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# **The Nature of the Audit Expectation Gap, its Existence in the Irish Context and the Views of the Irish Accountancy Profession on Bridging the Gap**

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**ABSTRACT**

In recent times, the auditing profession around the world has been involuntarily placed in the spotlight, mainly because of the spectacular corporate collapses of seemingly successful companies and the subsequent implication of the reporting auditors. This 'widespread criticism of, and litigation against, auditors indicates that there is a gap between society's expectations of auditors and auditors' performance, as perceived by society' (Porter, 1993).

The purpose of this dissertation is to examine the nature of the audit expectation gap, to investigate the existence of the audit expectation gap in the Irish context and to determine the views of Irish practitioners on ways of bridging the expectation gap. The Commission of Inquiry into the Expectations of Users of Financial Statements (1992) examined the existence of the expectation gap in Ireland during the early 1990's. However, there appears to be a lack of evidence of the extent of the audit expectation gap currently in existence in the Irish context. This dissertation aims to address this issue and to determine the most appropriate methods of narrowing the gap.

The findings of this study indicate that an audit expectation gap exists, particularly with regard to the following issues: fraud detection and prevention, responsibility for internal controls, responsibility for the maintenance of accounting records, the auditors use of judgement regarding the selection of audit procedures and the level of assurance given by the audit report. The findings also reveal that the Irish accountancy profession are aware that an audit expectation gap exists. The interviewees clearly believed that the most effective method of reducing the audit expectation gap would be the education of both shareholders and company directors with regard to the limitations of the audit process as well as the roles and responsibilities of both the auditors and company directors.

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## LIST OF ABBREVIATIONS

ACCA	Association of Certified Chartered Accountants
AICPA	American Institute of Certified Public Accountants
APB	Auditing Practice Board
ARK	Auditing Research Foundation
CICA	Canadian Institute of Chartered Accountants
CIEUFS	Commission of Inquiry into the Expectations of Users of Financial Statements.
CPA	Institute of Certified Public Accountants
ICAI	Institute of Chartered Accountants in Ireland
UK	United Kingdom

**LIST OF TABLES & FIGURES**

Figure 2.1	The structure of the audit expectation gap	5
Figure 3.1	Types of questionnaire	20
Figure 3.2	Advantages and disadvantages of tape-recording an interview	22
Table 4.1	Response rates & demographic details of respondents	25
Table 4.2	Occupational experience of respondents	26
Table 4.3	Comparative responses – Responsibility statements	27
Table 4.4	Comparative responses - Reliability statements	29
Table 4.5	Comparative responses – Decision usefulness statements	31

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**TABLE OF CONTENTS**

<b>Abstract</b>	<b>i</b>
<b>Acknowledgements</b>	<b>ii</b>
<b>List of abbreviations</b>	<b>iii</b>
<b>List of Tables and Figures</b>	<b>iv</b>
<b>Chapter 1: Introduction</b>	<b>1</b>
1.1 Introduction	1
1.2 Research objectives	1
1.3 Motivations for conducting the research	1
1.4 Chapter outline	2
<b>Chapter 2: Literature Review</b>	<b>3</b>
2.1 Introduction	3
2.2 The emergence of the audit expectation gap	3
2.2.1 The nature & structure of the gap	4
2.2.2 Components of the audit expectation gap	5
2.2.3 Factors contributing to the existence of the gap	5
2.3 Empirical Evidence	6
2.3.1 UK	6
2.3.2 New Zealand	6
2.3.3 Singapore	7
2.3.4 Malaysia	7
2.3.5 Egypt	8
2.3.6 Ireland	8
2.3.6.1 Accuracy	8
2.3.6.2 Going concern status/ solvency	9
2.3.6.3 Warning of impending collapse	9
2.3.6.4 Fraud	9
2.3.6.5 Regulation of auditors and audit independence	9

---

2.4	Proposals to bridge the audit expectation gap	10
2.4.1	Education	10
2.4.2	Expanded audit reports	11
2.5	Conclusion	12
<b>Chapter 3: Research Methodology</b>		<b>14</b>
3.1	Introduction	14
3.2	Research aims & objectives	14
3.3	Research Philosophy	15
3.3.1	Positivism	15
3.3.1.1	Strengths of Positivist Research	16
3.3.1.2	Criticisms of Positivist Research	16
3.3.2	Phenomenology	16
3.3.2.1	Strengths of phenomenological research	17
3.3.2.2	Weaknesses of phenomenological research	17
3.3.3	Research philosophy adopted	17
3.4	Research focus	18
3.4.1	Research focus adopted	18
3.5	Data collection methods	19
3.5.1	Observation	19
3.5.2	Questionnaires	19
3.5.3	Interviews	20
3.5.3.1	Unstructured interviews	21
3.5.3.2	Semi-structured interviews	21
3.5.3.3	Structured interviews	21
3.5.3.4	Tape-Recording interviews	21
3.5.4	Research methods adopted	22
3.6	Research population	23
3.7	Conclusion	24
<b>Chapter 4: Findings &amp; Analysis</b>		<b>25</b>
4.1	Introduction	25

---



4.2 Analysis of survey results	25
4.2.1 Demographic details	25
4.2.2 Auditors responsibilities	26
4.2.3 Reliability of audit and audited financial statements	29
4.2.4 Usefulness of audited financial statements	31
4.3 Interview findings	32
4.3.1 Public expectations of the auditing profession	32
4.3.2 Causes of the expectation gap	33
4.3.3 Effects of the audit expectation gap on the auditing profession	33
4.3.4 Effects of the existing duties of auditors on the auditing profession	34
4.3.5 The impact of the provision of non-audit services on the expectation gap	34
4.3.6 Methods of reducing the audit expectation gap	35
4.4 Conclusion	36
<b>Chapter 5: Conclusions and Recommendations</b>	<b>37</b>
5.1 Introduction	37
5.2 The research process	37
5.3 Overview of the main findings	38
5.3.1 Survey findings	38
5.3.2 Interview findings	39
5.4 Strengths & limitations of the research	40
5.5 Overall conclusions and recommendations	41
<b>Appendices</b>	<b>44</b>
<b>References</b>	<b>72</b>

## Chapter 1

### INTRODUCTION

#### 1.1 Introduction

An audit is an independent examination of the financial statements of a company, which is performed by an auditor. The audit report provides reasonable assurance that the financial statements are prepared in accordance with the companies acts and the accounting standards, are free from material misstatement and give a true and fair view. There is widespread concern that auditors and the public have different beliefs about the responsibilities and duties of auditors as well as the messages conveyed in the audit report. The ‘audit expectation gap’ is the term used to describe the variance between what the users of financial statements ‘believe auditors do (or ought to do) and what the auditors actually do’ (Cooke, 1990). The aim of this dissertation is to address the issue of the audit expectation gap within the Irish context.

#### 1.2 Research objectives

The objectives of this dissertation are to study the nature of the audit expectation gap and the proposals that have been put forward to bridge the gap. These objectives were met by conducting a review of the existing literature on the subject. The literature review is discussed further in chapter 2. Other objectives of the research include an investigation of the existence of the audit expectation gap in the Irish context and an examination of Irish practitioners views on the proposed methods of bridging the audit expectation gap. These objectives were achieved through the use of a questionnaire and a series of semi-structured interviews, the findings of which are discussed in chapters 5 and 6.

#### 1.3 Motivations for conducting the research

Public misperceptions of auditors’ responsibilities are a cause of the legal liability crises, which is currently facing the auditing profession. In recent times, the well-publicised collapses of large companies and the subsequent implication of the

reporting auditors, has highlighted the audit expectation gap. As the various crises have shown, there is a common perception that a person who has any interest in a company should be able to rely on the audited financial statements as a guarantee of business viability. Therefore, if a company that has been given an unqualified audit report suddenly collapses, the investors will feel that somebody should be to blame, this somebody is often the auditor.

The researchers' motivations for conducting this study are the potential benefits to be derived from the resolution of the audit expectation gap including; a decrease in the number of lawsuits taken against auditors, reduced insurance premiums for auditors, reduced audit fees, increased investor confidence in the audit process and an increase in the quality of financial reporting.

#### **1.4 Chapter outline**

Chapter 2 Literature Review considers the nature of the audit expectation gap. This chapter examines the origins and structure of the gap including a review of previous empirical studies carried out in the area. This chapter also includes a review of the existing proposals to bridge the gap.

Chapter 3 Methodology discusses the methodology employed in this study. The research design, research focus, research population and data collection methods adopted are discussed.

Chapter 4 Findings & Analysis examines the survey responses in order to determine the extent of the audit expectation gap in the Irish context and reviews the transcripts of the interviews in order to ascertain the views of the accounting profession regarding the expectation gap and how it may be resolved.

Finally, chapter 5 Conclusions and Recommendations presents the overall findings and conclusions drawn from the study and outlines the researchers' recommendations for future research.

## Chapter 2

### LITERATURE REVIEW

#### 2.1 Introduction

This chapter considers the nature of the audit expectation gap. At the outset the origins and structure of the phenomenon are explored. This is followed by an examination of previous empirical studies carried out in the area. Finally, there is a review of the proposals that have been suggested as a means of bridging the audit expectation gap.

#### 2.2 The emergence of the audit expectation gap

Liggio (1974) was the first to apply the term ‘expectation gap’ to auditing. It was defined as the difference between the levels of expected performance

‘as envisioned by the independent accountant and by the users of financial statements’ (pp. 27).

During the same year, the AICPA established the Commission on Auditors Responsibilities (often referred to as the Cohen Commission). The terms of reference of the commission stated that its aim was to consider

‘whether a gap exists between what the public expects or needs and what auditors can and should be reasonably expected to accomplish’ (AICPA, 1978) .

The AICPA had been prompted to establish the Cohen Commission by

‘the growing public concern about the criticisms of the quality of auditors’ performance’ (Humphrey, 1991).

In 1978, the commission concluded that an expectation gap did exist and attributed its existence primarily to the failure of the accounting profession

‘to react and evolve rapidly enough to keep pace with the speed of change in the American business environment’ (AICPA, 1978).

Over the years, extensive research has been conducted by other professional bodies (CICA 1988; ARK (UK) 1989; ICAI 1992) and researchers (Gloeck and de Jager, 1993; Humphrey, Moizer and Turley, 1993; Monroe and Woodliff, 1993; Pierce and Kilcommins, 1997; Porter 1993). A common feature of such research was the finding that an expectation gap exists and that this gap cannot be solely attributed to the ignorance of users of financial information.

### **2.2.1 The nature & structure of the gap**

Porter (1993) conducted an empirical study of the audit expectation-performance gap. It was noted that the widespread criticism of and litigation against auditors indicated that such a gap existed and the audit expectation-performance gap was defined as the

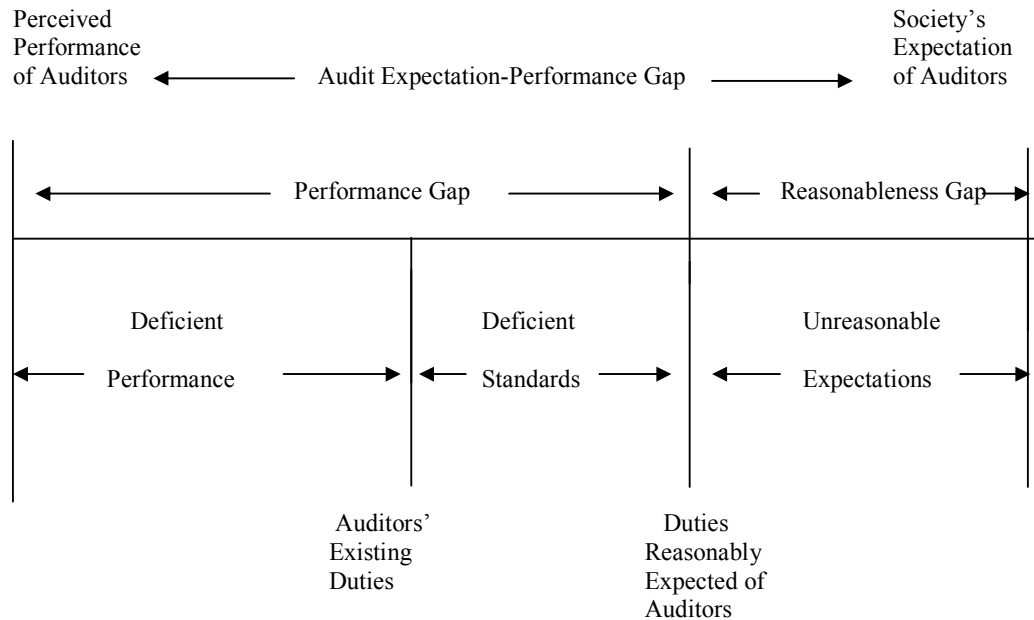
‘gap between society’s expectation of auditors and auditors performance, as perceived by society (Porter, 1993).

Porter considered that previous definitions of the audit expectation gap were “too narrow”, and that they did not consider the ‘possibility of substandard performance’ by auditors. Porter’s research indicated that the gap comprised of two major components:

A reasonableness gap i.e. a gap between what society expects auditors to achieve and what they can reasonably be expected to accomplish

A performance gap i.e. a gap between what society can reasonably expect auditors to accomplish and what they are perceived to achieve.

The performance gap was further subdivided into ‘deficient standards’ and ‘deficient performance’. A deficient standard refers to the gap between the duties, which can reasonably be expected of auditors, and auditors’ existing duties as defined by the law and professional promulgations. Deficient performance refers to the gap between the expected standard of performance of auditors existing duties and auditors perceived performance as expected and perceived by society.

**Figure 2.1 The structure of the audit expectation gap**

(Porter, B.A. (1993). An Empirical Study of the Audit Expectation-Performance Gap, *Accounting and Business Research*, Vol.24, No. 93, pp. 49-68.)

### 2.2.2 Components of the audit expectation gap

The report of the CIEUFS (1992) examined the audit expectation gap in Ireland. It concluded that an expectation gap existed in the following areas: accuracy, going concern status/ solvency, warning of impending collapse, fraud, the regulation of auditors and the independence of auditors. The findings of the commission are discussed in greater detail in section 2.3.6 of this paper.

### 2.2.3 Factors contributing to the existence of the gap

The potential causes of the audit expectation gap are many and varied. Humphrey et al (1992) suggested that the gap could be attributed to a number of factors: the probabilistic nature of auditing; the ignorance, naivety and unreasonable expectations of non-auditors; the hindsight evaluation of audit performance; the evolutionary development of audit responsibilities which create response time lags to changing expectations; corporate crises which lead to new expectations and accountability requirements and period of high standard setting activities; and a self-interested

profession, which is a self-regulatory monopoly operating in the guise of a socially orientated role.

### **2.3 Empirical Evidence**

Numerous empirical studies regarding the nature and structure of the audit expectation gap have been conducted. The majority of which aimed to elicit the views of auditors and various sections of society about auditors' roles and responsibilities. This section outlines a number of studies that have been conducted in various countries including: the UK, New Zealand, Singapore, Malaysia, Egypt and Ireland.

#### **2.3.1 UK**

Humphrey et al (1993) conducted a study in the UK, which examined how auditors and their work were perceived by various users of financial statements. The study was conducted using a questionnaire. The respondents included: chartered accountants in public practice, financial directors, investment analysts, bankers and financial journalists.

The results confirmed that an audit expectation gap exists particularly regarding the nature of the audit function and the perceived performance of auditors. The critical components of the expectation gap were found to be: the auditors role in relation to fraud detection, 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)

#### **2.3.2 New Zealand**

Porter (1993) researched the existence of the audit expectation performance gap in New Zealand. The research was an extension of previous research conducted by Lee (1970) and Beck (1974), who investigated the duties which auditors were expected to perform in the late 1960's in Britain and early 1970's in Australia respectively. Porter used a mail survey to ascertain the views of auditors' interest groups regarding auditors existing duties, the standard of performance of these duties and the duties that auditors should perform. The findings revealed that 50% of the gap is attributable to deficient standards, 34% is attributable to society's unreasonable expectations of

auditors and 16% was attributed to the perceived substandard performance by auditors.

### **2.3.3 Singapore**

Best et al (2001) examined the extent of the audit expectation gap in existence in Singapore, by considering the differences between expectations of users of audited financial reports and auditors' perceptions of their role. The study also determined whether the continued use of the short form audit report in Singapore may be responsible for the expectation gap existing in the country and whether prior calls for a change to the long form audit report should be continued as a means of reducing the expectation gap. A questionnaire was sent to three hundred potential respondents from three groups: auditors, bankers and investors.

The findings revealed a wide expectation gap in relation to areas of auditors' responsibilities for fraud prevention and detection, and auditors' responsibilities for maintenance of accounting records and exercise of judgement in the selection of audit procedures. The audit expectation gap also extended to the areas of auditors responsibilities for the soundness of internal controls, the degree to which financial statements give a true and fair view, auditor agreement with accounting policies used in the financial statements and the usefulness of audited financial statements in monitoring the performance of the entity. The results support the call by Low et al (1988) for a change from short-form audit report to the long-form audit report.

### **2.3.4 Malaysia**

Fadzly and Ahmad (2004) examined the extent of the audit expectation gap in Malaysia. The study aimed to assess users perceptions of auditors and to seek an alternative way of educating users about the audit process. The findings were consistent with Best et al (2001), revealing substantial evidence of an expectation gap.

It was revealed that a gap existed with regard to auditors' responsibilities in fraud detection and prevention, preparation of financial statements and accounting records and internal controls. In addition, a gap was found with regard to auditor's scope of legal responsibility and culpability in a fraud related business failure, two issues that



had not been considered by Best et al (2001). The authors expressed concern about the disagreement among brokers and investors that audited financial statements are not useful for performance monitoring purposes. It was suggested that this might reflect a lack of confidence in the statements for evaluating investment prospects.

### **2.3.5 Egypt**

Dixon et al (2006) investigated the existence of an audit expectation gap in Egypt. The research method adopted was identical to that used by Schelluch (1996), Best et al (2001) and Fadzly and Ahmed (2004). The study found evidence of a significant audit expectation gap in the areas of auditor responsibilities for fraud prevention, maintenance of accounting records and auditor judgement in the selection of audit procedures. A gap was also found to exist with regard to the reliability of audited financial statements and the usefulness of the audit.

### **2.3.6 Ireland**

In the early 1990's the Council of the ICAI became increasingly concerned at the widespread criticism of financial statements, particularly in cases of company failure. The council wanted to establish whether or not there was

‘a gap between the expectations of users of financial statements and the product delivered to them by the preparer and auditor (ICAI, 1992)

In order to determine whether or not such a gap existed the CIEUFS was set up, under the chairmanship of Dr. Loudon Ryan. The terms of reference of the commission were to

‘research the extent to which the expectations of users of published financial statements of companies in the Republic of Ireland are met by such statements...where significant disparity is identified to put forward proposals to reduce or eliminate such disparity’ (ICAI, 1992)

The report of the CIEUFS (1992) found that an expectation gap existed in the following areas: accuracy, going concern status/ solvency, warning of impending collapse, fraud, the regulation of auditors and the independence of auditors each of which are considered in the following section.

#### **2.3.6.1 Accuracy**

The report found that there was a widely held belief among users that an unqualified audit report guaranteed the material accuracy of the financial statements. The commission stated that ‘the gap which exists between auditors and users on the degree of accuracy is one which can be narrowed only by making users aware that in the preparation of financial statements, judgement is unavoidable.’

#### **2.3.6.2 Going concern status/ solvency**

According to section five of the Companies Act 1986, financial statements should be prepared on the assumption that the company will continue in operational existence for the foreseeable future. If the financial statements are prepared on an assumption other than that of a going concern basis, then this must be disclosed in the notes to the accounts. It is the responsibility of the directors to decide whether or not the going concern assumption is appropriate. The commission recommended that the directors should acknowledge this fact in their responsibility statement (which should be included in the annual report of the company).

#### **2.3.6.3 Warning of impending collapse**

It was found that both users and auditors regard auditors as having a duty to give warning of impending collapse, provided they have reasons for believing this to be the case. The report suggested that if the auditor identifies significant risks, then they should disclose them to the audit committee or in its absence to the board of directors.

#### **2.3.6.4 Fraud**

It was found that the majority of users of financial statements did not accept that despite planning and carrying out the audit in a professional manner, the auditor may not detect material fraud, especially where there is collusion among a number of members of the company. With regard to illegal acts, there was a consensus that if such acts, which affect the public interest were discovered, they should be reported to the relevant regulatory authority.

#### **2.3.6.5 Regulation of auditors and audit independence**

The report noted that there appeared to be a:

‘perception among users of published financial statements that the self-disciplinary procedures currently operated by the profession lack both effectiveness and transparency’ (ICAI, 1992).

There was a view that measures were needed to be taken to strengthen auditor independence. Concerns were expressed about the provision of non-audit services and the possibility of auditors’ undue dependence on clients.

#### **2.4 Proposals to bridge the audit expectation gap.**

Having established that the expectation gap is a global phenomenon, it would appear that it has the potential to impact on the credibility of financial statements worldwide. Therefore there is a need to formulate and implement measures to counter these negative effects and to bridge the audit expectation gap. This section considers methods that have been put forward to narrow the audit expectation gap.

##### **2.4.1 Education**

Several studies have investigated the effectiveness of audit education on the expectation gap. Monroe & Woodliff (1993) examined the effect of education on students’ perceptions of messages communicated by audit reports in Australia. The research instrument was given to two groups of undergraduate students at the beginning and end of the semester and to auditors. It was found that the beliefs of the students about the responsibilities of auditors had changed significantly over the semester. At the end of the semester they believed that: the auditors assumed a much lower level of responsibility, financial information was more reliable and the audit report conveyed less information about the company’s future prospects than they had first thought. Therefore the results of the study suggest that education ‘may be an effective approach to narrowing the expectation gap. However, the authors suggested that further research would be required to ascertain the quality and content of public education required to educate the users of financial information about the nature of auditing.

Further research conducted by Monroe & Woodliff (1994) suggested that the difference in perceptions between auditors and sophisticated users was much less than the differences between the perceptions of auditors and unsophisticated users (mainly students and shareholders). The research suggests that audit education may be used as

a means of educating users. A similar study was carried out by Pierce and Kilcommins (1997). The study focused on the impact of audit education on the unreasonable expectation element of the gap. The findings revealed that audit education reduced the levels of user misunderstanding and therefore resulted in a narrowing of the gap.

Ferguson et al (2000) carried out a study that explored formal undergraduate education and work experience under a co-operative education program, as an alternative means of educating students about auditing. The findings of the study suggested that while audit education did reduce the extent of the education gap between students and auditors, the gap reduced significantly when the students undertook work experience in audit related areas.

Whilst much of the research suggests that education is an effective means of narrowing the gap, some studies suggest that used in isolation it will not result in an elimination of the expectation gap. Pierce and Kilcommins (1997) state that

‘education will be largely ineffective in addressing the expectations gap unless it is accompanied by a willingness on the part of the profession to address reasonable expectations of users’.

Boyle et al (2005) investigated the effect of audit education on perceptions of deficient auditor performance. The results of the study indicated that the respondents who were exposed to the most audit education were also the groups most sceptical of the duties performed by auditors. The researchers suggest that

‘exposure to audit education can significantly increase perceptions of deficient auditor performance and consequently widen the deficient performance gap’ (Boyle, et al, 2005).

#### **2.4.2 Expanded audit reports**

Numerous studies examined the messages conveyed in audit reports and the effect that the use of an expanded audit report would have on reducing the effects of the expectation gap. Holt and Moizer (1990) conducted research, which investigated the effect of the expanded audit report in the UK. It was found that there were differences in the perceptions of users and auditors regarding the meaning of audit reports. It was

also noted that by changing the wording of the auditors report, users perceptions of the meaning of audit reports could also be changed.

Estes (1982) recommended that:

‘all standardized wording should be dropped: the auditors report should be composed anew, from scratch, for each audit’.

Estes considered the use of freeform reporting with regard to the audit opinion. Whilst, such a proposal may reduce misconceptions about the types of audit opinion, it would do little to enhance the users’ understanding of the audit process. Hatherly, Innes and Brown (1996) conducted a study, which involved the use of a free-form report. The report included information about: management letter points, adjustments made to financial statements as a result of the audit and issues which arose during the audit which required the use of judgement, as well as information about how such issues were resolved. The findings of the study revealed that the use of a free-form report had a significant impact on users’ perceptions of the audit process. Users perceived the audit process to be more rigorous and the audit report to be more useful. Hatherly (1997) discussed the use of ‘free-form’ reporting as an alternative to standardized wording. It was noted that the potential value of freeform reporting lies in its ability to provide insights into the ‘quality’ of the audit with regard to the evidence gathered and the opinion formed. It was also suggested that the use of such a report might change the basis on which audit firms compete i.e. from brand name and cost to quality.

Robert Medwick (1986) suggested that the traditional report language should remain unchanged. It was suggested that the audit report should be accompanied by a supplementary explanation of the audit. This explanation should inform users of the limitations of the audit and the meaning of the audit report without altering the language of the report.

## **2.5 Conclusion**

It has been argued that due to the nature of the expectations gap it may never be entirely eliminated (CICA, 1992, Sikka et al., 1992). Audit education and the use of expanded audit reports are two methods that have been proposed to reduce the gap.

Other methods include broadening the role and responsibilities of auditors in the area of fraud detection and reporting (Humphrey et al., 1992) and strengthening the perceived independence of auditors (Moizer, 1991; ICAI, 1992, Sikka et al., 1992). However, questions regarding the existence of the audit expectation gap in Ireland as well as the appropriateness and effectiveness of each of these methods as an adequate response to narrowing the gap continue to be raised. Such questions are fuelled mainly by the lack of research in the area. The aim of this study is to address this deficiency in the existing literature. The findings of which are outlined in chapters 4 and 5.

## Chapter 3

### RESEARCH METHODOLOGY

#### 3.1 Introduction

An examination of research literature would seem to suggest that there is a lack of consensus regarding how research and indeed methodology should be defined.

Saunders, M et al (2003) define research as:

‘something that people undertake in order to find out things in a systematic way, thereby increasing their knowledge’.

Kumar, R (1999) identifies the following characteristics of research:

‘it is undertaken within a framework of a set of philosophies, it uses procedures, methods and techniques that have been tested for their validity and reliability and it is designed to be unbiased and objective’.

The term ‘methodology’ also lacks a universally agreed definition. Kaplan (1973) states that the purpose of methodology is:

‘to describe and analyse...methods, throwing light on their limitations and resources, clarifying their suppositions and consequences, relating their potentialities to the twilight zone at the frontiers of knowledge. It is to venture generalisations from the success of particular techniques, suggesting new applications, and to unfold the specific bearings of logical and metaphysical principles on concrete problems, suggesting new formulations’.

#### 3.2 Research aims & objectives

This dissertation aims to address the following issues:

1. What is the audit expectation gap and how has it evolved?
2. To what extent does the audit expectation gap exist in the Irish context?
3. What are Irish practitioners views on bridging the audit expectation gap?

The objectives of this research are as follows:

1. To examine the nature of the audit expectation gap.
2. To study the proposals that currently exist for bridging the expectation gap.
3. To investigate whether or not the audit expectation gap exists in Ireland
4. To determine Irish practitioners views on bridging the audit expectation gap.

### **3.3 Research Philosophy**

A research design is a plan, structure and strategy of investigation so conceived as to obtain answers to research questions. The first stage in designing any research is to identify the most appropriate research philosophy to follow in terms of designing and gathering the research. The research paradigm chosen will depend on the way that the researcher thinks about the development of knowledge. Paradigms are:

‘universally recognised scientific achievements that for a time provide model problems and solutions to a community of practitioners’ Kuhn (1962).

Two research paradigms dominate the literature, these are referred to as positivism and interpretivism. They are different, if not mutually exclusive views about the way in which knowledge is developed and judged as being acceptable (Saunders, M et al, 2003).

Positivism is a structured approach to collecting data, which is analysed and interpreted in a factual statistical manner. Interpretivism otherwise referred to as phenomenology is a more flexible approach to the collection of data that focuses on the meanings behind the research.

#### **3.3.1 Positivism**

Saunders, M et al (2003) suggest that if the research philosophy reflects the principles of positivism then the researcher will probably adopt the philosophical stance of the natural scientist. Positivism involves:

‘working with the an observable social reality and that the end product of such research can be law-like generalisations similar to those produced by the physical and natural scientists’ (Remenyi et al, 1998).’



Positivism is based on the concept that other similar studies should be comparable and achieve similar results. Gill, J & Johnston, P (1997) identified a number of distinguishing characteristics of positivist research: it is deductive, it seeks to explain relationships between variables, it generally uses quantitative data, it uses controls to test a hypothesis and it is a highly structured methodology to allow repetition.

### **3.3.1.1 Strengths of Positivist Research**

The following have been identified as the strengths of positivist research: positivist research is developed to achieve defined theoretical objectives; positivist research is economical both in terms of time and for sampling large numbers; it is easily analysed and clearly demonstrates existing or emerging patterns and trends; it gives the researcher control in measurement using validity and reliability testing. (Easterby-Smith et al 1991, Jankowicz,1995).

### **3.3.1.2 Criticisms of Positivist Research**

The criticisms of positivist research include; it is impossible to treat people as being separate from their social contexts and they cannot be understood without examining the perceptions they have of their own activities; a highly structured research design imposes certain constraints on the results and may ignore more relevant and interesting findings; researchers are not objective, but part of what they observe and capturing complex phenomena in a single measure is at best misleading. For example, is it possible to assign a numerical value to a persons intelligence? (Collis et al, 2003).

### **3.3.2 Phenomenology**

Easterby-smith et al (1991) state that phenomenology is based on the concept that reality is socially constructed rather than objectively determined. According to Hussey, J & Hussey, R (1997), phenomenology assumes that the social world is continuously changing and that the research and researchers are part of this. It is concerned with understanding meanings rather than measuring facts. The researcher tries to:

‘understand and explain why people have different experiences, rather than search for external causes and fundamental laws to explain their behaviour’ (Easterby-Smith et al, 2003).

Collis et al (2003) identify a number of features of this approach; it tends to produce qualitative data; it uses small samples; it is concerned with generating theories; data is rich and subjective; the location is neutral; reliability is low; validity is high; it generalises from one setting to another.

### **3.3.2.1 Strengths of Phenomenological Research**

Saunders, M et al (2000), identifies the following strengths of phenomenological research: it facilitates the understanding of how and why; it enables the researcher to be alive to changes, which occur during the research process and it is good at understanding social processes.

### **3.3.2.2 Weaknesses of Phenomenological Research**

Saunders, M et al (2000) identifies the following weaknesses of phenomenological research: data collection can be time consuming; data analysis can be difficult; researcher must be aware that clear patterns may not emerge and it is generally perceived as less credible by ‘non-researchers’.

### **3.3.3 Research Philosophy adopted**

The choice of research philosophy will depend on the nature of the research question chosen. In this case the research question seems to lend itself more to phenomenology than to positivism. This is due to the subjective nature of the subject matter i.e. the audit expectation gap. The audit expectation gap is concerned both with perceptions of how auditors perform their duties and with interpretations of what auditors duties actually entail. This research is predominately qualitative in nature but the analysis of existence of the gap in the Irish context involves the use of quantitative data, therefore the researcher has used a combination of both philosophies.

### **3.4 Research Focus**

Enquiries can be classified in terms of their purpose as well as by the research strategy used (Robson, 2002). There are three classifications that may be used i.e. exploratory, explanatory and descriptive.

Robson (2002) states that exploratory studies are a valuable means of finding out:

‘what is happening; to seek new insights; to ask questions and to assess phenomena in a new light’.

Saunders, M et al (2003) note that the main advantage of this type of research is its flexibility and its ability to adapt to change. This allows the researcher to change the direction of the research as a result of new data or insights.

Explanatory studies:

‘examine causal relationships between variables’ (Saunders, M et al 2003).

This type of research involves focusing on a specific problem or situation in order to identify relationships between key variables.

The object of descriptive studies is:

‘to portray an accurate profile of persons, events or situations’ (Robson, 2002).

Descriptive research may be an extension of, or a forerunner to a piece of exploratory research.

#### **3.4.1 Research Focus adopted**

This research may be classified as descriptive in nature since it involves an analysis of the evolution of the audit expectation gap and the relevant literature. However, this research also aims to determine the extent of the audit expectation gap in Ireland as well as to ascertain the views of Irish practitioners on bridging the gap, therefore this study is predominately exploratory in nature.

### **3.5 Data collection methods**

There are many data collection methods available. This study will consider the merits and demerits of a number of methods.

#### **3.5.1 Observation**

Observation involves:

‘the systematic observation, recording, description, analysis and interpretation of people’s behaviour’ (Saunders, M. et al 2003).

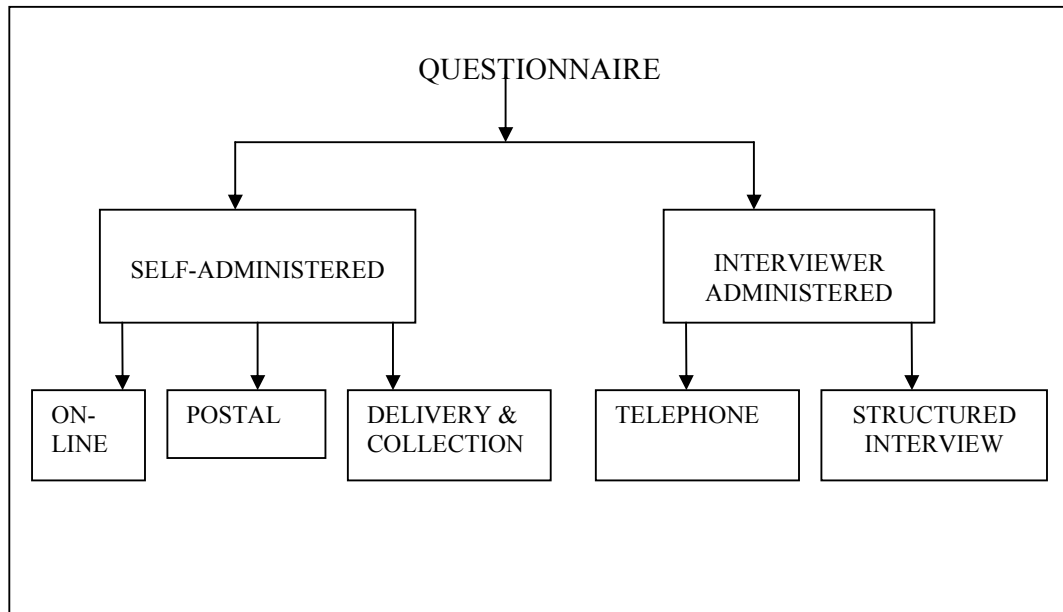
There are two types of observation i.e. participant and structured. According to Saunders, M. et al (2003) participant observation is:

‘qualitative and derives from the work of social anthropology...its emphasis is on discovering the meanings that people attach to their actions’.

Structured observation is quantitative and is more concerned with the frequency of those actions.

#### **3.5.2 Questionnaires**

Saunders, M. et al (2000) refer to a questionnaire as a general term to include all techniques of data collection in which each person is asked to respond to the same set of questions in a predetermined order. There are various types of questionnaire as shown in the figure 3.1.

**Figure 3.1 Types of questionnaire**

(Saunders, M. *et al* (2003) *Research Methods for Business Students* (3<sup>rd</sup> edn), pp 282.)

The choice of questionnaire is influenced by a number of factors related to the research question(s) and objectives of the study. Saunders, M. *et al* (2000) state that a number of factors may influence this decision. Firstly, the characteristics of the respondents. Secondly, the importance of respondents answers not being contaminated or distorted. Thirdly, the types and number of questions you need to ask and fourthly the sample size.

Malhotra, N.K. (1999) identifies a number of objectives of questionnaires. Firstly, the questionnaire must translate the information needed into a set of specific questions that the respondent will answer. Secondly, in designing the questionnaire, the researcher should aim to minimise respondent boredom and attempt to maximise completeness and response. Thirdly, a questionnaire should minimise response error

### 3.5.3 Interviews

An interview is a purposeful discussion between two or more people (Kahn and Cannell, 1957). Interviews can be an effective means of obtaining valid and reliable data that is relevant to the research questions and objectives. There are three types of

interview: unstructured, semi structured and structured, each of which is considered below.

### **3.5.3.1 Unstructured interviews**

Unstructured interviews are often referred to as in-depth interviews. This type of interview is usually conducted on a one to one basis, the aim of which is to get beyond short answers to establish true motivations and depth that influence a person's opinion. Sample sizes are small and tend to be time consuming as they are conducted on a one to one basis. Interpretation of findings is also difficult and time consuming requiring extensive coding.

### **3.5.3.2 Semi structured interviews**

Semi structured interviews involve the researcher having a list of general topics or questions, which may vary from interview to interview. Questions may be omitted or new questions raised by the interviewee or the interviewer. The order and number of questions may also vary depending on the flow of conversation.

### **3.5.3.3 Structured interviews**

This type of interview is based on a predetermined list of questions. The interviewer reads out each question and then records the response on a standardized schedule, usually with pre-coded answers (Saunders, M. et al 2003). There is little interaction between interviewer and respondent.

### **3.5.3.4 Tape- recording interviews**

According to Saunders M. et al (2003) there is a need to record an interview soon after its occurrence in order to control bias and to produce reliable data for analysis. One method of recording an interview is by using a tape recorder. The advantages and disadvantages of tape-recording an interview are outlined in figure 3.2.

**Figure 3.2 Advantages and disadvantages of tape-recording an interview**

<b>ADVANTAGES</b>	<b>DISADVANTAGES</b>
<ul style="list-style-type: none"> <li>• Allows the interviewer to concentrate on questioning and listening</li> </ul>	<ul style="list-style-type: none"> <li>• May adversely affect the relationship between the interviewee and the interviewer</li> </ul>
<ul style="list-style-type: none"> <li>• Allows questions formulated in an interview to be accurately recorded for use in later interviews, if appropriate</li> </ul>	<ul style="list-style-type: none"> <li>• May inhibit some interviewee responses and therefore reduce reliability</li> </ul>
<ul style="list-style-type: none"> <li>• Can re-listen to the interview</li> </ul>	<ul style="list-style-type: none"> <li>• Possible technical problems</li> </ul>
<ul style="list-style-type: none"> <li>• Provides an accurate and unbiased record</li> </ul>	<ul style="list-style-type: none"> <li>• Disruption when changing tapes</li> </ul>
<ul style="list-style-type: none"> <li>• Allows for direct quoting</li> </ul>	<ul style="list-style-type: none"> <li>• Transcribing tapes is time consuming</li> </ul>
<ul style="list-style-type: none"> <li>• It is a permanent record which can be used by others</li> </ul>	

(Saunders, M. *et al* (2003) *Research Methods for Business Students* (3<sup>rd</sup> edn), pp 264.)

### 3.5.4 Research methods adopted

The researcher has used a combination of semi structured interviews and self-administered questionnaires in order to satisfy the aims & objectives of the research. A questionnaire was used in order to investigate the existence of the audit expectation gap in Ireland. The questionnaire used is similar to that used in Schelluch (1996), Best *et al.* (2001), Fadzly and Ahmed (2004) and Dixon *et al.* (2006). Schelluch (1996) developed a semantic differential instrument to measure the messages communicated through audit reports. Best *et al.* (2001) used the same approach in measuring the expectation gap in Singapore. Fadzly and Ahmed (2004) used the same approach as Schelluch and Best *et al.*, with minor modifications in measuring the audit expectation gap in Malaysia. Dixon *et al* (2006) used a similar approach to determine the extent of the audit expectation gap in Egypt. The original construct of the questionnaires was modified slightly. The original belief statements were retained

whilst the likert scale was replaced with a five point scale. Respondents were asked to choose a number from the scale that identified their level of agreement to each statement. Section A of the questionnaire gathers demographic information of the respondents. Section B contained sixteen belief statements grouped into three factors: responsibility, reliability and usefulness. The research instrument used has the advantage of having its external validity tested and verified in several other countries. The questionnaire was test piloted prior to circulation. No significant changes were made. In order to determine Irish practitioners views on bridging the audit expectation gap, three semi structured interviews were conducted.

### **3.6 Research Population**

The questionnaire was distributed to three groups: auditors, bankers and investors. As in the Dixon et al (2006) study, participants were selected using systematic random sampling from appropriate categories of the Irish business listed telephone directory. The investor group included financial analysts and stockbrokers. The financial analyst and stockbroker participants were selected using systematic random sampling from the Irish business listed telephone directory. These parties were grouped together as proxies for investors. One hundred and twenty questionnaires were sent out by post i.e. forty to each of the, auditor, banker and investor groups. Each respondent received a survey questionnaire, a cover letter, a sample of an audit report and a prepaid return envelope. A number of the auditors received personally delivered questionnaires. This was due to limited resources and a low response rate from the auditor group. This may impact on the results of the survey, as the majority of auditor responses are derived from the north west of the country.

Semi-structured interviews were conducted with three of the professional accountancy bodies in Ireland involved in auditing, in order to ascertain their views about the audit expectation gap and how it may be narrowed. The professional bodies that participated in the research were: the Institute of Chartered Accountants (ICAI) – the largest and longest established accountancy body in Ireland, with over 13,000 members; the Institute of Certified Public Accountants (CPA) – the smallest professional body in Ireland with in excess of 2,500 members and 1,600 students; the Association of Chartered Certified Accountants (ACCA) - Ireland's fastest growing professional accountancy body, with over 14,500 members and students throughout



Ireland. All of the interviews were conducted by telephone in early June and were approximately forty-five minutes in duration. The interviewees held appropriate positions of authority within their respective professional bodies.

The researcher has chosen these participants as they have the appropriate level of knowledge on the subject matter and hence should provide reliable responses. A number of accounting practitioners were consulted prior to undertaking the interviews. This revealed that accounting practitioners in general did not have extensive knowledge of the subject matter and therefore it was decided to interview the professional accountancy bodies. All interviews were tape-recorded.

Taking into consideration that the researcher has decided to gain the views of all the professional bodies in Ireland involved in auditing, no sampling was required. Therefore, according to Saunders, M. *et al*, (2000):

‘as the researcher has collected and analysed data from every possible case or group member this research represents a census.’

### **3.7 Conclusion**

This research was carried out to determine the existence of the audit expectation gap in Ireland and to gain the views of the Irish accounting profession about effective methods of reducing the gap. It involved both the phenomenological and positivist philosophies. It represents an exploratory study with an element of description. The research process consisted of the circulation of one hundred and twenty questionnaires and three semi-structured interviews with the professional accounting bodies involved in auditing in Ireland. The findings of which will be discussed further in chapter 4.

## Chapter 4

### FINDINGS & ANALYSIS

#### 4.1 Introduction

The purpose of this chapter is to analyse the results of the research methods adopted in this study. This involves an examination of the survey responses in order to determine the extent of the audit expectation gap in the Irish context and a review of the transcripts of the interviews with the Irish accountancy bodies in order to ascertain their views of the audit expectation gap and of the proposed methods of bridging the gap.

#### 4.2 Analysis of survey results

##### 4.2.1 Demographic Details

The questionnaire was sent to 120 subjects consisting of 40 subjects from each of three groups: auditors, bankers and investors. At the end of the data collection period a total of 50 responses were received, yielding a 41.6 per cent response rate. Bankers displayed the highest response rate (52.5 per cent) whilst investors displayed the lowest response rate (30 per cent). Respondents were asked to answer demographic questions as part of the questionnaire in order to obtain a profile of the characteristics of the respondents. Response rates and demographic details are shown in table 4.1 and 4.2.

**Table 4.1 Response rates & demographic details of respondents**

Group	Survey sent	Response received		Accounting experience		Accounting qualification	
		n	%	Yes	No	Yes	No
Auditors	40	17	42.5	17	0	17	0
Bankers	40	21	52.5	5	16	4	17
Investors	40	12	30.0	5	7	5	7
Total	120	50	41.6	27	23	26	24

**Table 4.2 Occupational experience of respondents**

Group	1 to 5 Years		6 to 10 Years		11 to 15 Years		Over 15 years	
	n	%	n	%	n	%	n	%
Auditors (n =17)	7	41.2	5	29.4	1	5.9	4	23.5
Bankers (n =21)	6	28.6	4	19.0	5	23.8	6	28.6
Investors (n =12)	3	25.0	5	41.6	2	16.7	2	16.7
Total (n =50)	16	32.0	14	28.0	8	16.0	12	24.0

The qualifications and experience of the respondents in relation to the auditing and accounting process appear to be moderate, since approximately half of the respondents indicated that they had either accounting qualifications or experience. The level of experience of the respondents seems to indicate that the respondents are aware of the uses of the financial statements and the auditing process. This indicates that the results of this study should be more reliable than if the respondents were largely inexperienced with regard to these issues. Approximately 68 per cent of respondents possess more than five years experience in their occupation. This would suggest that respondents to the survey had considerable experience in their area of expertise and should provide experienced opinions and judgements. The high level of occupational experience together with the moderate level of accounting experience and qualifications should enhance the credibility of the findings of the study.

Following the basic principle used in Schelluch (1996), Best et al. (2001), Fadzly and Ahmed (2004) and Dixon et al (2006), any significant difference detected in the responses between auditor and non-auditor groups (bankers and investors) indicates the potential existence of the expectation gap.

#### **4.2.2 Auditors responsibilities**

Table 4.3 provides details of the responses concerning responsibility statements associated with the use of financial statements. Seven statements on responsibility address the issues of fraud detection and prevention, internal control, financial statement preparation, auditors objectivity, and audit procedures.

**Table 4.3 Comparative responses- Responsibility statements**

		[Percentages]				
		Strongly Agree	Agree	Not Sure	Disagree	Strongly Disagree
<b>1</b> The auditor is responsible for detecting all fraud	Auditors	11.8	5.9	0.0	47.1	35.2
	Bankers	9.5	47.6	0.0	38.1	4.8
	Investors	0.0	25.0	25.0	50.0	0.0
<b>2</b> The auditor is responsible for the soundness of the internal control structure of the entity	Auditors	0.0	11.8	0.0	41.2	47.0
	Bankers	14.3	38.1	28.6	9.5	9.5
	Investors	0.0	41.7	8.3	50.0	0.0
<b>3</b> The auditor is responsible for maintaining accounting records	Auditors	0.0	0.0	0.0	29.4	70.6
	Bankers	9.5	23.8	19.1	38.1	9.5
	Investors	0.0	50.0	25.0	8.3	16.7
<b>4</b> Management has responsibility for producing the financial statements	Auditors	29.4	70.6	0.0	0.0	0.0
	Bankers	23.8	76.2	0.0	0.0	0.0
	Investors	25.0	75.0	0.0	0.0	0.0
<b>5</b> The auditor is not responsible for preventing fraud	Auditors	35.3	58.8	0.0	5.9	0.0
	Bankers	9.5	38.1	14.3	33.3	4.8
	Investors	0.0	58.3	0.0	41.7	0.0
<b>6</b> The auditor is unbiased and objective	Auditors	52.9	35.3	11.8	0.0	0.0
	Bankers	47.6	52.4	0.0	0.0	0.0
	Investors	41.7	58.3	0.0	0.0	0.0
<b>7</b> The auditor does not exercise judgement in the selection of audit procedures	Auditors	0.0	29.4	5.9	58.8	5.9
	Bankers	9.5	42.9	19.0	23.8	4.8
	Investors	0.0	50.0	8.3	41.7	0.0

The results in Table 4.3 indicate significant differences in all responsibility areas except managements responsibility for producing the financial statements (statement 4) and the objectivity of the auditor (statement 6). All respondents agree that the responsibility for producing the financial statements rests with the management of the entity and all user groups agree that the auditor would conduct the audit in an objective and unbiased manner, with the exception of 11.8 per cent of auditors who were unsure if this would be the case. Significant differences were discovered in

relation to the auditors responsibilities for the detection and prevention of fraud (statements 1 and 5). Whilst a majority of auditors recognised that they were not responsible for the detection and prevention of fraud, a small minority 17.7 per cent indicated that they thought they were responsible for the detection of fraud and 5.9 per cent thought they were responsible for the prevention of fraud. Such uncertainty may be indicative of the current climate of increasing litigation and ever increasing pressure on auditors to provide absolute protection against fraud. There appears to be an expectation gap in relation to fraud detection with 57.1 per cent of bankers and 25 per cent of investors being of the opinion that the auditors are responsible for the detection of fraud, whilst a further 25 per cent of investors were unsure. Likewise, 38.1 per cent of bankers and 41.7 per cent of investors were of the opinion that auditors were responsible for the prevention of fraud, whilst 14.3 per cent of bankers were not sure with whom the responsibility for fraud prevention should rest. Table 4.3 also indicates that there is an expectation gap between auditors and users with regard to the auditors responsibility for the soundness of the internal controls of the entity (statement 2). This is in conformity with the findings of Best et al. (2001), Fadzly and Ahmed (2004) and Dixon et al (2006), where investors in Singapore, Malaysia and Egypt were also found to believe that auditors were responsible for the soundness of the internal controls of the client entity.

The results of the survey indicate that whilst all of the auditors surveyed believe that management are responsible for maintaining accounting records, 33.1 per cent of bankers and 50 per cent of investors believe that the auditor is responsible for this, whilst a further 19.1 per cent of bankers and 25 per cent of investors remain unsure who is responsible for the maintenance of accounting records (statement 3). A gap was also found with regard to the auditors use of judgement in the selection of audit procedures (statement 7), 52.4 per cent of bankers and 50 per cent of investors believed that auditors do not exercise judgement in the selection of audit procedures and 19 per cent of bankers and 8.3 per cent of investors did not know whether the auditors used their judgement or not. It is interesting to note that, whilst most auditors agreed that they used judgement, 29.4 per cent of auditors were of the belief that auditors do not use judgement in the selection of audit procedures.

### 4.2.3 Reliability of audit and audited financial statements

The results of the statements relating to the reliability of audit and audited financial statements are presented in Table 4.4. Six statements on reliability pertain to the extent of assurance provided by audit, accounting policies, the truth and fairness of financial statements, the existence of fraud within the entity and effectiveness of the audit report in communicating the extent of work performed by the auditor.

**Table 4.4 Comparative responses – Reliability statements**

		[Percentages]				
		Strongly Agree	Agree	Not Sure	Disagree	Strongly Disagree
<b>8</b> Users can have absolute assurance that the financial statements contain no material Misstatements	Auditors	0.0	11.8	17.6	64.7	5.9
	Bankers	23.8	47.6	14.3	14.3	0.0
	Investors	0.0	50.0	16.7	33.3	0.0
<b>9</b> The auditor does not agree with the accounting policies used in the financial statements	Auditors	0.0	0.0	5.9	52.9	41.2
	Bankers	0.0	14.3	28.6	23.8	33.3
	Investors	0.0	16.7	16.7	58.3	8.3
<b>10</b> The extent of assurance given by the auditor is clearly indicated	Auditors	5.9	76.4	5.9	11.8	0.0
	Bankers	28.6	61.9	9.5	0.0	0.0
	Investors	8.3	75.0	8.3	8.4	0.0
<b>11</b> The financial statements give a true and fair view	Auditors	17.7	76.4	0.0	5.9	0.0
	Bankers	28.6	71.4	0.0	0.0	0.0
	Investors	33.3	66.7	0.0	0.0	0.0
<b>12</b> The entity is free from fraud	Auditors	0.0	41.2	5.9	35.3	17.6
	Bankers	28.6	42.9	19.0	0.0	9.5
	Investors	8.3	41.7	25.0	25.0	0.0
<b>13</b> The extent of audit work performed is clearly Communicated	Auditors	5.9	76.4	0.0	17.7	0.0
	Bankers	47.5	42.9	4.8	4.8	0.0
	Investors	25.0	58.3	0.0	16.7	0.0

The table shows that there is agreement between the auditors and non-auditors, that the financial statements give a true and fair view (statement 11), with the exception of

a small minority of auditors. An expectation gap was found to exist with regard to the level of assurance provided by the audit report. An analysis of the responses to statement 8 revealed that 71.4 per cent of bankers and 50 per cent of investors believe that the audit report gives absolute assurance that the financial statements contain no material misstatement and a further 14.3 per cent of bankers and 16.7 per cent of investors are unsure about the level of assurance provided by the audit report. Interestingly, 11.8 per cent of auditors thought that the audit report gave absolute assurance and 17.6 per cent indicated their uncertainty as to the level of assurance given in the audit report. The researcher believes that this may be linked to the uncertainty of auditors regarding their fraud detection and prevention responsibilities as evidenced in Table 4.3 (statements 1 and 5) and may be the result of the ever increasing rules and regulations imposed on auditors in the current litigious environment. Related to the issue of assurance, statements 10 and 13 address the effectiveness of the audit report in explaining the extent of audit work performed and the assurance provided. The vast majority of auditors and non-auditors agree that the extent of assurance given is clearly indicated and the extent of audit work is clearly communicated. However, it is worth noting that 11.8 per cent of auditors disagreed that the level of assurance given was clearly indicated and 5.9 per cent were unsure. Similarly, 17.7 per cent of auditors and 16.7 per cent of investors believed that the extent of audit work performed was not clearly communicated. This may suggest that the both issues need to be clarified in the audit report.

The result of statement 12 suggests that a substantial proportion (71.5 per cent of bankers and 50 per cent of investors) of non-auditors view the audit report as a guarantee that the entity is free from fraud. Furthermore, 19 per cent of bankers and 25 per cent of investors were uncertain as to whether the entity was free from fraud. Notably, 41.2 per cent of auditors indicated that they believed that the entity was free from fraud and 5.9 per cent were unsure. This confirms the suggestion that auditors are uncertain as to their responsibilities with respect to fraud. The result of statement 9 indicates that the auditor and non-auditor groups largely believe that the auditor is in agreement with the accounting policies used in the financial statements. However, 14.3 per cent of bankers and 16.7 per cent of investors believe the auditor does not agree with the accounting policies used. This may be an indication that there is a need to clarify this issue in the audit report.

#### 4.2.4 Usefulness of audited financial statements

Three statements address the usefulness of audited financial statements in performance monitoring, decision-making and assessing the management of the entity.

**Table 4.5 Comparative responses – Decision usefulness statements**

		[Percentages]				
		Strongly Agree	Agree	Not Sure	Disagree	Strongly Disagree
<b>14</b> The audited financial statements are not useful in monitoring the performance of the entity	Auditors	0.0	0.0	5.9	88.2	5.9
	Bankers	4.8	4.8	14.3	57.1	19.0
	Investors	0.0	0.0	0.0	83.3	16.7
<b>15</b> The audited financial statements are not useful in making decisions	Auditors	0.0	0.0	5.9	88.2	5.9
	Bankers	0.0	0.0	4.8	61.9	33.3
	Investors	0.0	0.0	0.0	75.0	25.0
<b>16</b> The entity is well managed	Auditors	0.0	41.2	29.4	29.4	0.0
	Bankers	0.0	47.6	42.9	9.5	0.0
	Investors	0.0	50.0	33.3	16.7	0.0

The majority of respondents indicated that they believed the audited financial statements to be useful in the decision making process (Statement 15). A small minority i.e. 5.9 per cent of auditors and 4.8 per cent of bankers were unsure as to the usefulness or otherwise of the audited financial statements. Statement 14 yielded similar results with the majority of auditors and non-auditors indicating that they believed the audited financial statements to be useful in monitoring the performance of the entity. 9.6 per cent of bankers believed that the audited financial statements were not useful in monitoring the performance of the entity and a further 14.8 per cent of bankers were not sure as to their usefulness in monitoring performance. With the exception of a small minority, it can be seen that an expectation gap does not exist with regard to the usefulness of the financial statements in either performance monitoring or decision-making. Whilst statement 16 revealed no significant evidence of an audit expectation gap, it is interesting to note that in excess of 50 per cent of both auditors and non-auditors were either unsure whether or not the entity was well



managed or believed that it was not well managed. This may indicate that auditors and non-auditors are reluctant to depend on the audit report as a measure of management ability.

### **4.3 Interview findings**

Semi-structured interviews were conducted with each of the three professional accountancy bodies in Ireland that are involved in auditing. The purpose of these interviews was to ascertain their views about the audit expectation gap and how it may be narrowed. The interviewees were guaranteed anonymity therefore; they will be referred to as interviewee 1, 2 and 3. Transcripts of the interviews are included in Appendix B.

#### **4.3.1 Public expectations of the auditing profession**

A common feature of all three interviews was the belief that

‘a huge disparity exists between what the public think the auditor does and what the auditor actually does’ (interviewee 2).

The interviewees also stated that there was a need to distinguish between financial analysts/ stockbrokers and members of the general public. There seemed to be a consensus that the general public are merely ‘passive observers’ (interviewee 3) whereas:

‘a financial analyst/ stockbroker would be more aware of what an auditor does and would be able to make more informed decisions on that basis’ (interviewee 2).

It was felt that society in general

‘doesn’t have a huge idea of what auditors do. They think that once an audit is signed off that everything is perfect, but society in general are not investors. Investors in the main do understand. The problem with the average prudent investor is that they don’t look at the accounts’ (interviewee 1).

Interviewee 1 was of the opinion that investors rely ‘more on the chairmans statement and the directors report’ than on the audited financial statements.

#### **4.3.2 Causes of the expectation gap**

The interviewees agreed that the audit expectation gap couldn't be entirely attributed to the ignorance of the users of audited financial statements. They attributed the existence of the gap to a lack of interest on the behalf of the users of the financial statements. Interviewee 1 stated that

‘I think a gap exists because people don't take the time to read the financial statements’.

According to interviewee 3 the existence of the audit expectation gap may be partly attributed to company law. The interviewee felt that the gap exists because:

‘company law only allows the auditor to express one form of report, whilst if there were other forms of report permitted, then perhaps there would be a greater understanding by users of accounts as to what is trying to be achieved.’

Interviewee 1 is of the opinion that the accounting profession itself may contribute to the existence of the gap. They feel that

‘the profession itself has questions to answer in terms of whether the accounting standards are robust enough. Some of the standards allow too many options e.g. IAS 19 Employee Benefits and IAS 26 Deferred Tax. This makes it more difficult for users to interpret accounts’.

### **4.3.3 Effects of the audit expectation gap on the auditing profession**

There was a general feeling that the recent financial reporting scandals, which resulted in the collapse of large corporate multinational companies has brought auditing into the spotlight. Barnes et al (1993) note that in such situations, the question that most people ask is ‘where was the auditor?’ and this is often ‘followed by claims of incompetence, negligence and lack of auditor independence.’ Such corporate collapses have impacted on the reputation of the auditing profession worldwide. According to interviewee 3

‘the audit expectation gap has resulted in increased regulation. In fact, the amount of regulation on the audit profession is almost at breaking point.’

This escalation in the volume of rules and regulations has had multiple effects on the auditing profession. According to interviewee 3

‘It has reached the level whereby many audit firms are thinking about packing it in. They are almost at that point and it won’t take much more to force them to it. There is an increase in costs and training as well as the fear- the fear that you are going to get it wrong. Regardless of how much quality work you put into it, there is a huge fear that you are going to miss something...it’s getting to the point where most firms think that audit is just not worth the effort anymore’.

#### **4.3.4 The Effect of the existing duties of auditors on the auditing profession**

With the exception of interviewee 2, the other professional bodies believed that the existing duties of auditors were too demanding. Interviewee 1 stated that in relation to the audit of large publicly quoted companies

‘the duties are too onerous especially when you consider that there is joint and several liability which means that if the auditor is only 5% responsible he may end up paying 100% of the bill’.

The additional duties such as the duty to report indictable offences have had a major impact on the audit of smaller companies. According to interviewee 1

‘Suddenly, you’ve gone from being an advisor to a policeman. The working relationship between the client and the auditor has changed, instead of there being working co-operation with the client to keep them compliant and keep them on track, now they will be more inclined to hide it from you rather than show it to you’.

All of the interviewees indicated that they believed the present system of practice review is an effective method of ensuring that auditors comply with the rules and regulations imposed on them.

#### **4.3.5 The impact of the provision of non-audit services on the expectation gap**

The interviewees agreed that the provision of non-audit services could impact on the auditors decision to qualify the audit report. According to interviewee 3

‘the challenge for the auditor is to strike the right balance using their judgment’.

Whilst interviewee 2 recognised the potential conflict of interest that may arise by the provision of non-audit services, they also made reference to the potential benefits of the provision of such services. It was felt that the provision of such services was a ‘double-edged sword’. Whilst it may result in an unwillingness to qualify the audit report, it often allows the auditor to gain an in-depth understanding of the client

entity. Interviewee 2 felt that this additional knowledge of the client might mean that the auditor is ‘ more likely to uncover going concern or fraud issues’. There was a general agreement amongst the interviewees that the ‘ethical rules provide a reasonable basis for the provision of non-audit services’ (interviewee 1). However, interviewee 3 acknowledged that there is a need to separate audit services from non-audit services and the ‘idea of the one-stop shop is gone’.

#### **4.3.6 Methods of reducing the audit expectation gap**

Whilst the interviewees acknowledged that the audit expectation gap was probably at its widest where going concern and fraud are concerned, they agreed that the expansion of auditors duties with respect to fraud detection and reporting would not be an effective method of reducing the expectation gap. It was believed that such a move ‘wouldn’t be realistic’ (interviewee 3) and that the audit process would become ‘much more difficult and costly’ (interviewee 2).

All interviewees welcomed audit education. Audit education ‘goes to the heart of the audit expectation gap’ (interviewee 2). Whilst interviewee 1 felt that if people read the audit report they would understand it, they also acknowledged that there was a need to educate shareholders about the meaning of financial statements before educating them about the meaning of audit reports. There was a strong belief amongst the interviewees that the key to reducing the audit expectation gap lies in the education of company directors. ‘ The education of directors is critical’ (Interviewee 3). According to interviewee 2

‘it has been proven in recent years, in this country in particular, that directors have been blissfully ignorant of their duties and obligations and legal position as company directors’.

Interviewee 3 suggested that

‘Perhaps there should be some requirement for them to have more formal education, before they are allowed to become a company director’.

The interviewees agreed that a change from the existing standardised wording of audit reports to ‘free-form’ reporting would not reduce the audit expectation gap.

Interviewee 1 expressed the opinion that

‘if there was a move to free-form reporting then auditors would try to think of how nicely they could say how wonderful their client was. Free-form reporting would make very little sense.’

Interviewee 2 felt that the use of free-form reports ‘would result in an increase in litigation taken against auditors’. There was a consensus that the existing standardised wording of audit reports promoted consistency and helped to reduce levels of misunderstanding amongst users of audit reports. The interviewees saw no merit in the use of ‘free-form’ reporting. According to interviewee 3

‘If auditors could use any wording that they wished, then the expectation gap would increase.’

Interviewees were divided over the suggestion of Robert Medwick (1986) that the audit report should be accompanied by a supplementary explanation of the audit including its limitations and the meaning of the audit report. Interviewee 1 believed that the audit report ‘has as much information as the user needs’. Interviewee 2 was in agreement with this statement. However, interviewee 3 suggested that

‘A one-page summary explaining why the audit report is structured in the way that it is and an explanation of the meaning of the audit report may be very useful. Whilst a booklet would probably be ignored, a short one-page explanation may be what is needed’.

#### **4.4 Conclusion**

The results of the survey instrument revealed that an audit expectation gap exists particularly in relation to the issues of fraud detection and prevention, internal control, the use of judgment in the selection of audit procedures and the level of assurance given by the audit report. The semi-structured interviews with the accountancy bodies revealed that the audit expectation gap has had an adverse impact on the auditing profession. The interviewees believed that audit education would be the most effective method of reducing the gap. The representatives of the accountancy bodies also made a number of other suggestions including the appointment of audit committees and internal auditors. They also gave practical examples of how they believed the audit expectation gap might be narrowed. These suggestions and practical examples will be discussed further in chapter 5 Recommendations and conclusions.

## Chapter 5

### CONCLUSIONS & RECOMMENDATIONS

#### 5.1 Introduction

The objectives of this study were as follows: to examine the nature of the audit expectation gap, to study the proposals that currently exist for bridging the expectation gap, to investigate whether or not the audit expectation gap exists in Ireland and to determine Irish practitioners views on bridging the audit expectation gap. The purpose of this chapter is to summarise the main findings of the research and to draw conclusions and make recommendations based on the findings of the study.

#### 5.2 The research process

An initial review of the existing literature revealed a lack of evidence of the existence of the audit expectation gap in the Irish context. The researcher also observed a lack of evidence of the opinions of the Irish accountancy profession regarding the audit expectation gap and how it may be resolved. A review of the existing literature resulted in the development of a research question, which was further refined into research aims and objectives.

The objectives of the research were achieved in the following manner; the nature of the audit expectation gap and the proposals that currently exist to bridge the gap were examined by extensively reviewing the existing literature on the subject as evidenced in chapter 2 Literature review. The researcher then considered the most appropriate research methodology required in order to answer the research question and to achieve the aims and objectives of the research, as outlined in chapter 3 Research Methodology. The researcher believed that this study was predominately qualitative in nature, however the analysis of existence of the gap in the Irish context involved the use of quantitative data. Therefore the researcher has used a combination of both the phenomenological and positivist approaches. The existence of the audit

expectation gap in the Irish context was determined by sending a questionnaire to a sample of auditors, investors and bankers. The main findings of the survey are outlined in section 5.3.1. The views of Irish practitioners were obtained by carrying out three semi-structured interviews with representatives of the professional accountancy bodies. The main findings of which are outlined in section 5.3.2.

### **5.3 Overview of the main findings**

#### **5.3.1 Survey findings**

An analysis of the results of the survey revealed that an audit expectation gap exists with regard to the following issues: fraud detection and prevention, responsibility for internal controls, responsibility for the maintenance of accounting records, the auditors use of judgement in the selection of audit procedures, the level of assurance given by the audit report, the existence of fraud within the entity and the extent of the agreement of the auditor with the accounting policies used.

The survey also revealed that a small percentage of the auditors surveyed believed that the level of assurance given by the audit report was not clearly indicated. Similarly, a small number of auditors believed that the extent of the audit work performed was not clearly communicated in the audit report. In relation to accounting policies adopted by the client, a number of auditors surveyed indicated that they believed the auditor was not in agreement with the accounting policies adopted. Surprisingly, quite a number of auditors were of the belief that the audit report gave absolute assurance that the financial statements contain no material misstatement and 41.2 per cent of auditors surveyed thought that the entity was free from fraud. The results of the survey also indicated that in excess of 50 per cent of both auditor and non-auditor groups were either unsure whether or not the entity was well managed or believed that it was not well managed. The researcher believes that the auditors apparent lack of understanding of the messages conveyed in the audit report may arise from the profusion of rules and regulations governing the profession and the pace at which changes in the rules and regulations occur.

### **5.3.2 Interview findings**

There was a common perception among the interviewees that a gap exists between what the users of audited financial statements think an auditor does and what the auditor actually does i.e. that an audit expectation gap does exist in the Irish context. Interviewees also stressed that there is a need to distinguish between the average member of the public and more informed users of accounts. It was generally accepted that the audit expectation gap does not apply to members of the general public, as their interest in the auditing process is minimal. The interviewees were of the opinion that the audit expectation gap refers exclusively to users of audited financial statements.

The interviewees attributed the causes of the gap to: users lack of interest in the audit process, the rigidity of company law and complex accounting standards. Interviewees acknowledged the threat, which the provision of non-audit services may pose to auditor independence, but it was felt that the ethical rules provide a reasonable basis for the provision of such services.

With regard to the resolution of the audit expectation gap, the representatives of the accountancy bodies rejected the idea put forward by Humphrey et al (1992) of extending the auditors duties with regard to fraud detection and prevention. It was envisaged that such a proposal would result in increased audit fees, without any perceived value added from the audit clients' perspective. Similarly, it was believed that the use of free-form reporting (Estes, 1982) would not be an effective method of bridging the audit expectation gap. Interviewees agreed that free-form reporting would lead to variations in the form and style of audit report, thereby creating inconsistencies between audit reports. Such inconsistencies would make comparisons between audit reports difficult and hence, increase users misunderstanding of the meaning of the audit report.

There was a lack of consensus regarding the suggestion of Robert Medwick (1986) regarding the use of a supplementary explanation of the meaning and limitations of the audit. Whilst, interviewee 1 and interviewee 2 felt that such an explanation would be ignored by users of audited financial statements, interviewee 3 suggested that a one-page explanation may increase users understanding of the audit report. All



interviewees agreed that audit education would be an effective method of bridging the audit expectation gap. It emerged that two groups in particular need to be educated i.e. shareholders and directors. It was suggested that audit education should begin by explaining the meaning and significance of the primary financial statements before explaining the audit process.

#### **5.4 Strengths & limitations of the research**

The main strength of this study lies in the achievement of all research questions, aims and objectives. Other strengths include the inclusion of the views of all the professional bodies through the use of semi-structured interviews as well as the participation of a reasonable number of auditors, bankers and investors in the research process. The main benefit of this research is that it provides current evidence of the existence of the audit expectation gap in the Irish context as well as the provision of practical solutions to the problem.

However, this research is not without limitations. The study completed was part of a masters in accounting programme, which consisted of various other subjects, assignments and presentations. Therefore, time constraints limited the amount of interviews and survey instruments used. The study was also privately funded, therefore the amount of questionnaires administered and telephone interviews conducted were dependent upon the limited resources of the researcher. The researcher capitalised on the resources available to them by carrying out in-depth interviews with representatives of the professional accountancy bodies, who the researcher believes are representative of the population as a whole. However, it must be noted that no consideration has been given to the views of individual practitioners in this study. It must also be noted that the survey responses from auditors were limited to auditors located in county Donegal. A major limitation of the use of a postal questionnaire is that the researcher cannot be assured that the respondent has the appropriate level of knowledge of the subject matter. The researcher attempted to overcome this limitation by addressing the survey instrument to the person in the appropriate position of authority. Another limitation of the use of survey instruments is the low response rate. The researcher attempted to maximise the response rate by enclosing a stamped addressed envelope with each questionnaire.

## 5.5 Overall conclusions and recommendations

It has been suggested that a number of the recent high profile corporate collapses such as Maxwells, Pollypeck and Enron were partly the result of audit failure. In the wake of such scandals, the main challenge facing the audit profession is to restore public confidence in the audit process. In order to rebuild faith in the audit profession and restore the professions reputation and credibility, it is vital that efforts are made to bridge the audit expectation gap. This study contributes to the existing research by providing evidence of the existence of the audit expectation gap in the Irish context and combines the opinions of the professional accountancy bodies to suggest practical methods of bridging the gap.

This study confirms that the audit expectation gap does exist in the Irish context and that it has had a major impact on the auditing profession in Ireland. It has resulted in an over abundance of rules and regulations, which are adversely affecting the profession. There is a real possibility that the cost of complying with the new rules as well as the threat of litigation may cause registered auditors to consider alternative professions as well as deterring newly qualified accountants from entering the auditing profession. This reluctance to join the profession may lead to a skills shortage and result in a situation whereby a small number of companies carry out the majority of audits in this country.

The findings of the in-depth interviews strongly suggest that audit education would be the most effective method of reducing the expectation gap. Education would be most effective if it focuses on both shareholders and company directors. According to interviewee 3 it is

‘no wonder there is an expectation gap when directors themselves are uneducated in terms of what their legal responsibilities are. It seems crazy that in this country, in order to get a licence to drive a car you need to do a driving test but in order to get a licence to drive a company you don’t need any test’.

Education should explain the meaning and purpose of financial statements as well as the audit process. As highlighted by interviewee 3, the education of directors would have a two-fold effect; directors would be more proficient in their role as company directors as well as being more informed users of financial statements. All interviewees agreed that the education of shareholders and company directors is a

realistic goal, which could be achieved through the co-operation and involvement of both government bodies and the professional accountancy bodies. There are many ways in which this could be achieved including: the use of advertisements on television, radio and newspapers. According to interviewee 2 ‘there is no reason that with some creative thinking a television programme couldn’t be put together to educate people about audit matters and general investment issues’. The researcher believes that in order to bridge the audit expectation gap, there should be mandatory training of company directors prior to company registration. Some may argue that such mandatory training may deter individuals from becoming company directors thereby stifling entrepreneurship and employment. However, the researcher believes that the benefits of such training would outweigh the negatives and suggests that the provision of related tax incentives would facilitate acceptance of the initiative. This would ensure that all company directors are aware of their legal responsibilities and duties as well as the duties of the auditor. Education would increase understanding of the meaning and limitations of the audit, thereby reducing the expectation gap.

Audit committees may also have a role to play in narrowing the gap. The audit committee should ensure that the directors discharge their function of detecting fraud effectively. Interviewee 1 stated that ‘if audit committees perform their role correctly, then there wouldn’t be an expectation gap’. Interviewee 3 suggested that directors could use internal audit as a means of preventing and possibly detecting fraud. Interviewee 3 also suggested that a one-page explanation of the meaning and limitations of the audit should accompany the audit report.

The findings of this study give a valuable insight into the existence of the audit expectation gap in Ireland and the views of the professional accountancy bodies regarding proposals to bridge the gap. This study considered the existence of the expectation gap without further analysing it into its constituent parts. This study may provide a basis for future research into the existence of the reasonableness gap and the performance gap in the Irish context. Research may also be usefully directed at obtaining the views of individual practitioners regarding how the gap may be narrowed. A major finding of this study is the potential benefits which the education of company directors may have in bridging the expectation gap. A comparison of the

level of accounting qualifications of directors with the extent of the audit expectation gap among directors may be useful in assessing the benefits of director education.

## APPENDIX A

### 1.1 Questionnaire

#### Section 1

Please **tick** your response.

1. Do you have:

- |                              |                              |                             |
|------------------------------|------------------------------|-----------------------------|
| ▪ Accounting qualifications: | Yes <input type="checkbox"/> | No <input type="checkbox"/> |
| ▪ Accounting experience      | Yes <input type="checkbox"/> | No <input type="checkbox"/> |

If yes:

- |               |                          |
|---------------|--------------------------|
| 1-5 years     | <input type="checkbox"/> |
| 6-10 years    | <input type="checkbox"/> |
| 11-15 years   | <input type="checkbox"/> |
| Over 16 years | <input type="checkbox"/> |

2. What is your occupation?

- |                                      |  |
|--------------------------------------|--|
| Banker <input type="checkbox"/>      | Stockbroker <input type="checkbox"/>       |
| Auditor <input type="checkbox"/>     | Financial analyst <input type="checkbox"/> |
| Shareholder <input type="checkbox"/> | Other <input type="checkbox"/>             |

3. How long have you been in your present occupation?

- |               |                          |
|---------------|--------------------------|
| 1-5 years     | <input type="checkbox"/> |
| 6-10 years    | <input type="checkbox"/> |
| 11-15 years   | <input type="checkbox"/> |
| Over 16 years | <input type="checkbox"/> |

#### Section 2

This section addresses your perception of the messages conveyed in the audit report.

Note: An audit report is attached should you wish to refer to it.

You are required to indicate **your** agreement with each statement by ticking the most appropriate box.

Please place one **tick** per question.

	Strongly Agree	Agree	Not sure	Disagree	Strongly Disagree
1. The auditor is responsible for detecting all fraud	()	()	()	()	()
2. The auditor is responsible for the soundness of the internal control structure of the entity	()	()	()	()	()

	<b>Strongly Agree</b>	<b>Agree</b>	<b>Not sure</b>	<b>Disagree</b>	<b>Strongly Disagree</b>
3. The auditor is responsible for maintaining accounting records	( )	( )	( )	( )	( )
4. Management has responsibility for producing the financial statements	( )	( )	( )	( )	( )
5. The auditor is not responsible for preventing fraud	( )	( )	( )	( )	( )
6. The auditor is unbiased and objective	( )	( )	( )	( )	( )
7. The auditor does not exercise judgement in the selection of audit procedures	( )	( )	( )	( )	( )
8. Users can have absolute assurance that the financial statements contain no material misstatements	( )	( )	( )	( )	( )
9. The auditor does not agree with the accounting policies used in the financial statements	( )	( )	( )	( )	( )
10. The extent of assurance given by the auditor is clearly indicated	( )	( )	( )	( )	( )
11. The financial statements give a true and fair view	( )	( )	( )	( )	( )
12. The entity is free from fraud	( )	( )	( )	( )	( )
13. The extent of audit work performed is clearly communicated	( )	( )	( )	( )	( )
14. The audited financial statements are not useful in monitoring the performance of the entity	( )	( )	( )	( )	( )
15. The audited financial statements are not useful in making decisions	( )	( )	( )	( )	( )
16. The entity is well managed	( )	( )	( )	( )	( )

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## INDEPENDENT AUDITOR'S REPORT TO THE SHAREHOLDERS OF XYZ LIMITED

We have audited the financial statements of (name of entity) for the year ended ... which comprise [state the primary financial statements such as the Profit and Loss Account, the Balance Sheet, [the Cash Flow Statement,] the Statement of Total Recognised Gains and Losses] and the related notes 1.

These financial statements have been prepared under the accounting policies set out therein and the requirements of the Financial Reporting Standard for Smaller Entities.

### Respective responsibilities of directors and auditors

As described in the Statement of Directors' Responsibilities the company's directors are responsible for preparing the financial statements in accordance with applicable law and Generally Accepted Accounting Practice in Ireland including the accounting standards issued by the Accounting Standards Board.

Our responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland).

We report to you our opinion as to whether the financial statements give a true and fair view in accordance with Generally Accepted Accounting Practice in Ireland applicable to Smaller Entities and are properly prepared in accordance with the Companies Acts, 1963 to 2005. We also report to you whether in our opinion: proper books of account have been kept by the company; whether at the balance sheet date, there exists a financial situation requiring the convening of an extraordinary general meeting of the company; and whether the information given in the directors' report is consistent with the financial statements. In addition, we state whether we have obtained all the information and explanations necessary for the purposes of our audit, and whether the financial statements are in agreement with the books of account.

We also report to you if, in our opinion, any information specified by law regarding directors' remuneration and directors' transactions is not disclosed and, where practicable, include such information in our report.

We read the directors' report and consider the implications for our report if we become aware of any apparent misstatements within it.

### Basis of audit opinion

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgments made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the company's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements.

### Opinion

In our opinion the financial statements:

- give a true and fair view, in accordance with Generally Accepted Accounting Practice in Ireland applicable to Smaller Entities, of the state of the company's affairs as at ... and of its profit [loss] for the year then ended; and
- have been properly prepared in accordance with the Companies Acts, 1963 to 2005.

We have obtained all the information and explanations which we consider necessary for the purposes of our audit. In our opinion proper books of account have been kept by the company. The financial statements are in agreement with the books of account.

In our opinion the information given in the directors' report is consistent with the financial statements.

The net assets of the company, as stated in the balance sheet are more than half of the amount of its called-up share capital and, in our opinion, on that basis there did not exist at ... a financial situation which under Section 40 (1) of the Companies (Amendment) Act, 1983 would require the convening of an extraordinary general meeting of the company.

*Registered auditors Address*

*Date*

**APPENDIX B****2.1 Interview Questions**

1. Do you think that the audit expectation gap has contributed to the increased litigation taken against auditors in recent times?
2. What other effects has it had on the accounting profession?
3. Research suggests that the existence of the expectation gap cannot be entirely attributed to the ignorance of users of financial statements. Do you agree or disagree with this statement?
4. In your opinion does society in general have unrealistic expectations of auditors? If so, in what way?
5. Do you think that the existing duties of auditors are too demanding? If so, in what way?
6. What safeguards are in place to ensure that auditors perform their existing duties properly? How effective are the existing safeguards?
7. Porter (1993) found that the deficient performance gap was at its widest where going concern and fraud were concerned. Do you feel that this would still be the case?
8. What effect do you think the high profile corporate scandals have had on the public's perceptions of auditors performance? Has the gap widened with respect to going concern and fraud?
9. Do you think that the provision of non-audit services would impact on the auditors decision to qualify an audit report?
10. It has been suggested that one method of reducing the expectation gap would be the expansion of auditors duties with regard to fraud detection and reporting i.e. the auditor would approach the audit with the view that material fraud had occurred until he/she could prove otherwise. How realistic would this be? What effect would it have on companies?



11. Pierce and Kilcommins (1997) concluded that audit education reduced the levels of user misunderstanding and therefore resulted in a narrowing of the audit expectation gap. How effective would such an approach be?
12. Do you think that there is a need to educate the public about auditors responsibilities/ the audit process? How could this be achieved?
13. Boyle et al (2005) suggested that exposure to audit education can significantly increase perceptions of deficient auditor performance. Do you agree with this statement?
14. The use of 'free-form' reporting has been suggested as a means of reducing the expectation gap. Do you think that changing the existing standardised wording of the audit report would reduce the gap?
15. In your opinion, would a change from standardised wording to free-form reporting change the way in which audit firms compete i.e. there would be more emphasis on quality rather than cost?
16. Robert Medwick (1986) suggested that the audit report should be accompanied by a supplementary explanation of the audit including its limitations and the meaning of the audit report. How effective do you think this approach would be in bridging the expectation gap?
17. In your opinion, what would be the most effective way of reducing the audit expectation gap?
18. Are there any other comments that you wish to make?

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## APPENDIX B

### 2.2 Interviewee 1

**1. Do you think that the audit expectation gap has contributed to the increased litigation taken against auditors in recent times?**

No. I don't think that it's the audit expectation gap. I think that its peoples perception that auditors have deep pockets and they are an easy target. It is an increase in litigation consciousness of investors, not necessarily there being some gap. I think that professional investors understand the role of an auditor but in the event of company failure they look for someone to blame.

**2. What other effects has the expectation gap had on the accounting profession?**

I think there is a difference between large company audit and small company audit. By large I mean quoted company audit. I think in terms of large company audit, auditors are very much changing and improving the quality of the audit. The failure of a large company can lead to the downfall of the audit firm in fact it has done.e.g. Enron. The big4 may become the big3 very shortly. So, in terms of the quoted company sector, it may be very worrying. Having said that, there is a lot more information available and IASSA would closely monitor auditing. In terms of small company audit there is a tendency to blame anything that goes wrong on the auditor but this has always been the case because the auditor has professional indemnity insurance. I actually know of one case where the auditor was set up by a small client and the auditor was deemed responsible for it. I think that this would deter people from registering as an auditor. However, I understand that after the Enron scandal there was a rush of people trying to become accountants, but in Ireland there is certainly less people willing to set up as registered auditors. Also the increase in the audit exemption will mean that there will be fewer companies subject to audit in Ireland

**3. Research suggests that the existence of the expectation gap cannot be entirely attributed to the ignorance of users of financial statements. Do you agree or disagree with this statement?**

I think that a gap exists because people don't take the time to read the financial statements, its not necessarily because of the ignorance of the users of financial statements.

**4. In your opinion, does society in general have unrealistic expectations of auditors?**

Society in general doesn't have a huge idea of what auditors do. They think that once an audit is signed off that everything is perfect, but society in general is not investors. I think that investors in the main do understand. The problem with the average prudent investor is that they don't look at the accounts. How many people have invested in Bank of Ireland shares and have never looked at the accounts? If you consider the financial statements of Elan for example, you will first of all get two profit figures one for US GAAP and one for UK GAAP. The UK GAAP will show a loss the US GAAP will show a profit. It will have approximately 130 pages of detailed accounting policy notes, statutory paragraphs. I think that a lot of accountants probably wouldn't understand it! . I think that people are relying more on the chairman's statement and the director's report rather than on the financial statements. Analysts probably look at the financial statements but analysts aren't the average investor. Indeed the profession itself has questions to answer in terms of whether the accounting standards are robust enough. Some of the standards allow too many options e.g. IAS 19 employee benefits and IAS 26 Deferred Tax. This makes it more difficult for users to interpret accounts.

**Do accountants understand their role?**

If you look at what sir David Tweedie said about IAS 39 which is FRS 26, he said that only 1% of accountants understood it.

**5. Do you think that the existing duties of auditors are too demanding?**

Yes, they are. Again you have to consider the different sectors i.e. the large publicly quoted companies and the small companies. In terms of the large sector, the duties are too onerous especially when you consider that there is joint and several liability which means that if the auditor is only 5% responsible he may end up paying 100%

of the bill. I think that there should be limited liability partnerships like there are in the UK. In terms of the small sector, there have been so many additional responsibilities piled on auditors like a duty to report indictable offences. Suddenly, you've gone from being an advisor to a policeman. The working relationship between the client and the auditor has changed, instead of there being working co-operation with the client to keep them compliant and keep them on track, now they will be more inclined to hide it from you rather than show it to you.

**6. What safeguards are in place to ensure that auditors perform their existing duties properly? How effective are they?**

In the republic, we have IAASA. In terms of the auditors themselves, auditors are subject to monitoring by their professional bodies. If you are an auditor of a publicly quoted company, your premises will be visited once every three years, if the audit files are not in accordance with auditing standards then they can take away your licence to audit. That oversight function is also overseen by IAASA to ensure it is applied consistently.

**Does this lead to greater consistency in approach from audit to audit?**

Yes, I think it does. The fact that it is very closely monitored and there is very precise auditing standards that tell you what to do. I think that there is quite a high level of auditing. Although no audit will pick up absolutely ever error, and it certainly has difficulty picking up director initiated fraud. I think an audit will pick up employee-initiated fraud if it is material.

**7. Porter (1993) found that the deficient performance gap was at its widest where going concern and fraud were concerned. Do you feel that this would still be the case?**

The issue in the event of company failure is that people in general think that auditors have deep pockets and are seen as a way of recouping their losses.

**8. What effect do you think the high profile corporate scandals have had on the public's perception of auditors performance? Has the gap widened with respect to going concern and fraud?**

I think that the public expect auditors to do their job but realise on occasion that they fail, which is usually as a result of the directors fault rather than the auditors.

**9. Do you think that the provision of non-audit services would impact on the auditors decision to qualify an audit report?**

Again there is the difference between quoted and unquoted companies. In the quoted sector, there are so few firms that have the resources to do the audits. E.g. Bank of Ireland basically have a choice between two auditors, no other firm has the resources to carry out the audit. So, if you are a very large company then there are only a small number of audit firms to choose from, which puts the auditor in a very strong position. They can charge the entire cost of the audit and make a profit on the audit. If the non-audit fee begins to become substantial then there could be a perception of it impinging on the auditor's opinion. I think that most if not all firms in the quoted sector certainly would have separate departments for dealing with non-audit services. It probably depends on the level and type of non-audit services being provided. There are obviously some services that you should not provide that would impinge on the audit function, but other services could be performed and would not see a problem with that. But, yes in an ideal world all non-audit services should be performed by another firm. In relation to a small company, the fact that you prepare the financial statements of the small company and then go and audit them, yes that is a conflict. But at the end of the day that small company probably shouldn't have been audited because there is no public interest in it being audited. Are you going to impose that one person should do the accounts and another perform the audit? Then yes you may find the occasional error, but the benefit will probably not outweigh the cost. So, in terms of the small audit I don't see a problem with the auditor preparing the accounts and doing the audit. I think the ethical rules provide a reasonable basis for the provision of non-audit services for the larger entities.

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**10. It has been suggested that one method of reducing the expectation gap would be the expansion of auditors duties with regard to fraud detection and reporting i.e. the auditor would approach the audit with the view that material fraud had occurred until he/ she could prove otherwise. How realistic would this be/ what effect would it have on companies?**

I think it would be unrealistic to try to persuade members of the public what exactly the segregation of duties between the auditor and the directors is. I don't think that the public is interested and I think that analysts probably know already.

**11. Pierce and Kilcommins (1997) concluded that audit education reduced the levels of user misunderstanding and therefore resulted in a narrowing of the audit expectation gap. How effective would such an approach be?**

I think that if people actually read the audit report, it sets out the respective duties of the auditors and directors. People won't even read the audit report. In their minds they think that someone has come and checked the accounts but they don't look at the accounts. I think if they actually read the audit report then they would understand the respective duties of the auditors and the directors. I think what is probably a better way round it is to look at it from the other end. For example, if large companies have audit committees it will ensure that directors actually discharge their function of detecting fraud and then the fraud will have been detected and therefore there won't be an expectation gap because the person primarily responsible for detecting it has done it. Section 42 of the 2003 companies act contains almost a full list of the duties of audit committees. If audit committees perform their role correctly then there wouldn't be an expectation gap.

**12. Do you think that there is a need to educate the public about auditors responsibilities/ the audit process? How could this be achieved?**

I don't think that the public need to be educated. I think that the investing community probably know already. The general public aren't interested, they don't get it, they don't need to get it because they don't invest. The average person doesn't have shares and the average person who has shares hasn't looked at the financial

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statements of the company. They have bought it based on a rumour. I think that they do need to be educated but you need to step back and educate them about the meaning of a set of financial statements before you educate them about the respective responsibilities of an auditor and a director.

**13. Boyle et al (2005) suggested that exposure to audit education can significantly increase perceptions of deficient auditor performance. Do you agree with this statement?**

I think that if you knew everything that an engineer did, you might be more suspicious that the bridge might fall down.

**14. The use of ‘free-form’ reporting has been suggested as a means of reducing the expectation gap. Do you think that changing the existing standardised wording of the audit report would reduce the gap?**

The wording would need to be very carefully crafted to distinguish and make it as understandable as possible and I think that if everyone is coming up with a different report then that is just going to make things worse. I think that the standardised report is far better. If you are trying to educate people about the subtle meaning of words, then it is much better to have a standardised report.

**15. In your opinion, would a change from the standardised wording to free form reporting change the way in which audit firms compete i.e. there would be more emphasis on quality rather than on cost?**

I think free form reporting would be a no-go. I think that if there was a move to free-form reporting then auditors would try to think of how nicely they could say how wonderful their client was. Free form reporting would make very little sense.

**16. Robert Medwick (1986) suggested that the audit report should be accompanied by a supplementary explanation of the audit including its limitations and the meaning of the audit report. How effective do you think this approach would be in bridging the expectation gap?**

I don't think it needs any supplementary information. The new audit report has as much information as the user needs, other than referring to actual auditing standards. The audit report is sufficiently long.

**17. In your opinion, what would be the most effective way of reducing the audit expectation gap?**

I don't think that there is an audit expectation gap. I think that there is an information gap. I think that people who interpret financial statements don't have an expectation gap. I think that when there is an audit failure it is determined that the auditors and directors are both a failure, but certainly it is the directors that go to jail. When a fraud occurs, people don't link the fact that the auditors should or shouldn't have detected that fraud. I don't think that they care, all they care about is that they have just lost a lot of money and the fifty year old that is dragged in front of the television screen to moan about how they have just lost their pension.

**18. Are there any other comments that you wish to make?**

I think that the theory of an audit expectation gap is fine. I think that the people who take the time to read financial statements and audit reports understand them. I think that the general public don't care about the financial statements in general or even understand them. I think that an information gap is probably a better term. I think that you need to have the information to form an opinion on the information to have that expectation gap



## APPENDIX B

### 2.3 Interviewee 2

**1 Do you think that the audit expectation gap has contributed to the increased litigation taken against auditors in recent times?**

Yes, definitely in recent times. There is a huge disparity between what the public think the auditor does and what the auditor actually does. I think that there is a difference between the average member of the public and a financial analyst or a stockbroker. The financial analyst/ stockbroker would be more aware of what an auditor does and would be able to make more informed decisions on that basis. The general public think that the auditor is a soft target, they have to be insured and if they can prove anything against the auditor then they will get money out of them. The average person does believe that the auditor can say with their hand on their heart that there is nothing wrong with the account, that the accounts are totally free of error. An audit involves taking a sample of items and procedures and processes. It would not be feasible for the auditor to check everything. A non-accountant would find it very difficult to comprehend the language that is used in an audit report.

**2. What other effects has the expectation gap had on the accounting profession?**

The litigation issue has certainly had a major impact on the profession and it has impacted on the reputation of the profession. The general public expect more from auditors than auditors are able to deliver. The collapse of seemingly successful companies has brought this to the fore in recent times.

**3. Research suggests that the existence of the expectation gap cannot be entirely attributed to the ignorance of users of financial statements. Do you agree or disagree with this statement?**

I think that people do not read audit reports. I think that the reason for this is that an audit report is not a light read and to an uneducated person it probably would not

make a lot of sense. I think that the audit expectation gap exists due to a lack of education about what an auditor does.

**4. In your opinion, does society in general have unrealistic expectations of auditors?**

Definitely. Society expects the auditor to be able to review the financial statements and the operations of an entity and be able to say without a shadow of a doubt that everything is in order.

**5. Do you think that the existing duties of auditors are too demanding?**

No. I think that they are clearly defined in the auditing standards and I think that the auditors adhere to them.

**6. What safeguards are in place to ensure that auditors perform their existing duties properly? How effective are they?**

All auditing firms are subject to in house monitoring and practice review. Their files are reviewed every few years for compliance with extant auditing standards. If auditors don't comply with them, then they are taken through the disciplinary process. Ultimately, they could lose their right to audit. This doesn't happen very often, but lesser disciplinary action does happen on a regular basis – this could be anything from a fine, to a restriction on the right to practice or the way in which they practice, restriction on the type of service that they offer to clients or restriction on the size of clients, publication by the institute. In a large number of cases they would be obliged to undergo training and to put in place processes and procedures to ensure that the problem doesn't arise again. These disciplinary procedures are effective and do act as a deterrent.

**7. Porter (1993) found that the deficient performance gap was at its widest where going concern and fraud were concerned. Do you feel that this would still be the case?**

I think that fraud and going concern will always be the issue. These are the most serious things that can be wrong with a set of financial statements. The main reasons for conducting an audit is to ensure that the entity is a going concern and is free from material fraud.

**8. What effect do you think the high profile corporate scandals have had on the public's perception of auditors performance? Has the gap widened with respect to going concern and fraud?**

No. I don't. I think that the audit expectation gap was always there. I think that those scandals have brought it to the fore, but I think that the audit expectation gap has always existed.

**9. Do you think that the provision of non-audit services would impact on the auditors decision to qualify an audit report?**

Its difficult to say that it doesn't. We try to put in place safeguards to ensure that it doesn't but has to have some impact on it.

**Do you think that there would be an expectation gap with regard to the independence of auditors?**

There is, it's a double-edged sword really. The provision of non-audit services by an auditor means that they have a more in depth knowledge of the business than would be possible during an audit. The auditor is probably more likely to uncover going concern or fraud issues because they have that additional knowledge of the firm that results from the provision of non-audit services. On the other hand, if it is a very good client and there is a question mark over whether or not the auditor should qualify or not qualify the audit report it is possible that the auditors opinion could be coloured by the provision of non-audit services. In my opinion, I think that the positives probably outweigh the negatives on that issue. The auditor would have a much better feel for the going concern aspects and have much more chance of uncovering fraud if it is there.

**10. It has been suggested that one method of reducing the expectation gap would be the expansion of auditors duties with regard to fraud detection and reporting i.e. the auditor would approach the audit with the view that material fraud had occurred until he/ she could prove otherwise. How realistic would this be/ what effect would it have on companies?**

That would be a complete change in the approach to the audit. The audit approach at the moment is based on a presumption that everything is o.k. and that the procedures that they carry out have a reasonable chance of detecting fraud if it is there rather than going out of their way to detect fraud. If you were to take the adversarial approach and assume that something was wrong before you start then the whole approach of the audit would change and the role of the auditor would change. It would become a much more difficult and costly process. This would have a huge effect on companies. The fact that the auditor conducts an audit on an annual basis is an imposition for the client. If the focus of the audit changed, then the clients would be trying to defend themselves against something that never happened in the first place. A very low percentage of companies would suffer from fraud. If you burden all the millions of companies that do everything right with presumption that they have committed fraud then it wouldn't improve the process for anybody.

**11. Pierce and Kilcommins (1997) concluded that audit education reduced the levels of user misunderstanding and therefore resulted in a narrowing of the audit expectation gap. How effective would such an approach be?**

I think that it would be effective. It has been proven in recent years, in this country in particular, that directors have been blissfully ignorant of their duties and obligations and legal position as company directors. They also fail to understand the responsibilities of the auditor. Directors of companies should be educated on their own responsibilities as directors and the responsibilities of the auditor.

**12. Do you think that there is a need to educate the public about auditors responsibilities/ the audit process? How could this be achieved?**

I think that there is a need to educate the public about the role and responsibilities of the auditor. I think that the media could be used to educate people in general, particularly television, radio perhaps to a lesser extent. Newspapers and magazines could also be used; I think that there is a lot that could be done. There is no reason that with some creative thinking that a television programme couldn't be put together to educate people about audit matters and general investment issues.

**13. Boyle et al (2005) suggested that exposure to audit education can significantly increase perceptions of deficient auditor performance. Do you agree with this statement?**

That's very true, because it goes to the heart of the audit expectation gap. An uneducated person will trust the auditor wholeheartedly and won't know any better. If they are educated as to the nature of the audit process e.g. the fact that sampling is used and 100% of transactions aren't checked and the difference between reasonable assurance and absolute assurance then they will think more about the level of assurance that is actually given. They will therefore become more aware of audit risk and consequently become more sceptical of the audit process. It is likely that they will become less trusting of the auditor. If a person were educated about the audit process then they would have more realistic expectations of the auditor.

**14. The use of 'free-form' reporting has been suggested as a means of reducing the expectation gap. Do you think that changing the existing standardised wording of the audit report would reduce the gap?**

I think that this would be very unrealistic. If the auditor has a list of issues that they must report on, then they are not going to write a report saying that I checked all the files and I'm satisfied that there is no fraud. I think that it would result in an increase in litigation taken against auditors and it would increase costs all round. Auditors wouldn't know what they had to report on so they'd either report on very little or report on absolutely everything that they did and the report would be very long.

**15. In your opinion, would a change from the standardised wording to free form reporting change the way in which audit firms compete i.e. there would be more emphasis on quality rather than on cost?**

No, I don't think that it would lead to a better quality audit. I think that is likely that it would increase costs all round. The audit report that currently exists works fine for at least 95% of companies.

**16. Robert Medwick (1986) suggested that the audit report should be accompanied by a supplementary explanation of the audit including its limitations and the meaning of the audit report. How effective do you think this approach would be in bridging the expectation gap?**

No. Because people don't read the audit report so they definitely wouldn't read a supplementary book that would accompany it. I think that it would be a waste of time. The information is there for anybody who wants to find it. Its not as though the information about the audit process isn't freely available, in addition the auditor will answer any questions that are asked of them at the AGM. The information is available on certain websites, that is perhaps another way of educating people is through the use of targeted websites.

**17. In your opinion, what would be the most effective way of reducing the audit expectation gap?**

I think education of the general public is the only way of reducing the audit expectation gap and this could be done, particularly through the use of the media.

**18. Are there any other comments that you wish to make?**

No. There are no further comments that I wish to make.

## APPENDIX B

### 2.4 Interviewee 3

#### **1. Do you think that the audit expectation gap has contributed to the increased litigation taken against auditors in recent times?**

I would think no. What has caused the increased litigation is simply poor work on the part of auditors. This is not a widespread thing; the quality of audit work in this country is very high. Unfortunately the few that have done poor quality work have received all the publicity. Enron and WorldCom etc have caused so much negative publicity around the world. This has resulted in increased regulation, which impacts on those auditors that are doing good work. Such firms must put increasing focus on the quality of their audit and perform to the highest possible standard. However, the reason for the expectation gap is not entirely attributable to auditors.

#### **Do you think that the audit expectation gap can be attributed to the misperceptions of the public? Re: Auditor's performance of their duties.**

I'm not sure what part the public has to play in the expectation gap- surely they are merely passive observers. However, there is certainly an expectation gap amongst users of financial statements. I'm not sure what the extent of the gap is at the moment, but it certainly exists. I think that when auditors do poor work, it widens the gap rather than narrows it. Such poor work has led to a climate of increasing regulation.

#### **2. What other effects has the expectation gap had on the accounting profession?**

Of course it has had an effect on the auditing profession. I think what needs to be done is that directors of companies need to be educated about their responsibilities. At the moment there is none or practically none. There is no education of company directors. There might be at very high levels in big corporate multinationals, maybe directors of those companies have had some training regarding their duties and responsibilities, but in the typical small Irish private company of which there are

around a hundred thousand I believe, they wouldn't have had any training whatsoever.

Many of them don't know what their duties are and the only people telling them what their duties are, are the auditors. The auditors have another job to do. It is not their primary job to tell directors what they are supposed to be doing and often auditors don't have time to explain everything to the directors and the fact of the matter is that nobody else is explaining it. No wonder there is an expectation gap when directors themselves are uneducated in terms of what their legal responsibilities are. It seems crazy that in this country, in order to get a licence to drive a car you need to do a driving test but in order to get a licence to drive a company you don't need any test. Basically all you need is money and if the company goes into liquidation a lot of people can be affected. The director has had no training in ways to prevent that and ultimately the auditor gets blamed.

The audit expectation gap has resulted in increased regulation. In fact the amount of regulation on the audit profession is almost at breaking point. It has reached the level whereby many audit firms are thinking about packing it in. They are almost at that point and it won't take much more to force them to it. There is an increase in cost and training as well as the fear- the fear that you are going to get it wrong. Regardless of how much quality work you put into it, there is a huge fear that you are going to miss something. The auditor is going to be heavily penalised as a result of that. It's getting to the point where most firms think that audit is just not worth the effort anymore.

**3. Research suggests that the existence of the expectation gap cannot be entirely attributed to the ignorance of users of financial statements. Do you agree or disagree with this statement?**

I agree with this statement. The audit expectation gap cannot be entirely attributed to the ignorance of the users of financial statements. I think that company law is at fault. Company law only allows the auditor to express one form of report, while if there were other forms of report permitted, then perhaps there would be a greater understanding by users of accounts as to what is trying to be achieved. The auditor is forced into a straight jacket. There is a single format of report that is allowed and



there is no deviance from this, I think that a supplementary booklet should accompany the audit report.

**4. In your opinion, does society in general have unrealistic expectations of auditors?**

Yes, they do but again that is part of the expectation gap. I think society expects auditors to catch fraud, even though that is not the primary purpose of an audit. I suppose there has always been a gap there that the users of accounts think that if there has been a fraud that the auditor is definitely going to find it. What they don't realise is what it would cost the auditor to be able to guarantee that there was no fraud. In other words the amount of additional work that an auditor would have to do. In some companies this would mean that the auditor would have to be on site all year round i.e. they would never leave.

**Do you think that banks understand the role of auditors?**

I think that banks often misunderstand what the audit is about. I've seen situations where banks have requested audited financial statements from sole traders and partnership businesses. There is no statutory requirement for them to have an audit yet banks sometimes ask accountants to send in audited accounts for those entities. If they knew what an audit was about, then they would know that a sole trader would have to pay more to have an audit done. There is a lot of misunderstanding regarding the meaning of an audit; it's not just the shareholders that misunderstand but also banks and quite possibly the legal profession as well. There is a lack of understanding of the limitations of the audit.

**5. Do you think that the existing duties of auditors are too demanding?**

Yes, I do. They are extremely demanding and I think there should be an alternative type of audit report. I know that there are discussions going on about what is known as a review type assignment. This would be a reduced form of audit report. It would be a negative assurance type report, where an auditor would state that nothing has come to their attention that would call anything in the accounts into question. Auditors feel that the expectations of shareholders are too high, yet, shareholders wouldn't want to pay the amounts that would be involved if the auditor were to give

a higher level of guarantee than is already given. The cost benefit is out of line. I think that the only way that anyone might get satisfaction is to appoint a government auditor. If the government were willing to appoint auditors, then it would take that decision away from the private sector and I don't think government would do that because it would be just too costly.

**Do you think government intervention would result in higher quality audits?**

No, not necessarily. It would depend on how they would enforce it. They might have a bottomless pit of money, but that doesn't mean it would result in higher quality than we have at the moment.

**6. What safeguards are in place to ensure that auditors perform their existing duties properly? How effective are they?**

I think that they are effective. The primary safeguard used by our institute is quality review. We have a team of inspectors that visit auditing practices. The inspections are mainly based on risk. The institute does a risk profile of each firm. A big4 firm will get a visit at least every two years. Smaller firms will be visited less frequently. The firm is chosen based on its risk profile. The way the risk profile works is that each firm completes a form called an annual return every year, highlighting what clients they've got, the different grades of audit staff etc. For instance, practices that have clients that hand clients money e.g. credit unions, estate agents, insurance brokers and travel agents would be more inclined to get a visit sooner rather than a firm whose clients would be involved in smaller businesses with less risk. The quality review process has been shown to work extremely effectively. If the auditors' work does not meet the required standard then the auditor would be disciplined. There are various forms of discipline depending on the problem. The institute can reprimand them in writing. There are various degrees of low quality work, maybe they have been slack in documenting work but the inspectors may be able to tell from the way that the work is done that it has been done o.k. , then they may be told so in writing. It depends on the nature of the work, there may be higher degrees of discipline involved, the ultimate discipline is the removal of the licence to practice and that has actually happened. In lesser situations, the institute may impose a heavy

fine. There is also negative publicity associated with disciplinary action, the names of such auditors will appear in the papers and that can be quite damaging. Auditors are aware that such action is a possibility, therefore it serves to improve the quality of audit work. The ultimate registration authority for auditors in Ireland is the Department of Enterprise, so if the institute finds that a member is in breach of company law, then the institute must report this to the department. The Department of Enterprise may take court action against that member. So, the member receives double discipline.

**7. Porter (1993) found that the deficient performance gap was at its widest where going concern and fraud were concerned. Do you feel that this would still be the case?**

I think that this is correct, especially as regards fraud. I think that there is possibly a lot more fraud going on out there, than is actually being discovered. You just have to look at the situation in other countries, why should Ireland be any different. The new auditing standards and ethical standards are very much focused on fraud. The focus on fraud will result in additional work, which a client probably doesn't want to pay for because they don't perceive any additional benefits; we're back to the expectation gap again.

**8. What effect do you think the high profile corporate scandals have had on the public's perception of auditors' performance? Has the gap widened with respect to going concern and fraud?**

The few scandals that have occurred in the auditing world, have overshadowed the good work of the majority of auditors, who are doing high quality work. Unfortunately, the few that have done poor quality work and have breached ethical rules have brought discredit on the entire profession and everybody is paying the price for that now with the increased burden caused by the new regulations.

**9. Do you think that the provision of non-audit services would impact on the auditors' decision to qualify an audit report?**

Yes, of course the provision of non-audit services could impact on the auditors' decision to qualify an audit report. The challenge for the auditor is to strike the right balance using their judgement. If there is a possibility that they may be perceived to be lacking independence then they may need to get a second opinion before they finalise their audit report. That opinion would ideally be from an independent auditor, saying I am aware of the level of non-audit services provided to the client but at the end of the day I still think you have performed a high quality audit and your audit opinion is correct. That is a safeguard that can be used in such a situation. There are no hard and fast rules on when this should and should not be done. It is left up to the auditors' judgement. Essentially, if the auditor believes that their independence could be challenged or be perceived to be deficient, it is recommended that it be done then.

**Do you think that the provision of non-audit services is a grey area, lacking solid rules?**

I suppose there aren't any solid rules and I suspect that the next scandal that occurs will probably drive a wedge between audit and non-audit services. It is likely, that firms will either perform audit or non-audit services but not both. There are already a number of entities selling audit services and nothing else. I know of one firm in the UK, that specialise in audit and they do not provide any other services to clients. Big 4 in the US are breaking up their legal departments and maybe other departments as well. The idea of the one-stop shop is gone now. Ten or fifteen years ago the big4 or the big 8 as they were then, had the idea that if they could sell clients all the different services, like valuations, pensions, financial services, tax, and legal then it would attract more clients. But, that day is over, that wont be the case in the modern climate.

**10. It has been suggested that one method of reducing the expectation gap would be the expansion of auditors duties with regard to fraud detection and reporting i.e. the auditor would approach the audit with the view that material fraud had occurred until he/ she could prove otherwise. How realistic would this be/ what effect would it have on companies?**

That wouldn't be realistic, because it would be too costly and the clients simply wouldn't pay for it. I don't think client are willing to pay the cost of eliminating fraud completely. It would impact too much on their bottom line. Perhaps the solution is to have more effective internal audit routines.

**11. Pierce and Kilcommins (1997) concluded that audit education reduced the levels of user misunderstanding and therefore resulted in a narrowing of the audit expectation gap. How effective would such an approach be?**

The education of directors is critical. Companies need a greater degree of education than they are getting at the minute. Perhaps there should be some requirement for them to have more formal education, before they are allowed to become a company director.

**12. Do you think that there is a need to educate the public about auditors responsibilities/ the audit process? How could this be achieved?**

Yes, there is a need to educate shareholders. Perhaps the accountancy bodies should do a series of seminars free of charge. Out institute did a series of seminars like this back in 1998 and they were well attended. They weren't just about auditing, they were about what your accountant can do for you. The seminars explained what accountants do. It something that maybe we could do again, with more focus on the auditors and directors roles and responsibilities.

**13. Boyle et al (2005) suggested that exposure to audit education can significantly increase perceptions of deficient auditor performance. Do you agree with this statement?**

No, I don't agree with that. I think that increased education would improve the performance of directors in controlling their companies, would greatly assist auditors in doing their job and would reduce the expectation gap. Increased education will result in a better understanding of what auditors have to do. What is expected of auditors is not impossible. The majority of auditors do good quality work. The small

number of auditors that have been deficient, have triggered a disproportionate amount of negative publicity and a disproportionate amount of increased regulation.

**14. The use of ‘free-form’ reporting has been suggested as a means of reducing the expectation gap. Do you think that changing the existing standardised wording of the audit report would reduce the gap?**

No. I think that changing the existing wording would not reduce the gap. If auditors could use any wording that they wished, then the expectation gap would increase. It would definitely increase levels of misunderstanding amongst users of audit reports. A consistent style of audit report helps to control things and to promote consistency. Unfortunately, the majority of users of financial statements probably don’t understand the audit report and that is due to lack of education. If they were better educated in this area, then they would understand what the auditor is required to do and why certain formats and wording are used. The existing audit reports are fine.

**15. In your opinion, would a change from the standardised wording to free form reporting change the way in which audit firms compete i.e. there would be more emphasis on quality rather than on cost?**

No. A change to free from reporting would not be realistic and would not help the situation. A change in wording would result in huge variations in the quality of audit reports. It could result in the temptation to adopt the lowest common denominator type approach. A standardised report means that there is a standardised expectation of quality, which is met most of the time.

**16. Robert Medwick (1986) suggested that the audit report should be accompanied by a supplementary explanation of the audit including its limitations and the meaning of the audit report. How effective do you think this approach would be in bridging the expectation gap?**

I think that this might be a good idea. A one-page summary explaining why the audit report is structured the way that it is and an explanation of the meaning of the audit report may be very useful. Whilst, a booklet would probably be ignored, a short one-

page explanation may be what is needed. Most people think that auditing is boring stuff.

**17. In your opinion, what would be the most effective way of reducing the audit expectation gap?**

We need to focus on the education of users of financial statements, even when things are going right. Just because audit reports are not in the spotlight, does not mean that auditors can afford to become complacent. The most effective way of reducing the audit expectation gap would be the education of directors as to their duties and responsibilities. When auditors get it wrong it is usually because they have been misled by the directors. In a lot of cases, it is the directors who are committing fraud lying to the auditors and the auditors haven't spotted that. If directors are better educated then I think they will know what their responsibilities are and they will know how responsible they are for their fellow directors.

**How do you think this could be achieved?**

I personally think that this is not the responsibility of the various institutes. I think that the education of directors is a government job. Companies are registered through the companies registrations office. A company cannot exist at law and have directors at law unless the company is legally created and then registered with the companies registration office. Perhaps, maybe FAS has a role to play in setting up cost-effective training schemes for directors – who pays for that is another question. Directors could pay some and the government could pay some. This would have a two-fold effect; directors would be more proficient in their role as company directors as well as being more informed users of financial statements.

**Do you think that such a course should be made mandatory prior to company registration?**

Yes, I think it should be made mandatory. If it is not made mandatory, then it won't happen.

**18. Are there any other comments that you wish to make?**

No. There are no further comments that I wish to make at this time.



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