

## AUDIT EXPECTATION GAP: A LITERATURE REVIEW

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### Abstract

*Accountancy is an incomparable profession that deals with the provision of true and decisive financial information that can assist all the stakeholders in taking apt decisions, but an expectation gap always occurs between the stakeholders and the auditors. The key objective of this study is the evaluation of the current state of knowledge on the audit expectation gap (AEG). Specifically, the study conducted a critical appraisal of the components of AEG and the approaches for narrowing the menace in society. The study was based mainly on a review of extant literature on the subject matter. The study looked at the conceptual, theoretical and empirical reviews on AEG. Findings from the review discovered that there are four (4) components of AEG and two (2) approaches for narrowing AEG. Therefore, the study recommended the adoption of those approaches to reduce the subsistence of AEG in our society.*

**Keywords:** *Responsibility factor, going concern factor, independence factor, reliability factor*

**JEL Classification Code:** M41, M42

### 1. Introduction

Accountancy is an incomparable profession that deals with the provision of true and decisive financial information that can assist all the stakeholders in taking apt decisions but an expectation gap always occurs between the stakeholders and the auditors. However, the increased fraud and illegal networks have resulted in lower public confidence in financial reporting and audit service. Furthermore, Jabbar (2018) posits that a difference occurs between the users of financial reporting about what audit assignment should be and what assertions should be made. The problem of the AEG arose, not so much from a decline in standards of performance, rather because the role of auditors is not understood because of the failure to recognise the happenings in the business environment (Oyewobi & Adetunji, 2019).

According to Nguyen and Nguyen (2020), the main function of an audit assignment is the provision of assurance services that assure stakeholders about the truthfulness and reasonableness of the financial reports. Meanwhile, Jannat (2022) stressed that the investors' expectation is the perceptions they have concerning auditors' performance regarding the audit responsibilities. However, the accounting profession met prevalent condemnation from the public between 1970 and 1980 following several corporate scandals, audit failures and lawsuits against many accounting firms (Ali, Lee, Mohamad & Ojo, 2008).

Above all, the subsistence of AEG has been confirmed in various countries all over the world (Porter, 1990; Humphrey, Moizer & Turley 1993; Fadzly & Ahmad 2004; Porter, Ohogartaigh & Baskerville, 2012; Olowookere & Soyemi, 2013; Boterenbrood, 2017; Ghandour, 2019; Olojede, Erin, Asiriwuwa & Usman 2020; Akther & Xu, 2020; Jannat, 2022). Furthermore, there have been criticisms that low levels of corporate accountability, transparency, disclosure, external auditor independence and internal auditor effectiveness have undermined confidence in the audit report, compromised the integrity of financial reporting and above all contributed to a widening of the AEG. Hence, this study is conducted to review existing literature on AEG. The study is further subdivided into the following segments – introduction, conceptual review, theoretical review, empirical review, conclusion and recommendation.

## 2. Literature Review

### 2.1 Audit Expectation Gap

AEG was revealed after cases of corporate fraud in 1937 with McEnroe and Martens fraud. Therefore, Lee (1969), cited in Porter (1990), seemed to be the pioneer study to examine the perceptions of the public concerning auditors' responsibilities. This was further corroborated with the work of Beck (1973, 1974). Meanwhile, in 1974, Liggio provided the first definition of AEG (Porter, 1990). He defined the term as the difference, in terms of expected performance between the auditors and users of financial information. In 1974, Liggio's definition of AEG was extended by the Commission on Auditors Responsibilities (CAR) (Cohen, 1978). The commission's definition included the examination of whether a gap exists between what auditors are expected to accomplish and what the public expects from them (Porter & Gowthorpe, 2004).

Recently, Jannat (2022) defined AEG as the investors' perceptions concerning auditors' performance regarding the audit responsibilities. Azagaku and Aku (2018) defined AEG as the variation between the expectation of the public regarding the audit assignment and the objective of auditing as proclaimed by the audit profession. Soyemi (2014) defined AEG as the discrepancy between users' perception of the role of audit assignment and the proclaimed professional stipulations for the conduct of an audit. Salehi (2016) defined AEG as the situation whereby a difference in expectation occurs between a group with certain knowledge and a group, which relies upon that knowledge while Elad (2017) defined the AEG as the variances in beliefs and desires between the auditor and the public regarding the duties and responsibilities of auditors.

#### 2.1.1 Audit Expectation Gap Factors

The AEG factors have been widely discussed and classified in the literature. These classifications are in relation to the works of Jannat (2022), Akther and Xu (2020), Enyi, Ifurueze and Enyi (2012), Schelluch and Gay (2006), Best, Buckby and Tan (2001). For instance, Jannat (2022) classified the factors into four (4) thus - internal control, fraud detection, appropriateness in using accounting numbers and reliability. Akther and Xu (2020) classified the

factors into ten (10) thus – auditors' responsibilities for fraud and usefulness of audit report, provision of non-audit services, going concern expectations, the expectation for other assurance services, provision of non-audit services, mandatory auditors' rotation, communication with the active audit committee, expansion of audit report and ensure audit education. Meanwhile, Best, Buckby and Tan (2001) classified the factors into responsibility and reliability. Schelluch and Gay (2006) only considered the audit report factor. Besides, Enyi, Ifurueze and Enyi (2012) in their work on AEG added the independence factor to the classifications. Above all, the aforementioned factors are hereby summarised into four (4) - going concern factor, independence factor, responsibility factor and reliability factor in the present study.

### 2.1.2 Going Concern Factor

According to the International Accounting Standards Board (IASB) conceptual framework for financial reporting, financial statements are expected to be prepared on the going concern assumption. That is, the reporting entity is expected to be in operation for the foreseeable future (IASB, 2018). Hence, the directors are expected to maintain the going concern status of the entity. Subsequently, the purported financial statements are supposed to be audited for the inherent going concern assumption and at the same time lend credibility to it. Furthermore, auditors are expected to adopt those procedures that assure them that the going concern assumption employed in the preparation of financial statements is appropriate and that there are adequate disclosures about such basis in the purported financial statements to give a true and view (Adeniji, 2012). However, the public in most cases perceives a clean audit report as a signal towards going concern status hence, the expectation gap. Quick (2020) posited that auditors are usually blamed when corporate entities fail after issuing a clean audit opinion and/or when they fail to report any fraud cases.

### 2.1.3 Independence Factor

In a bid to lend credibility to the financial statements prepared by the directors under section 377(1) of the Companies and Allied Matters Act (CAMA) (2020); an auditor is appointed to examine the records. Subsequently, the auditor is expected to be independent of the management. Independence is defined as a situation where the auditor conducts the audit assignment with integrity and objectivity (Izedonmi, 2000). Therefore, independence means the ability of the auditor to examine the financial statements without prejudice and undue influence. Therefore, to guarantee auditor's independence, the Institute of Chartered Accountants of Nigeria (ICAN) and CAMA (2020) made certain pronouncements to uphold the independence of auditors.

Moreso, the auditor of an entity is not expected to render other non-audit services to his client. However, where the independence of the auditor is threatened in the course of discharging his duty, the relationship with the organisation might be affected and this may, in turn, affects the opinion to be expressed by the auditor. In essence, the impairment of the auditor's independence gives room for AEG. The impairment leads to the variation between the expectations of the public and the auditor.

#### 2.1.4 Responsibility Factor

Section 401 of CAMA, 2020 states that every corporate entity must appoint an auditor to audit the financial statements of the entity. The auditor appointed is responsible for the examination of the financial statements and making a report to members of the company (S. 404, CAMA, 2020). Section 407 of CAMA, 2020 states that the auditor in the preparation of his report shall make necessary investigations that would allow him to form an opinion on the financial statements. Also, the auditor is expected not to be a servant, officer, partner or in the employment of the reporting entity (S. 403, CAMA, 2020).

Furthermore, the auditor is expected to discharge his duties efficiently and effectively; have adequate staff with appropriate qualifications and experience to carry out the tasks. Therefore, the main duty of an auditor is the examination of the financial statements and to make a report on the true and fair view of the entity's financial position. The auditor is not part of the entity's management and he is not responsible for the day-to-day administration of the entity. However, where there is corporate failure after the audit exercise, the public usually questioned the audit process thereby leading to AEG.

#### 2.1.5 Reliability Factor

Financial statements are prepared by the directors of corporate entities (CAMA, 2020). Such reports are used by diverse users for different purposes (IASB, 2018). Subsequently, in a bid to add credibility and reliability to the financial statements, an independent person is appointed to conduct a detailed analysis of the information contained in the reports. Therefore, an audit is conducted to examine the financial statements to establish their conformity with Generally Accepted Accounting Principles (GAAP) and other statutory regulations, certify that they are free from any material misstatements and above all, present a true and fair view of the entity's financial position.

Quick (2020) maintained that auditors issue their reports in a bid to improve the reliability of financial statements which are used by investors for varying purposes. Furthermore, the opinion as expressed by the auditor is expected to be constant (Adeniji, 2012). However, there are occasions when the above statement may not hold due to certain circumstances and presumptions that make users more expectant than expected thereby giving room for AEG. These presumptions include claims like – an audit report is issued after the audit exercise, the audit exercise should have discovered all fraud, auditors give assurance concerning the continuing existence of the entity and the fact that a clean audit report is a satisfactory bill of the entity's position (Adeniji, 2012).

#### 2.1.6 Approaches to Audit Expectation Gap

The two approaches (solutions) which could be implemented by the audit profession to lessen the effect of the AEG in our society are the defensive and constructive approaches. These approaches have been adopted by various scholars all over the world in their works on the AEG.

### 2.1.7 The Defensive Approach

Several studies concurred with the assertion that the defensive approach entails educating the public whose expectations about auditors' responsibilities are sometimes unreasonable due to unawareness of the actual duties of auditors (Humphrey, Moizer & Turley, 1992). The defensive approach is regarded as education approach (Lee, Gloeck & Palaniappan, 2007). Meanwhile, according to Humphrey *et al* (1992), it is important to educate and reassure the public through various means such as; changing the wordings of the audit report, publishing professional statements on the actual responsibilities of auditors, to narrow the effect of the AEG.

Similarly, Porter and Gowthorpe (2004) equally emphasised the effectiveness of education in reducing the performance gap. They further recommended education for auditors and audit trainees to ensure they understood their responsibilities as required by the relevant statutes. Some of the scholars that have worked on the defensive approach include Fulop, Tiron-Tudor and Cordos 2018; Kumari, Ajward and Dissabandara 2017; Adafula, 2016.

### 2.1.8 The Constructive Approach

This approach focuses on enhancing auditors' performance and expanding auditors' responsibilities to meet society's needs. In a report, the Association of Chartered Certified Accountants (ACCA) (2011) pushed forward the constructive approach by recommending that audits should encompass areas such as corporate governance and risk management. Therefore, the constructive approach comprises the expansion of audits' scope, restructuring audit methodologies, expanding auditors' responsibilities, embracing corporate governance principles and adopting an effective risk management strategy. Some of the authors that have worked on the constructive approach are Fijabi (2020); Alaraji (2017); Shebeilat, Abdel-Qader and Ross (2017); Shbeilat (2013).

## 2.2 Theoretical Review

Some of the theories that advocate the need for audit can be identified thus;

### 2.2.1 Theory of Inspired Confidence

The theory was developed by a Dutch Professor, Theodore Limperg. The theory took its origin from one of the publications of Limperg (1932) titled 'Theory of inspired confidence'. The theory focused on both the demand and supply of audit services. Limperg argued that auditors derive their general function in society from the need for an expert who can express an independent opinion based on the stewardship reports examined. The demand for audit services is the direct consequence of the participation of outside stakeholders in an organisation (Salehi, 2011). However, where there is a variation between the interests of the management and the stakeholders, an audit exercise is then required for the information (Adeyemi & Uadiale, 2011).

### 2.2.2 Policeman Theory

The policeman theory was the widely held theory in auditing until 1940. It is a theory of auditing that is based on arithmetical accuracy as well as the prevention and detection of fraud and error. The theory makes an auditor detect and prevent errors and fraud in organisations. According to Hayes, Schilder, Dassen and Wallage (1999), policeman theory is a generally pronounced auditing theory before the 1950s. The theory posits that auditors should act like policemen. That is, they should concentrate on arithmetical accuracy as well as the prevention and detection of fraud. However, with the recent developments in auditing, the policeman theory is gradually losing its importance.

### 2.2.3 Role Theory

The role theory posits that prediction can easily be made if information about a particular position is possessed. Hence, in corroboration with audit, this proposition was confirmed by the work of Lee et al (2007) where the auditors are seen as role players that most stakeholders in social settings especially corporate governance participants do depend on, look up to and interact with as his audit performance (auditor report) assures them that all is well with their investments in business organisations.

The auditors in their role of attestation, providing audit assurance to diverse stakeholders and users of financial accounting information may be perceived with some expectations far and above what their actual roles and responsibilities are (Gbadago, 2015b). Consequently, the theory places auditors in multi-role and multi-expectations situations (Lee et al, 2007). Therefore, it is suggested that there could be different expectations between the auditors and their role senders/observers thereby leading to an expectation gap.

### 2.2.4 Role Conflict Theory

The theory was postulated by Rizzo, House and Lirtzman (1970) in their work titled “Role Conflict and Ambiguity in Complex Organizations”. The theory provided a theoretical elucidation for the presence of an expectation gap. The theory is grounded on certain assumptions that auditors are required to monitor the client's financial statements while the public is of the expectation that the role be satisfactorily carried out (Koo & Sim, 1999). Meanwhile, auditors are professionally required to comply with the stipulated regulations and rules that uphold their independence. In the same vein, auditors are expected to maintain a balance between the professional stipulations and their role as the watchdog, who are expected to serve the interests of the key users and the client as well as look after their interests. Auditors’ roles are subject to the interactions of the normative expectations of the various interest groups in the society, having some direct or indirect relationship to the role position (Davidson, 1975).

### 2.2.5 Attribution Theory

The theory posited that users of audit report become naïve scientists as they attempt to assign causation by observing traits of consistency, distinctiveness, and consensus (Kelley, 1973). Furthermore, Kelley (1973) submitted that the theory was hypothesised to explain why auditors

are blamed when the fraud occurred in their work. According to Fiske and Taylor (1991), the theory deals with how information is used to arrive at causal explanations for events as it examines the kind of information to be gathered and how such information produces a causal judgment and subsequently decide. With auditing, Kelly (1993) stressed that the AEG could hurt the image of the accounting profession and at the same time lower the confidence level of users of financial statements. Also, as the users assume that the audit report may reflect the credibility of financial statements and had to be used as an important tool for decision-making, an expectation gap problem arises (FASB, 2010). The attribution theory is a relevant theory of the AEG.

### 2.2.6 Readers Response Theory

The readers' response theory is grounded on the assumptions that a reader's background knowledge and experiences impact his/her interpretation of a text and that there is no particular correct reading of a text, and readers are active interpreters of messages and can infer variable meanings in a text-based on their psychology, content, or motives (Anderson, Maletta & Wright, 1998). Hence, it was argued that because the public who used and read audit report have different backgrounds, knowledge and experience, may misinterpret and misunderstand the content of the audit report, which in turn may cause the existence of an AEG (Anderson, *et al*, 1998). The readers' response theory is also a relevant theory of AEG as it relates to the way and manner the public perceive the financial information based on their educational background and experiences.

### 2.3 Empirical Review

The review of literature in this study was classified into three – evidence from developed countries, evidence from developing countries and evidence from Nigeria. For instance, from the developed economies, Porter (1990) considered the relationship between auditors' role and the AEG in New Zealand. Subsequently, in 1992, Humphrey *et al* evaluated the accounting profession's responses to AEG in the United Kingdom over two decades. Again in 1993, Porter published another work in which she carried out a research in New Zealand to investigate the nexus between audit expectation and performance gap. Furthermore, Humphrey, Moizer, and Turley (1993) examined the AEG in Britain.

Consequently, Kumari, *et al* (2017) investigated the influence of audit education on AEG. Fulop *et al* (2018) in their study on the nexus between audit education and AEG only considered one of the elements of the AEG – Audit Reasonableness Gap (ARG). Tangl (2018) highlighted the possibilities of bridging the AEG between external auditors and stakeholders. Quick (2020) reviewed the literature on the subsistence of AEG across continents all over the world. The study found the existence of AEG in most countries around the world. The countries include the USA, UK, Australia, New Zealand, Singapore, Malaysia, South Africa, Ghana and Nigeria to mention a few.

From the developing economies, Fadzly and Ahmad (2004) investigated the presence of AEG in Malaysia. From the Iranian environment, Salehi and Azary (2008) ascertained the AEG in auditors' responsibility between auditors and bankers. Rehana (2010) carried out survey research in which the nexus between audit education and AEG was investigated in Bangladesh. More so, Salehi (2011) carried out research that focused on the review of the literature regarding the concept, nature and trace of AEG around the world. Pourheydari and Abousaiedi (2011) considered the presence of AEG among independent auditors and the public in Iran via survey research.

Al-qtaihs (2014) examined the factors affecting AEG from the lookout of the investors in Jordan. Gbadago (2015b) examined the AEG among stakeholders in Ghana based on Spellman's hydrostatic pressure modelling approach. Adafula, Asare, Arku, Atuilik & Onumah (2016) in their study considered the importance of users' education on the limits of audit reports in a bid toward bridging AEG in Ghana. Kangarluie and Aalizadeh (2017) employed survey research to examine the AEG in Iran with the administration of questionnaires on audit officials and the management of some privately held firms. From Libya, Masoud (2017) investigated the causes of the AEG.

Adopting the constructive approach, Alaraji (2017) examined the influence of corporate governance principles on the AEG in Iraq while Shbeilat (2013) had earlier looked at the influence of corporate governance codes on the AEG in Jordan. Investigating the subsistence of AEG and its effect on stakeholders' confidence, Akther and Xu (2020) administered questionnaires among auditors, investors, investment analysts, credit analysts and regulatory agencies in Bangladesh. Recently, Jannat (2022) investigated the existence of an AEG between auditors and investors in Bangladesh.

In a bid to showcase the factors that account for AEG in Nigeria, Enyi, Ifurueze and Enyi (2012) conducted survey research by administering questionnaires on accountants, auditors, bankers, investors and shareholders. Olowookere and Soyemi (2013) examined the presence of an expectations gap between auditors and the public in Nigeria. Okafor and Otalor (2013) examined the impact of the auditing profession in narrowing the AEG. Also, Enofe, Mgbame, Aronmwan and Ogbide (2013) examined users' perception of the reasonableness AEG in Nigeria.

However, in a bid to further consider ways of reducing AEG, Ihendinihu and Robert (2014) considered the influence of audit education in minimising the AEG in Nigeria. From another perspective, Ubaka (2016) investigated the difference in the perceptions of the public about fraud detection and the expectation gap. Ocheni and Adah (2018) examined the extent to which the public is conversant with the duties of auditors under Nigerian law and at the same time ascertain through the stakeholders' perceptions whether the AEG can influence their decision-making process. Most recently and evaluating the presence of AEG in Nigeria, Olojede, Erin, Asiriwawa



and Usman (2020) conducted a qualitative study that was premised on the opinion gathered from questionnaires administered to auditors, investors, bankers, stockbrokers and financial analysts in Lagos, Nigeria.

### 3. Summary and Conclusion

The present study focused on the review of extant literature on the AEG. To achieve this, the study engaged in an extensive review of extant literature on the subject matter from developed and developing countries as well as evidence from Nigeria. The findings revealed the subsistence of AEG among countries all over the world. More so, it was revealed that there are two (2) approaches for narrowing AEG. Besides, the study discovered that the factors of AEG can be classified into four (4) - going concern factor, independence factor, responsibility factor and reliability factor.

The review from this study revealed that AEG can be reduced via two (2) major approaches - defensive and constructive approaches. Meanwhile, the factors of AEG can be classified into four (4) going concern factor, independence factor, responsibility factor and reliability factor. Therefore, the study recommended the adoption of the two (2) approaches to reduce the menace of AEG factors in our society. That is, through the defensive approach, there should be public enlightenment to educate and sensitise the general public on the duties and responsibilities of auditors as well as that of the directors. Also, via the constructive approach, the government should encourage the enactment and enforcement of corporate governance codes and principles for corporate entities.

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