41 IPBJ Vol. 1 (1), 41 - 75 (2009)

REVIEWING THE AUDIT EXPECTATION GAP LITERATURE FROM 1974 TO 2007

KHALED SLAMEN YSALAM ALJAAIDI

ABSTRACT

In auditing literature, the issue of audit expectation gap is still a concern in that auditors and the public grasp different beliefs about the auditors' duties and responsibilities and what messages they communicate in the audit reports. Recently, the audit expectation gap has been highlighted as a hot spot in the auditing researches because of the collapse of some spectacular and well-publicized corporations such as Enron. Thus, the aim of this paper is to review the literature on the audit expectation gap which is divided into the following sections: definition of the audit expectation gap; nature, structure, and elements of the audit expectation gap; a brief history about the audit expectation gap; evidence on the expectation gap from all over the world; and mechanisms used to narrow and eliminate the audit expectation gap. It is hoped that this paper can provide insights into the audit expectation gap.

Keywords: *Audit expectation gap, audit, financial statements*

Introduction

There is a general agreement by various empirical studies that the continuing gap between what the users of financial statements expect from the auditing profession and what the auditors define as their role in the assurance process still exists (Sidani, 2007). In recent years, the auditing profession has been involuntarily placed in the spotlight, particularly because of some spectacular and well-publicized corporate collapses and the subsequent implication of the reporting auditors. As mentioned in Godsell (1992), there is a widespread belief that a person who has any interest in a company (shareholders, potential investors, take-over bidders, creditors etc.) should be able to rely on its audited accounts as a guarantee of its solvency, propriety and business viability. Hence, if it transpires, without any warning that the company is in serious financial difficulty, it is widely felt that somebody should be made accountable for these financial disasters, and this somebody is always perceived to be the auditors. These misperceptions by the public feed

the legal liability crisis facing the accounting profession (Maccarrone, 1993). However, any "accountability vacuum" is not something that can be placed on the auditors' shoulders alone, for the nature and objectives of auditing are differently perceived by different parties (Lim, 1993).

This study is proposed in an effort to review the literature on the audit expectation gap. The issues that have been discussed in the literature can be classified into five main categories:
1. Definition of the audit expectation gap;
2. Nature, structure, and elements of the audit expectation gap;
3. A brief history about the audit expectation gap;
4. Evidence on the expectation gap from all over the world;
5. Mechanisms used to narrow or eliminate the audit expectation gap.

Definition of the Audit Expectation Gap

The expectations gap is not a new research area. There are several studies defining how the expectations gap occurs in the private sector and from this, the gap has received several definitions. The term 'expectations gap' was first mentioned in 1974 by Liggio who defined it as the difference between the levels of expected performance 'as envisioned by the independent accountant and by the user of financial statements'. This definition was extended a little in the Cohen Commission's (CAR, 1978) terms of reference. The Commission was charged, inter alia, to 'consider whether a gap may exist between what the public expects or needs and what auditors can and should reasonably expect to accomplish. However, it is considered that both of these definitions are too narrow in that they do not recognize that auditors may not accomplish 'expected performance' or what they 'can and reasonably should'. They do not allow for sub-standard performance. It is submitted that the gap which gives rise to criticism of auditors is that between what societies expect from auditors and what it perceives it receives from them. It is therefore proposed that the gap, more appropriately entitled 'the audit expectation performance gap', be defined as the gap between society's expectations of auditors and auditors' performance, as perceived by society. Moreover, the expectations gap can be defined as: ... the difference between what the public and financial statement users believe auditors are responsible for and what auditors themselves believe their responsibilities are (AICPA, 1992). Monroe and Woodcliff (1993) defined the audit expectations gap as the difference in beliefs between auditors and the public about the duties and responsibilities assumed by auditors and the messages conveyed by

audit reports. Jennings et al. (1993), in their study on the use of audit decision aids to improve auditor adherence to a "standard", are of the opinion that the audit expectations gap is the difference between what the public expects from the auditing profession and what the profession actually provides. This definition is also advocated by Lowe (1994) in his research on the expectation gap in the legal system. Porter (1993) carried out an empirical study of the audit expectation-performance gap and defined the expectations gap as the gap between society's expectations of auditors and auditors' performance, as perceived by society. According to Pierce and Kilcommins (1995), the audit expectations gap is when external auditors' understanding of their role and duties is compared against the expectations of user groups and the general public. Humphrey (1997) provides an accessible introduction to the expectations gap literature and provides a general definition of the expectations gap: A representation of the feeling that auditors are performing in a manner at variance with the beliefs and desires of those for whose benefit the audit is carried out. The expectation gap was originally defined as the difference between levels of expected performance as envisaged by auditors and users of financial reports. It is the gap between society's expectations of auditors and auditors' performance, as perceived by society (Shaikh & Talha, 2003). Humphrey et al. (1993) provide an introduction to the expectations gap literature and provides a general definition. He defined the expectations gap as ''... a representation of the feeling that auditors are performing in a manner at variance with the beliefs and desires of those for whose benefit the audit is carried out." He also notes that the expectations gap can be defined more narrowly as a "role-perception gap", that is, the expectations of users are capable of comparison with a predetermined notion of what is reasonable to expect auditors to provide. In turn this leads to the idea of an "ignorance gap", that is, the expectations gap can be closed (or at least narrowed) by the education of users. The expectations gap exists when auditors and the public hold different beliefs about the auditor's duties and responsibilities and the messages conveyed by audit reports (Wollf et al., 1999; Koh & Woo, 1998; Frank et al., 2001). According to Godsell (1992), there is a widespread belief that a person who has any interest in a company (shareholders, potential investors, take-over bidders, creditors, etc.) should be able to rely on its audited accounts as a guarantee of its solvency, propriety and business viability. Hence, if it transpires, without any warning that the company is in serious financial difficulty, it is widely felt that somebody should be made accountable for these financial disasters, and this somebody is always perceived to be the auditors.

These misperceptions of the public feed the legal liability crisis facing the accounting profession (Maccarrone, 1993). That is, the public in general has come to view audits as guarantees of the integrity of financial statements and as an insurance policy against fraud and illegal acts (Epstein and Geiger, 1994). Also, Kelly and Mohrweis (1989) explained that the expectations gap has been most conspicuous in legal decisions. Judicial litigants often appear to apply, as a standard, the concept that an audit is a comprehensive check on a corporation's financial activities. A business failure is often interpreted to be an audit failure, regardless of the level of procedures and tests performed by the auditor. Auditors can perform their audits in strict accordance with generally accepted auditing standards and still be found negligent in not preventing risks to financial statement users (Almer & Brody, 2002). Tricker (1982) viewed the expectation gap as the result of a natural time lag in the auditing profession identifying and responding to continually evolving and expanding public expectations. Other authors argued that it is the consequence of the contradictions in a self regulated audit system operating with minimal government intervention.

Nature, Structure, and Elements of the Audit Expectation Gap

Empirical studies on the nature and structure of the expectation gap aim to elicit the actual as well as the perceived roles and responsibilities of auditors and attempt to uncover the factors contributing to the expectation gap.

Most of the studies ascertain the auditors' and the public's view of the roles and responsibilities of auditors through the use of questionnaire surveys. In the USA, Baron et al. (1977) examined the extent of auditors' detection responsibilities with respect to material errors, irregularities and illegal acts. They attempted to establish whether there are any differences in the perceptions regarding auditors' detection and disclosure duties between the auditors and users of accounting reports (financial analysts, bank loan officers and corporate financial managers). They found that auditors and users of accounting reports have significantly different beliefs and preferences on the extent of auditors' responsibilities for detecting and disclosing irregularities and illegal acts. In particular, users held auditors to be more responsible for detecting and disclosing irregularities and illegal acts than the auditors believed themselves to be.

Jennings et al. (1991) asserted that auditor liability depends on the attitudes of judicial litigants towards the auditing profession. In a slightly different perspective and in an attempt to contemplate how

an expectation gap could have legal implications for the profession, Lowe (1994) compared the perceptions of auditors and judicial litigants regarding their expectations of the auditing profession.
It was found that an expectation gap exists between the auditors and judicial litigants and that judges systematically expect more from auditors than auditors believed they provide.

Epstein and Geiger (1994) conducted a survey of investors to gather information on various aspects of financial reporting issues, in particular on the level of assurance they believed auditors should provide with respect to error and fraud. The survey results suggested that investors seek very high levels of financial statement assurance and there exists an expectation gap between auditors and investors on the level of assurance an audit provides.

In the UK, Humphrey et al. (1993) examined the expectation gap by ascertaining the perceptions of individuals of audit expectations issues through the use of a questionnaire survey comprising a series of mini-cases. The issues investigated include the following: what is and should be the role of the auditor? What should be the prohibitions and regulations placed on audit firms? And what decisions could auditors be expected to make? The respondents included chartered accountants in public practice, corporate finance directors, investment analysts, bank lending officers and financial journalists. The survey revealed a significant difference between auditors and the respondents (representing some of the main participants in the company financial report process) in their views on the nature of auditing. The results confirmed that an audit expectation gap exists, specifically in areas such as the nature of the audit function and the perceived performance of auditors. The critical components of the expectation gap were found to include auditors' fraud detection role, the extent of auditors' responsibilities to third parties, the nature of balance sheet valuations, the strength of and continuing threats to auditors' independence, and aspects of the conduct of audit work (e.g. auditors' ability to cope with risk and uncertainty).

Chandler et al. (1993) looked at the various aspects of the development of the audit function in the UK and sought to explore the nature of auditors' responsibilities and the public's perception of the auditors' role. A review of the evolution of audit objectives over the period 1840 to 1940 suggested that statement verification was the primary concern of auditors in relation to public companies in the period 1830 to 1860, after which more emphasis was placed on fraud detection in the late nineteenth century. In the early part of this century, the primary audit

objective reverted to statement verification. The study showed that audit objectives and practices tend to follow external events and that the profession has encountered great difficulty in reconciling public expectations with the practicalities of auditing. It also suggested that general confusion over the role of auditors has existed to such an extent that it has been difficult even for the profession to reach agreement on the main purpose of company auditing and the message to be sent to the investing public.

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

Meanwhile, Porter (1993) conducted an empirical study in New Zealand to test the postulated structure of the audit expectation-performance gap and to establish the composition and extent of the gap and its constituent parts. The research is an extension of those conducted by Lee (1970) and Beck (1974), who investigated the duties which auditors were expected to perform in the late 1960s in Britain and early 1970s in Australia, respectively. Using a mail survey, Porter ascertained the opinions of auditors' interest groups (auditors, officers of public companies, financial analysts, auditing academics, lawyers, financial journalists and members of the general public) regarding auditors' existing duties, the standard of performance of these duties, and the duties that auditors should perform. The findings from the survey revealed that 50 per cent of the gap is attributable to deficient standards, 34 per cent from society holding unreasonable expectations of auditors and 16 per cent from perceived sub-standard performance by auditors.

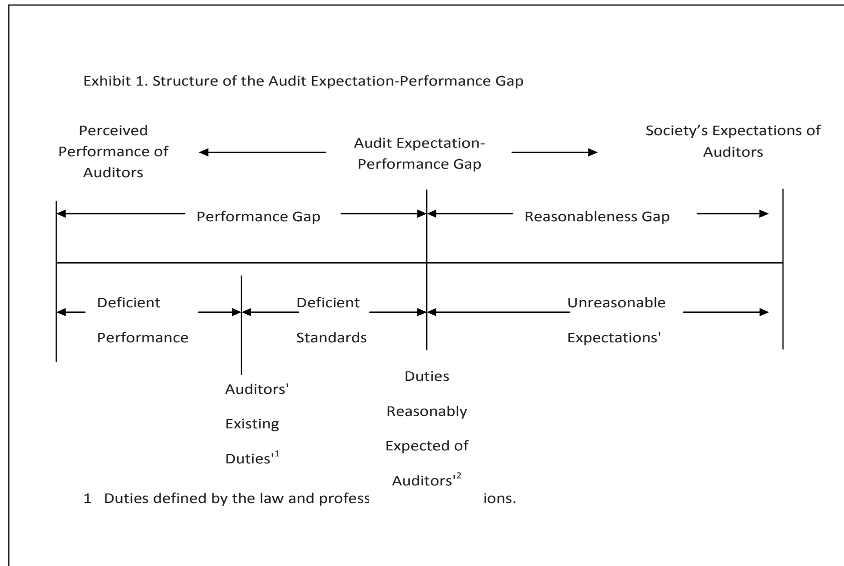
On the other hand, Cameron (1993) explored the relationship between public accountants and their small business clients in New Zealand by seeking the opinions of public accountants, small businesses and associated third parties (bankers, business consultants and enterprise agencies) with respect to the roles that auditors are expected to perform and those that they actually perform. The results revealed that the three groups expected auditors to provide compliance services, give

accounting-related advice, show concern for clients' financial health, actively seek out client problems, and give general business advice. Auditors were perceived as actually providing all of the services expected of them except the service of actively seeking out client problems. In relation to the other functions, the actual performance of chartered accountants was generally perceived to fall below the expected levels. McInnes (1994) reviewed Gloeck and Jager's (1993) study on the audit expectation gap in the Republic of South Africa and found three areas (independence of auditors; role of auditors, in particular relating to fraud and going concern issues; and compulsory audit of small owner-managed companies) in which an expectation gap exists between auditors and non-auditors.

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

As can be seen from the literature review, evidence of the existence of an audit expectation gap is substantial. Porter (1993) 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 the 'reasonableness gap');
2. A gap between what society can reasonably expect auditors to accomplish and what they are perceived to achieve (designated the 'performance gap'). This may be subdivided into:
    - 2.1 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
    - 2.2 A gap between the expected standard of performance of auditors' existing duties and auditors perceived performance, as expected and perceived by society ('deficient performance') (Porter, 1993).



A Brief History about the Audit Expectation Gap

The origins of auditing date back to Greek, Egyptian and earlier civilizations and whilst there was the emergence of large manufacturing organizations in the eighteenth century, the usual association between audits and fraud detection remained.

Towards the end of the nineteenth century, a more prominent accountancy profession associated audits with fraud detection even though there was opposition by those who argued that it was unreasonable to expect the auditor to expose fraudulent acts. Lawrence Dicksee's textbook is often considered to be the first major auditing textbook and his original book which was published in 1892 stated clearly that the scope of an audit included namely: the detection of fraud, technical errors and errors of principle. He also stated that the detection of fraud was a most important portion of the auditor's duties and that the whole duty of the auditor was to ascertain the exact state of the client's affairs on a certain date. However, other authors such as Robertson and Montgomery argued on the contrary and considered the detection of fraud to be a secondary audit objective. Humphrey et al noted that the position adopted by the profession in Britain during the twentieth century played down any suggestion that auditors had responsibility linked to fraud apart from that which arose from the need to confirm the truth and fairness of financial statements.

Chandler et al reviewed the development of audit objectives between 1840 and 1940 and concluded that the primary objective in relation to public companies between 1830 and 1860 was the verification of financial statements and that more emphasis was put on fraud detection in the late nineteenth century. They also added that the primary audit objective reverted back to financial statements verification in the early part of the twentieth century. However, according to some, in the early part of the twentieth century, fraud detection continued to be regarded as a major audit objective.

According to Brown, the confusion over audit objectives was finally resolved after 1940 and fraud detection was generally accepted to be a secondary objective. However, the objectives of auditing have not been adjusted to conform to operational processes of auditing. For example, selective sampling would have corresponded to a primary objective of financial statements verification whilst 100% testing would correspond with the detection of fraud. One important difference between mid-to-late Victorian England and more recent times is the presence or lack of presence of audit expectations. Victorian England is seen as a time of evolution and formulation of expectations and whilst gaps existed in the nineteenth century, they were mainly to do with inconsistencies and not expectations.

The differing inconsistent expectations between the judiciary and the auditing profession is illustrated in the landmark cases of London and General Bank (No 2) [1895] and Kingston Cotton Mill (No 2) [1896] in which the UK Court of Appeal delivered two significant judgments (London and General Bank (No2) [1895]). This case concerned the adequacy of security on bank loans, whether shareholders had been deceived as to the condition of the company, whether dividends had been paid out of capital and not out of available profits. In the first instance decision had been against the defendants (the auditor). However in the Appeal Court, Lindley LJ overturned the previous court's decision and his opinion on the auditor's duty is as follows:'.......the duty of an auditor is to convey information, not to arouse inquiry and although an auditor might infer from an unusual statement that something was seriously wrong, it by no means followed that ordinary people would have their suspicions aroused.' Lindley LJ also stated that it was not the auditor's duty to guarantee the books showing the true position of the company's affairs or to guarantee that the balance sheet was accurate (Kingston Cotton Mill (No 2) [1895]).

The first instance decision was one which involved the auditor relying on managers' certificates without the auditor conducting a physical observation of the inventory or taking steps to confirm valuation. In that decision, Vaughan Williams J found that the auditors and directors were liable for dividends paid from nonexistent profits. However damages sought against them in respect of consequent insolvency on the basis of tort was denied. There was a lot of concern by the audit profession following this decision and the validity of managers' certificates was also called into question. However Lopes LJ in the Appeal Court overturned the decision in his famous judgment: – It is the duty of an auditor to bring to bear on the work he has to perform that skill, care and caution which a reasonably competent, careful and cautious auditor would use. What is reasonable skill, care and caution must depend on the particular circumstances of each case. An auditor is not bound to be a detective or as was said to approach his work with suspicion or with a foregone conclusion that there is something wrong. He is a watchdog but not a bloodhound. He is justified in believing tried servants of the company in whom confidence is placed by the company.

These two cases were the foundations of certain auditing standards which focused on the accepted fraud and error objectives and placed the nature of the audit on centre stage. Apart from establishing that the auditor was not expected to fish out every fraud it established the use reasonable care and skill in his handling of relevant books and records. However, the fact that London and General Bank (No 2) [1895] and Kingston Cotton Mill (No 2) [1896] confirmed the "reasonableness" test, did not completely remove any concern created due to the subjective nature of the reasonableness test.

During the early years of the twentieth century, fraud detection as an audit objective came to be replaced by the objective of checking that the appropriate accounting standards had been adopted and correctly used in constructing financial statements. Between 1940 and 1970, fraud detection seemed to be regarded as a secondary audit objective even though this move had not been approved by the Companies Acts of 1948 and the re-emergence of fraud detection as an audit objective occurred during the Thatcher administration and was also strongly highlighted during the mid-1970's property and secondary banking crisis.

In 1985, a working party of the Institute of Chartered Accountants in England and Wales (ICAEW) was established to consider the matter relating to auditors' responsibilities in relation to fraud. This was

prompted as a result of criticisms about the audit function following the collapse of Johnson Matthey Bankers. The collapse of Johnson Matthey Bankers in 1984 also brought about questions on regulation of financial markets and the government being unhappy with the role of auditors, wanted to impose upon auditors a duty to report fraud to the Bank of England even without the knowledge of the client organization. In response to this, the Institute of Chartered Accountants in England and Wales argued against Lord Justice Bingham's recommendations for an imposition of statutory duty. The working party of the Institute of Chartered Accountants in England and Wales suggested instead that companies should be required by statute to maintain adequate systems of internal control.

Problems which could threaten the auditor client relationship, duty of confidentiality were mentioned and these issues though apparent seemed more important than the protection of the public's interests. It took another three years for the Institute of Chartered Accountants in England and Wales to issue draft guidance on the auditor's responsibility for detecting fraud and other irregularities. This document was amended further and published as a full operational guideline in February 1990. Management responsibility for setting-up adequate systems of internal controls is highlighted but auditors are reminded to plan the audit to provide a "reasonable expectation" of detecting material misstatements.

"Materiality" has been interpreted in professional guidance as the degree of tolerable or acceptable error in financial statements but like the term "reasonable expectation" it is not specified beyond this. It is important that further clarification in relation to these terms are provided as the question of whether auditors have a responsibility to detect fraud depends on the interpretation of these terms. The guidance document does not deny the auditor's duty to detect fraud – however, it qualifies this duty by the "reasonable expectation" term (Ojo, 2006).

Evidence on the Expectation Gap from All over the World

The existence of the audit expectation gap has been investigated by several studies in various countries such as USA, UK, Australia, New Zealand, China, Singapore, Malaysia, Middle East countries, and other regions in various areas such as the nature of the audit function, the perceived performance of auditors, the auditor's duties and role, the independence of auditors, and the non-audit services. The results indicate that the audit expectation gap still exists.

The first imitative studies on the audit expectation gap (Libby, 1979; Liggio, 1974; The Cohen Commission, 1978; Bailey et al, 1983) concerned about the explanation of the audit expectation gap's foundation and origins. More extensive discussions on the issue were found in the 1990's, mainly due to rising public concerns over the integrity of the public accounting profession stirred by numerous financial scandals in the 1980's.

Nair and Rittenberg (1987) extended previous research by examining the agreement on messages in nine types of reports including compilations and reviews across a diverse group of CPAs and bankers. Their investigation was based on the alternative report (long-form report) suggested by the American Institute of Certified Public Accountants (AICPA) (AICPA Commission on Auditors' Responsibilities, 1978). Their results indicated that there were some differences between bankers' and CPAs' perceptions of audit reports. Bankers placed more responsibility for financial statements on auditors (rather than on management) than did CPAs. This result was associated with the size of the bank and the CPA firm. In addition the expanded audit report appeared to change users' perceptions about the responsibilities of management and auditors, i.e. users found expanded reports more useful and understandable than short-form audit reports.

Kelly and Mohrweis (1989) examined the impact of the new SAS No.58 auditor's report on users' perceptions regarding messages conveyed by this report. The study was based on bankers and investors, to test whether the changes in wording of the report would increase understandability and clarify the level of responsibility assumed by auditors. The results showed that understandability increased significantly. However, wording changes did not alter investors' perceptions of the level of responsibility being assumed by auditors. Bankers perceived auditors as assuming less responsibility under the new audit report as compared to the old one. Bankers and investors reading the new report agreed that management was responsible for presentation and disclosure of financial statements. Hatherly et al. (1991) examined whether an expansion of the audit report can shift the perception of the user. An experiment was conducted with 140 part-time MBA students of the University of Edinburgh. Eighteen dimensions were used to determine the perceptions of readers of the report. The results showed that the expanded report did change reader perceptions. They observed a ''halo'' effect where the expanded report wording seemed to have given a sense of well-being affecting other dimensions not directly addressed by the expanded wording of the report. The dimensions that enjoyed the ''halo'' effect

included the freedom of the company from fraud. They recognized that the ''halo'' effect will not aid in the reduction of the expectation gap and suggested that the auditing profession address this issue in expanded reports to dampen expectations.

Lowe's (1994) study compared US auditor and judicial attitudes toward the auditing profession. It was found that an expectation gap existed between auditors and judges, with the latter group expecting more of the auditor. Epstein and Geiger (1994) surveyed a pool of US investors and found out that they held auditors to a higher level of assurance where almost half expected absolute, and not only reasonable, assurance that material misstatements were not present. They suggested that such a gap can be partially narrowed through educating the public about the role and inherent limitations of an audit.

Frank et al. (2001) and addition, found a large divergence in perceptions of US auditors and jurors pertaining to their expectations of the accounting profession. Koh and Woo (1998) suggested that prior research supported the existence of a substantial expectation gap in auditing. Their conclusion was interesting given the fact that they acknowledged that such a gap should be tackled through lowering public's expectations and raising auditor performance.

Furthermore, McEnroe and Martens (2001) have also uncovered an expectation gap between US auditors and investors on such items as responsibility for fraud detection and reporting. They suggested that education is the key to narrow the gap. Humphrey et al. (1992; 1993) established the existence of an expectation gap in the UK. The gap existed in several areas including the auditor's role in relation to fraud detection and the extent of the auditor responsibility to third parties. Low (1980) also revealed the existence of an expectation gap in Australia. It was found that auditors and non-auditors differed significantly in their perceptions pertaining to such things as fraud detection. Likewise, Porter (1993) established the existence of an expectation gap in New Zealand which could be attributed to deficient standards in addition to unreasonable expectations from auditors and sub-standard performance by them.

Another group of scholars, Gloeck and De Jager (1994) studied the expectation gap in the Republic of South Africa. Respondents were grouped into users, auditors, and ''financially knowledgeable persons, characteristics as the ''sophisticated users'' in Humphrey et al. (1993). The authors argued that ''financially knowledgeable persons'' in South

Africa seemed to be more sophisticated than their counterparts in the United Kingdom, particularly in understanding the contents of an auditor's report. However, there were also signs of the expectation gap regarding fraud and auditor's going-concern opinion.

Monroe and Woodliff (1994) also measured the effectiveness of the new form of audit report of the revised Australian AUP 3. In a survey amongst auditors, accountants, directors, creditors, shareholders and undergraduate students, respondents were given either the old or new (long) forms of audit reports (with variants of auditor's opinion ranging from unqualified to adverse) together with the questionnaire. Significant differences in expectations were found between the auditors and users with the old report, particularly in the issues of auditor's responsibilities, reliability of audited financial statements, and prospects of the audited entity, whilst in the new audit report, there was increase of the gap in areas pertaining to fraud detection and prevention.

Best et al. (2001) conducted an empirical study to provide evidence of the level and nature of the audit expectation gap in Singapore in the mid-1990's. The results of this study showed an expectation gap which was quite wide particularly in relation to the level of nature of auditor's responsibilities.

Fadzly and Ahmad (2004) conducted an empirical study to investigate the existence of an audit expectation gap in Malaysia. The results indicated wide expectation gaps and misconceptions about audit in Malaysia. Also, Lee et al. (2007) conducted a study to examine whether an expectation gap exists in Malaysia among the auditors, auditees and audit beneficiaries in relation to the auditors' duties and to analyze the nature of the gap using Porter's (1993) framework. It was found that the auditees and audit beneficiaries placed much higher expectations on the auditors' duties when compared with what auditors have perceived their duties to be. The analysis of the expectation gap indicated the existence of unreasonable expectations on the part of users; deficient standards of auditing in Malaysia; and deficient performance of auditors.

Similarly, Lin and Chen (2004) conducted a study to investigate the rise of expectation gap and related auditing issues under business and auditing environment in the People's Republic of China. It was found that the role and benefits of public accounting (independent auditing) had been positively recognized by Chinese audit beneficiaries and auditors, and there were increasing demands for expanding the applicability of public accounting. This study obtained substantial evidence on the emergence

of audit expectation gap in China, with respect to audit objectives, auditor's obligation to detect and report to fraud, auditor independence, and third party liability of auditors.

Another researcher, Hussain (2003) conducted a study to investigate the expectation gap in Oman. The results indicated the existence of the audit expectation gap. The study looks at education as a way of reducing this gap and proposes that discussion in the introductory accounting texts would reduce this gap. In like manner, Mohammad and Roszaini (2000) conducted a study to investigate on audit perceptions gap that exist in the Saudi environment. The methodology used in the study is a combination of mail questionnaires and semi-structured interviews. It was found that there were two factors viz. ideology and legal structure in the Saudi environment significantly affect audit perceptions gap.

Still in line with expectations gap, Sidani (2007) conducted a study to assess the possible existence of an expectation gap between accountants and non-accountants in Lebanon. It was found that there is a gap between the auditors' understanding of their profession compared with the perceptions of others. There is a significant difference in perceptions of the role of the auditor in respect of fraud detection. Neither group had a strong image of the Lebanon profession compared with worldwide audit practices or with the technical qualifications of the auditors.

Dixon and Woodhead (2006) conducted a study to investigate the existence of an audit expectation gap between auditors and financial statement users in Egypt. It was found that there is an evidence of a wide audit expectation gap in Egypt in the areas of auditor responsibilities for fraud prevention, maintenance of accounting records, and auditor judgment in the selection of audit procedures. An expectation gap was found concerning the reliability of audit and audited financial statements, and the usefulness of audit.

Mechanisms Implemented to Narrow or Eliminate the Audit Expectation Gap

According to Sikka et al. (2003), the nature of the components of the expectations gap makes it difficult to eliminate the audit expectation gap. Perceived performance of auditors is an element which is difficult to measure and changes constantly. It is however possible to substantially reduce but not to totally eliminate it (Marianne, 2006). A number of suggestions have been put forward as a means of narrowing the expectations gap as follows:

Expanded Audit Report

Several studies have investigated the messages communicated by audit reports and the public expectations of auditors. These studies are based mostly in the USA, UK and Australia. In the USA, Nair and Rittenberg (1987) concluded that user's perception about the relative responsibilities of management and auditors are changed with an expanded audit report. Kelly and Mohrweis (1989) also found that users' perceptions of the nature of an audit were significantly changed by wording modifications in audit reports. Miller et al. (1990) reported that bankers found expanded audit reports to be more useful and understandable than the short form reports. In general, these studies provided evidence that an expanded audit report gives a fuller understanding of the scope, nature and significance of the audit and influences the reader's perceptions concerning the audit and the auditor's role. That is, an expanded audit report has reduced the audit expectation gap in one way or another.

In the UK, Holt and Moizer (1990) found that accountants and sophisticated users differ in their perceptions of the meaning of audit reports. In a slightly different context, changing the wording of the auditor's report resulted in different perceptions of the meaning of audit reports for 140 part-time MBA students. In Hartherly et al.'s (1991, 1992) studies, however, the perceptions of management's and auditors' responsibilities were not significantly influenced by the modified wording. Hanks (1992) expressed concern about the level of assurance that investors may assume from the financial reports. He suggested that the audit report should be expanded to convey more specifically what an audit entails and implies. Also the public should be educated on the meaning of the audit report and the scope of work required to express an opinion.

In Australia, Gay and Schelluch (1993) found that audit reports based on the revised Statement of Auditing Practice AUP 3 has significantly increased users' understanding of the audit process, the auditor's role, the nature and limitations of financial reports and, to a lesser extent, the directors' responsibility for material errors and the basis of forming an audit opinion. Monroe and Woodliff (1994) also studied the impact of the wording changes in the revised AUP 3 on the expectation gap. Their findings confirm the existence of an expectation gap between auditors and various user groups under the old report. However, the modified wording in the revised AUP 3 has a significant impact on the beliefs about the nature of an audit and the auditors' and management's

responsibilities. The researchers suggested that wording changes in the audit report that address the specific areas of the expectation gap should be considered in closing the gap.

Structured Audit Methodologies

Increased use of auditor decision aids is one of the responses made by some audit firms to narrow the expectation gap with the hope of eventual reduction in the legal liability of auditors. By adopting more structured methods of operation, these firms hope that consistently high-quality audits can be rendered.

Purvis (1987) looked into the effectiveness of using structured and semi-structured methods of data collection and concluded that the imposition of structure can have functional and dysfunctional aspects. Likewise, Boritz et al, (1987) also concluded that structured audit methodologies do not lead to greater intra firm consensus. Jennings et al. (1993) empirically addressed the legal impact of the increased use of audit decision aids and structured audit approaches in the audit environment. Findings revealed that decision aids are used as surrogate standards of the auditors by jurists. That is, jurists do accept and use audit decision aids as a method to increase or at least maintain auditing standards.

Expansion of Auditor's Responsibilities and Enhancement of Auditor Independence

Humphrey et al. (1993) also suggested other ways to close the expectation gap. They stated that it is no good expecting the public to abandon their hope of auditors as fraud detectives through education, or modifying the length of the audit report, or pretending that highly publicized audit failures are exceptions. Instead, they offered three suggestions: setting up an independent office for auditing to enhance auditor independence by overseeing the appointment of auditors of large companies and to regulate audit fees; extending auditors' responsibilities by statute so that they clearly include responsibilities to shareholders, creditors and potential shareholders; and clarifying that auditors have a duty to detect fraud. However, the magnitude of the expectation gap and the costs and benefits of these suggested solutions need to be carefully assessed before any solution is implemented.

O'Malley (1993) also agreed to imposing additional responsibilities on auditors, especially with regard to detecting fraud. He proposed four additional responsibilities which the profession might consider:

management and auditor evaluation of internal control systems; compliance reporting; direct reporting by auditors to regulators; and auditor's association with interim financial information. However, he stated that these proposals will increase the threat of liability unless the liability crisis is dealt with. Any expansion of auditors responsibilities will not be feasible as long as the liability system operates as a risk transfer mechanism, with auditors as the prime transferees. Lochner (1993) also believed that it is not fair to expect auditors to assume more responsibilities without sufficient insurance provided to them against possible litigation.

Knutson (1994) proposed a standard for addressing the expectation gap. His opinion is that the fairest standard is to hold auditors responsible for what they should have known, and not to the impossibly high standard of what they could have known. Furthermore, the reliance of the audit report should not be restricted only to the board of directors and shareholders but to potential shareholders as well. Similarly, Rabinowitz (1996) noted a few deficiencies in the audit process which have resulted in the reduction of public confidence in the profession. The solutions to compensate for these deficiencies are: enhancing the control structures surrounding top managers and executives; matching auditors in terms of experience and training to the entities being audited; increasing internal-external audit interaction; revising employment practices; developing more effective audit procedures; and strengthening audit committees.

In a research study on financial reporting and auditing undertaken jointly by the Australian Society of Certified Practising Accountants and The Institute of Chartered Accountants in Australia in 1994, the working party reviewed the recommendations of previous studies in other countries and came up with some solutions to close the expectation gap. These include the following: the management of reporting entities should be required to report on the effectiveness of its internal control over financial reporting and auditors should report on this assertion; a review partner should be appointed for the audit of all reporting entities and he/she should countersign the audit report; and all reporting entities should be required to produce audited half-yearly and quarterly financial reports.

Establishing Standards for Materiality among Auditors

The survey's conclusions appear to indicate the need for standards, at least for auditors, in order to ensure a degree of uniformity. In order

to establish common standards for auditors, a Committee for Auditing Standards should be appointed by the Association of State Authorized Public Accountants in Denmark (FSR) to draw up common guidelines.

Every financial statement is unique and individual in the sense that it sends its own signals about a concrete firm. The form is (or can be) the same for most firms, but information that is very relevant and material in one financial statement can be relevant but immaterial in another, while in a third both irrelevant and immaterial. The information which the user of a financial statement seeks about one firm can therefore be very different from what is sought about another firm. As a result of this difference, the materiality levels users employ can be related to different items in different financial statements, just as absolute items are assigned different weights. Thus, even an infinite number of rules for assessing materiality would not be able to take account of all situations.

These provisional guidelines should therefore be made more concrete by supplementing them with examples (from surveys, for example) of how the frameworks for materiality levels can be established in different concrete situations and in different concrete companies. These examples will not be able to cover all situations, of course, but they can help determine some normative levels.

There have been dialogues with primary users of financial statements about standards for materiality in financial statements. The guidelines drawn up by auditors should then be discussed in structured dialogues with the primary user groups. A starting point for this can be FSR's Committee for Auditing Standards in Denmark, with representatives from the primary user groups and public authorities. Such a committee or panel should, of course, fully inform all parties about its work, and hold hearings, seminars, etc. with contributions from different sides. The aim of this is to include as many informed views as possible. The task of the committee will be, on the basis of the provisional guidelines proposed by the auditors, to draw up "the standards" that can win the most support. In view of the results, in order to achieve such a consensus, or even to achieve acceptance, several of the groups will ''shift" their position first.

The dialogues should result in a description of those guidelines on which agreement has been reached in the form of a discussion paper with examples, and later in the form of a statement on auditing standards. This approach will ensure that the criteria in the statement on auditing standards conform to the expectations/demands of the primary user groups.

Disclosure of Materiality Levels in the 66 Engagement Letter

After a degree of consensus has been reached between auditors and the primary user groups, the auditor should be required to disclose, and give reasons for his materiality levels in the engagement letter to the board. In other words, the materiality levels can be included as part of the agreement between firm and auditor. This can be done in the form of a statement on auditing standards.

Apart from the engagement letter, the information can also be used in connection with making an offer for the audit, of course. In this way, the board will get factual information about the precision of the auditor's work, and ''unrealistic'' expectations among board members can be adjusted. The dialogues this information can give rise to will probably mean that the provisional guidelines will have to be adjusted, and thus be made permanent at a later date.

Disclosure of Materiality Levels in the Audit Report

Once the auditor's materiality levels are known to the board and after the dialogues with primary user groups are done, there is a general guideline setting out which criteria the materiality levels should be based on, a logical next step would be for the auditor to also inform users of financial statements in his report which specific materiality levels he has used.

Since the firm discloses the principles on which a concrete financial statement has been drawn up, it only seems reasonable for the auditor to disclose the principles his audit is based on. As far as accounting principles are concerned, the firm can, within the limits of the law, choose those practices it regards as being best suited to its needs. Users can then base their views of the financial statement on the published accounting practice. Similarly, users can consider audit precision on the basis of information about the audit, including the materiality levels used, in the auditor's report.

The advantage for the auditor is that he can no longer be held responsible for an unknown error under his own materiality level, since everybody now knows the level, even though some may disagree with it. There is still a risk of unknown material errors (the audit risk) in the financial statement, of course. In the USA, Fisher (1990) has studied the effect of whether or not auditors disclose their materiality levels

in an experimental market setting. She concludes that information on materiality levels is relevant to share dealers, and that it results in a more efficient market. The requirement of information about materiality levels in the auditor's report can be incorporated into audit report regulations and in auditing standards on the auditor's report, so that, to start with, it is made voluntary by the regulation first coming into effect after, say, three years. This should rule out misunderstandings, though there can still be disagreement about the size of the materiality level. The - not inconsiderable - difference is, however, that the disagreement is now ''out in the open , which means that it can be discussed and taken into consideration, whether at the annual general meeting or through interested parties' direct enquiries to the firm.

> If the materiality levels are disclosed in the auditor's report, the importance of the guidelines will probably be somewhat reduced because they are general and the information in the report is specific. And if users know the actual levels, they can be assumed to be not greatly interested in knowing how the auditor has arrived at them.

One consequence of disclosing the materiality levels in the auditor's report, of course, will be that there must be no doubt that all known errors have been corrected. If they have not been corrected, the user will have doubts about whether the financial statements actually contain known errors near the materiality level. This uncertainty can be eliminated by a legal requirement for all known errors to be corrected, and, if necessary, that the firm should positively state that this has been done.

If this suggestion is not adopted, the uncertainty must be eliminated in another way. For example, by the auditor stating in his report, after the disclosure of the materiality level, that all known errors, apart from petty errors, have been corrected. The purpose of the above-mentioned proposals is, of course, to help establish a greater degree of consensus between society's expectations (including users of financial statements) of auditors and its opinion of auditors' performance on the one hand, and the concept of generally accepted auditing standards, as laid down in the current statement of auditing standards, on the other. This can be achieved by attitudes on both sides being influenced. For example, the dialogues can result in the elimination of unreasonable expectations of auditors, including those that are too costly to fulfill.

The dialogues can also help reconcile generally accepted auditing standards (and thus auditors' performance) with users' expectations by

means of guidelines in the area. Or reduce, and perhaps eliminate, the expectation gap, since, in principle, expectation gaps should not result from inadequate/out-of-date guidelines, but solely from isolated cases of inadequate work. A study carried out in New Zealand by Porter (1993) shows that 34 percent of the reasons for the expectation gap between auditors and society, including users of financial statements, were due to unreasonable expectations of the auditors, __% percent to inadequate guidelines, and only 16 percent to inadequate work from the auditors.

According to these results, dialogues and standards could help reduce a huge 84 percent of the expectation gap (in New Zealand), which is quite remarkable. And there is no reason to think that things are different in the rest of the world.

The aim and goal of these proposals has been to eliminate, or at least reduce, the general - or abstract and often not understandable - content of materiality, and instead relate materiality assessments and levels to something concrete in the financial statement, to the benefit of both auditors and users of financial statements.

Reducing the Expectation Gap by Way of Limiting Liability Language in Engagement Letters

Engagement letters are tools that are used to manage client's expectations. One of its fundamental benefits is that it clearly defines the scope of the job and has the mutual agreement of the accountants and the clients. Engagement letters are able to close the expectation gap concerning who is responsible and who will pay in liability settlements. Camico Mutual Insurance Company recommends the use of limiting liability language in engagement letters where the risk-versus-reward scale is not appropriately balanced. Limiting liability language is recommended on jobs in which the risk is high compared to the reward. For example, Y2K consulting obviously was a situation that needed the use of such language. The types of engagements appear more often today as accountants take up more assignments involving high technology and investment advising, in which the risks are less predictable than in more traditional services. One Camico member recently evaluated a client's entire accounting system, in which he would purchase, install, and test new accounting software. He was worried about the likelihood for liability problems if the new system developed major glitches, so he included the following limiting liability language in the engagement letter.

As we discussed, our essential fees in this engagement are very small compared to the amount of business that will be processed by your new accounting system. Accordingly, our liability to you in the event of any defects in the system will be limited to the lesser of our fees for this engagement, or the cost to repair any defects in the accounting system that we may have caused.

This language shows a number of key characteristics of effective limiting liability language. First, it is short and unintimidating enough to not provoke a client's reservations about lengthy or ''tricky'' legalese. Second, it clearly states the area of concern (in this case the new accounting software system). Third, it provides a detailed explanation of the accountant's liability if there are major problems with the system. Finally, it recognizes that problems could be caused by the accounting firm. Such language is more likely to be accepted in court than other form of disclaimers that seek to avoid responsibility in areas where the accountant is actually negligent.

Despite its value, there are disadvantages to the use of limiting liability language. It does not limit liability to any third parties in a lawsuit and it is not enforceable in every court. In addition, some clients might be offended, which may lead to loss of business. However, Camico believes that, particularly in high risk/lower reward jobs, the advantages of limiting liability language far offset the disadvantages. Advantages can be seen during the assessment stage, by encouraging the accountant to assess risks versus rewards, an essentially valuable exercise. Additionally, discussions and negotiations with the client contribute to an environment of open communication from the start. The communication process can also help identify future clients that are totally nonflexible in sharing liability risks. This type of client one may be better off without. Most notably, limiting liability language can be an important reference point in settlement negotiations.

As to whether such language will have any grounds in court, this will vary from state to state and court to court. Currently, such decisions are being made on a case-by-case basis. On the other hand, the simple act of communicating with the prospective client and coming to a mutual agreement that is formally documented is a positive step toward limiting liability. In short, a few short, clearly written sentences that state the risk, describe the appropriate liability, and acknowledge responsibility for potential negligence may significantly reduce settlement fees.

Reduction of Expectation Gap through Unqualified Opinion Expressed by Auditors

To reduce the expectation gap, the auditors have to exercise reasonable skill, care and maintain their professional independence in issuing unqualified opinion regarding true and fair view of a client's financial statement. This is to ensure that the auditors do not provide any misleading information that will provide a false perception to the public. An auditor should not issue an unqualified opinion unless the best judgment is that the financial statements are free of misstatements resulting from management fraud.

In the Malaysia context, MIA By-Law A-2 Integrity and Objectivity states that all members of the accounting profession have to be fair, intellectually honest and free of conflicts of interest. In fact, the MIA By-Law even specifically states that members shall be fair in their approach to their professional work and shall not allow any prejudice, bias or influences of others to override their objectivity. Thus, if the auditors are unable to maintain their professional independence in carrying out their audit work, an unqualified opinion on the client's financial position should not be issued. Otherwise the audit report will not be based on the true judgment of the financial position of the client. In the public practice, members may in the course of their professional work, be exposed to situations which involve the possibility of pressures being exerted on them. These pressures may impair their objectivity. Hence, members shall identify and assess such situations and ensure that they uphold the principles of integrity and objectivity in their professional work at all times. Members shall neither accept nor offer gifts or entertainment which might reasonably be believed to have a significant and improper influence on their professional judgment or those with whom they deal, and shall avoid circumstances which would bring their professional standing or the institute into disrepute.

A member in public practice shall be, and be seen to be, free in each professional assignment he undertakes, of any interest which might detract from objectivity. The fact that this is self-evident in the exercise of the reporting function must not obscure its relevance in respect of other professional work. Although a member not in public practice may be unable to be, or be seen to be, free of any interest which might conflict with a proper approach to his professional work, this does not diminish his duty of integrity and objectivity in relation to that work. The auditor should resign from performing that audit task and may advise the client to hire others who are competent to perform the work (Audit Commission,

www.cipfa.org). If the client is involved in any criminal activities which might threaten the safety of the public, MIA By-Law A-5- Confidentiality states that the auditor has the legal right or duty to disclose such fact in the qualified opinion expressed in the audit report to warn the public of such incidence.

Creating an Independent Agency to Oversee Audit Regulation

The government could play an important role in reducing the expectation gap by creating an independent agency to oversee the audit regulation. To investigate stakeholder perceptions of the structure and function of such an agency, three models were developed: an Auditing Council; a Commission for Audit; and a Securities and Exchange Commission (SEC). Auditing Council would be a private body analogous to the Financial Reporting Council. Commission for Audit would be a public sector body analogous to the Audit Commission for local and health authorities in England and Wales. A SEC would be a public sector body with overall responsibility for City regulation, including that of listed company audit.

An Auditing Council received the most support, a Commission for Audit the least, with a UK SEC provoking the strongest reactions both for and against. Currently, arguments in favour of increased regulation were generally framed in terms of increased openness that would ''materially enhance the credibility of audits''; arguments against expressed fears that it would be 11 cumbersome'' and add a ''ftirther tier of bureaucracy'' Overall, there was a significant degree of support to make the case for establishing an independent regulatory body.

The structure of the independent body should match the expectation gap's main components as revealed by the study: independence, monitoring and discipline. Such a body might be called a Listed Companies Audit Board (LACB), structured into three panels of responsibility: an auditor independence panel; an audit quality panel; and a disciplinary panel. An auditor independence panel's role would be to set up to monitor independence standards and guidelines, for example by restricting non-audit services in whole or in part, or by setting up procedures formally to authorized provision of non-audit services. It can be argued that providing audit services should be remunerative in itself and not conditional, or perceived as conditional, on the auditor providing non-audit services.

The role of an audit quality panel would be to set up and maintain a register of auditors whom the panel recognized as capable of undertaking listed company work, and to monitor the quality of audit work done. A

possible consequence of such a licensing procedure is that it might lead to increased competition for listed company audits. These are increasingly dominated by the Big Four firms, partly because of the reputation effect. External validation procedures might allow other firms to join the register and compete against the Big Four, especially for the audit of middle or lower-ranking listed companies, where the importance of global reach is less significant. Failure to observe standards of auditor independence and quality, and ignoring guidelines, would result in referral to a disciplinary panel. Sanctions against a firm, a firm's office or a partner might include ''naming and shaming'', fines, or removal from the register of listed company auditors.

Going Concern Reporting Developments for Standard Setters

According to Monroe and Woodliff (1994) they have formally defined the expectations gap as the difference between the beliefs of auditors and the public about the duties and responsibilities assumed by the auditor, and the message conveyed by the audit report. One key purpose of financial statements is to foster the optimal allocation of investing capital between competing uses by providing all material, relevant information to the user community. The purpose of the audit report is to reveal the auditor's success in verifying the financial statement assertions. Thus, it is dismaying to find differences between the auditors' definition of their responsibilities and that of the user community. Accordingly, the expectations gap has prompted many questions about audit quality in general and, in particular, the auditor's ability to make judgments in the presence of going concern uncertainties. This gap has led to the issuance of new standards in many countries. For example, in the USA, Statement of Auditing Standards (SAS) No. 59 entitled ''Auditors' consideration of an entity's ability to continue as a going concern'' (AICPA, 1989) was issued to help reduce the expectations gap. The Australian Auditing Standards Board issued AUS 708, entitled ''Going concern'' (AASB, 1996). The UK issued SAS 130 entitled ''Going concern'', to accomplish similar objectives (APB 1996).

Financial statement users have stated that the type of report issued is an important element in their investing and credit-granting decisions (AICPA, 1982). Therefore, inaccurate reporting can result in suboptimal investment and credit decisions. The resulting misallocation of capital slows economic and productivity growth. This situation arose because, initially, auditors were not required to search for indicators of going concern problems. Financial statement users, on the other hand, expected auditors to search for and report on uncertainties that could threaten

that company's ability to survive. The US Auditing Standards Board's (ASB) deliberations led to the issuance of SAS No. 58, which addressed all uncertainties, and SAS No. 59, which had particular reference to going concern uncertainties. A major purpose of these standards was to enhance the auditors' reporting responsibilities in order to remedy the financial statement users' complaints.

In the USA, the goal of Auditing Standard Board (ASB) was to reduce the expectations gap in audit reports on uncertainties. Most studies indicate that investors do depend on audit reports to highlight significant uncertainties. Nevertheless, published research indicates that many companies receive clean reports prior to filing for bankruptcy. Users have frequently asked the question, ''If an audit report cannot provide an early warning signal of impending business failure, what good is it?'' (Carmichael & Pany, 1993). From the financial statement's users' perspective, the new form of going concern report should send a clear and unambiguous signal to them. But from the perspective of auditors, with the new standard, they are more likely to modify reports for distressed companies in accordance with users' expectations (Carmichael and Pany, 1993).

The auditor should be required to evaluate whether there is ''substantial doubt'' about the client's ability to continue as a going concern in every audit. They are asked to obey the following:

- Detection. The auditor now has an obligation to make an assessment at the conclusion of the audit of the client's ability to continue as a going concern.
- Time period. The focus of the auditor's assessment of the client's ability to continue as a going concern is now tied to a ''reasonable'' time period of one year.
- Evaluation. Previously, the decision to modify the audit report hinged on recoverability of the assets, and recognition and classification of liabilities. Now going concern status is a separate issue.
- Reporting. The ''subject to'' qualification should be supplanted by an explanatory paragraph for all material uncertainties including going concern uncertainties. The major objectives of the new standards were to improve communication to financial statement users, and to ensure that auditors made an affirmative effort to evaluate and report on each client's going concern status. This will not only lead to addressing the issue of auditor reputation and credibility, but it also ensures useful, clear and unambiguous financial statements to the user community.

The Effect of Education on Reducing the Expectation Gap Concerning Perceptions of Messages Conveyed by Audit and Review Reports

The audit expectation gap has been described by Humphrey et al. (1992) as the gap between the public's perception of the role of the audit and the auditor's perception of that role. Expectation gap still continues to persist, only with respect to naive users, but also with respect to sophisticated users of general purpose financial reports. Thus, efforts must be doubled by the profession in its attempt to narrow the expectation gap. According to the Middleton Report, it recognized that education is vital to help contain the expectation gap. This view is supported by Jenkins (1990) who indicated that the profession needs a continuing, imaginative program of explaining the inherent limitations in accounting, reporting and auditing to the users of accounts. Smithers (1992) stated that he believes that an education process would have to form a major part of any campaign aimed at closing the expectation gap. Monroe and Woodliff (1994) found that auditing students' beliefs about auditors' responsibilities, the reliability of audited financial information and future prospects changed significantly over the semester. They concluded that education is an effective approach to address the expectation gap. Ferguson et al. (2000) found that Canadian co-operative students had pre-scores on an expectation gap instrument that are closer to practicing auditors relative to the pre-scores of Australian non-co-operative students, which they attributed to experience. There were significant differences between auditors and students who had not completed an auditing course, about auditors' responsibilities, the reliability of audited financial information and the decision usefulness of audited or reviewed financial statements. After completing their course, the auditing students believed auditors assumed less responsibility for soundness of internal control, maintaining accounting records, preventing fraud and detecting fraud; management assumed more responsibility for producing financial statements; the auditor/ reviewer was more independent; and the auditor/reviewer exercised more judgment in the selection of procedures, than they did at the beginning of the course. These changes were in the direction of auditors' beliefs indicating a significant reduction in expectation gap in responsibilities.

After finishing the auditing course, students believed to a greater extent that the auditor agreed with the accounting policies and to a lesser extent that the entity was free from fraud. These changes were in the direction of auditors' beliefs indicating a significant reduction in the expectation gap in relation to the reliability of audited or reviewed financial statements. However, the auditors still had a significantly stronger belief that the audited financial statements give a true and fair view and believed a

significantly higher level of assurance was provided by the audit. All groups believed that an audit provided a higher level of assurance that there were no material errors than a review.

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

The results indicate that education may be an effective way to reduce the expectation gap. Bailey et al. (1983) did a study in the USA, and found that more knowledgeable users placed less responsibility on auditors than less knowledgeable users, implying that a larger gap exists between auditors and less sophisticated users. Similarly, Epstein and Geiger (1994) found that more educated investors (with respect to accounting, finance and investment analysis knowledge) are less likely to demand higher auditor assurance. Hence, they proposed that one way to narrow the expectation gap is through increased public awareness of the nature and limitations of an audit. And to increase users' knowledge and awareness it is important to communicate the merits and limitations of an audit at every available chance (e.g. shareholder meetings). Another way is to have the audit report explicitly indicating reasonable assurance. But Epstein and Geiger (1994) noted that the fundamental role of an audit in society must be re-examined by both the audit profession and financial users and they must all agree to close the gap.

However, several differences in expectations still existed. It must be remembered that it may not be practical to expect all parties to the expectation gap to undertake the equivalent of an undergraduate auditing course. However, it emphasizes the importance of the accounting bodies retaining auditing as a prescribed subject for accreditation purposes for undergraduate tertiary degrees, to help ensure that members of the accounting profession do not have misconceptions about the audit function.

Conclusion

To conclude, researchers and the accounting profession have responded in different ways to the expectation gap. However, it must be noted that the expectation gap arises from a combination of excessive expectations

and insufficient performance. Steps must be taken to lower the public's expectations as well as to improve the auditors' performance. Misconceptions and differences in expectations will persist unless effective and timely solutions are implemented. As it exists, it is likely that the audit expectation gap will continue to be a major concern for many more years to come.

References

Accounting Practices Board. (1984). American Institute of Certified Public Accountants, Major Issues for the CPA Profession and the AICPA, American Institute of Certified Public Accountants, New York, NY.

American Institute of Certified Public Accountants (AICPA) . (1978). Commission on Auditors, Responsibilities Report: Conclusions and Recommendations, AICPA, New York, NY.

Almer, E., & Brody, R. (2002). An empirical investigation of context-dependent communications between auditors and bankers. *Managerial Auditing Journal*, 17(8), 478-486.

American Institute of Certified Public Accountants (AICPA). (1992). Statement of position regarding mandatory rotation audit firms of publicly held companies. SEC Practice Section, Division for CPA Firms.

American Institute of Certified Public Accountants.(1978). Cohen Commission: Commission on Auditors' Responsibilities. Report, Conclusions and Recommendations. New York, AICPA.

Anderson, J., Jennings, M., Kaplan, S., & Reckers, P. (1995). The effect of using diagnostic decision aids for analytical procedures on judges' liability judgments. *Journal of Accounting and Public Policy, 14*(1), 33-62.

Bailey III, K., Bylinski, J., & Shields, M. (1983). Effects of audit report wording changes on the perceived message. *Journal of Accounting Research, 21*(2), 355-370.

Bailey III, K., Bylinski, J., & Shields, M. (1983). Effects of audit report wording changes on the perceived message. *Journal of Accounting Research*, *21*(2), 355-370.

Beck, G.W. (1974). Pubic Accountants in Australia – Their Social Role, Australian Accounting Research Foundation, Melbourne.

Best, P., Buckby, S., & Tan, C. (2001). Evidence of the audit expectation gap in Singapore. *Managerial Auditing Journal, 16*(3), 134-144.

Boritz, J., Gaber, B., & Lemon, W. (1987). *An experimental study of review of preliminary audit strategy by external auditors*: Canadian Academic Accounting Association, Toronto.

Cameron, A. (1993). Do chartered accountants live up to small business expectations? *Accountants' Journal, 72*, 76-78.

Chandler, R., & Edwards, J. (1993). Changing perceptions of the role of the company auditor, 1840-1940. *Accounting and Business Research, 23*(92), 443.

Dixon, R., Woodhead, A., & Sohliman, M. (2006). An investigation of the expectation gap in Egypt. *Managerial Auditing Journal, 21*(3), 293-302.

Dopuch, N., & King, R. (1992). Negligence versus strict liability regimes in auditing: An experimental investigation. *Accounting Review*, 97-120.

Epstein, M., & Geiger, M. (1994). Investor Views of Audit Assurance: Recent Evidence of the Expectation Gap. *Journal of Accountancy, 177*(1), 60-65.

Fadzly, M., & Ahmad, Z. (2004). Audit expectation gap. *Managerial Auditing Journal, 19*(7), 897-915.

Frank, K., Lowe, D., & Smith, J. (2001). The expectation gap: perceptual differences between auditors, jurors and students. *Managerial Auditing Journal, 16*(3), 145-150.

Gay, G., & Schelluch, P. (1993). The impact of the longform audit report on users' perceptions of the auditor's role. *The Australian Accounting Review, 3*(2), 1-11.

Gloeck, J., & Jager, H. (1993). The audit expectation gap in the Republic of South Africa. *School of Accountancy, University of Pretoria, Pretoria, working paper*.

Gramling, A., Schatzberg, J., & Wallace, W. (1996). The Role of Undergraduate Auditing Coursework Reducing the Expectations Gap. *Issues in Accounting Education, 11*, 131-162.

Guy, D., & Sullivan, J. (1988). The expectation gap auditing standards. *Journal of Accountancy, 165*(4), 36-46.

Hatherly, D., Innes, J., & Brown, T. (1991). The expanded audit report–an empirical investigation. *Accounting and Business Research, 21*(84), 311-319.

Holt, G., & Moizer, P. (1990). The meaning of audit reports. *Accounting and Business Research, 20*(78), 111-121.

Hubbert, A., Sehorn, A., & Brown, S. (1995). Service expectations: the consumer versus the provider. *International Journal of Service Industry Management, 6*(1), 6-21.

Hudaib, M., & Haniffa, R. Audit Perceptions Gap: Some Evidence From Saudi Arabia. Department of Accounting and Financial Management, University of Essex.

Humphrey, C. (1997). *Debating Audit Expectations*, Chapter 2 in Sherer, M. and Turley, S. (Eds), Current Issues in Auditing, 3rd ed., Paul Chapman, London.

Humphrey, C., Moizer, P., & Turley, S. (1992). *The audit expectations gap in the United Kingdom*: The Research Board, The Institute of Chartered Accountants in England and Wales, London.

Humphrey, C., Moizer, P., & Turley, S. (1992). *The audit expectations gap in the United Kingdom*: The Research Board, The Institute of Chartered Accountants in England and Wales, London.

Humphrey, C., Moizer, P., & Turley, S. (1992). The audit expectations gap in Britain An empirical investigation.

Kelly, A., & Mohrweis, L. (1989). Bankers' and investors' perceptions of the auditor's role in financial statement reporting: the impact of SAS No. 58. *Auditing: a journal of practice and theory, 9*(1), 87-97.

Knutson, P. (1994). " In the Public Interest"-Is It Enough? *CPA JOURNAL, 64*, 32-32.

Koh, H., & Woo, E. (1998). The expectation gap in auditing. *Managerial Auditing Journal, 13*(3), 147-154.

Lee, T. (1970). The nature of auditing and its objectives. *Accountancy, April*, 292-296.

Lee, T., Gloeck, J., & Palaniappan, A. (2007). The audit expectation gap: an empirical study in Malaysia. *Southern African Journal of Accountability and Auditing Research, 7*, 1-15.

Libby, R. (1979). Bankers' and auditors' perceptions of the message communicated by the audit report. *Journal of Accounting Research, 17*(1), 99-122.

Liggio, C. (1974). The Expectation Gap: The Accountant's Legal Waterloo. *Journal of Contemporary Business, 3*(3), 27-44.

Lin, Z., & Chen, F. (2004). An Empirical Study of Audit'Expectation Gap' in The People's Republic of China. *International Journal of Auditing, 8*(2), 93-115.

Lochner, P. (1993). Accountants' legal liability: A crisis that must be addressed. *Accounting Horizons, 7*, 92-92.

Low, A. (1980). The auditor's detection responsibility: is there an "expectation gap?". *Journal of Accountancy, 150*, 65-70.

Low, A., Foo, S., & Koh, H. (1988). The expectation gap between financial analysts and auditors–some empirical evidence. *Singapore Accountant, 4*, 10-13.

Lowe, D. (1994). The expectation gap in the legal system: perception differences between auditors and judges. *Journal of Applied Business Research, 10*, 39-39.

Maccarrone, E. (1993). Using the expectation gap to close the legal gap. *CPA JOURNAL, 63*, 10-16.

McEnroe, J., & Martens, S. (2001). Auditors' and Investors' Perceptions of the" Expectation Gap". *Accounting Horizons, 15*(4), 345-359.

McEnroe, J., & Martens, S. (2001). Auditors' and Investors' Perceptions of the" Expectation Gap". *Accounting Horizons, 15*(4), 345-359.

McEnroe, J., & Martens, S. (2001). Auditors' and Investors' Perceptions of the" Expectation Gap". *Accounting Horizons, 15*(4), 345-359.

McInnes, W. (1994). The audit expectation gap in the Republic of South Africa. *Accounting and Business Research, 24*, 282-283.

Monroe, G., & Woodliff, D. (1993). The effect of education on the audit expectation gap. *Accounting And Finance-Sydney-, 33*, 61-61.

Monroe, G., & Woodliff, D. (1994). An empirical investigation of the audit expectation gap: Australian evidence. *Accounting And Finance-Sydney-, 34*, 47-47.

Nair, R., & Rittenberg, L. (1987). Messages perceived from audit, review, and compilation reports: extension to more diverse groups. *Auditing: a journal of practice and theory, 7*(1), 15-38.

Ojasalo, J. (2001). Managing customer expectations in professional services. *Managing Service Quality, 11*(3), 200-212.

Ojo, M. (2006). Eliminating the Audit Expectations Gap: Myth or Reality? *MPRA Paper*, No. 232, Posted 07. 2007. UK

O'Malley, S. (1993). Legal liability is having a chilling effect on the auditor's role. *Accounting Horizons, 7*, 82-82.

Pierce, B., & Kilcommins, M. (1996). The audit expectations gap: the role of auditing education: Dublin City University Business School Research Papers 1995-1996 No 13.

Porter, B. (1991). Narrowing the Audit Expectations–Performance Gap. *A Contemporary Approach, Pacific Accounting Review. June, 3*(1), 1-36.

Porter, B. (1993). An empirical study of the audit expectation-performance gap. *Accounting and Business Research*, 23(93), 49.

Porter, B. (1993). An empirical study of the audit expectation-performance gap. *Accounting and Business Research, 23*(93), 49.

Purvis, C. (1987). The impact of documentation format on auditors' preliminary evaluation of internal accounting control. *Working Paper, Centre of Accounting Research, University of Southern California.*

Rabinowitz, A. (1996). Rebuilding public confidence in auditors and organizational controls. *CPA Journal, 66*, 30-35.

Schelluch, P. (1996). Long-form audit report massages: further implications for the audit expectation gap. *Accounting Research Journal*, Vol. 9 No. 1, 48-55

Shaikh, J., & Talha, M. (2003). Credibility and expectation gap in reporting on uncertainties. *Managerial Auditing Journal, 18*(6/7), 517-529.

Sidani, Y. (2007). The audit expectation gap: evidence from Lebanon. *Managerial Auditing Journal, 22*(3), 288-302.

Sikka, P., Puxty, A., Willmott, H., & Cooper, C. (1998). The impossibility of eliminating the expectations gap: some theory and evidence. *Critical Perspectives on Accounting, 9*(3), 299-330.

Sikka, P., Puxty, A., Willmott, H., & Cooper, C. (1998). The impossibility of eliminating the expectations gap: some theory and evidence. *Critical Perspectives on Accounting, 9*(3), 299-330.

Tricker, R. (1982). Corporate accountability and the role of the audit function. *Auditing Research: Issues and Opportunities,* Pitman Books, London.