

Reducing the Audit Expectation Gap: A model for Bangladesh Perspective

Mohammad Alam Shikdar¹

Department of Business Administration, Britannia University, Comilla,
Bangladesh

Omar Faruk

Business Administration, Daffodil Institute of IT, Dhaka, Bangladesh

Mohammad Mojahid Hossain Chowdhury

Department of port & Shipping Management, BSMRMU, Dhaka, Bangladesh

Abstract

The main objective of this study is to identify the variables that reduce the audit expectation gap and to prescribe a model in doing so in Bangladeshi context. Prominent researchers from various countries suggested several factors in reducing the audit expectation gap. Out of whom only the impact of audit education and the implementation of Financial Reporting Act regulations (FRA-2015 of Bangladesh) have been studied so far in Bangladesh; which indicates the research gap. This motivated the current study in identifying the holistic view for drawing a rigorous conclusion. In doing so, Likert 5 point scale based structured questionnaire has been randomly surveyed to 50 respondents including 20 university faculty members of accounting and auditing discipline; 10 qualified and practicing Chartered Accountants; and a group of 20 articled students of accounting bodies from Bangladesh. Principal component tool of factor analysis and Pearson's correlation analysis have been employed in analyzing the collected data. Correlation results prove that the identified variables reduce the audit expectation gap significantly and factor analysis strongly recommends a model that reduces the audit expectation gap in Bangladesh.

Keywords: Audit Expectation Gap, Audit Expectation Gap Reduction Model, Bangladesh

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¹ Corresponding author's email: shikdarais15@gmail.com

Introduction

An audit of financial statement is to provide an independent opinion on the fairness of financial statement. The word fairness represents whether the financial statement is materially misstated or not and whether any material fraud exists or not. There is a gap between society's expectation from the auditors and the performance or role of auditors. This is a prevalent matter in accountancy and auditing. However, this gap has been accelerated by the collapse of Enron, WorldCom and Lehman Brothers etc. which has left a severe effect on the reputation of auditors. Accounting and auditing are significant elements of any organization as they play key roles in effective and efficient operation of an organization, capital markets and the economy by adding reliability to financial information (Lee & Ali, 2008). Most of the users of audited financial statements expect auditors to perform the audit with technical competence, integrity, independence and objectivity and detect material misstatements, whether intentional or unintentional. Some users of financial statements have conducted that these expectations are not being met, leading to what has become known as the expectation gap. The expectation gap arises when auditors and the user of financial information hold different perception about the auditors' responsibilities. For audit expectation gap between auditors and users of financial statements, the accounting profession has attempted to narrow the gap because the expectation gap is critical to the audit profession as it impacts on the auditing practice and reputation of auditor in society.

Public confidence is a must for auditing profession. Hence, if such confidence is impaired the professional function of the auditors is deteriorated. Ardelean, (2013) concludes that higher moral standing and better ethics may be the answer to re-establishing public trust in the audit profession. Several studies have been conducted in different countries that have identified the causes of audit expectation gap. In Bangladesh audit expectation gap exists like many other countries as has been revealed by Chowdhury, Innes, & Kouhy, (2005); Siddiqui, Nasreen, & Chowdhury-Lema, (2009). However, these researchers argue that the magnitude of the problem can certainly be reduced in Bangladeshi context and they insisted on the expansion of audit education as a remedy to this problem.

On the other hand, the literature review suggests that there are several other factors that reduce the audit expectation gap. Hence, those factors must be analyzed in Bangladeshi context to form a conclusion about the factors that reduce audit expectation gap. So this is clearly evident that there exists a research gap and there should have a thorough study in this arena. With this end in view, the present study focuses on the research question: 'Can audit expectation gap be significantly reduced in Bangladesh'? From the perspective of the current research question the following hypothesis has been developed to get the appropriate answer.

H₀: The identified variables from literature study cannot significantly reduce the audit expectation gap in Bangladesh.

H₁: The identified variables from literature study can significantly reduce the audit expectation gap in Bangladesh.

Thus the main objective of this study is to identify whether the identified variables in the literature review can significantly reduce the audit expectations gap in Bangladeshi context or not.

The rest of this paper is outlined in different sections. Section 2 describes the theoretical framework and critically analyses the prior literature on causes, effects and solution of audit expectation gap. Section 3 is the problem statement, while Section 4 describes the data and methodology of the research with reliability and validity tests. Section 5 represents the results discussion through correlations and factor analysis and finally Section 6 draws a constructive conclusion with a reply to the research question and unique contribution and implications.

Theoretical Framework and Literature Review

Audit expectation gap and the causes of such gap

Audit expectations gap is the unreasonable expectations that various user groups of accounting information have over the role and responsibility of auditors. The word expectation gap in audit was first introduced by Liggio, (1974a). He defines it as the difference between the levels of expected performance as intended by the independent accountant and by the financial statements users, through considering whether a gap may exist between what the public expects or needs and what auditors can and should reasonably expect to accomplish. The existence of such gap was later confirmed by the AICPA through the Cohen's Commission report, which concluded after considerable study of available evidence that such a gap do exists (AICPA, 1978).

Lee, Ali, and Bien, (2009) defines audit expectation gap as the difference between what the auditors' believe their responsibilities to be and what the public expects from an audit. In describing the essence of audit they focused that audit expectation gap is an important issue in auditing because the audit reliability; earnings potential and prestige of the audit profession becomes lower with the higher unreasonable expectation of the public. Several studies across the countries have been conducted to identify the causes of audit expectation gap. Some of these studies highlight the following factors responsible for the expectation gap including the complex nature of audit function; conflicting role of auditors; retrospective assessment of auditors' performance; time lapse in answering to fluctuating expectations; self-regulation process of the auditing profession and the lack of awareness and unreasonable expectations (Lee & Ali, 2008). The audit expectation gap can be raised from factors such as lack of technical competence, the timeliness of auditor communication and a lack of audit independence (Dando & Swift, 2002).

Factors in reducing audit expectation gap

A study by Nasreen, (2006) was conducted on students of Bangladesh. She considered two groups of students, first group did not study audit course and second group did one audit course. Findings revealed that students who completed one audit course still had unreasonable expectation regarding auditor's responsibility for detecting and preventing fraud and audit assurance. She also found major differences in decision usefulness of

audited information area (as cited in Fowzia, 2010, p. 6). Another study by McEnroe and Martens, (2001) suggest that public education might be a suitable action to lessen the audit expectation gap. Study by Fowzia, (2010) concluded that for reducing such a gap a possible way is through audit education of the nature and limitation of audit. This study also suggests audit education is the significant tool in narrowing the audit expectation gap. In eliminating the audit expectation gap the auditors' responsibilities must not exclude detection of fraud and the fixed meaning of the audit must be established (Sikka, Puxty, Willmott, & Cooper, 1998). A number of ways were identified and suggested by Sidani, (2007); Best, Buckby, and Tan, (2001) which include the improvement of quality of auditing practice; enhancing the audit education in different level; expanding the audit engagement letter and long form audit report.

Nair and Rittenberg, (1987) find out that the expanded audit report appeared to change users' perceptions about the responsibilities of management and auditors that means users found expanded reports more useful and understandable than short-form audit reports (as cited in Aljaaidi, 2009, p. 52). There exists differing views of the researchers regarding the structured audit methodology for reducing audit expectation gap. Kamau, (2013) finds that the structured audit methodology was measured using the number of specific steps taken by the auditor in fraud detection. Lack of structured audit methodologies does not significantly contribute to high audit expectation gap. Koh and Woo, (1998) expressed that by adopting more structured methods of operation the audit firms hopes to provide high quality audits consistently. Purvis, (1987) looked into the effectiveness of using structured and semi-structured methods of data collection and concluded that the imposition of structure can have functional and dysfunctional aspects (as cited in Koh & Woo, 1998, p. 151).

Lee & Ali, (2008) concluded that quality of the audit can be improved by establishing an independent office to oversee the appointment of auditors and to regulate the audit fee. They believe that the statutory duties of the auditors can be expanded to accommodate some of the expectations of the public. Imposing additional roles on the auditor would lessen the audit expectation gap (Humphrey, 1997). A study by Porter, Ó hÓgartaigh and Baskerville, (2012) in UK states that more stringent monitoring of auditors' performance in the UK could reduce the audit expectation gap. In a study in Australia and New Zealand, Porter and Gowthorpe, (2004) suggests better monitoring of auditors' performance; improving the quality control in audit firms along with the introduction of new audit standard in ensuring quality performance of the auditors which in turn reduce the deficient performance gap.

Shbeilat, Abdel-Qader, & Ross, (2017) finds that the audit committee helps in narrowing the audit expectation gap since they are independent and non-executive committees and they aim to settle disputes and to reinforce external and internal audit performance. Putting essence on the strong role of audit committee Megat (2000) added that if audit committees do not play their role not more than just window dressing, then the audit expectations gap will be widened (as cited in Shbeilat et al., 2017, p.77). While, Akinbuli, (2010) in his work argues that the professional bodies should set up new standards and renew existing ones as one of the remedies to the expectations gap. A common response in order to reduce the gap is to set out more auditing and accounting

standards (Humphrey et al., 1993) (As cited in Saeidi, 2012, p. 7032). Salehi, (2011) concludes that the audit expectation gap can be reduced by the auditors' themselves through enhancing audit responsibilities, educating various users, and introducing new standards. Porter, (1993) finds that half of the expectation gap problem arises from deficient standards. He finds that the deficient standards can easily be revised through the reforms of the auditing standards and it is therefore relatively easier to reduce the expectations gap arising from this element.

Although accountancy profession is historically self-regulated, the big accounting scandals in the recent past have put a question mark on the self-regulation. Consequently independent professional oversight bodies like FRC in the UK and PCAOB in the USA came into existence. Several other countries namely, Malaysia, Australia, Sri Lanka and Bangladesh have such oversight bodies that are in charge of auditing of the auditors. Shil, (2015) argues that Financial Reporting Act (FRA) and its effective implementation can be a strong intervention to narrow the expectations gap in Bangladesh. FRA becomes necessary to establish trust and bring confidence on financial reporting by the investors and other stake holders in Bangladesh.

The Identified variables in the literature review clearly exhibit the research gap in Bangladeshi context since only two of variables have been studied so far in Bangladesh. Thus, the rest of the variables along with the existing ones need to be studied in Bangladeshi context in establishing a rigorous conclusion about the factors that reduce audit expectation gap.

Problem Statement

There are hundreds of audit firms in Bangladesh playing vital role in ensuring financial audit and enhancing the credibility of financial statements prepared by the corporations. Shareholders are principles who appoint the agents to perform the internal management of the firm but principles have little control over the functions of the agents. Auditors play the role between the auditors and shareholders and other users of accounting information. Auditors are expected to perform their roles in such a way that the financial information users get confidence in the facts and figures presented in the financial statements. The expectations of users of accounting information to the auditors is too high due to the nature of job they perform for the users and those expectations mostly exceed the functions that actually the auditors purports to perform.

The consequence is the audit expectations gap. The presence of audit expectation gap in Bangladesh has been identified by Chowdhury et al., (2005) and Fowzia, (2010). The presence of audit expectations gap is very harmful in many respects as it adversely affects the investors' decision; creditors' decision; impairs the reputation of audit firm and deteriorates the value of independent audit in the long run. Complete extinction of the audit expectation gap is not possible due to the nature and component of the audit expectation gap as has been revealed by Sikka et al., (2003). This study is an attempt in identifying the factors the implementations of those will certainly reduce the audit expectations gap in Bangladesh.

Data and Methodology

Primary data has been collected and interpreted for this study. A questionnaire of nine independent variables and a dependent variable has been surveyed to 50 respondents of three groups randomly. The selection of the groups was based on the expertise knowledge of accounting and auditing. The 1st group consisted of 20 university faculty members of accounting and finance discipline from three renowned public Universities and a private University. The second group consisted of 10 qualified and practicing chartered accountants and the third group consisted of a total of 20 CA articulated & CMA 1000 plus marks passed students from Bangladesh. Data has been collected on Self-administered basis through the Likert 5 point scale on the variables that potentially reduce the audit expectations gap in Bangladeshi context against the dependent variable to see whether the independent variables have impact on reducing the audit expectations gap in Bangladesh. Hence Pearson's correlation coefficient between individual independent variables and dependent variable has been calculated using SPSS 20. Finally, the principal component tool of factor analysis has been employed to identify the major factors that contribute to the reduction of audit expectation gap.

Research design and content validity

The variables under study have been extracted from the sources presented below in table 1 and table 2.

Table 1: Variables in reducing Audit Expectation Gap

Code	Items	Sources
v1	Audit Education	(Nasreen, 2006); (McEnroe & Martens, 2001); (Fowzia, 2010)
v2	Expanded Audit Report	(Koh & Woo, 1998); (Nair & Rittenberg, 1987)
v3	Structured Audit Methodology	(Kamau, 2013); (Koh & Woo, 1998)
v4	Expansion of Auditors' Responsibilities	(Lee et al., 2008); (Humphrey, 1997)
v5	Monitoring Auditors' Performance	(Porter et al., 2012); (Porter & Gowthorpe, 2004)
v6	Improving quality control in audit firm	(Porter & Gowthorpe, 2004)
v7	Strengthening the role of Audit Committee	Shbeilat, Abdel-Qader, & Ross, (2017);
v8	Introducing New Audit Standards	(Porter, 1993); (Akinbuli, 2010); (Porter & Gowthorpe, 2004); (Salehi, (2011); (Humphrey et al., 1993)
V9	Implementation of the Financial Reporting Act (FRA) 2015 Regulations	(Shil, 2015)

Table 2: Reduction of audit expectation gap

Code	Item	Sources
RAEGB	Reduction of Audit Expectation Gap in Bangladesh	(Siddiqui et al.,2009); (Shil, 2015); (Fowzia, 2010)

Reliability and validity of the study

The reliability statistic Cronbach's alpha value is .808 which considered optimal for the reliability of the current study.

Table 3: Reliability Statistics

Cronbach's Alpha	Cronbach's Alpha Based on Standardized Items	N of Items
.808	.803	10

The value of Kaiser-Meyer-Olkin (KMO) measure of sampling adequacy here is 0.733 as shown in Table 4. This suggests the adequacy of the sample size for the research study. From the results of the Bartlett's test of Sphrecity, it is seen that the approximate chi-square statistics of responses to the factors that reduce the audit expectation gap are significant since they are greater than the table value.

Table 4: Validity statistics

	KMO		Bartlett's test of Sphrecity	Sig.
	Value	Acceptable Status		
Reduction of Audit Expectations Gap in Bangladesh	.733	Middling/good	171.819	.000

So, it is clearly evident that this study is valid for identifying the factors that reduce the audit expectations gap in Bangladesh.

Results Discussion

Correlation Analysis

Correlation results represent the high and statistically significant correlation between the dependent and most of the independent variables. This implies that the variables together have significant contributions towards the reduction of audit expectation gap.

Table 5: Correlations between Dependent and Independent variables

Independent Variables	Dependent Variable (Reduction of Audit Expectation Gap in Bangladesh)	
	Correlations	Significance
Audit Education	.417	.003
Expanded Audit report	.089	.538
Structured Audit Methodology	.246	.086
Expansion of Auditor's responsibility	.345	.014
Monitoring auditor performance	.467	.001
Improving quality control in audit firm	.380	.006
Strengthening the role of audit committee	.395	.005
Introducing New audit standard	.534	.000
Implementation of FRA regulations	.369	.008

Table 5 shows that, the structured audit methodology and expanded audit report have lower impact on the reduction of audit expectations gap. Audit education has high positive correlations with dependent variable meaning that the expansion of audit education can significantly reduce the audit expectations gap. This finding corrects the earlier studies of Fowzia, (2010) in Bangladesh. The implementation of FRA regulations, the most talked issue of recent days in bringing back the confidence in the auditors' work, has been proved to have significant impact in reducing audit expectation gap. In a nutshell, the strong positive correlations between independent and dependent variables reject the null hypothesis and accept the alternative hypothesis, 'The identified factors can significantly reduce the audit expectation gap in Bangladesh'.

Factor Analysis

Total variability indicates the amount of variability in the data that has been modeled by the extracted factors. Table 6 shows three extracted factors out of nine variables whose Eigen value is greater than 1. The first factor explains 42.28% variability, while the second and third factors explain 14.88% and 12.09% variability respectively.

Table 6: Total Variance explained

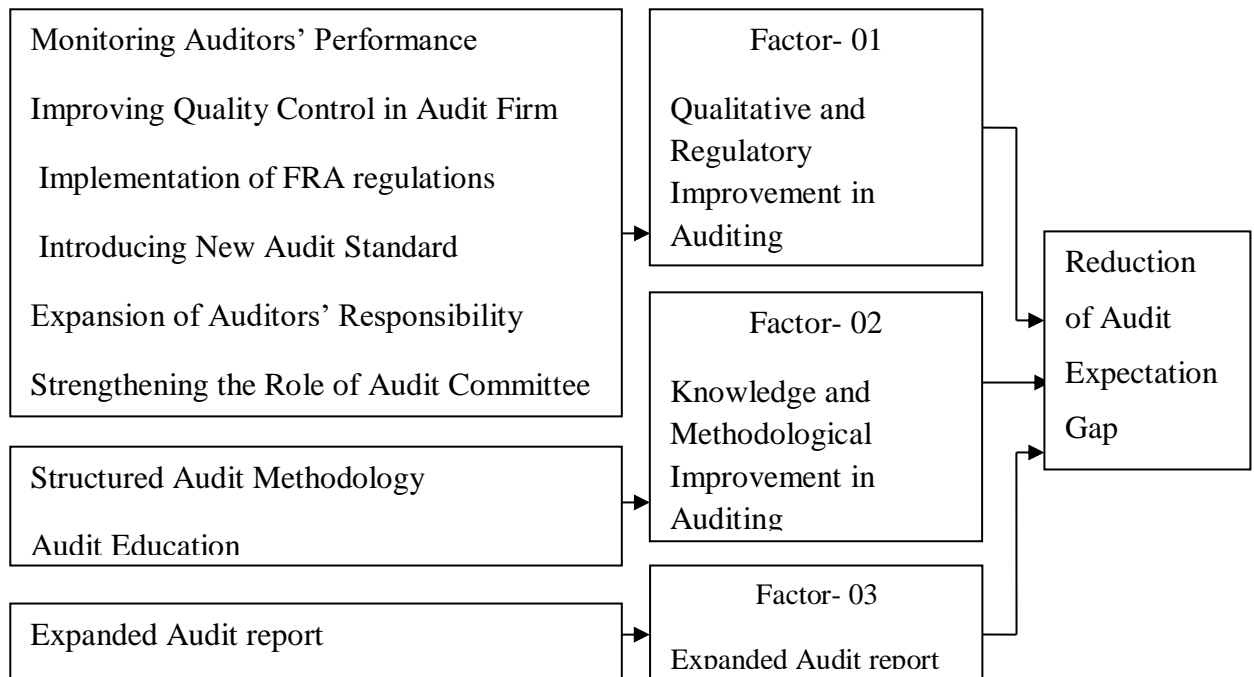
Components	Initial Eigen Values			Rotation Sums of Squared Loadings		
	Total	% of Variance	Cumulative %	Total	% of Variance	Cumulative %
1	3.833	42.585	42.585	3.806	42.285	42.285
2	1.389	15.431	58.016	1.339	14.880	57.165
3	1.012	11.243	69.259	1.088	12.093	69.259

As a result the cumulative variability is 69.25% which indicates that 69.25% of the variability is explained by the three factors. Table 7 shows that the component 1 includes 6 variables, component 2 includes 2 variables and component 3 includes 1 variable. The variables of each component are similar and related to each other.

Table 7: Rotated component matrix

Variables	Components		
	1	2	3
Monitoring auditors' performance	.845		
Improving quality control in audit firm	.830		
Implementation of FRA regulations	.789		
Introducing New audit standard	.782		
Expansion of Auditor's responsibility	.747		
Strengthening the role of audit committee	.643		
Structured Audit Methodology		.817	
Audit Education		.705	
Expanded Audit report			.934

The variables that load highly on component1 include all those relate to qualitative and regulatory improvement in auditing. Therefore we call it Factor-01 and label as 'qualitative and regulatory improvement in auditing'. Similarly, the variables that load highly on component 2 include those related to knowledge and methodological development. Thus, we call it factor-02 and label as 'knowledge and methodological improvement in auditing'. The single variable that loads highly on component 3 seems to relate to presentation of audit report. Therefore, we call it factor-03 and label as 'expansion of audit report'. This finding has been modeled in the figure below.



Model: Reduction of Audit Expectations Gap in Bangladesh.

The above model clearly depicts that the qualitative and regulatory improvement in auditing; knowledge and methodological improvement and the expansion of audit report can significantly reduce the audit expectations gap in Bangladesh.

Conclusion

The statistical analysis proves that the present study complies with the reliability and validity test. The uniqueness of this study is that it incorporates both correlations and factor analysis. None of the previous studies did so as has been evidenced by the literature study. The findings of this study are very remarkable since it identified nine variables and three principle factors that together can reduce the audit expectations gap in Bangladesh. The factors modeled in reducing audit expectation gap in Bangladesh include the qualitative and regulatory changes in auditing; knowledge and methodological improvement in auditing and the expanded audit report.

This study is differentiated from prior research in another way since it includes nine variables that reduce the audit expectation gap whereas the earlier ones did not focus on all these variables. Consequently, this gives a holistic look at the pervasive audit expectation gap and after rigorous analysis, suggests powerful remedies to curve this problem. The implementation of the factors shall help in bringing back the confidence of the accounting information users' over the audit and auditing profession as a whole. The value addition of this paper is that it redefined the dimensions of the factors that reduce the audit expectation gap in Bangladesh. Academicians, practitioners and regulators shall have an important insight into the current subject matter from this work. Future researchers shall also get a good base of scholarly work from this study.

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