

# Stakeholders' Trust towards the Role of Auditors: A Synopsis of Audit Expectation Gap

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## Abstract

The role of external auditor has always been a dubious issue since the emergence of the profession whereas public expectation is beyond imagination regarding the role of auditors. With the inevitable facts that the business entity assumption separates the business and owners; agency conflict exists between the parties and the role of external auditors rises as a means of monitoring the task of management on behalf of owners. As auditing is a powerful tool to retain stakeholders confidence on the result of business operations, numerous expectations ambiances the role played by the external auditors. This paper is an attempt towards empathizing the Audit Expectation Gap (AEG) and offers a rationale to look upon the issue, based on the extensive literature review. Further, the study portrays the necessity of involving stakeholder's expectation towards the auditing profession and auditors should not skip the issue merely enunciating that it is a self-regulatory profession; otherwise, stakeholders will lose faith on auditors, and its consequence is far reaching.

## Keywords

External Auditors, Stakeholders Trust, Audit Expectation Gap

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## 1. Introduction

Massive Global corporate scandals, financial crisis and collapses of large entities such as Barings, HIH, Parmalat, Enron and Lehman Brothers have diluted the stakeholders confidence in the world's capital market. The auditing profession has also come under the spotlight, following the melodramatic flop of eminent companies without any prior warning signals in audit reports and highlighted the miracle phenomena, the audit expectation gap (AEG). The collapse of the big companies have always been costly to the auditing profession in many ways, such as compromising the professional reputation, incurring high cost of litigation in order to settle down these cases in courts, and the possibility of taking increased responsibilities and the most importantly losing stakeholders faith (Wolf, Tackett, & Claypool, 1999).

In the eve of 2018, the collapse of Carillion Construction Company in UK has made the situation worse and the Audit Expectation Gap has been noticed from a newfangled perspective and this downfall indicates, it is stint to reassess the role of auditors. Carillion is the latest in a string of cases where auditors have conveyed a clean message about the health of companies soon afore austere financial snags arose that in many cases evidenced ruinous. Most users of accounts undoubtedly surmise that if an auditor signs off a company's accounts without qualification there should exist next to zero risk of being bankrupt within a year where as Carillion collapsed just after ten months of its being audited. If through the legislation, it can be decided, what users want from the audit process, only then the profession will know where it stands, as a consequence an acceptable out-

comes-based auditing model can be achieved (Kingsley Stephen, 2018). Either auditors need to start excavating extensive into latent glitches or people should start expecting less of them or customers of audited accounts must be articulated the fact that they are just expecting too much (Wighton David, 2018).

The Big Four firm's failure to hook a years-long fraud containing made-up mortgages at Colonial Bank happened due to professional negligence; a recent verdict referred on the case of Colonial Bank collapsed in USA. The testimonial was found that, the auditor of the aforesaid Bank did not design the audit procedures to detect fraud and very junior level employee, as like as college-aged intern were assigned and sent to evaluate such a big issues and the consequence was catastrophic (Masters Brooke, 2018). As investors believe on the financial figures produced by the company's executives and they can demand higher standards regarding auditors' independence and judgment and it is high time to lessen the dependency of auditors on the lucrative non audit work, therefore urge for the breakup of big four firm into consultancy and audit only services (Ford Jonathan, 2018).

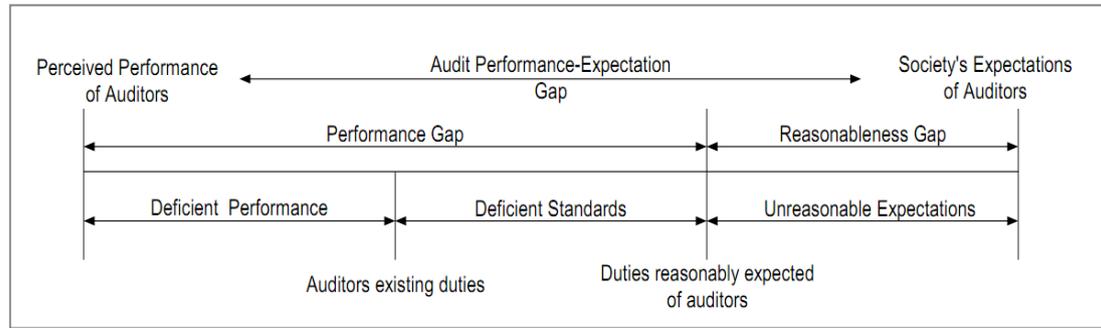
The objective of this paper is to articulate an overview of the audit expectation gap (AEG), the contributing factors behind the AEG, and the consequences of not handling the AEG properly. We also infer some ways of mitigating AEG and the pluses of doing so. Moreover, the study proposes a conceptual model relating the causes, consequences, and the ways of mitigating AEG; whereas the ultimate upshot is enhancing stakeholder's confidence on the auditors. Considering the worldwide corporate crisis, the research has significant contribution to the audit literature and guiding the audit practitioners and also the policy makers. The research issue guides the standard setters and policy makers to think about audit expectation gap more precisely and will be able to meet expectation from audit to attain the trust and confidence of the stakeholders.

The subsequent segment of this paper presents an overview of the audit expectation gap in section 2, followed by a conceptual AEG model in section 3. After that, section 4 includes concluding remarks.

## **2. An Overview of the Audit Expectation Gap**

Liggio (1974) demarcated, Audit Expectation Gap (AEG) as the difference between the levels of expected performance as anticipated by both the user of a financial statement and the independent accountant. The Cohen commissions (1978) defined Audit Expectation Gap as the gap what the public expects or desires and what auditors can and should reasonably expect to accomplish. According to the American Institution of Certified Public Accountants (AICPA, 1992), AEG is the gap concerning what the public and financial statement consumers believe auditors are responsible for and what auditors themselves believe their responsibilities are. Moreover, Porter (1991; 1993) came with a comprehensive definition of AEG and introduced the term reasonableness gap and performance gap.

- a. Reasonableness Gap: The difference between what the public believes auditors to achieve and what they can practically be likely to achieve. This gap arises due to the misapprehension of users regarding the objective and scope of audit, lack of sufficient accounting and audit related familiarity, above expectation of users to auditor performances as well as obliviousness of users about audit responsibilities and limitations.
- b. The deficient standards gap: The difference between what can sensibly be expected from auditors and auditors' existing duties as defined by the law and professional standards. This gap arises due to dissimilar perception regarding what duties reasonably can be expected from auditors' existing duties as defined by the law and professional promulgations.
- c. The deficient performance gap: The gap between the expected standard of performance of auditors' existing duties and auditors' perceived performance, as perceived by the public. This gap arises due to the dissimilar perception about the expected standard of performance of auditors' existing duties prescribed in the existing laws and standards and auditors' perceived performance, as expected and perceived by society.



**Figure 1.** Structure of the audit expectation performance – gap.

Source: Porter1993, p. 2.

AEG is the deviation of notion between auditors and the public about the duties and responsibilities assumed by auditors and the messages conveyed by audit reports (Monroe & Woodliff, 1994) as well as the AEG subsists when auditors and the public embrace dissimilar beliefs regarding the auditor's obligations and responsibilities and the messages channeled by audit report (Chye Koh & Woo, 1998; Frank, Jordan Lowe, & Smith, 2001; Wolf et al., 1999)

Accounting and auditing literature and the institutional setup seems to assent the presence of AEG and has entitled to litigate in order to moderate the gap or to edge its influence on auditors (Cohen1987, Porter 199, AICPA1978, Mock et al., 2012, Gold, Gronewold, & Pott, 2012). Liggio (1974), noted a wide expectations gap between what users of company accounts consider auditors' job is and what the auditors and their regulators think. The artifact of an audit is amplified trustworthiness committed to the audited financial statements whereas biasness, conflict of interest and lack of perceived independence make the audit report nothing just a company commercial, whereas huge monetary and reputation losses, misplacing credibility to the profession, augmented legal fees, exorbitant out-of-court settlements, elevating insurance premiums, and susceptible guideline are some of the costs associated with not responding to the AEG properly (Wolf et al.,1999)

The auditing professions anxiety about the appearance of expectation gap is justified; however, steps should be taken to lessen the gap. More literate, conversant and educated users stretch less burden to auditors, conversely professional bodies should take active steps regarding educating users about the duties and responsibilities of the auditors and the meaning of auditors report. Moreover, the wording of the audit report have significant effect on the gap as different audit report will bear different wording and the responsibilities of the auditors to be specified clearly (Monroe & Woodliff, 1993, 1994). Considering numerous corporate scandals the role of external auditors come into question and users are more concerned regarding the auditors independence and objectivity towards the entity subject to auditing, auditor's responsibility to evaluate the entity's viability; and the influence of auditing fees and remuneration on audit quality (Mansur & Tangl, 2018).

The significant causes of AEG is the self-regulatory framework of the profession that enable the profession to set audit objective though it may give less importance to public expectation. The need for government interference and renovating the legal proclamation regarding auditor's responsibilities, selection and compensation of auditors may bridge the gap (Onulaka & Samy, 2017). The audit expectation gap curtails from the permutation of the insufficient auditors performance, divergence in the audit standards and regulations, irrational expectations and misconceptions of audit functions. Ameliorating auditors professional training, ensuring quality control and enhancement of audit methods were suggested to bridge the auditors performance gap, Expansion of auditors independence and responsibility were put to bridge the standard gap and finally educating people and society about the role of auditors and introducing the extended (long form) audit reports to bridge the reasonable-gap in Hungary (Füredi-Fülöp, 2015).

Public has extravagant expectations of auditors' responsibilities beneath the present professional standards as they face difficulty in evaluating the auditor's performance and auditors are not effusively alert of their responsibilities. Limited information content of the audit opinion is one of the major causes of AEG. Changes in the content of the audit report is probable to narrow the gap, however, compulsory auditors rotation and a prohibition on providing non-audit services, may lessen the gap only to a smaller extent (Ruhnke & Schmidt, 2014). Pourheydari & Abousaiedi (2011), found Audit expectation gap in the areas of auditor responsibility for fraud detection, internal control soundness, and the preparation of financial statements. Furthermore, they ground peanut upshot whether audit purpose could be accredited to the culture of reliance amid auditors and stakeholders in Iran. Progresses in auditor-user communication, audit reports, auditing framework, and auditor integrity could be the probable propositions in narrowing AEG in the existing state of affairs.

Replicating the study of Schelluch (1996), significant Reasonableness gap was discovered in Lebanon (Munir Sidani, 2007) as well as AEG was identified in the expanse auditor errands for fraud prevention, conservation of accounting records, and auditor decision in the assortment of audit techniques and also the dependability of audit and audited financial statements, and the expediency of audit in Egypt (Dixon, Woodhead, & Sohlman, 2006); in Malaysia (Nazri Fadzly & Ahmad, 2004); in Singapore (Best, Buckby, & Tan, 2001) identified AEG mostly in the area of auditors responsibility and trustworthiness of the audited financial statements. Meanwhile, Chowdhury, Innes, & Kouhy (2005) ascertained AEG mostly in the area of accountability and audit independence in the Public sector auditors of Bangladesh as well Siddiqui, Nasreen, & Choudhury-Lema (2009) portrayed that there is significant audit expectation gap in Bangladesh in the area of auditors responsibility and somewhere auditors responsibility in fraud detection while education plays an important role in reducing AEG in a emergence economy setup like Bangladesh.

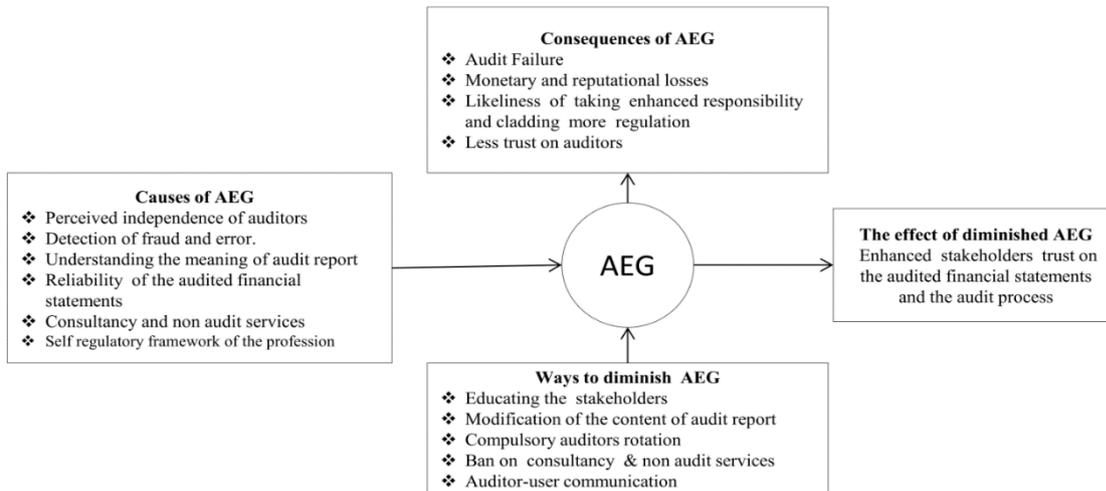
The standard audit report provides users a ominously upper degree of assurance in the company's management, investment soundness, and achievement of strategic objectives although there is differences in the perception among the auditors and different level of users in understanding of the message carried out by the SAR and inferring the technical word in SAR (Asare & Wright, 2012). An audit report on the general purpose financial statements articulates a positive and unbiased opinion providing a high but not absolute level of assurance whereas the report on review engagement provides a moderate level of assurance, which is a lower level of assurance (Gay, Schelluch, & Baines, 1998). Moreover significant AEG was found in respect of Auditors independence and in respect of the short form of audit report (P Schelluch, 1996). Lin & Chen (2004) revealed AEG in the areas of role of auditors, objectives of audit, and auditors' role regarding the discovery of fraud in China.

Sweeney (1997) notified that educating the public as to what the audit function currently entails and changing the nature of the audit function to meet the public expectation. The revenues earned from consultancy outweigh the revenues earned from audit by the accounting firm where as less proficient auditors performing the riskiest audits and in the end an upturn in audit failures and external appointment of auditors, required auditor rotation and a market based instrument that would hedge against inevitable audit failure (Wolf et al., 1999).

### 3. Conceptual AEG Model

A theoretical model (Figure 2) has been developed that reflect the relationship among the audit expectation gap and the variables affects such gap. Lack of perceived independence is prime causes of AEG, biasness and lack of objectivity make the audit report nothing just a company advertisement (Wolf et al., 1999). Other causes are self-regulatory framework of the profession (Onulaka & Samy, 2017), responsibility for fraud detection, viability of the audited financial statements (Ruhnke & Schmidt, 2014; Pourheydari & Abousaiedi, 2011), reliability of the audited financial statements (Dixon, Woodhead, & Sohlman, 2006; Nazri Fadzly & Ahmad, 2004; Best, Buckby, & Tan, 2001), difficulties in understanding the meaning of audit report (Asare & Wright, 2012). The consequences of AEG is also fatal such as huge financial and status losses, dropping integrity to the profession, am-

plified legal fees, overpriced out-of-court settlements, elevating insurance premiums, and inclined guideline and finally losing the stakeholders' faith on auditors, are some of the costs associated with not responding to the AEG properly (Wolf et al., 1999). However, it is possible to keep the AEG in a control mode and earning stakeholders' confidence, and it is vital because if stakeholders lose trust on auditors, the necessity of the existence of auditors is questionable. Educating the society regarding the role and responsibility of the auditors beneath the particular standard set up is the most effective way of diminishing AEG (N



**Figure 2.** Conceptual AEG model.

#### 4. Concluding Remarks

Notwithstanding the self regulatory eminence of the profession, contradictory institutional structure, inequality in the circulation of wealth, influence, politics and power, as well as in a fluctuating social context, AEG is an incessant phenomenon. However, to retain stakeholders trust and confidence in the profession and placing rationalities to the birth of auditors, the auditors should be responsive towards AEG. The number of proposed mechanism such as, educating the public towards the role and responsibilities of auditors, ensuring perceived independence, demand for the enhanced regulation such as modification for the content of auditors report, limiting the mix service provided by auditors, mandatory auditors rotation, regulating the appointment of auditors and so on may act as arbitrator to lessen the GAP; where cost of audit may increase considerably, nevertheless may and will not exceed the cost procured to the profession through the AEG. Instead of fetching huge professional disgrace and fronting lawsuit, it is punter to uphold perceived independence and ensure the reliability and the usefulness of the audited financial statements, hence retaining stakeholders trust and confidence towards the profession.

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