IMPERATIVES OF BRIDGING THE AUDIT EXPECTATION GAP AND ENHANCING THE CREDIBILITY OF CORPORATE FINANCIAL INFORMATION

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ABSTRACT

The study sought to ascertain if reducing the audit expectation gap would led to greater public confidence in corporate financial information. Self-administered questionnaires were used in the study. The data generated from the responses of the subjects were analyzed using descriptive and statistical analysis through the computer (Eview3.1).

The result showed that the higher the audit expectation gap, the higher the negative impact on the credibility of corporate financial reports. Thus, audit expectation gap creates doubt on the reliability of financial statements. Based on the findings and conclusion, it was recommended that the scope of auditors' responsibilities should be expanded; companies should create a forum for regular interface between management, auditors and financial statement users to enhance confidence in financial reports and strengthening the audit committee and regulatory oversight of auditors to enhance their respective performances.

Keywords: Audit expectation gap, Independent auditor, Public confidence and credibility of financial information.

1. Introduction

Dependable financial information is essential to the very existence of our society. Generally, the objective of corporate financial reports (financial statements) is to provide information about the reporting entity's financial performance and financial position that is useful to a variety of users for assessing the stewardship of management and for making economic decisions (Glautier, Underdown and Morris, 2011). The communication of financial and other economic data is vital in the modern society (Meigs, Larsen and Meigs, 1977) and economic environment as information is required for decision making by the various interests in a company. The information so provided must be reliable to be useful to users who rely on the periodic financial statement for assurances that their investments are being efficiently and prudently managed. The lack of accurate and credible information could lead to substandard decision which may result in losses of monumental proportion. Credibility means that financial statements can be believed or relied upon by outsiders or users external to the business.

Auditing plays an important role in contributing to the effectiveness and efficient functioning of business operations, the capital markets, and the economy by adding credibility to financial statements (Lee, Azham and Kandasamy, 2008; Lueng, Coram, Cooper, Cosserat and Gill, 2004. The independent auditor plays a very crucial role in ensuring that financial statements faithfully represent the activities of management during the period covered by the financial report. Thus, auditors occupy a prime place in bridging the expectation gap between management and the users of the published financial reports through their authentication of the reliability and accuracy of the financial statements (Annual Report and Accounts) which include Profit And Loss Account, or Income Statements, Balance Sheet, Value Added Statements, Cash Flow Statement, Directors Report, Historical Financial Summary and so on. The audit expectation gap is defined as the difference between what the users of the financial statements expects from the auditors and what the audit profession accepts the audit objective to be.

Many users do not seem to understand the nature of the attest function, especially in the context of an unqualified opinion as they believe that an unqualified opinion means foolproof financial reporting. Some feel that the auditor should not only give an opinion, but also interpret the financial statements to enable users evaluate whether to invest in the company. These expectations create a gap between auditors and users expectation of the audit function. Moreover, users place the responsibility for narrowing the gap on auditors and others involved in preparing the financial statements (Okafor & Otalor, 2013:43).

This study reviewed and evaluated some possible solution that can be explored in bridging the gap in order to enhance the credibility of the financial reports which bears the auditor's attestation.

The several corporate collapses in recent years and the consequent implication on the reporting auditor have tended to widen the audit expectation gap. Therefore, we think it would be interesting to investigate the impact of efforts geared toward bridging the expectation gap on the credibility of financial statements hence we have formulated the following hypothesis:

H 1 *Reduction in the audit expectation gap does not lead to enhancement of the credibility of corporate financial reports?*

2. Review of Audit Expectation Gap Literature

The term expectation gap has been used not only in the accounting literature, but also in other fields to describe the perceptions of the information systems industry relating to the academic preparation of graduates, difference in expectations of advertising agencies and their clients with respect to campaign values, differences in relation to various issues associated with corporate environmental reporting on one hand and the clash between auditors and the public over preferred meanings of the nature, objectives and outcomes of an audit, the gap in banks between the transaction-audit approach that evolved during the industrial age and the information age, and a financial reporting expectation gap(Trauth, Farwell and Lee, 1993; Murphy and Maynard, 1996; Sikka, Puxty, Wilmott and Cooper ,1998; Deegan and Rankin, 1999 and Andrew,2003).

Although the terms 'audit expectation gap' was not applied to the gap between society's (or financial statement users') and auditors' expectation of an audit until about 40 years ago, the existence of the gap was recognized more than 100 years ago and the enduring theme in the audit expectation gap literature is the lack of a universally accepted understanding, both within the auditing profession and between the public and auditors of what constitutes auditors' duties (Porter and Gowthorpe, 2004).

Liggio (1974) who first introduced the term "audit expectation gap" to audit literature defines expectation gap as the difference between the levels of expected performance as perceived by both users of financial statement and the auditor. In 1978, the definition was extended to some degrees in the terms of reference of the Commission on Auditors Responsibilities (CAR)(the Cohen Commission, 1978) by taking into account whether a gap exist between what the public expects or needs and what auditors can and should reasonably expect to accomplish (Salehi and Rostami, 2009; Porter and Gowthorpe, 2004). In each of these cases, the gap is defined in terms of the difference in the expectations of auditors on the one hand and those of users of financial statements (Liggio, 1974) or the public (Cohen,1978) on the other hand as regards auditors responsibilities.

The audit expectation has been defined as the difference in beliefs between auditors and the public about the duties and responsibilities assumed by auditors and the messages conveyed by audit reports (Monroe and Woodliff, 1993) and as the difference between what the public expects from the auditing profession and what the profession actually provides (Jennings, Reckers and Kneer, 1993). This definition is also the position of Lowe (1994) in his research on the expectation gap in the legal system.

A number of studies have been conducted to examine the causes of audit expectation gap. The studies reveal the following as some factors contributing to the existence of the gap. (Lee and Azham, 2008a)

a.) The Complicated Nature of Audit Function

Poor understanding of the complicated nature of audit function by the public is likely to contribute to the prevalence of audit expectation gap. The complex nature of the audit function is not unconnected with the objective of auditing and the role of auditors (Lee and Azham, 2006) and the change in the auditing paradigm over the years (Leung, Coram, Cooper, Cosserat and Gill, 2004; Boynton and Johnson, 2005).

b.) Conflicting Role of Auditors

Conflict of interest arising from the provision of "non-audit services" and products such as engagements for risk assessment, business performance measurement, information reliability system and so on, have the potential of impairing the independence of the auditors and their ability to perform creditable audit{Glock and Jager, (1993); Lueng, et al,(2007) and Johnson, (1988)} .

c.) Time Lag in Responding to Changing Expectations

Studies has shown that the time lags between the accounting profession identifying and responding to the changing and expanding expectations of the public can create an audit expectation gap Humphrey, et al (1992). In response to the new demands on the audit function (Ticker, 1982) and the high litigations against the auditing profession, professional bodies have issued series of new statements on auditing standards to address such areas as detection of fraud and illegal act, the assessment of internal control and audit reporting (Guy and Sullivan, 1988) with the aim of improving the quality of audit by expanding the duties of auditors.

d.) Self Regulation Process of the Auditing Profession

The auditing profession just like other professions, operates under a self-regulatory framework which arose because of the belief that service quality may not be maintained especially when customers (that is, credit clients) are not able to measure the audit themselves (Humphrey, et al 1992; Shaked and Sutton, 1982). But self-regulation has been criticized on the premise that it only stipulates a minimum acceptable level of quality which leaves room for compromise.

As a result of the detrimental effects of the audit expectation gap on the financial reporting and auditing process, researchers and the auditing professional bodies have conducted various studies to identify effective methods for narrowing the gap. The methods that have been identified include: Education {Lee, Azham and Kandasamy, (2008), Monroe and Woodliff (1993), Ariff and Rosmaini (2005) and Gramling et al, 1996)}, Expanded Audit Report{ Rittenberg (1987), Gay and Schelluch (1993) Monroe and Woodliff (1994), Hatherly, Jones and Brown, (1991)} , Structured Audit Methodologies {Purvis (1987); Koh and Woo (1998), Boritz, Gabor and Lemon (1987)}, Expansion of Auditors' Responsibilities and Enhancement of Auditor Independence{ Lee, et al. (2008), Humphrey et al, 1993, Knutson, 1994 and O'Malley, 1993), Rabinowitz (1996)}

3. Methodology

This section presents the methods adopted in the research.

The sample for the study was randomly selected from accountants in private practice, accounting teachers and students from three universities and the investing public in Edo State. The aim of the study was to investigate the impact of reducing the audit expectation gap on the quality of financial information as perceived by the public. A total of 130 questionnaires were administered but only 94(consisting of 45 Accounting students, 20 Accountants in practice, 18 investing public and 11 Accounting teachers) were returned constituting about 72 %.

The data collected were analyzed using descriptive and statistical analysis through the computer (Eview3.1) (See Appendices II &III). Analysis of Variance (ANOVA) was employed to compare the variation between the population means with variations within populations. We carried out econometric analysis to empirically investigate the strength and direction of the hypothesized relationships among the variables using regression analysis (Ordinary Least Square techniques). Both the statistical and econometric tests were carried out at 5% margin of error or level of significance (i.e. $\alpha = 0.05$) for either the acceptance or rejection of the null hypotheses. We tested for the impact of the audit expectation gap (AUDEXGAP) on the credibility of corporate financial reporting (CRCFINR) by analyzing our data using regression models as follows:

CRCFINR = f(AUDEXGAP)

CRCFINR = $\alpha_0 + \alpha_1$AUDEXGAP + et

Where CRCFINR = Credibility of Corporate Financial Reporting

AUDEXGAP = Audit Expectation Gap.

α = a constant

et = Stochastic error term or residual value.

4. Results

The result of the analysis of variance output as generated by the EVIEW is reported in table 1 above. In the result, the factor to be analyzed is CRCFINR. We consider the analysis of variation between audit expectation gap and credibility of corporate financial reporting. The f-value for the relationship is 14.863. This calculated value is greater than the 5 percent critical f-value of 9.78. Thus, we reject the null hypothesis and accept the alternative hypothesis that a reduction in audit expectation gap can enhance the credibility of corporate financial reporting.

4.1 Discussion of Findings

A review of the responses in appendix I reveals that audit expectation gap casts doubt on the credibility of corporate financial reporting (see attribute 1 where 58 (69.88%) out of 83 agrees that expectation gap creates doubt on credibility of financial statements, while 18 (21.69%) disagrees and 7 (8.43%) are undecided). Similarly, 583 (75.91%) out of 768 believes that measures suggested in items 2-10 will assist in reducing if not eliminating both ‘reasonableness gap’ and ‘performance gap’.

Moreover, we consider the behavioural model specified in the analysis using the ordinary least square method (See appendix III). The result of the impact of bridging the audit expectation on the credibility of corporate financial reporting is reported in the equation below:

Audit Expectation Gap and Credibility of Corporate Financial Reporting

CRCFINR = 19.928 + 9.1568 AUDEXGAP

(10.316) (4.061)*

R^2 = 0.172

The R^2 squared of the model above is 0.172. However, the slope coefficient in the model is positive and the t-value of 4.061 is greater than the 5 percent critical t-value of 2.01. Thus, it is shown that audit expectation gap has a significant impact on credibility of corporate financial reporting. The higher the audit expectation gap, the higher the negative impact on credibility of corporate financial reporting. Indeed, audit expectation gap creates doubt on the reliability and hence credibility of corporate financial reporting.

5. Conclusion and Recommendation

The communication of dependable financial information is essential to the very existence of our society and economic environment as information is required by the various interest group in a company for the purpose of making informed decisions. Users' expectation of auditors to perform certain functions which are not required of the auditor by law creates a gap between the auditor and users of financial information. Consequently, a higher audit expectation gap leads to greater doubt on the reliability and credibility of corporate financial reporting. Credibility means that financial statements can be believed or relied upon by outsiders or users external to the business. The higher the expectation gap, the higher the negative impact on corporate financial information. Since there is the need to bridge the expectation gap between management and the users of the published financial reports whose reliability and accuracy is attested to by the auditor, efforts should be made by all concerned to implement the policy recommendations enumerated below.

On the strength of the conclusion of this study, the following recommendations are made:

1. The scope of auditors' existing responsibilities should be expanded to cover areas which are of concern to stakeholders, e.g. examining client's compliance with stock exchange governance requirement and reporting non-compliance.
2. Regulatory and professional bodies should increase the liability of auditors to improve their commitment to performance of their duties.
3. A forum should be created for regular interface between management of the auditee, auditors and the financial statement users to deliberate on the functions of the auditors and management of the client with respect to corporate financial reports.
4. The role of audit committee should be strengthened to contribute more to credible financial statements.
5. The regulatory oversight of corporate bodies and auditors should be strengthened to enhance their performance and increase the reliability and credibility of financial reporting.
6. A representative of the public (probably, information intermediaries) should be included in the audit committee. This will enhance the confidence of investors (public) in the auditee and auditors.

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Table 1: ANOVA Results

Variables	**Df**	**F**	**Reliability**
CRCFINR	1	14.863	0.000

Appendix I. Credibility of Corporate Financial Reporting

S/N	Attributes	RESPONSES				
		SA	A	DA	SD	U
1	Audit expectation gap creates doubt on the credibility of the financial statement	27*	31*	14	4	7
2	Expansion of auditor's responsibility will reduce the expectation gap.	22*	29*	20	7	5
3	There is need to educate auditors the more to enhance the performance of their duties.	46*	32*	6	2	3
4	More education of the public on the duties and responsibilities of the auditors will reduce the audit expectation gap.	37*	36*	5	6	
5	Increasing the existing scope of audit will reduce the expectation gap.	20*	37*	15	10	5
6	Strengthening the role of the audit committee will help reduce the audit gap.	36*	37*	4	2	5
7	Increasing the liability of the auditors will enhance will enhance the performance of the duties and responsibilities.	20*	34*	19	11	3
8	Creation of forum for regular interaction between management of the auditee, auditors and the public will reduce audit expectation gap.	34*	24	12	7	7
9	Inclusion of a representative of the public probably information intermediaries in the audit committee will reduce the expectation gap and enhance credibility of financial statement.	19*	46*	15	3	2
10	Strengthening regulatory oversight of corporate bodies and auditors will increase credibility of financial reporting.	33*	41*	7	1	3
	Total	294*	347*	117	53	40

Source: Field Work, 2012.

APPENDIX II

ANOVA TABLE FROM EVIEW 3.1

		Sum of Squares	df	Mean Square	F	Sig.
CRCFINR	Between Groups	1211.943	1	1211.943	14.863	.000
	Within Groups	7420.186	91	81.541		
	Total	8632.129	92			

Source: Researchers' computation (2012)

APPENDIX III

Dependent Variable: CRCFINR

Method: Least Squares

Date: 05/12/12 Time: 21:13

Sample(adjusted): 1 93

Included observations: 93 after adjusting endpoints

Variable	Coefficient	Std. Error	t-Statistic	Prob.
AUDEXGAP	8.786301	2.279039	3.855266	0.0002
C	20.20000	2.019165	10.00414	0.0000

R-squared	0.140399	Mean dependent var	27.09677
Adjusted R-squared	0.130953	S.D. dependent var	9.686459
S.E. of regression	9.029978	Akaike info criterion	7.260248
Sum squared resid	7420.186	Schwarz criterion	7.314712
Log likelihood	-335.6015	F-statistic	14.86308
Durbin-Watson stat	2.318906	Prob(F-statistic)	0.000215

Dependent Variable: CRCFINR

Method: Least Squares

Date: 05/12/12 Time: 21:17

Sample(adjusted): 2 93

Included observations: 92 after adjusting endpoints

Convergence achieved after 4 iterations

Variable	Coefficient	Std. Error	t-Statistic	Prob.
AUDEXGAP	9.156864	2.254692	4.061248	0.0001
C	19.92762	1.931770	10.31573	0.0000
AR(1)	-0.199639	0.106959	-1.866490	0.0653

R-squared	0.171529	Mean dependent var	27.05435
Adjusted R-squared	0.152912	S.D. dependent var	9.730844
S.E. of regression	8.956014	Akaike info criterion	7.254593
Sum squared resid	7138.706	Schwarz criterion	7.336825
Log likelihood	-330.7113	F-statistic	9.213431
Durbin-Watson stat	1.924747	Prob(F-statistic)	0.000231
Inverted AR Roots	-.20		