional duties.

4. Conclusion

The auditing profession believes the increase in litigation against, and criticism of auditors can be traced to the audit expectation gap. The audit expectation gap is detrimental to the auditing profession as it has a negative impact on the value of auditing and the reputation of auditors in the modern society. This paper reviews of the factors which may contribute towards the existence of an audit expectation gap. It is submitted that the evaluation of these factors provide better insight into the

phenomenon of the audit expectation gap. In addition, a review of methods (i.e. education, expanded audit report, structured audit methodologies, expansion of auditors' responsibilities and enhancement of auditor' performance) shows that most of the proposed solution to reduce the audit expectation gap in the literature are only likely to be effective on theoretical grounds. Thus, further research needs to be conducted to investigate more effective ways in reducing the audit expectation gap.

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