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RESEARCH REPORT

Will the expanded audit report model proposed by IAASB reduce the expectation gap in South Africa?

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DEDICATION

This research report is dedicated to Rev. Jan Hofmeyr, the former director of Studietrust. Thanks for giving many poverty stricken learners from rural areas, including myself, opportunities to attain their academic dreams. You are a true hero.

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I praise God Almighty for helping me throughout my MCom studies.

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ABSTRACT

In 2013 the International Auditing and Assurance Standards Board (IAASB) proposed the revision of the international auditing standard on the audit report (ISA 700) to meet the information needs of the users of audited financial statements. The purpose of this research was to investigate whether the International Standards Assurance and Accounting Board's (IAASB) revised International Standard on Auditing (ISA 700) would reduce the expectation gap. It focused on the expectation gap investigation in three areas, namely: responsibilities of auditors, reliability of audited financial statements and decision-making usefulness of audited financial statements. A differential testing instrument was used in the study and completed by research subjects that comprised auditors, bankers and shareholders. Non-parametric Kruskal-Wallis H test and non-parametric Mann-Whitney test were used to analyse the data. The results of the study showed that despite the audit report modifications, expectation gap remained persistent with regard to auditors' responsibilities. On the positive front, the study showed that the revised ISA 700 resulted in users finding audited financial statements reliable and useful for decision-making purposes.

DECLARATION

I declare that this research is my own original work and that all sources have been accurately reported and acknowledged. The report is submitted for the degree of Masters of Commerce at the University of the Witwatersrand, Johannesburg. This research has not been submitted for any degree or examination at this or any other university.

Kwena Nicholas Maseko Date: 05 August 2015

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CHAPTER 1

INTRODUCTION

Introduction

There is a long-standing debate over the gap that exists between what the auditing profession considers its roles and responsibilities to be, and the needs and expectations of audits' stakeholders. The concept of the 'expectation gap' was first coined in the terms of reference of the Cohen Commission (1978), a commission established by the American Institute of Certified Public Accountants (AICPA). However, historically the expectation gap debate can be traced back to 1880, when the audit profession had to address public dissatisfaction over the work performed by the auditors (Humphrey et al., 1992). Public concerns over auditor performance gained momentum in the 1980s primarily due to the failure of auditors in the area of fraud detection and in signalling audit clients' financial difficulties (Manson and Zamon, 2001). Evidence of an expectation gap is provided by the increase in incidents of litigation and negative press instituted against the audit profession (Humphrey et al., 1992). When business failures occur, courts have been able to find auditors culpable for these failures, even if the auditors can prove their adherence to generally accepted audit methodologies (Lowe, 1994). Such outcomes point to differences in perceptions between auditors and the public regarding the meaning and function of the audit.

Explanations for the expectation gap

The definition provided by Porter (1993) reveals two views on the source of the expectation gap problem.

The first view attributes the prevalence of the expectation gap to societal ignorance of the nature of the audit (Humphrey et al., 1993). This view has been used by the audit profession to counter criticisms of its performance (Manson and Zamon, 2001). Consequently, strategies adopted by the audit profession over the years to overcome the expectation gap have been aimed at educating the public, and enhancing its awareness of the meaning of an audit. These efforts included publication of auditing standards designed to address expectation gaps, the distribution of educational pamphlets, and effecting changes to the wording of the audit report (Geiger and Epstein, 1994). The audit profession's sole focus on educational efforts has been branded a defensive strategy, as no blame is apportioned to the auditors for the persistence of the expectation gap (Humphrey et al., 1992).

The second view arises out of criticism of the audit profession's defensive mechanisms. One such criticism is that the education efforts only serve to create a false impression in society that something is being (or has been) done to address the perceived shortcomings of the audit (Sweeney, 1997). Furthermore, the Cohen Commission (1978) found that the public does not always have unreasonable expectations regarding the audit.

This view sees the meaning of the audit as socially contested (Sikka et al., 1998). It implies that the audit profession cannot ignore societal expectations of what the audit of financial statements should achieve. The fact that, in the event of business failures, auditors can lose court cases despite abiding by the generally accepted auditing standards (Lowe, 1994) shows the power of societal expectations of the audit. Therefore, to adequately address the expectation gap, constructive approaches, which consider societal needs and expectations, ought to be favoured over defensive ones.

This study tests the first view attributed to the audit profession, which holds that the expectation gap is a result of a lack of knowledge about the audit on the part of the public. The study focuses on the function of the audit report as a communication medium, intended to help society have a better understanding of what the audit of financial statements entails. It is therefore focused on the reasonableness expectation gap. The fact that this research study does not address the performance expectation gap constitutes an inherent limitation. This study uses the audit report format proposed by the International Auditing and Assurance Standards Board (IAASB) in 2013, and evaluates the communication effectiveness of this expanded audit report. At the time of writing (2015), the new International Standard on Auditing (ISA 700) has just been published. The revised ISA 700 was compared to the proposed ISA 700 and no material differences were found.

Prior research on the expectation gap and the audit report

There is an extensive body of published research on the effectiveness of the audit report as a communication tool. Hatherly et al. (1991), Kelly and Mohrweis (1989), and Miller et al. (1993) each involved one or more user groups, reading one or more versions of the audit reports, to evaluate whether the structure of the audit report shifted users' perceptions regarding the audit outcome. Nair and Rittenberg (1987), Lowe (1994), Gold et al. (2012), Asare and Wright (2009), and Best et al. (2001) provided auditors and other user groups with one or more versions of the IAASB's proposed new audit reports to determine the nature and extent of the expectation gap between auditors and user groups as well as among the user groups' members. The impact of auditing education, or lack thereof, on the expectation gap was investigated by Bailey et al. (1983) as well as Monroe and Woodliff (1993).

The approach most commonly used in prior research of the expectation gap, regarding the communication effectiveness of the audit report, involves both auditors and user groups. This approach has not previously been used in any published studies performed in South Africa and is used in this research study to enable meaningful comparison with the findings of similar studies carried out in other countries. Surveying the prior literature reveals mixed findings, with some studies showing changes to the wording of the audit report having a positive effect on diminishing the expectation gap (Bailey et al. (1983); Nair and Rittenberg (1987); Miller et al. (1993)), while other studies report the persistence of the expectation gap, despite changes to the wording of the audit report (Gold et al. (2012); Porter et al. (2009); Dixon et al. (2006)). In South Africa, the extent of expectation gap (particularly from the point of view that the audit report is a communication tool), and the effectiveness of the audit report has not yet been comprehensively researched, and it was therefore selected as the subject for investigation in this study.

Problem statement

This study investigates whether changes to the audit report (as published in the new International Standard on Auditing (ISA 700) and adopted in 2015), will reduce the expectation gap between what South African auditors and two user groups (bankers and shareholders) regard the responsibilities of auditors to be, the reliability of audited financial statements, and the decision-making usefulness of audited financial statements.

Purpose of the study

The problem statement addresses three areas of the expectation gap relating to the effectiveness of the audit report as a communication tool; these were explored in this study. The objective of this study was, therefore, to investigate whether the IAASB's new expanded audit report will reduce the expectation gap in South Africa regarding:

a) The roles and responsibilities of auditors (responsibility factor);
b) the reliability of audited financial statements (reliability factor); and
c) the decision-making usefulness of audited financial statements (decision-making factor).

The South African auditing and reporting environment

Answers to these three research questions are affected by the auditing and reporting context in South Africa. This context will provide the basis from which readers of this study can interpret its research findings.

Until the 2001 Enron debacle prompted a worldwide review of the regulatory system for auditors, the South African audit profession was self-regulated under the auspices of the Public Accountants and Auditors Board (PAAB) (Odendaal and de Jager, 2008). The outcome of this review in South Africa was the promulgation of the Auditing Profession Act No.26 of 2005 (APA) which established the Independent Regulatory Board for Auditors (IRBA). Measures to ensure the independence of IRBA include requiring accountability to the government; auditors comprising a maximum of 40% of the board membership, and government being partly responsible for its (the IRBA’s) funding (Odendaal, 2005), as cited in (Odendaal and de Jager, 2008)). These mechanisms are intended to ensure that the South African audit profession acts in the public interest. Upon reviewing the regulation of the South African audit profession against factors which, inter alia, include the competence and independence of the regulator, Odendaal and de Jager (2008) concluded that SA fared well by international standards. This should enhance the confidence of SA audit report users in the audit profession.

Another factor favouring the South African audit profession is the presence of mechanisms that help safeguard the integrity of the financial reporting process. The Johannesburg Stock Exchange (JSE) has stringent requirements with which listed companies must comply. Listing requirements include compliance with the provisions of the King Code of Governance for South Africa 2009 (King III), the APA, and the International Financial Reporting Standards (IFRS); stringent accreditation requirements for audit firms which audit listed companies, and requirements for audit firms to employ IFRS experts, who are in turn also subject to accreditation requirements (JSE, 2014). Such measures contribute to the strength of governance within listed entities, which may contribute to the integrity of financial statements contents. As regards the audit profession, the listing requirements reinforce principles of professional competence and due care in the manner in which auditors carry out their responsibilities.

The APA, together with the Companies Act, also plays a part in safeguarding the independence of the audit profession. Examples of the safeguards mandated by the APA include the rotation of individual auditors after every five years, as well as prohibiting entities from appointing an auditor who has “habitually” or “regularly” fulfilled secretarial or bookkeeping duties for that entity (Companies Act No. 71, 2008). These Acts also put the responsibility for the nomination of the auditors on an audit committee comprised of non-executive directors. These measures increase the legislative and structural safeguards that should encourage users to put faith in the work of the auditor, and thus put more reliance on the contents of audit reports provided by South African auditors.

These auditing and reporting practices may explain South Africa’s high standing in the world auditing community. For the past five years (2010-2014 inclusive) South Africa has retained the top spot globally for the rigour of its auditing and financial reporting standards (World Economic Forum, 2014). This global pre-eminence makes the South

African audit profession a role model for the entire world, and should positively impact how users receive the messages contained in audit reports prepared by SA auditors.

Significance of the study

Findings arising from this research will provide insights into how South African users perceive the wording of the audit report and how this in turn affects their perception of the role of the audit profession. A search of South African literature on the expectation gap phenomenon revealed that no previous research studies had been undertaken on auditors' and users' interpretations of the messages conveyed by the audit report. The only previous scientific study on the expectation gap in South Africa was conducted by (Gloeck and De Jager, 1993), which investigated the causes of the expectation gap based on causal factors, generated from a review of international literature. This study will, therefore, be the first to explore the expectation gap, premised on how users and auditors construe messages conveyed by the audit report in South Africa.

This study was based on the newly expanded audit report that at the time of writing had just been adopted by the IAASB (February 2015). The newly expanded audit report addresses some of the weakness in the previous standard audit report that had been highlighted by prior studies (e.g. Asare and Wright (2009); Gray et al. (2010)), in order to enhance its communicative effectiveness. It is therefore of interest to the IAASB, auditors, and other stakeholders, to evaluate whether the affected enhancements to the audit report have succeeded in reducing the expectation gap between auditors and users. If the results reveal a persisting expectation gap, this study would support findings by Gold et al. (2012) that audit report changes are not an effective mechanism by which to address the expectation gap and that other causal factors need to be attended to by the audit profession (Wolf et al., 1999). However, if the research results reveal a convergence of perceptions by users and auditors on the messages conveyed by the audit report, it may be an indication that the IAASB's efforts have in fact yielded positive results.

Furthermore, this research may be beneficially replicated locally to enhance the understanding of variations in perceptions of the expectation gap amongst various user groups. While this study focuses on the expectation gap amongst auditors, bankers and shareholders, it can easily be extended to jurors, students, audit committees, and many more interest groups, which will help enrich the understanding of the expectation gap within the South African environment. This can then facilitate targeted interventions if studies reveal specific user groups with significantly divergent expectations of the audit process.

Lastly, findings of this study are comparable to international studies undertaken on the expectation gap phenomenon. South Africa took a decision to adopt International Standards on Auditing (ISAs) and International Financial Reporting Standards (IFRSs) in 2005 (Independent Regulatory Board for Auditors, 2014). It is axiomatic therefore that global developments in auditing and financial reporting will directly impact on South Africa. Thus, the audit profession and users of financial statements in South Africa will be able to compare the extent of the local expectation gap with global trends.

Conclusion

This chapter has provided the goals of this research study and identified the major benefits. The next chapter provides a literature review of prior studies on the expectation gap phenomenon. It is followed by Chapter 3 (research methodology) which details how the research problem was investigated, and Chapter 4, the analysis and interpretation of research data. The final chapter makes recommendations based on the research findings and suggests areas for future research.

CHAPTER 2

LITERATURE REVIEW

Introduction

The purpose of this chapter is to review the academic literature on the expectation gap emanating from the communicative effectiveness of the audit report. As this study is about the communicative effectiveness of the audit report, this chapter commences with a review of the importance of the audit report to financial statement users. This is followed by the historical narrative of the application of the concept of the expectation gap in the auditing field. This conceptual framework is then discussed before a comprehensive review of expectation gap studies across the world, grouped by continent, is carried out.

The importance of the audit report

If the audit report is to be used as an educational tool to reduce the expectation gap by educating the public, it is important to assess the degree to which the audit report is regarded as important by the users of audited financial statements, as this will indicate whether it is suitable for this task. Research undertaken by Asare and Wright (2009) found that lenders and investors find the unqualified standard audit report useful when making lending and investment decisions. The investment decision value of the audit report was confirmed by a survey undertaken by the (CFA Institute (2010)), which found that 72% of the respondents found the audit report to be important in investment decision-making processes. With regard to lending decisions, Blackwell et al. (1998) found that, after controlling for firm-specific risk factors and loan characteristics, firms subject to audits are offered lower interest rates on borrowings. This was further confirmed by the study of Guiral-Contreras et al. (2007), which found that lenders who had given a favourable rating to a borrower, based on other factors, changed their attitudes if that borrower was the subject of an unfavourable audit opinion. The unfavourable audit opinion has been shown to have an adverse effect on risk assessment, and to have attracted higher interest premiums (Bamber and Stratton, 1997). The type of audit opinion received not only impacted decisions as to whether or not a loan should be granted but also the quantum of the loan; additionally analysts' decisions regarding whether or not to invest in a company were also impacted (Gomez-Guillamon, 2003).

This research evidence shows that users value the audit report for decision-making purposes. Therefore, any changes made to the audit report will be noticed. The most important question then is whether such modifications to the audit report, which is clearly valued by the users, will be sufficient to reduce the expectation gap.

History of expectation gap research

Liggio (1975) is generally credited with the application of the expectation gap concept to the auditing field (see Gloeck and De Jager (1993); Porter et al. (2009)). These publication dates show that investigation of the audit expectation phenomenon has a long history, spanning more than four decades. Liggio (1975) defined the expectation gap as the difference in views between financial statement users and independent auditors, with regard to the expected auditor performance. Over the years, many scholars have provided alternative definitions of expectation gap. Sikka et al. (1998) construed it to mean the difference between the public's expectation of the audit and the audit profession's preferential meaning of the audit. Other authors have explained the expectation gap in the context of differences between views held by society and auditors over what auditors' responsibilities in fact entail (Guy and Sullivan (1988); McEnroe and Martens (2001)). These various definitions all have at their centres the discrepancies between what the public and the auditors expect regarding the performance of auditors, the meaning of the audit, and what auditors' responsibilities should be.

Porter (1993) suggested that the expectation gap should be referred to as the 'audit expectation-performance gap', and provided an expanded definition for this concept. The expanded definition separates the expectation gap into a reasonableness gap and a performance gap, to reflect gaps emanating from differing expectations of the auditor's role and performance, respectively (Porter, 1993).

The 'reasonableness gap' is defined as "the gap between the responsibilities society expects auditors to perform and those it is reasonable to expect of auditors" (Porter, 1993). This concept refers to the fact that society can have unrealistic expectations of what the audit of financial statements can offer. The existence of the reasonableness gap was illustrated in a study by McEnroe and Martens (2001), which found that the investing public did not want auditors to express an unmodified opinion if a 'public watchdog' responsibility had not been fulfilled, if internal controls were found to be ineffective, or if all items significant to investors and creditors had not been disclosed.

Conversely, the 'performance gap' arises when auditors' performance fails to meet society's reasonable expectations (Porter et al., 2009). Sikka et al. (1998) argue that defining the expectation gap solely in terms of the public's unreasonable expectations would ignore the audit profession's contribution to its existence.

While there is no universally agreed definition of the expectation gap, there has been widespread scholarly acceptance of Porter (1993) broader definition (see Best et al. (2001); McEnroe and Martens (2001); (Gray et al., 2011)). The research undertaken for this study investigated both reasonableness and performance aspects of the expectation gap.

Conceptual framework

Normative approach versus positive approach

Research studies on the expectation gap are performed using either the normative or the positive approach (Innes et al., 1997). The positive approach focuses on perceptions of what auditors *are* doing, while the normative approach is based on perceptions of what the auditors should be doing (Innes et al., 1997). In this research, both the positive and the normative approaches have been used.

Communication theory and the expectation gap

In the study of communication theory, the process and semiotic views are the two main ways of assessing communication processes (Bedard et al., 2012). The process view regards communication as the transmission of messages, and focuses on enhancing information through the provision of the largest volume of information (Bedard et al., 2012). The semiotic view introduces the human factor by judging the effectiveness of communication by interpretations made, or inferences drawn by message recipients (Bedard et al., 2012). When IAASB embarked on the process of improving the audit report, it invited auditors and users of the financial statements to provide input (IAASB., 2012). The result was an audit report which contained the additional information sought by users and that clarified technical terms used in the previous audit report. Thus, the new audit report embraces both the process and semiotic views of communication, as it provides extra information while explaining technical terms in order to make the audit report understandable to financial statement users.

Schandl (1978), as cited in Chong and Pflugrath (2008), suggests various ways to overcome obstacles that can lead to the misinterpretation of messages. One suggestion is that plain language be used. The technical jargon used in the audit report makes its intended message susceptible to misinterpretation by the lay users (Cohen Commission, 1978). Examples of terms which are likely to be misunderstood are: “fairly presents”; “reasonable assurance”; “material misstatements”, and “test basis”. The term “fairly presents” is easily misconstrued by unsophisticated users, as it does not help them appreciate the uncertainties associated with every financial statement, every line item, and the entire audit (Wallison, 2007). Asare and Wright (2009) found widespread differences in the manner in which auditors, investors, and bankers interpreted technical terms in the audit report. Such misinterpretation of technical terms was found to be prevalent even among auditors (Gray et al., 2011). If technical terms used in the audit report confuse auditors, it can be expected that users who are underexposed to such terminology will be even more confused, contributing to the persistent expectation gap problem.

To address the complexity of language used in the audit report, the newly expanded audit report clarifies two technical terms that were found to be confusing to the users. These two technical terms are “reasonable assurance” and “material misstatements” (IAASB., 2013). However, the new audit report does not explain the term “fairly presents,” which was also found to be subject to misinterpretation by users and auditors (Asare and Wright (2009); Gray et al. (2011)).

It is also suggested that the use of signs and symbols that are understandable to the receiver is one of the ways to overcome obstacles to communication (Schandl, 1978). This suggestion appears to support the use of a standardized audit report, given its ability to evoke readers' schemata. However, research has also shown that the standardized format of the audit report does not encourage users to read the report in detail (AQF, 2007). Even if modifications were made to the audit report, users would not be interested in reading it as long as the changes were seen as 'boilerplate' (Gray et al., 2011). The Cohen Commission (1978) suggested that if the wording of the audit report departed from a standardized expression of information, users would more likely read it. Despite this, the standardized format of the audit report has been retained in the new audit report (IAASB., 2013). The only departure is the introduction of a 'key audit matters' paragraph, which will deal with aspects peculiar to the entity being audited. Therefore, from the communication effectiveness standpoint, the retention of the standardized format is appropriate for the effectiveness of communication of the audit report.

Another suggestion for improving communication effectiveness is by providing adequate amounts of data (Schandl, 1978). One of the criticisms of the audit report was that it did not contain sufficient information (CFA Institute, 2010). In the CFA Institute's audit report survey, 94% of the respondents wanted additional information to be included in the auditor's report. More specifically, financial analysts wanted additional information (about materiality, circumstances that might impede the auditor's independence, as well as the actual level of assurance achieved from the audit), to be added to the audit report (CFA Institute, 2010). Another survey also showed that financial analysts wanted the audit report to contain the basis of and rationale for any conclusions on the going concern status of the auditee (CFA Institute, 2012). Disclosure of such information would enhance the communication value of the audit report (Gray et al., 2010). As a result of these findings, the audit report as proposed in 2013 was to include several new sections allowing for: a) going-concern assurances, b) auditor commentary, and c) other information (IAASB., 2013). From the communication theory perspective, this should have enhanced the communicative effectiveness of the audit report.

Data organisation represents one of the ways of overcoming barriers to effective communication (Schandl, 1978). One of the new developments in the new audit report is that it puts the audit opinion at the top (IAASB., 2013). Putting the audit opinion at the top provides a foundation that allows the readers to link the audit opinion with subsequent information contained in the audit report (Chong and Pflugrath, 2008). This provides greater coherence to the information, which can help users of the financial statements to interpret it correctly.

Development of research questions

Roles and responsibilities of auditors

In the context of the roles and responsibilities of the auditor, the expectation gap emerges when society has unreasonable expectations of what auditors can accomplish (Porter, 1993). The expectation gap could, inter alia, emerge when auditors are expected to: verify every transaction or guarantee the accuracy of financial statements and the solvency of the company (Porter, 1993); detect all incidents of fraud (Best et al., 2001); or attest to the complete effectiveness of the entity's entire internal control system as part of an unqualified audit report (McEnroe & Martens, 2001). These are examples of unreasonable user expectations that allow the problem of the expectation gap to persist. McEnroe and Martens (2001) suggest that providing clarification of the duties of auditors in the audit report would reduce the expectation gap as it pertains to the roles and responsibilities of auditors. One of the improvements in the new audit report (ISA 700, of 2015) is clarification of the respective responsibilities of auditors, management, and those charged with governance (TCWG) (IAASB., 2013). This leads to this first research question:

Will the wording of the new audit report reduce the expectation gap with regard to the roles and responsibilities of auditors?

Reliability of financial statements

The auditor's objective in performing a financial statement audit is the expression of an opinion regarding reliability of representations by management (Schelluch et al., 1997). An audit executed by external auditors enables users to have confidence in an entity's financial statements. However, high-profile audit failures have lessened the credibility users place on audited financial statements (Wolf, Tackett & Claypool, 1999). The expectation gap, as regards the reliability factor, shows users' confusion around the level of assurance to be derived from the audit of the financial statements. Technical terms, such as "reasonable assurance" and "fairly presents", were found to be confusing to users as regards the level of assurance to be derived from the audit of financial statements (Asare & Wright, 2009). Some users perceive assurance from audit to imply the soundness of the business from an investor's perspective, or the entity's ability to meet its strategic imperatives (Asare & Wright, 2009). Other users perceive the wording "fairly presents" to imply the audited financial statements are accurate (Wallison, 2007). The new audit report provides an explanation of the phrase "reasonable assurance", to help users understand the level of assurance an audit of financial statements is intended to provide. This leads to the second research question:

Will the wording of the new audit report reduce the expectation gap with regard to the reliability of the audited financial statements?

Decision-making usefulness

Some research studies have not found evidence of an expectation gap as regards to the decision-making worth of audited financial statements (Best et al., 2001; Schelluch et al., 1997; Asare & Wright, 2009). However, other studies have found that users require the audit report to include additional information, including: audit findings (Vanstraelen, Schelleman, Hofmann & Meuwissen, 2011); the auditor's conclusion regarding the entity's status as a going concern (CFA Institute, 2012), and auditor independence (CFA Institute, 2010). The new audit report provides additional information on aspects such as the going-concern status of the entity and other key audit matters (IAASB., 2013). This gives rise to the third research question:

Will the wording of the new audit report reduce the expectation gap with regard to the decision-making usefulness of the audited financial statements?

Review of the expectation gap literature relating to the audit report

North America

In 1974, the Cohen Commission was established to investigate the expectation gap phenomenon in the United States (Cohen Commission, 1978). It found that the expectation gap existed and as a result of this finding a number of auditing standards were issued, as weaknesses had been found in the short-form audit report then in use (SAS 53-61). These standards were referred to as expectation gap standards. The rationale behind their publication was to better inform the users about the roles and responsibilities of the auditor (Guy and Sullivan, 1988). They included SAS 58, which prescribed a long-form audit report which was intended to provide clarification regarding the auditor's role. However, the persisting audit expectation gap problem, and fall-out as a result of financial reporting scandals and audit failures of the 1980s and 1990s, saw the enactment in the United States of the draconian Sarbanes-Oxley Act (SOX) of 2002. The implementation of SOX, together with a move towards globalisation of auditing standards triggered a worldwide re-think regarding the communication effectiveness of the audit report (Asare and Wright, 2009). The outcome of this worldwide rethink was the issuing of the ISA 700 auditing standard, which was the auditing standard in effect until February 2015, the date the IAASB formally implemented the revised ISA 700.

The expectation gap literature in the US exists across all generations of audit reports, from the short-form audit report (circa 1970) all the way to the original ISA 700 (2002). Libby (1979) undertook a research study which had loan officers and audit partners as its research subjects. The study required participants to rate the similarity of messages contained in various reports, which included the audit report. It found that concerns around the communicative effectiveness of the audit report were unfounded, as no expectation gap existed.

The common denominator of recent audit report changes (regarding going concern status, fraud, commentary on key audit matters, and other information) is that they are characterized by the transfer of wording from the auditing standards to the audit report. This is perhaps an acknowledgement by the audit profession that the auditing standards are not an effective communication and educational medium. McEnroe and Martens (2001) found that auditing standards that were aimed at reducing the expectation gap were not effective because “the general public is not exposed to these auditing standards.” The audit report as a vehicle for the education of the users, rather than the more technical auditing standards, has been recommended by Asare and Wright (2009). The IAASB has responded by effectively transferring content from expectation gap standards to the more widely accessible and accessed audit report.

The other common feature of these latest changes to the audit report is that they do not place any additional responsibilities on the auditor. This means that education is the primary motivation of the changes to the audit report. There appears to be an agreement among scholars that increasing the responsibilities of auditors may not be the solution. For instance, expecting auditors to prevent fraud would be unrealistic as “auditors do not have the power to implement the required controls” (Schelluch et al., 1997). However, Schelluch et al. (1997), argue that users’ scepticism may not be driven by their naivety, but by genuinely poor audit performance (which has led to audit failures), and that the appropriate mechanism should rather be the enforcement of compliance and reinforcement of disciplinary procedures. The implication is that the focus on education, unless accompanied by measures to prevent audit failures, will not be sufficient to reduce the expectation gap.

Subsequent studies have made use of long-form audit reports to evaluate whether a shift from the short-form audit report would reduce the expectation gap. Bailey et al. (1983) are credited by Asare and Wright (2009) with being the first to evaluate the impact of the long-form audit report on the expectation gap. (Bailey et al., 1983) evaluated differences in perceived audit report messages, based on audit report wording changes and readers’ knowledge. Research subjects included recent graduates who had completed their CPA exams, and fourth-year students who had studied advanced accounting but not auditing. Two major findings came from the study. One was that wording changes made a difference in how users perceived audit report messages, and another was that knowledgeable users put less responsibility for financial statements on auditors. This study showed that auditing education can reduce the expectation gap.

Kelly and Mohrweis (1989) compared participants' reactions to the short-form audit report with those to the long-form audit report (SAS 58). The participants included bankers and investors. The SAS 58 audit report was found to improve understandability, and the banking participants demonstrated a shift by attributing responsibility for financial statements to management. However, investors were still found to put more responsibility for financial statements on auditors than on management.

Similarly, positive findings were found in a study by Nair and Rittenberg (1987). With CPAs and bankers as research subjects, Nair and Rittenberg (1987) investigated agreements by users and auditors on messages in different types of reports, including the long-form audit report suggested by the Cohen Commission (1978). The expanded audit report was found to be more useful, and it also altered users' perceptions regarding the different responsibilities of management and auditors, thus showing a positive effect in diminishing the expectation gap.

While the above studies focused on improving the understandability of audit reports, and on users' ability to distinguish between the responsibilities of auditors and management, Miller et al. (1993) extended their study to cover reliability as a factor. Miller et al. (1993) assessed the reactions of bankers to both the short-form audit report and the SAS 58 audit report. This revealed a greater awareness of auditors' and management's responsibilities, due to the SAS 58 audit report. However, on aspects of reliability of audited financial statements and the scope of the audit, responses to the different audit reports did not show any differences. This showed that the SAS 58 audit report failed to provide clarification on the nature, scope, and limitations of the audit.

The consistent pattern of the findings that show users' ability to distinguish between roles and responsibilities of auditors and management was contrasted by Lowe (1994), whose study surveyed auditors and judges as its research participants. This study revealed the existence of a significant expectation gap between these two groups of subjects. Judges placed much more responsibility on auditors (which included the expectation that auditors search for the smallest incident of fraud), than did subjects from other groups. This expectation on the part of the judiciary that auditors act as public watchdogs were evident in the judgement pronounced by the United States' Chief Justice Warren Burger in 1984:

"By certifying the public reports that collectively depict a corporation's financial status, the independent auditor assumes a public responsibility transcending any employment relationship with the client. The independent public accountant performing this special function owes ultimate allegiance to the corporation's creditors and stockholders, as well as to the investing public. This "public watchdog" function demands…complete fidelity to the public trust" (Gramling et al., 2012).

The "public watchdog" expectation is not unique to judges, as McEnroe and Martens (2001) found that investors also require auditors to serve as "public watchdogs".

High user expectations were also revealed by Geiger and Epstein (1994). In their study (with investors as research subjects), Geiger and Epstein found that despite changes to the audit report, the expectation gap persisted. Most investors expected almost absolute assurance, rather than reasonable assurance" auditors seek to provide. On the decision-making front, it was found that the new audit report wording did not enhance users' ability to determine entities' investment attractiveness (Pringle et al. (1990)).

31 December 2006 saw the introduction of a new version of the audit report, in the form of ISA 700. Asare and Wright (2009) carried out a study to assess, among other things, whether the ISA 700 audit report was effective in helping users understand the roles and responsibilities of auditors regarding fraud detection. Research participants in this study were drawn from local auditors, lenders, and Masters of Business Administration (MBA) students (who served as proxies for investors). The study found that both lenders and investors attributed more responsibility to auditors than was legally required, expecting them to ensure an entity was able to meet its strategic goals, as well as providing an evaluation of the quality of the company's management. On the positive front, this research also showed the absence of an expectation gap on the decision-making facilitation value of the audit report.

These studies in the United States paint an inconclusive picture. While some show a decline in the expectation gap, due to the transition from short to long-form audit reports, others show that it persists, while yet others show that the long-form report aggravates the expectation gap problem.

Europe

In the United Kingdom (UK), Hatherly et al. (1991) undertook research on the expectation gap, using 140 part-time MBA students from the University of Edinburgh as research subjects. The purpose of the study was to determine whether the UK's version of the SAS 58 audit report (SAS 600) would shift users' perceptions. They found that users' perceptions of the audit process, extent of auditors' responsibilities, and audit environment did change with the introduction of SAS600. However, the long-form audit report was found to have what they termed a "halo effect". This means new expectation gaps were uncovered in areas not previously addressed by the audit report, such as users considering the audit report to imply that the company is free from fraud. The persistence of the expectation gap in the area of fraud was confirmed in another study by Innes et al. (1997), which showed a marginal decline in the expectation gap overall, but found no shift in perceptions regarding fraud detection, despite the existence of the long-form audit report. To close the expectation gap as regards users' expectation that auditors detect and prevent fraud, Hatherly et al. (1991) recommended that the audit report should clarify the auditor's role and responsibilities specifically pertaining to fraud.

Despite a change to SAS 600 in the UK, (Manson and Zamon, 2001) found that users still required more information to be included in the audit report than the various standards prescribed. While the study found a decline in the expectation gap after the introduction of the SAS 600 audit report, users still found the information provided to be inadequate. In order to increase the information value of the audit report, the users required additional information (such as audit findings and materiality levels), to be included in the audit report. The need for such information was also evident in the results of a survey conducted in the United States by (CFA Institute, 2010). This shows that while the expanded audit report had provided additional information to help users understand the audit process better, it had nevertheless still not gone far enough.

Following the publication of the ISA 700 audit report standard, Gold et al. (2012) carried out a research study to evaluate its communication effectiveness in Germany and the Netherlands. Participants in this study included auditors, financial analysts and students. The study found that the expectation gap persisted with regard to auditors' responsibilities, but declined in respect of management responsibilities, and a minor gap was found to exist on the financial statement reliability aspect.

It is clear from these findings that even in Europe, expanded audit reports did not sufficiently address the expectation gap problem, especially in the area of fraud prevention. Users also believe that the information value of the audit report can be improved through the inclusion of additional information.

Oceania

Porter et al. (2009) found that a failure to understand 'reasonableness' accounted for over 50% of the expectation gap problem in both the UK and New Zealand, showing users' unrealistic expectations to be primarily responsible for its prevalence. It was Porter (1993) that extended the definition of the expectation gap to facilitate targeted interventions to reduce it. Porter et al. (2009)'s subsequent research compared data from the UK with that from New Zealand. They found that the expectation gap was bigger in New Zealand, and that none of the generations of audit report had succeeded in reducing the expectation in areas such as auditors' responsibilities and nature of the audit process.

In Australia, Schelluch (1996) investigated the impact of the long-form audit report on users' perceptions. The research subjects were auditors and company secretaries. The study showed a diminishing expectation gap pertaining to auditors' responsibilities as a result of the introduction of the long-form audit report. However, as regards financial statements reliability, users questioned the value add provided by auditors. While Schelluch (1996) found a diminishing expectation gap on the aspect of auditors' responsibilities, Schelluch et al. (1997) showed a persistent expectation gap to exist in all responsibility, reliability, and decision-making factors. Additionally, scepticism regarding auditor's objectivity and independence, existed on the part of users. As the auditor's objectivity and independence are the cornerstones for societal trust in the audit profession, these findings are concerning.

Similarly to Hatherly et al. (1991), a "halo effect" was confirmed in an Australian study by Monroe and Woodliff (1994). The study found that, while the long-form audit report decreased the expectation gap overall, it created a further expectation gap, as users expected auditors to prevent fraud and to scrutinize the company's future prospects. This indicates that the extension of the audit report is able to provide clarity, but may also create misperceptions.

Furthermore, education was also found to be an influential factor in the expectation gap problem. Monroe and Woodliff (1993) sought to assess the influence of education on the expectation gap in Australia. The study involved auditors and students, with the students including those educated in auditing and those without education in auditing. It found some perception differences between auditors and educated students, when compared to auditors and students who did not have any auditing education.

Schelluch and Gay (2006) also studied the assurance provided by the audit report on forward-looking financial information. It was found that users placed more responsibility on auditors for the reliability of such information than the standards require. Reporting ongoing concern issues was also given impetus by the global financial crisis, with users expecting auditors to provide “warning signals” (CFA Institute, 2012). In the CFA Institute (2012) survey, 92% of the respondents thought the basis and reasons for the auditor concluding that the entity enjoyed going concern status should be provided in the audit report. It is therefore not surprising that the new audit report (IAASB., 2013) contains such information.

In Oceania, most studies indicate that the expectation gap remains a problem. Similarly to Europe, the “halo effect” on the expectation gap was found to have occurred following the introduction of the long-form audit report. More is now expected from auditors regarding forward-looking information, while education is found to be contributing to the reduction of the expectation gap in other respects.

Asia

Low et al. (1988) investigated the expectation gap phenomenon in Singapore by comparing auditors’ perceptions regarding company audit objectives to those of financial analysts. The study found that gaps existed, with users expecting auditors to prevent fraud and guarantee the accuracy of financial information. The prevalence of the expectation gap in Singapore was given further credence by Best et al. (2001).

Participants (including auditors, bankers, and investors) were provided with the short-form audit report which was then in use in Singapore. The purpose of the research was to assess to what extent the expectation gap existed by comparing the perceptions of users and auditors regarding messages conveyed by the audit report. A wide expectation gap was found to exist with respect to the nature of auditors' responsibilities (especially pertaining to fraud detection and prevention), as well as to the maintenance of accounting records. No expectation gap was found on the usefulness of audited financial statements in the decision-making process, or on the reliability of audited financial statements. The wide expectation gap on the auditors' responsibilities prompted Best et al. (2001) to call for the long-form audit report (which was already in place in countries such as the USA and the UK), to be introduced in Singapore.

In Malaysia, Fadzly and Ahmad (2004) also found that users had serious misconceptions about the audit process. Their research subjects included bankers, investors and brokers who were provided with short-form audit reports. Misconceptions users revealed included attributing to auditors the preparation of financial statements and the responsibility for the implementation of internal controls.

Lin and Chen (2004) investigated the rise of the expectation gap in the People's Republic of China. The study focused on the beneficiaries of auditing, which included investors, creditors, government officials, business managers, and academics. Similar to the results obtained by Best et al. (2001) and Low et al. (1988), an expectation gap was found to exist with regard to auditors' obligations in relation to fraud detection.

A different research approach was adopted by Lee et al. (2010), who undertook an expectation gap study in Thailand. In a comprehensive study which had 1000 respondents that included auditors, auditees and audit beneficiaries, they sought to examine the expectation gap using the framework proposed by Porter (1993). (Porter (1993)'s definition identified a reasonableness gap and a performance gap.) The study aimed to facilitate the identification of causal factors unique to a country, so that appropriate measures could be implemented to address the expectation gap problem. The study found that the reasonableness gap (which is the focus of this current research study) also existed in Thailand, with auditees and audit beneficiaries having expectations regarding auditors' duties that significantly exceeded what auditors considered to be within their sphere of responsibility. Users' expectations included that auditors should verify every transaction, and detect and disclose all fraud and theft occurrence, including identifying all of the company's employees involved.

Similarly to other continents, there is compelling evidence of the existence of the expectation gap in Asia. These studies reveal a very strong expectation by users in Asia that auditors ought to do more for fraud detection. However, research subjects in most of the mentioned Asian research studies did not have the benefit of the long-form audit report, making it impossible to determine whether the expanded audit report could alter their expectations.

Africa

Dixon et al. (2006) examined the expectation gap problem between auditors and financial statement users in Egypt. The study's purpose was to determine if there were differences in the perceptions of the messages conveyed by the short-form audit report. The researchers found a wide gap, with the users attributing more responsibilities for fraud prevention and the maintenance of accounting records to auditors than regulations required. With regard to the perceived reliability of audited financial statements and the usefulness of audited financial statements in decision-making, the gap was found to exist, but to a lesser extent.

In a study by Gloeck and De Jager (1993) the researchers intended to establish where the expectation gap was concentrated in the South African audit context. The study found that the expectation gap was premised on a lack of auditor independence and objectivity, on auditor role uncertainties, and on the mandatory audit of small owner-managed entities. However, the mandatory audit of small owner-managed entities has since been reversed through the enactment of the new Companies Act No. 71 of 2008. The Companies Act now allows such entities to opt for independent review in place of a statutory audit (Companies Act No. 71, 2008).

In line with the findings from other continents, evidence indicates the existence of an expectation gap problem in Africa. It is also primarily driven by users expecting auditors to assume more responsibilities than auditors deem reasonable. However, scientific research on the expectation gap in Africa has not been as extensive as on other continents. Therefore, this study will add to the body of literature on the expectation gap on the African continent. However, countries differ in their auditing and reporting standards, which may have a bearing on how users perceive the messages contained in the audit report. For this reason, it is worthwhile to examine South African auditing and reporting practices, both for the benefits these insights should bring the South African auditing community, and because it will provide a solid basis for comparison for future studies of other African audit environments and economies.

Literature review conclusion

Research carried out across the world shows that the expectation gap permeates all continents in the global community. It persists despite various interventions in the form of audit report changes and education programs. The new audit report has embraced ways of improving the effectiveness of its communication and is supported by research into communication theories. This study examines whether the latest expanded audit report will reduce the expectation gap in South Africa.

Definition of terms

Expectation gap:	The difference between levels of expected performance as understood by the auditor and as perceived by users of the financial statements (Liggio, 1975)
Reasonableness gap:	The difference between what society expects auditors to achieve and what they can reasonably expect to accomplish (Porter, 1993)
Performance gap:	The difference between the responsibilities society reasonably expects of auditors and auditors' performance (Porter, 1993)

CHAPTER 3

RESEARCH METHODOLOGY

Introduction

This study seeks to establish whether the recently introduced standardised audit report will bring about a reduction in the expectation gap in three areas, namely: a) the responsibilities of auditors; b) the reliability of audited financial statements, and c) the usefulness of the audited financial statements for decision-making purposes. The results of this research indicate the degree to which new modifications to the independent audit report are likely to be helpful in reducing the expectation gap problem in South Africa.

Type of research

The research goal was achieved by carrying out descriptive quantitative research in the form of a survey study. Survey research entails obtaining information about people's opinions, attitudes, experiences and traits by asking them questions (Leedy and Ormond, 2010). In this study, the perceptions of auditors, bankers and shareholders regarding the wording of the new audit report, have been obtained to determine the nature and extent of the expectation gap in South Africa. Survey research has challenges which include possible intentional misrepresentation of facts by respondents, and a reliance on what people believe to be true, which (in addition to not always being congruent with reality) could be affected by various events unrelated to the questions the study seeks to answer (Leedy and Ormond, 2010).

Ethical considerations

Merriam (2009) suggests that ethical concerns facing researchers when performing survey studies include the significance of the research purpose, promises and reciprocity, risk assessment, confidentiality, informed consent, and data access and ownership. Prior to sending the survey used in this study, an e-mail was sent to intended respondents explaining the purpose of the research and requesting that they indicate if they would be willing to participate in the study. The surveys were only sent to those who indicated that they would be willing to participate. The questionnaire used did not require the participants to disclose their personal details, and they were notified that their information would be treated as confidential. The online survey also requested respondents to grant consent before they could proceed with the completion of the survey. The surveys were sent to a qualified and independent statistician, Dina Venter, to administer and analyse.

Population and study sample

The study population was made up of three groups of respondents, namely auditors, bankers, and shareholders. The academics were chosen as proxies for shareholders. These three research groups have commonly been used in many scholarly investigations of the expectation gap phenomenon (see Schelluch *et al*., 1997; Best *et al*., 2001; Humphrey *et al*., 1993; Nair and Rittenberg; 1987; Porter *et al*., 2009). However, there is a wide range of other user groups that are affected by the audit report which have not been surveyed in this study due to time and budgetary limitations. Consequently, the results of this study may not be representative of the perceptions of the wider audit report stakeholders. Association with the audited financial statements was the criterion used to select the research subjects as it would enable them to answer the questionnaire from an informed perspective. Having a study sample made up of both auditors and user groups facilitates rigorous investigation of the expectation gap, as the IAASB aims to improve the effectiveness of communications between auditors and financial statement users (IAASB., 2012). Academics were selected from faculties of economic and management sciences at various universities across the country. Bankers were drawn from the staff at financial institutions countrywide, whose work requires them to review audited financial statements as one of the considerations in commercial lending decisions. Respondents in the auditors group came from Big 4 audit firms as well as from small and medium sized ones. The criterion for selection was that any participating auditor should have passed a final qualifying exam in the auditing specialism and have completed the required period of articles of clerkship. A study sample of 300 participants was selected, with 100 participants representing each respondent group.

Selection of sample

Due to time and budget constraints, it was not possible to undertake random sampling on the population. Consequently, this puts a limitation on this study as its findings cannot be used to draw inferences regarding the population. In response to the limited availability of resources and time, convenience sampling was used. Below is a detailed description of how each respondent group was selected.

Bankers

Participants from financial institutions were recruited through meetings with departmental heads at the financial institutions, and by means of direct contact through the LinkedIn business networking website (https://www.linkedin.com). Linkedin is a business-oriented social networking service, used primarily for professional networking. Again, due to time and budget constraints, only respondents identified from meetings at financial institutions from Gauteng province were surveyed.

Appointments were made with various banks to discuss the purpose of the research and how the banks could assist in the study. These meetings were held with appropriate departmental heads who (in the event that they agreed to participate) assisted in coordinating the survey distribution and collection process. During these meetings it was emphasized that the participants should only be those staff members who use audit reports as inputs in business lending decisions. Clear instructions regarding the completion of the survey were also provided, and repeated on the survey instrument itself.

Additionally, a search was made on LinkedIn for bank staff involved in commercial lending evaluation processes at financial institutions across the country. The job titles and descriptions of responsibilities on potential participants' curriculum vitae were scrutinized to ensure they were involved in making business lending assessments. Messages were sent to these potential participants through LinkedIn, explaining the purpose of the research and asking if they were willing to participate. Those who responded positively also provided e-mail addresses to which surveys could be sent. In the overwhelming majority of the cases, the participants provided their work e-mail addresses, which helped verify that they worked for financial institutions indicated on their profiles.

Auditors

Auditor respondents were obtained through LinkedIn, personal referrals, and meetings with partners within audit firms. The numbers of respondents sourced through meetings with audit partners was insignificant. This was due to the difficulty in securing meetings with audit partners, due to their busy schedules.

The majority of the auditor participants were thus sourced from LinkedIn. Participants contacted via LinkedIn were selected according to whether they identified themselves with either the CA (SA) or the RA designation. (Candidates who have passed the final qualifying exam in the auditing specialism are also entitled to use the CA (SA) designation.) To achieve broader participation, individuals identifying themselves on LinkedIn as employees of audit firms were also contacted. The curriculum vitae of prospective participants were examined to ensure that they had completed their articles within an audit firm. Before participants were sent the survey, their right to the CA (SA) and/or RA designations was confirmed using the online verification facilities provided by the South African Institute of Chartered Accountants and the Independent Regulatory Board for Auditors. In all searches performed all participants were found, providing assurance that responses obtained came from participants with the necessary qualifications.

Academics

Participants from academia were sourced through personal visits to universities, LinkedIn, personal contacts, and searches on the websites of universities across the country.

Visits to universities allowed the researcher to make personal contact with some of the respondents. This allowed the researcher to explain the purpose of the research, provide instruction regarding completion of the questionnaire, and to build rapport with potential respondents. It also allowed the researcher to answer any questions respondents had, and to obtain the email addresses to which surveys were subsequently sent. Due to financial and time constraints, personal visits could only be made to universities within Gauteng province.

Most universities have faculty names and contact details listed online. Potential participants, listed as members of the relevant faculties at universities in South Africa, were contacted using these publicly-available e-mail addresses. Initial message explained the purpose of the study and requested the potential participants to indicate whether they would be willing to assist in the study. Surveys were then only sent to those who expressed willingness to respond to the survey. The same approach was followed when sourcing academics from LinkedIn. LinkedIn was used as a supplementary source as some universities did not have staff email address publicly available. Staff members at such universities were therefore contacted through LinkedIn. Their participation was seen as essential to ensure that this study reflects responses of as many South African academics as possible.

Sources and collection of data

This study draws its conclusions from the analysis of primary data collected for this specific purpose. The use of primary data contributes to the validity of research results (Leedy and Ormond, 2010). Data for this study has been gathered by means of the surveys sent to participants in the three respondent groups (auditors, bankers, and shareholders) identified above. The study investigated the effects of the proposed (2013) changes in the audit report with no pre-existing data. The purpose of this study was to solicit from auditors and users of financial statements their perceptions of how the envisaged changes would affect their interpretation of messages conveyed by the audit report. This audit report format has since been implemented as the new ISA 700 standard.

Instrumentation

The survey instrument used to collect data for the purpose of this study was a questionnaire. The questionnaire was designed for a prior study of the expectation gap phenomenon, carried out in Australia (Schelluch et al., 1997). The instrument was used in that instance to study the expectation gap regarding the communicative effectiveness of audit reports on annual financial statements and interim reports. However, in this study it has been used to study the expectation gap on the communicative effectiveness of audit reports on annual financial statements only. The instrument has also been used in several other studies to determine the extent of expectation gaps in other countries, with authors recommending that it be used to further investigate the problem in yet more countries (Best et al. (2001); Dixon et al. (2006); Fadzly and Ahmad (2004). Use of an instrument that has been utilized in other countries to study the same phenomenon will facilitate comparison of the expectation gap in South Africa with those of other countries.

Given the persistent identification of an expectation gap on auditors' responsibility regarding fraud in the literature review (Innes et al. (1997); Monroe and Woodliff (1994); Hatherly et al. (1991); Best et al. (2001)), five (5) additional questions relating to fraud were added to the questionnaire. These were obtained from an expectation study conducted by (Porter et al., 2009). The demographic section of the instrument was adapted to enable better collection of data regarding the professional profiles of participants in this research. A copy of the questionnaire is included in the appendix. The different messages conveyed by the audit report are measured using semantic differential belief statements in the questionnaire. The audit report used in this study is the expanded audit report that was proposed by IAASB in 2013, and that has now been adopted. The expanded audit report was adapted to include the specific responsibility of SA auditors regarding reportable irregularities. This expanded audit report is included in the appendix. The questionnaire has 21 semantic differential belief statements in total, with the first 12 relating to the responsibility factor, statements 13 to 18 pertaining to the reliability factor, and statements 19 to 21 dealing with the decision-making usefulness of the proposed expanded audit report (Schelluch et al., 1997). These belief statements are bipolar, separated by a seven-point Likert scale. A Likert scale is more appropriate when attitude or other phenomena of interest require evaluation on a continuum (Leedy and Ormond, 2010). However, experts have mixed views on the Likert scale in that it allows respondents an option to remain neutral (Leedy and Ormond, 2010). The respondents should choose a number from the scale showing their level of agreement with either of the two opposing statements.

Content and construct validity

The questionnaire was a culmination of the review of academic and professional literature aimed at identifying messages intended to be conveyed by the audit report (Schelluch et al., 1997). The following explanations provide insight into the rigorous process followed by Schelluch et al. (1997) in designing the questionnaire. The thirty-five (35) belief statements were considered for use in the questionnaire and submitted to three audit academics, one audit partner, and two audit managers. They were asked to review the statements for completeness. A pilot testing was also carried out with 200 auditors who were asked to complete the questionnaire and to assess it for consistency with professional literature. The outcome of these exercises resulted in a reduction in the number of belief statements from 35 to 16, after tests for reliability. Modifications to some statements were affected, as recommended by the respondents. Responses received from the auditors participating in the pilot test, indicated that the belief statements were consistent with auditing standards and relevant academic literature.

Reliability

The semantic differential instrument was designed by Schelluch et al. (1997), using the steps described in scholarly work, on the scale to measure concepts by Maholta (1981). The approach adopted by Monroe and Woodliff (1994), who used the instrument to investigate the audit expectation gap problem in Australia, was also considered (Schelluch et al., 1997). From the pilot testing carried out by Schelluch et al. (1997), factor comparability analysis was performed, which yielded three stable factors, namely: a) decision-making usefulness, b) reliability and c) responsibility. These factors each achieved coefficients of factor comparability which ranged from 0.90 to 0.97. The feedback from the pilot study did not result in the addition of questions, but minor changes to a number of statements (Schelluch et al., 1997).

As part of the instrument design process, Cronbach's coefficient alpha was computed, which resulted in the reduction of the statement count from 35 to 16 in the final instrument. It is this final instrument of 16 statements, categorized into three factors (responsibility, reliability and decision-making), that has been adopted in this research to explore the expectation gap issue in SA. This instrument was constructed using sound academic approaches and it was also used with success in Singapore (Best et al., 2001) and Malaysia (Fadzly and Ahmad, 2004). Taken together, these factors made it desirable to utilize this instrument to investigate the expectation gap phenomenon in the South African context.

To enhance the reliability of responses received from the research subjects, survey questions were randomized. Furthermore, factor classifications were not included in the instrument to limit the potential for bias in the responses.

Data Analysis

The distribution of the data was evaluated by performing the Kolmogorov-Smirnov and Shapiro-Wilk tests of normality, which test the null hypothesis that the data is normally distributed in the population. When the *p* value is less than 0.05, it will indicate that the null hypothesis has been rejected and that the data can be assumed to be not normally distributed. The parametric test (ANOVA) was to be used if the data was normally distributed. One would always utilise parametric tests if at all possible, since these tests generally have more statistical "power". The ANOVA also has *post hoc* tests available to indicate the exact group pairs between which there are significant differences, should it indicate there is a significant difference between at least one group pair. In the event that the data was found to be not normally distributed, non-parametric tests were to be performed. A non-parametric Kruskal-Wallis H test would be conducted in such cases, to establish if at least two groups differ significantly in their responses. As the Kruskal-Wallis test does not indicate which specific groups are statistically different from each other (*post hoc* test), a non-parametric Mann-Whitney test using a Bonferonni correction test was to be performed for each possible group pair, to assist in determining which mean differences were statistically different. These tests (non-parametric Kruskal-Wallis H test and non-parametric Mann-Whitney test) were applied to auditors and shareholders, auditors and bankers as well as bankers and shareholders. If the results of the Mann-Whitney test returned a *p*-value of less than or equal to 0.05, that would indicate a statistically significant difference in the perceptions between the relevant groups, and thus indicate the existence of an expectation gap. The results were analysed using the IBM Statistical Package for Social Sciences (SPSS) v22.

Data management

A web-based survey was used for this study. The rationale for using an internet survey was to facilitate administration and to eliminate postal costs associated with mail delivered surveys. Furthermore, the targeted groups from which respondents were drawn have near-universal access to computer and internet facilities, which made the use of a web-based survey convenient for them and were therefore expected to lead to a better response rate. The SurveyMonkey website (www.surveymonkey.com) was used, as it provides a cost-effective way to design, collect, administer, and analyse the response data. To facilitate management and categorisation of data, each of the three groups of respondents was provided with its own unique survey link. The data received has been kept securely and will be used solely for academic purposes. An undertaking was made to respondents that their feedback would remain confidential.

Assumptions

The first important assumption is that respondents would read the sample audit report attachment prior to completing the survey. To ensure that participants did read the sample audit report before completing the survey, a request to do so was included in the e-mail and on the first page of the internet survey, as part of the instructions on how to complete the questionnaire. The second assumption is that respondents would be honest when answering the survey. To encourage honesty, a request was made on the first page on the survey asking respondents to be honest, as that would enhance the integrity of the study. Respondents were also made aware that participation in the research was not compulsory.

Limitations

Due to limited resources (of time and money) it was not possible to select the sample randomly even though this would have improved the representativeness of the data relative to the population. The use of convenience sampling, which is a non-statistical sampling method, makes it difficult to generalize and extrapolate conclusions to the population. Randomization allows the selection of a representative sample, which then gives validity to generalisations of the research findings to a population (Creswell, 2003).

There may be influential cultural differences between Australia and South Africa. The instrument was not validated for possible cultural differences and the impact of adding 5 more questions. This may affect the reliability of the research results. Another limitation was that the questionnaire was only distributed once. Therefore, only a post-test of responses was undertaken. If the survey had been distributed twice, it would have been possible to do both a pre-test and post-test of responses.

Procedure and time frame

The study was undertaken over a period of three months (8th September 2014 – 9th December 2014). Targeted respondents were sent an e-mail request which included the survey website link and an attachment containing the sample audit report. They were given a week to return the survey, after which a follow-up e-mail was sent, or a telephone call made, to remind the (non-) participants to complete and submit the survey. For participants obtained from LinkedIn, the initial step involved asking those who had accepted invitations if they were still willing to participate in the study, and asking them to provide their e-mail addresses. Subsequent steps similar to the ones outlined above were then followed. On 8th December 2014 the independent statistician (Dina Venter) was handed manual surveys received from financial institutions whose Information Technology systems blocked the SurveyMonkey.com website for security reasons. Ms Venter closed off the surveys on 10 December 2014 thus preventing any further surveys being received from participants. From 15 December 2014 to 19 December 2014 Ms Venter performed statistical analysis of the collected data. The results of the analysis were received by the researcher on 22 December 2014.

CHAPTER 4

RESULTS AND DATA INTERPRETATION

Introduction

The objective of this study was to evaluate whether the new IAASB audit report would reduce the expectation gap with regard to:

1. The understanding of the roles and responsibilities of the auditor (responsibility factor);
2. The enhancement of the reliability of financial statements (reliability factor), and
3. The decision-making usefulness of audited financial statements (decision-making factor).

Demographic characteristics of the sample

The sample selected for this study was made up of 300 respondents which comprised auditors, bankers and shareholders. The number of participants included in the sample for each respondent group was 100. Demographic details for the respondents are provided below:

Table 1 shows that the overall response rate for the study is 42,7% and that the response rates are reasonably evenly distributed across the three respondent groups.

Table 1: Current occupation

Subject group	No. of surveys sent	Responses received	Response rate
Shareholders	100	46	46%
Auditors	100	43	43%
Bankers	100	37	37%
Undisclosed occupation		2	0.7%
Total	**300**	**128**	**42.7%**

This response, both as a percentage and in absolute terms, was deemed sufficiently high to lead to valid and meaningful statistical analysis.

Table 2: Highest Qualification

Qualification	Number	Percentage
Diploma	9	7.0
Post-graduate diploma	6	4.7
Bachelor's degree/BTech	4	3.1

Honours degree	80	62.5
Master's degree/Master of Technology degree	28	21.9
Phd/Doctoral degree/Doctorate of Technology	1	.8
Total	**128**	**100.0**

The results of Table 2 show that nearly two-thirds of respondents (62.5%, *n*=80) have an Honours degree. Just over one-fifth of respondents (21.9%, *n*=28) have a Master's level qualification, while only one respondent has a degree at PhD level. This indicates that overall 85% of participants possessed at least an Honours degree.

Table 3: Working experience

Years of working experience	Number	Percent
1-5	37	28.9
6-10	47	36.7
11-15	23	18.0
16 or more	20	15.6
Total	127	99.2
Not provided	1	.8
Total	**128**	**100.0**

Table 3 indicates that, in terms of working experience, the largest cohort of participants (37% of respondents) comprised those who had between 6 and 10 years of working experience. Those with over 10 years of working experience constituted the second largest cohort of participants (34% of respondents), almost equally distributed between those with 11 – to 15 years of experience (18.1%, *n*=23), and those with 16 years or more of experience (15.7%, *n*=20). The significant majority (70%) of research participants have 6 or more years of working experience, while 34% of participants have in excess of 11 years of experience.

Table 4: Membership of professional bodies

Professional bodies	Responses		Percent of Cases
	Number	Percent	
IRBA	19	15.1%	20.0%
CIMA	9	7.1%	9.5%
IIASA	10	7.9%	10.5%
SAICA	81	64.3%	85.3%
CFA	4	3.2%	4.2%
SAIPA	3	2.4%	3.2%
Total	**126**	**100.0%**	**132.6%**

This was a multiple response variable, where the respondents were able to make multiple selections. 126 selections were made in total and, because the sub-samples in the "Number" column are not independent, the percentage of cases adds up to more than 100%. On average, each respondent acknowledged membership of 1.326 different bodies, an indication that some respondents are members of multiple professional bodies. With auditors dominating the sample, it is not surprising that the most popular professional body in this sample is SAICA. With the number of respondents in the category of auditors totalling 45, this result shows that there were 36 other Chartered Accountants (CA (SA)) in the shareholders and bankers respondent categories. Of the 45 auditor respondents, 19 are currently registered with IRBA and 26 qualified as Registered Auditors, but later moved to other departments within the audit firms or pursued other professions outside the audit firms and therefore only use CA(SA) designation. The criteria for the selection of the auditor respondent group was the completion of articles within the audit firm and successful completion of the final qualifying exam in the auditing specialisation.

Seniority of participants

Respondents in this category of auditors were primarily made up of auditors who are involved in managerial positions. Of the 45 responses received from auditors, 28.8% were from managers, 26.7% were from senior managers, and 20% from audit partners. Of the 43 participants from academia, more than half (51.1%, *n*=22) were senior lecturers. Only 1 professor participated in the study as an academic. Bankers mostly chose to describe their seniority level using the “banker” (30%) and “team member” (17.5%) options. Only 12.5% described their seniority as “investment associates”. Inclusion of the “banker” option made it difficult for participants to describe their occupational seniority more accurately.

Research Question 1 results: Responsibility factor

Tests for normality

The Kolmogorov-Smirnov and Shapiro-Wilk tests were performed to test the normality assumption for responses to the responsibility statements across different occupation groups. The results of the normal distribution tests are provided in Table 5.1 below:

Table 5.1: Tests of Normality

Responsibility statements	Which of the following best describes your present occupation?	Kolmogorov-Smirnov[a]			Shapiro-Wilk		
		Statistic	df	Sig.	Statistic	df	Sig.
1. The auditor is/is not responsible for detecting all fraud	Shareholder	.215	44	.000	.855	44	.000
	Auditor	.310	41	.000	.635	41	.000
	Banker	.164	35	.017	.876	35	.001
2. The auditor does not/does exercise	Shareholder	.276	44	.000	.713	44	.000
	Auditor	.399	41	.000	.483	41	.000

judgement in the selection of audit procedures	Banker	.240	35	.000	.787	35	.000
3. The auditor/ Management is responsible for maintaining accounting records	Shareholder Auditor Banker	.508 .535 .402	44 41 35	.000 .000 .000	.353 .222 .547	44 41 35	.000 .000 .000
Responsibility statements	**Which of the following best describes your present occupation?**	**Kolmogorov-Smirnov[a]**			**Shapiro-Wilk**		
		Statistic	**df**	**Sig.**	**Statistic**	**df**	**Sig.**
4. The auditor is not/is responsible for preventing fraud	Shareholder Auditor Banker	.333 .444 .216	44 41 35	.000 .000 .000	.731 .414 .830	44 41 35	.000 .000 .000
5. The auditor/ Management is responsible for the soundness of the internal control structure of the entity	Shareholder Auditor Banker	.417 .480 .334	44 41 35	.000 .000 .000	.574 .508 .573	44 41 35	.000 .000 .000
6. Management/The auditor has responsibility for producing the financial statements	Shareholder Auditor Banker	.478 .512 .298	44 41 35	.000 .000 .000	.471 .311 .718	44 41 35	.000 .000 .000
7. The auditor is unbiased and objective/biased and not objective	Shareholder Auditor Banker	.245 .284 .228	44 41 35	.000 .000 .000	.780 .688 .775	44 41 35	.000 .000 .000

The Kolmogorov-Smirnov and Shapiro-Wilk tests of normality test the null hypothesis that the group data is normally distributed in the population. In this instance both tests indicate that the distribution of the scale scores deviate significantly from normality. This is shown by a **Sig**. value of less than 0.05, leading to the rejection of the null hypothesis and showing that the data deviate significantly from the normal distribution. Due to the non-normality of the data, a non-parametric test (in this case the Kruskal-Wallis H test) was used to test the mean differences among the occupation groups. The results of the Kruskal-Wallis H test of the mean differences relating to responsibility statements are shown on Table 5.2 below:

Table 5.2: Kruskal-Wallis H test: Mean Ranks

Responsibility statements	Which of the following best describes your present occupation?	No.	Mean Rank
1. The auditor is/is not responsible for detecting all fraud	Shareholder	45	64.77
	Auditor	43	82.22
	Banker	36	36.11
	Total	124	
2. The auditor does not/does exercise judgement in the selection of auditor procedures	Shareholder	46	64.01
	Auditor	43	79.84
	Banker	37	43.88
	Total	126	
3. The auditor/Management is responsible for maintaining accounting records	Shareholder	46	62.89
	Auditor	42	69.69
	Banker	37	55.54
	Total	125	
4. The auditor is not/is responsible for preventing fraud	Shareholder	45	61.62
	Auditor	42	47.35
	Banker	36	79.57
	Total	123	
5. The auditor/Management is responsible for the soundness of the internal control structure of the entity	Shareholder	46	62.99
	Auditor	43	70.78
	Banker	37	55.68
	Total	126	

6. Management/The auditor has responsibility for producing the financial statements	Shareholder Auditor Banker Total	46 43 37 126	59.14 53.47 80.58
7. The auditor is unbiased and objective/biased and not objective	Shareholder Auditor Banker Total	46 43 37 126	65.28 53.94 72.39

Table 5.3: Test Statistics

Responsibility statements	Chi-Square	df	Asymp. Sig.
1. Resp: The auditor is/is not responsible for detecting all fraud	34.725	2	.000
2. Resp: The auditor does not/does exercise judgement in the selection of auditor procedures	22.687	2	.000
3. Resp: The auditor/Management is responsible for maintaining accounting records	7.697	2	.021
4. Resp: The auditor is not/is responsible for preventing fraud	19.717	2	.000
5. Resp: The auditor/Management is responsible for the soundness of the internal control structure of the entity	5.405	2	.067
6. Resp: Management/The auditor has responsibility for producing the financial statements	20.123	2	.000
7. Resp: The auditor is unbiased and objective/biased and not objective	5.881	2	.053

As shown on Table 5.3, the Krushal Wallis Test found that at least one pair of means is significantly different, at the 5% or 0.1% level of significance, for five of the statements. For the other two statements, the differences are marginally significant at the 5% level but significant at the10% level of significance. In the case of the 4 statements that are significant at the 0.1% level of significance, perceptions of bankers differ significantly from those of both shareholders and auditors, while in the case of the other three statements, bankers differ significantly from only the auditors (see test results below).

Mann-Whitney U Tests

Due to the violation of the equal variances assumption, the non-parametric Mann-Whitney U test is used with a Bonferroni correction (i.e., for three pairs the alpha coefficient will be divided by 3: .05/3=0.0167≈0.02, rounding up to make it slightly less conservative) for each pair of means for statements one, two, three, four, and six to see which pairs are responsible for the significant results found by the Kruskal-Wallis test for these statements. The results of the Mann-Whitney U tests are shown in Table 5.4 below:

Table 5.4: Ranks and Test Results: Shareholder vs. Auditor

Which of the following best describes your present occupation?		The auditor is/is not responsible for detecting all fraud	The auditor does not/ does exercise judgement in the selection of audit procedures	The auditor/ Management is responsible for maintaining accounting records	The auditor is not/is responsible for preventing fraud	Management / The auditor has responsibility for producing the financial statements
Shareholder	N	45	46	46	45	46
	Mean Rank	37.79	39.24	42.23	49.38	46.96
	Sum of Ranks	1700.50	1805.00	1942.50	2222.00	2160.00
Auditor	N	43	43	42	42	43
	Mean Rank	51.52	51.16	46.99	38.24	42.91
	Sum of Ranks	2215.50	2200.00	1973.50	1606.00	1845.00
Total	N	88	89	88	87	89
Mann-Whitney U		665.500	724.000	861.500	703.000	899.000

Wilcoxon W	1700.500	1805.000	1942.500	1606.000	1845.000
Z	-2.689	-2.504	-1.660	-2.457	-1.167
Asymp. Sig. (2-tailed)	.007	.012	.097	.014	.243

Ranks and Test Results: Shareholder vs. Banker

Which of the following best describes your present occupation?		The auditor is/is not responsible for detecting all fraud	The auditor does not/ does exercise judgement in the selection of audit procedures	The auditor/ Management is responsible for maintaining accounting records	The auditor is not/is responsible for preventing fraud	Management/ The auditor has responsibility for producing the financial statements
Shareholder	N	45	46	46	45	46
	Mean Rank	49.98	48.27	44.16	35.24	35.68
	Sum of Ranks	2249.00	2220.50	2031.50	1586.00	1641.50
Banker	N	36	37	37	36	37
	Mean Rank	29.78	34.20	39.31	48.19	49.85
	Sum of Ranks	1072.00	1265.50	1454.50	1735.00	1844.50
Total	N	81	83	83	81	83
Mann-Whitney U		406.000	562.500	751.500	551.000	560.500
Wilcoxon W		1072.000	1265.500	1454.500	1586.000	1641.500
Z		-3.901	-2.758	-1.294	-2.608	-3.167
Asymp. Sig. (2-tailed)		.000	.006	.196	.009	.002

Ranks and Test Results: Auditor vs. Banker

Which of the following best describes your present occupation?		The auditor is/is not responsible for detecting all fraud	The auditor does not/does exercise judgement in the selection of audit procedures	The auditor/ Management is responsible for maintaining accounting records	The auditor is not/is responsible for preventing fraud	Management/ The auditor has responsibility for producing the financial statements
Auditor	N	43	43	42	42	43
	Mean Rank	52.70	50.67	44.20	30.61	32.56
	Sum of Ranks	2266.00	2179.00	1856.50	1285.50	1400.00
Banker	N	36	37	37	36	37
	Mean Rank	24.83	28.68	35.23	49.88	49.73
	Sum of Ranks	894.00	1061.00	1303.50	1795.50	1840.00
Total	N	79	80	79	78	80
Mann-Whitney U		228.000	358.000	600.500	382.500	454.000
Wilcoxon W		894.000	1061.000	1303.500	1285.500	1400.000
Z		-5.555	-4.596	-2.778	-4.209	-4.075
Asymp. Sig. (2-tailed)		.000	.000	.005	.000	.000

Table 5.4 shows that the perceptions of bankers differ significantly from those of auditors on five responsibility statements at the 5% level of significance. The Asymp. Sig. (2 tailed) value of ≤ 0.05 is an indication that the null hypothesis that the mean scores for auditors and bankers are the same in the population, can be rejected in

favour of the alternative hypothesis, stating that the mean difference is statistically significant, thus providing evidence of an expectation gap. Bankers' views differ significantly from those of shareholders on four counts of responsibility statements at the 5% level of significance. Furthermore, there is evidence of an expectation gap between bankers and auditors on three counts of responsibility statements at the 5% level of significance.

The first objective of this study was to determine whether there is likely to be a reduction in the expectation gap between auditors and users, regarding the responsibilities of auditors and management, as a result of the introduction of the new audit report (ISA 700) by the IAASB.

Table 5.5: Responsibility statements

Statement	Mean responses			
	Shareholder	Auditor	Banker	Across Groups
1. The auditor is/is not responsible for detecting all fraud	5.511*	6.302	3.611*	5.234
2. The auditor does not/does exercise judgement in the selection of audit procedures	5.978*	6.558	4.568*	5.762
3. The auditor/Management is responsible for maintaining accounting records	6.500	6.929	6.135*	6.536
4. The auditor is not/is responsible for preventing fraud	1.978*	1.405	3.306*	2.171
5. The auditor/Management is responsible for the soundness of the internal control structure of the entity	6.261	6.767	5.946	6.341
6. Management/The auditor has responsibility for producing the financial statements	1.543	1.163	2.838*	1.794
7. The auditor is unbiased and objective/biased and not objective	2.152	1.767	2.865	2.230
Note: * Significantly different from auditors at $p \leq 0.05$				

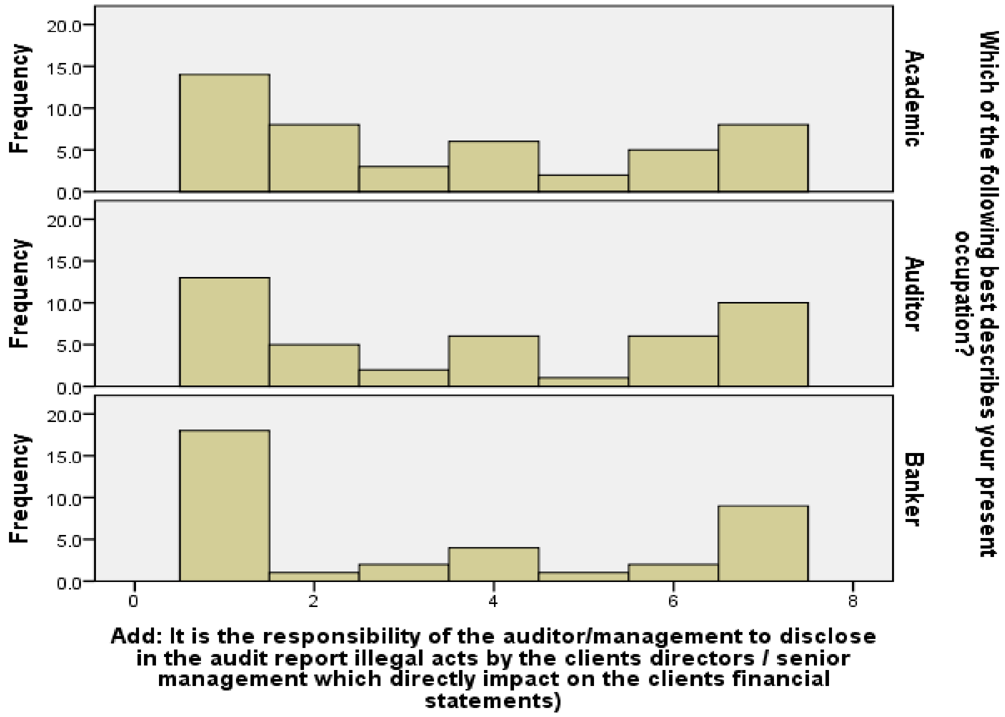
The results presented in Table 5.4 and summarized in Table 5.5 show that the expectation gap still exists between auditors and both groups of users (shareholders and bankers) on responsibility statements 1, 2, and 4. There is also evidence of an expectation gap between auditors and bankers on statements 3 and 6.

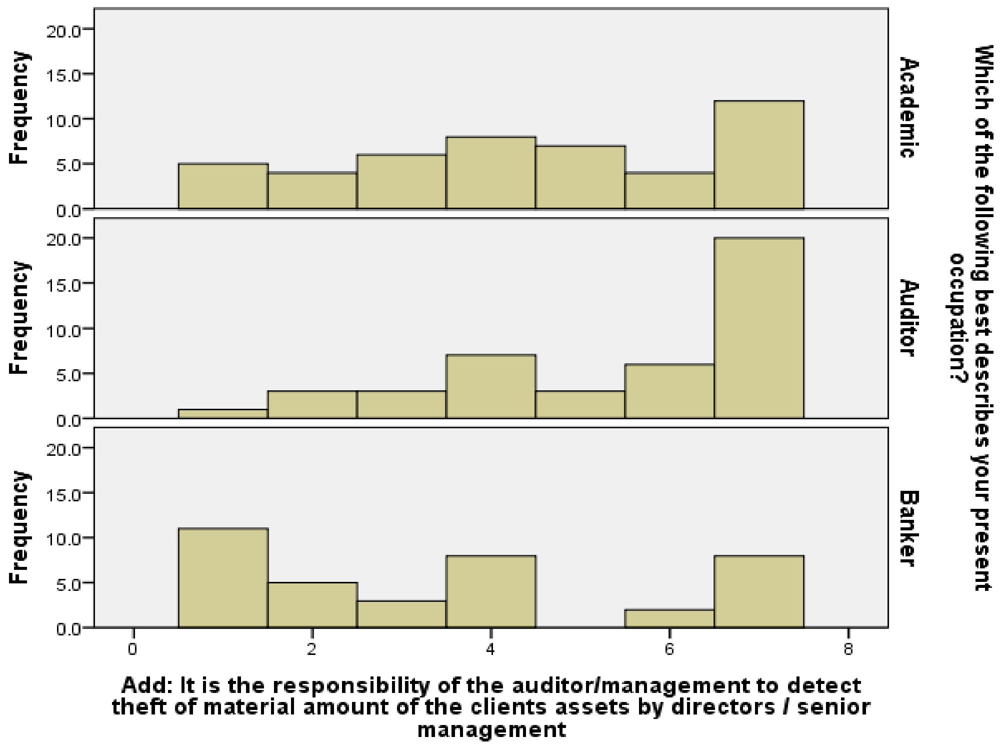
Table 5.6: Tests of Normality: Additional responsibility statements

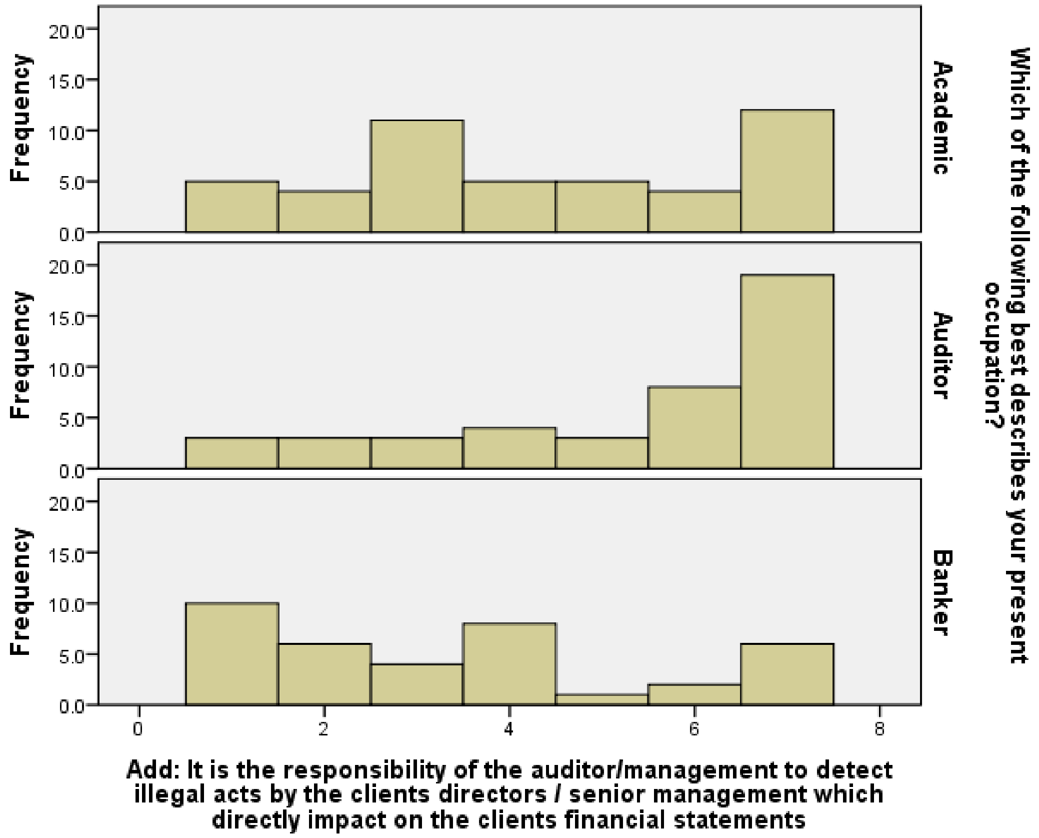
Additional responsibility statements (Brenda Porter, 2009)	Which of the following best describes your present occupation?	Kolmogorov-Smirnov[a]			Shapiro-Wilk		
		Statistic	df	Sig.	Statistic	df	Sig.
8. It is the responsibility of the auditor/management to disclose in the audit and report illegal acts by the client's directors / senior management which directly impact on the client's financial statements (e.g., breaches of tax laws)	Shareholder Auditor Banker	.214 .192 .291	46 42 36	.000 .000 .000	.841 .827 .761	46 42 36	.000 .000 .000
9. It is the responsibility of the auditor/management to detect theft of material amounts (e.g., > 5% of turnover or of total assets) of the client's assets by directors / senior management	Shareholder Auditor Banker	.153 .258 .178	46 42 36	.009 .000 .005	.902 .814 .842	46 42 36	.001 .000 .000

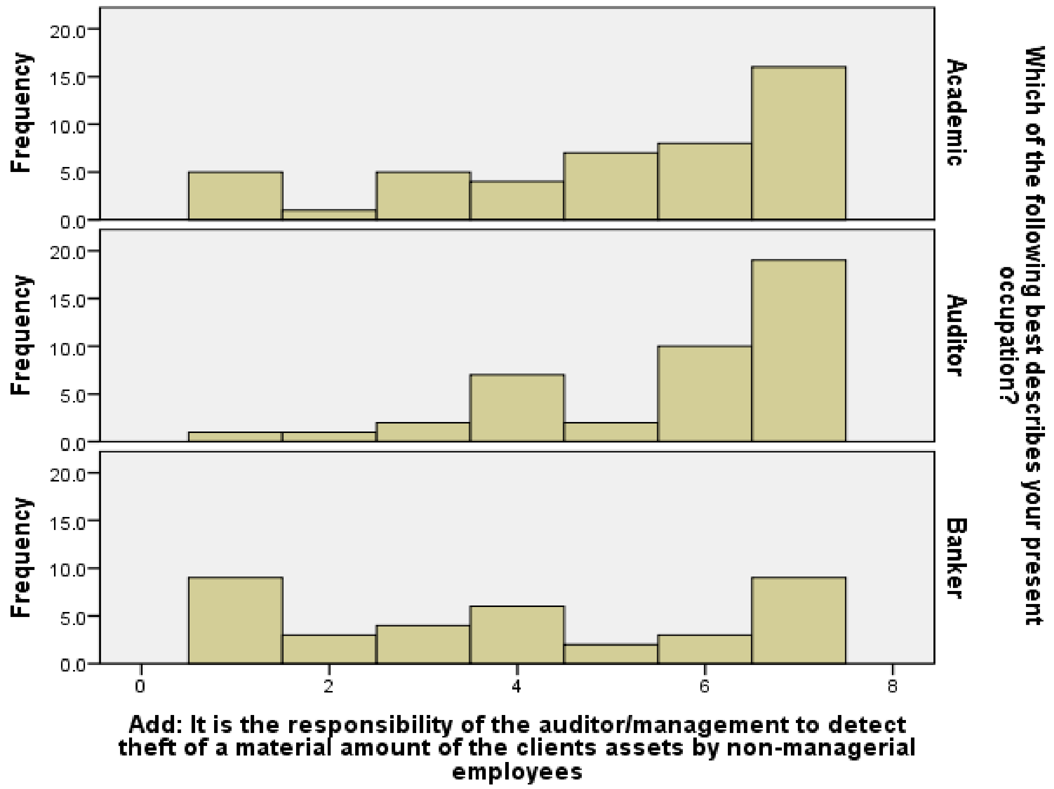
Additional responsibility statements (Brenda Porter, 2009)	Which of the following best describes your present occupation?	Kolmogorov-Smirnov[a]			Shapiro-Wilk		
		Statistic	df	Sig.	Statistic	df	Sig.
10. It is the responsibility of the auditor/management to detect illegal acts by the client's directors / senior management which directly impact on the client's financial statements (e.g., breaches of tax laws)	Shareholder Auditor Banker	.172 .253 .160	46 42 36	.002 .000 .021	.891 .799 .866	46 42 36	.000 .000 .000
11. It is the responsibility of the auditor/management to detect theft of a material amount (e.g., > 5% of turnover or of total assets) of the client's assets by non-managerial employees	Shareholder Auditor Banker	.199 .261 .154	46 42 36	.000 .000 .030	.841 .790 .862	46 42 36	.000 .000 .000
12. It is the responsibility of the auditor/management to disclose in the audit report embezzlement of the client's assets by directors / senior management	Shareholder Auditor Banker	.215 .280 .246	46 42 36	.000 .000 .000	.844 .819 .748	46 42 36	.000 .000 .000
a. Lilliefors Significance Correction							

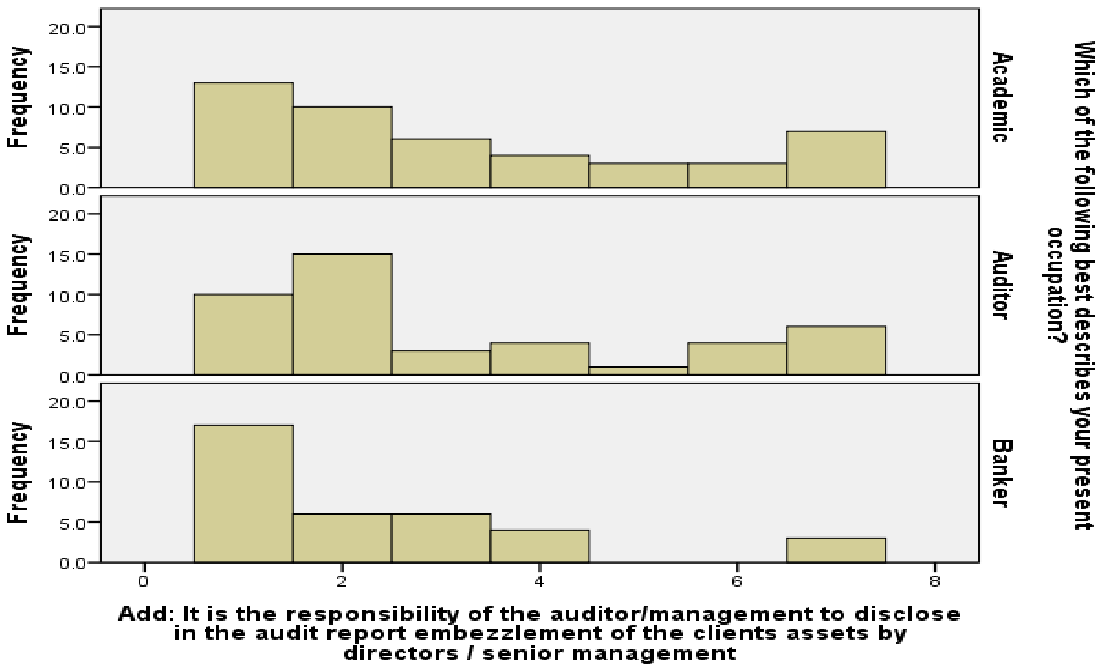
Due to the non-normality of the data, a non-parametric test (in this case the Kruskal-Wallis H test), was used to test the mean differences among the occupation groups. This is presented graphically in the histograms below.



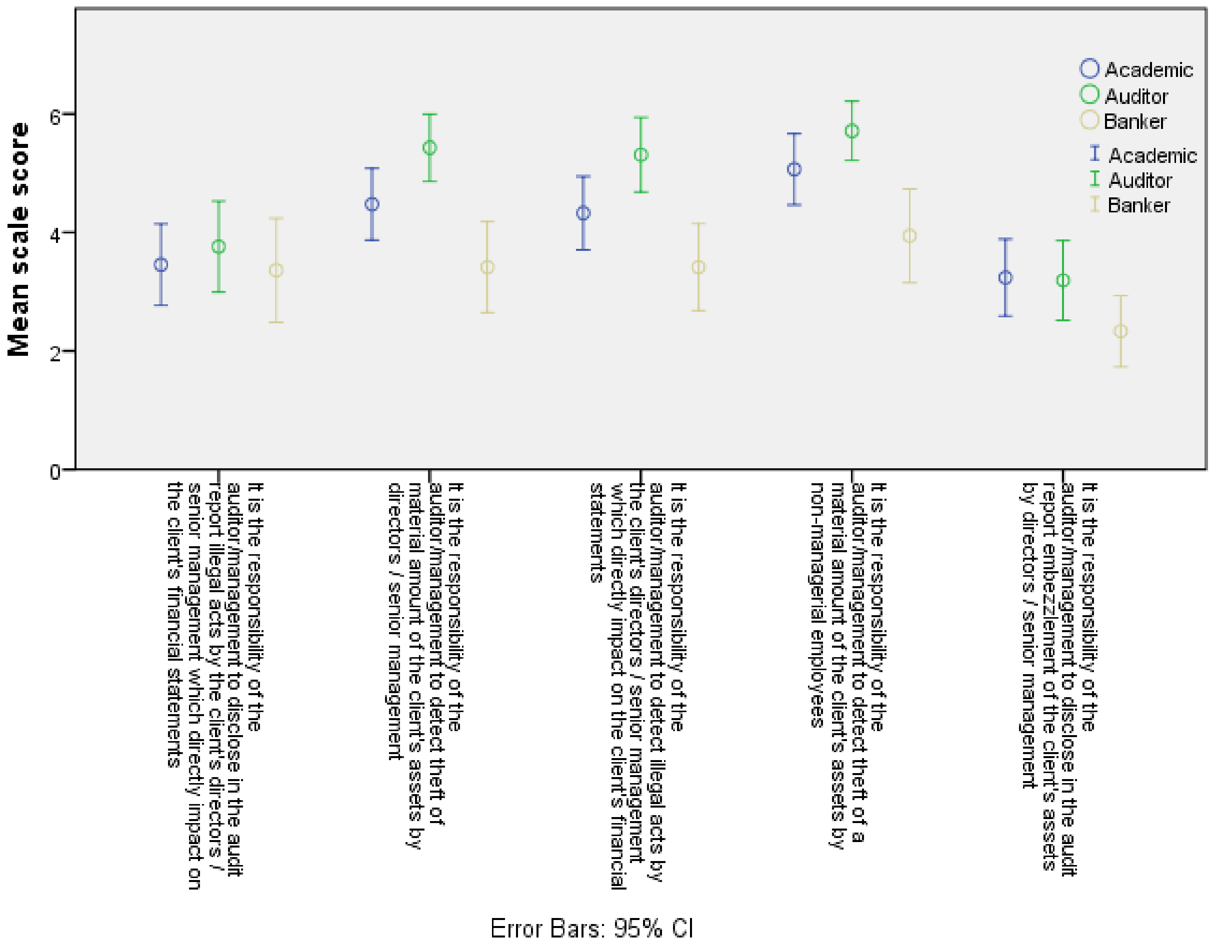



Frequency
20.0
15.0
10.0
5.0
0.0
0
2
4
6
8
Academic
Auditor
Banker
Which of the following best describes your present occupation?
Add: It is the responsibility of the auditor/management to detect illegal acts by the clients directors / senior management which directly impact on the clients financial statements


Frequency
20.0
15.0
10.0
5.0
0.0
0
2
4
6
8
Academic
Auditor
Banker
Which of the following best describes your present occupation?
Add: It is the responsibility of the auditor/management to detect theft of a material amount of the clients assets by non-managerial employees



Visual inspection of differences



Visually, it appears to be the case that the mean scale scores differ significantly between the three occupation groups, for a number of the additional statements.

Kruskal-Wallis H test

The non-parametric Kruskal-Wallis H test was used to test the mean differences between the occupation groups.

Table 5.7: Kruskal-Wallis H test: Mean Ranks

Additional responsibility statements	Which of the following best describes your present occupation?	N	Mean Rank
8. It is the responsibility of the auditor/management to disclose in the audit report illegal acts by the clients directors / senior management which directly impact on the client's financial statements	Shareholder	46	63.39
	Auditor	43	67.60
	Banker	37	58.86
	Total	126	
9. It is the responsibility of the auditor/management to detect theft of material amount of the client's assets by directors / senior management	Shareholder	46	62.23
	Auditor	43	78.57
	Banker	37	47.57
	Total	126	
10. It is the responsibility of the auditor/management to detect illegal acts by the clients directors / senior management which directly impact on the client's financial statements	Shareholder	46	62.26
	Auditor	43	78.65
	Banker	37	47.43
	Total	126	
11. It is the responsibility of the auditor/management to detect theft of a material amount of the client's assets by non-managerial employees	Shareholder	46	63.61
	Auditor	42	74.13
	Banker	36	47.51
	Total	124	

Additional responsibility statements	Which of the following best describes your present occupation?	N	Mean Rank
12. It is the responsibility of the auditor/management to disclose in the audit report embezzlement of the clients assets by directors / senior management	Shareholder	46	67.66
	Auditor	43	67.01
	Banker	36	52.25
	Total	125	

Table 5.8: Test Statistics

Additional responsibility statements	Chi-Square	df	Asymp. Sig.
8. It is the responsibility of the auditor/management to disclose in the audit report illegal acts by the clients directors / senior management which directly impact on the client's financial statements	1.213	2	.545
9. It is the responsibility of the auditor/management to detect theft of material amount of the client's assets by directors / senior management	15.079	2	.001
10. It is the responsibility of the auditor/management to detect illegal acts by the clients directors / senior management which directly impact on the client's financial statements	15.170	2	.001
11. It is the responsibility of the auditor/management to detect theft of a material amount of the client's assets by non-managerial employees	11.328	2	.003
12. It is the responsibility of the auditor/management to disclose in the audit report embezzlement of the clients assets by directors / senior management	4.708	2	.095

The test found that at least one pair of means is significantly different at the 1% level of significance for three of the statements.

Mann-Whitney U Tests

Due to violation of the equal variances assumption (see histograms above), the non-parametric Mann-Whitney U test was used with a Bonferroni correction (i.e., for three pairs the alpha coefficient will be divided by 3: .05/3=0.0167≈0.02, rounding up to make it slightly less conservative) for each pair of means for statements two, three, and four to see which pairs are responsible for the significant results found by the Kruskal-Wallis test for these statements.

Table 5.9: Ranks and Test Results: Shareholders vs. Auditors

Which of the following best describes your present occupation?		It is the responsibility of the auditor/ management to detect theft of material amount of the client's assets by directors / senior management	It is the responsibility of the auditor/ management to detect illegal acts by the clients directors / senior management which directly impact on the client's financial statements	It is the responsibility of the auditor/management to detect theft of a material amount of the client's assets by non-managerial employees
Shareholder	N	46	46	46
	Mean Rank	39.02	39.10	40.83
	Sum of Ranks	1795.00	1798.50	1878.00
Auditor	N	43	43	42
	Mean Rank	51.40	51.31	48.52
	Sum of Ranks	2210.00	2206.50	2038.00
Total	N	89	89	88
Mann-Whitney U		714.000	717.500	797.000
Wilcoxon W		1795.000	1798.500	1878.000
Z		-2.324	-2.289	-1.468
Asymp. Sig. (2-tailed)		.020	.022	.142

Ranks and Test Results: Auditors vs. Bankers

Which of the following best describes your present occupation?		It is the responsibility of the auditor/ management to detect theft of material amount of the client's assets by directors / senior management	It's the responsibility of the auditor/management to detect illegal acts by the clients directors/ senior management that directly impact the client's financial statements	It is the responsibility of the auditor/management to detect theft of a material amount of the client's assets by non-managerial employees
Auditor	N	43	43	42
	Mean Rank	49.17	49.34	47.11
	Sum of Ranks	2114.50	2121.50	1978.50
Banker	N	37	37	36
	Mean Rank	30.42	30.23	30.63
	Sum of Ranks	1125.50	1118.50	1102.50
Total	N	80	80	78
Mann-Whitney U		422.500	415.500	436.500
Wilcoxon W		1125.500	1118.500	1102.500
Z		-3.703	-3.747	-3.300
Asymp. Sig. (2-tailed)		.000	.000	.001

Table 5.10: Additional responsibility statements

Statement	Mean responses			
	Shareholder	Auditor	Banker	Across Groups
8. It is the responsibility of the auditor/management to disclose in the audit report illegal acts by the clients directors / senior management which directly impact on the client's financial statements	3.457	3.814	3.297	3.532

Statement	Mean responses			
	Shareholder	Auditor	Banker	Across Groups
9. It is the responsibility of the auditor/management to detect theft of material amount of the client's assets by directors / senior management	4.478*	5.465	3.514*	4.532
10. It is the responsibility of the auditor/management to detect illegal acts by the clients directors / senior management which directly impact on the client's financial statements	4.326*	5.349	3.378*	4.397
11. It is the responsibility of the auditor/management to detect theft of a material amount of the client's assets by non-managerial employees	5.065	5.714	3.944*	4.960
12. It is the responsibility of the auditor/management to disclose in the audit report embezzlement of the clients assets by directors / senior management	3.239	3.163	2.333	2.952
Note: * Significantly different from auditors at p≤0.05				

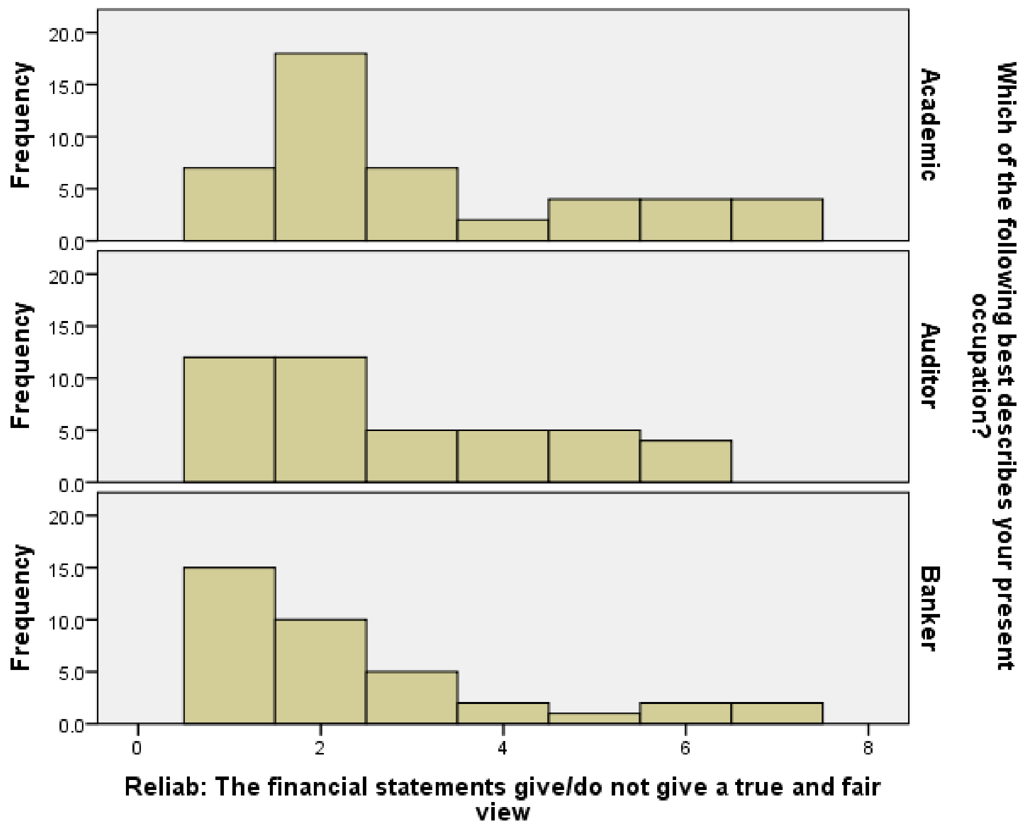
The results on Table 5.9, which are summarized in Table 5.10, show that bankers differ significantly from auditors on three counts of the additional responsibility statements, at the 5% level of significance. The expectation gap between bankers and auditors exists with respect to statements 9, 10, and 11. Auditors differ from shareholders on two counts of additional responsibility statements, at the 5% level of significance. The evidence of the expectation gap between auditors and shareholders is with respect to statements 9 and 10.

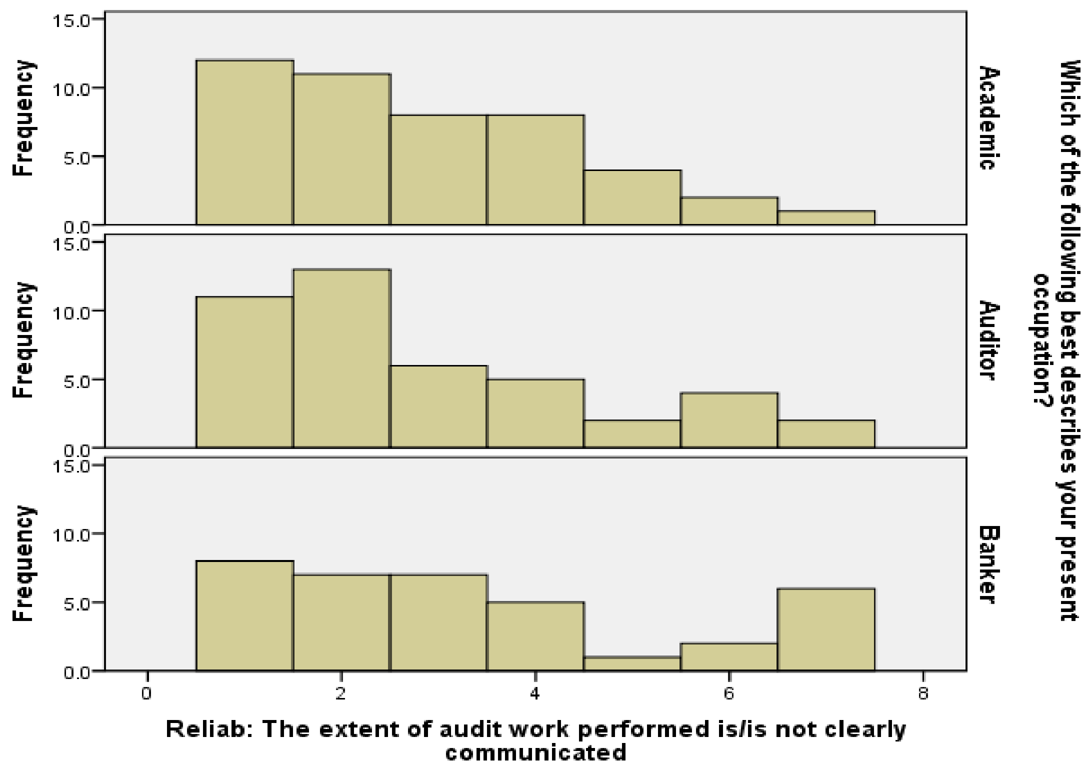
Research Question 2: Reliability factor

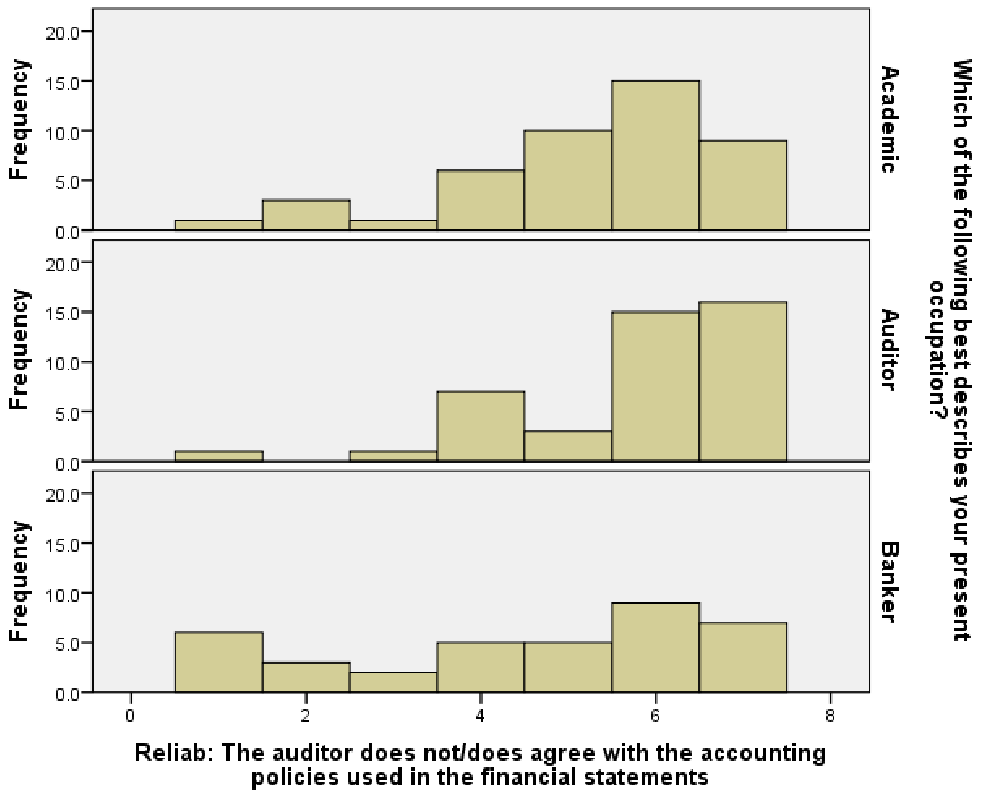
Table 6.1: Tests for normality

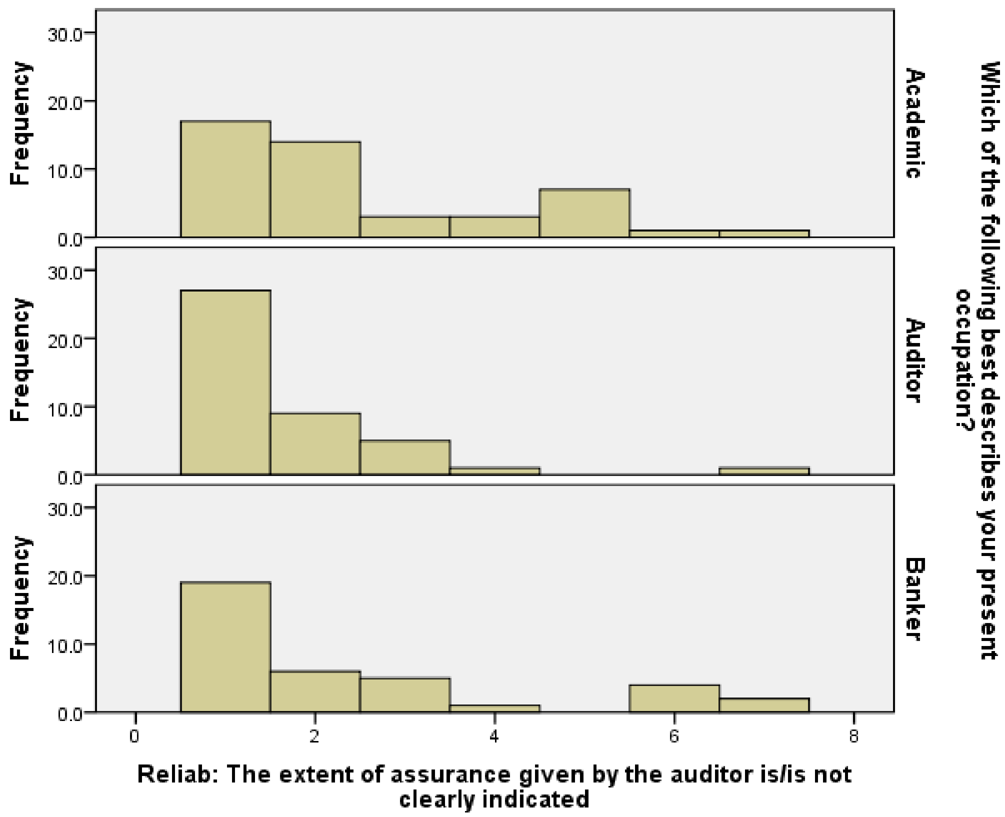
Reliability statements	Which of the following best describes your present occupation?	Kolmogorov-Smirnov[a]			Shapiro-Wilk		
		Statistic	df	Sig.	Statistic	df	Sig.
13. The financial statements give/do not give a true and fair view	Shareholder	.271	45	.000	.831	45	.000
	Auditor	.241	42	.000	.864	42	.000
	Banker	.275	36	.000	.751	36	.000
14. The extent of audit work performed is/is not clearly communicated	Shareholder	.201	45	.000	.896	45	.001
	Auditor	.244	42	.000	.855	42	.000
	Banker	.184	36	.003	.865	36	.000
15. The auditor does not/does agree with the accounting policies used in the financial statements	Shareholder	.219	45	.000	.872	45	.000
	Auditor	.287	42	.000	.790	42	.000
	Banker	.197	36	.0001	.869	36	.001
16. The extent of assurance given by the auditor is/is not clearly indicated	Shareholder	.294	45	.000	.798	45	.000
	Auditor	.336	42	.000	.621	42	.000
	Banker	.280	36	.000	.700	36	.000
17. Users can have absolute/no assurance that the financial statements contain no material misstatements	Shareholder	.132	45	.049	.943	45	.027
	Auditor	.271	42	.000	.878	42	.000
	Banker	.154	36	.030	.900	36	.003
18. The entity is/is not free from fraud	Shareholder	.225	45	.000	.911	45	.002
	Auditor	.215	42	.000	.890	42	.001
	Banker	.157	36	.025	.893	36	.002

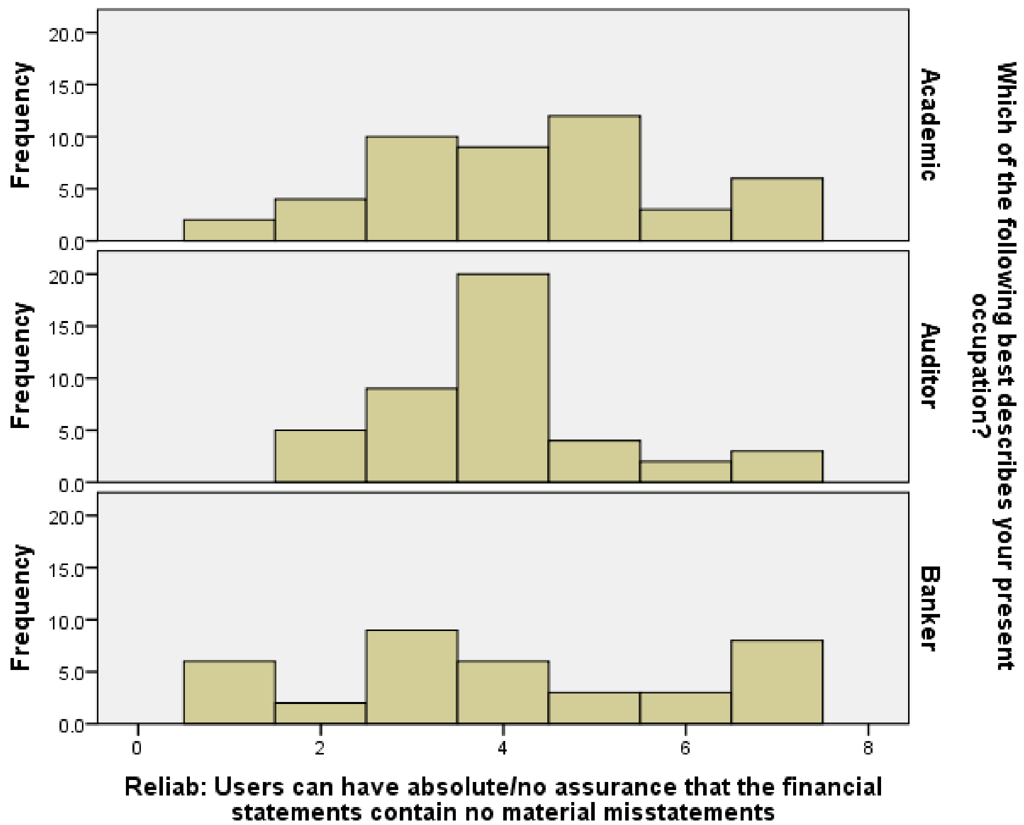
This is presented graphically in the histograms below.

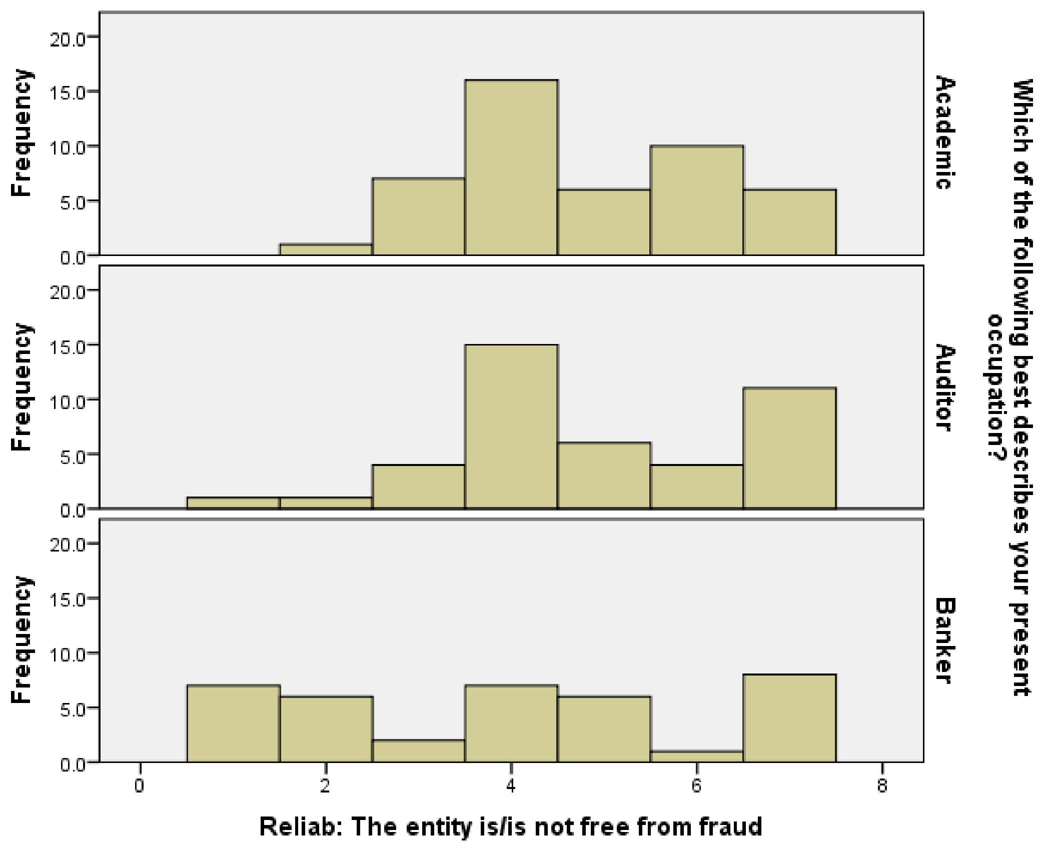

Frequency
20.0
15.0
10.0
5.0
0.0
0
2
4
6
8
Academic
Auditor
Banker
Which of the following best describes your present occupation?
Reliab: The financial statements give/do not give a true and fair view


Frequency
15.0
10.0
5.0
0.0
0
2
4
6
8
Academic
Auditor
Banker
Which of the following best describes your present occupation?
Reliab: The extent of audit work performed is/is not clearly communicated


Frequency
Academic
Auditor
Banker
Which of the following best describes your present occupation?
Reliab: The auditor does not/does agree with the accounting policies used in the financial statements

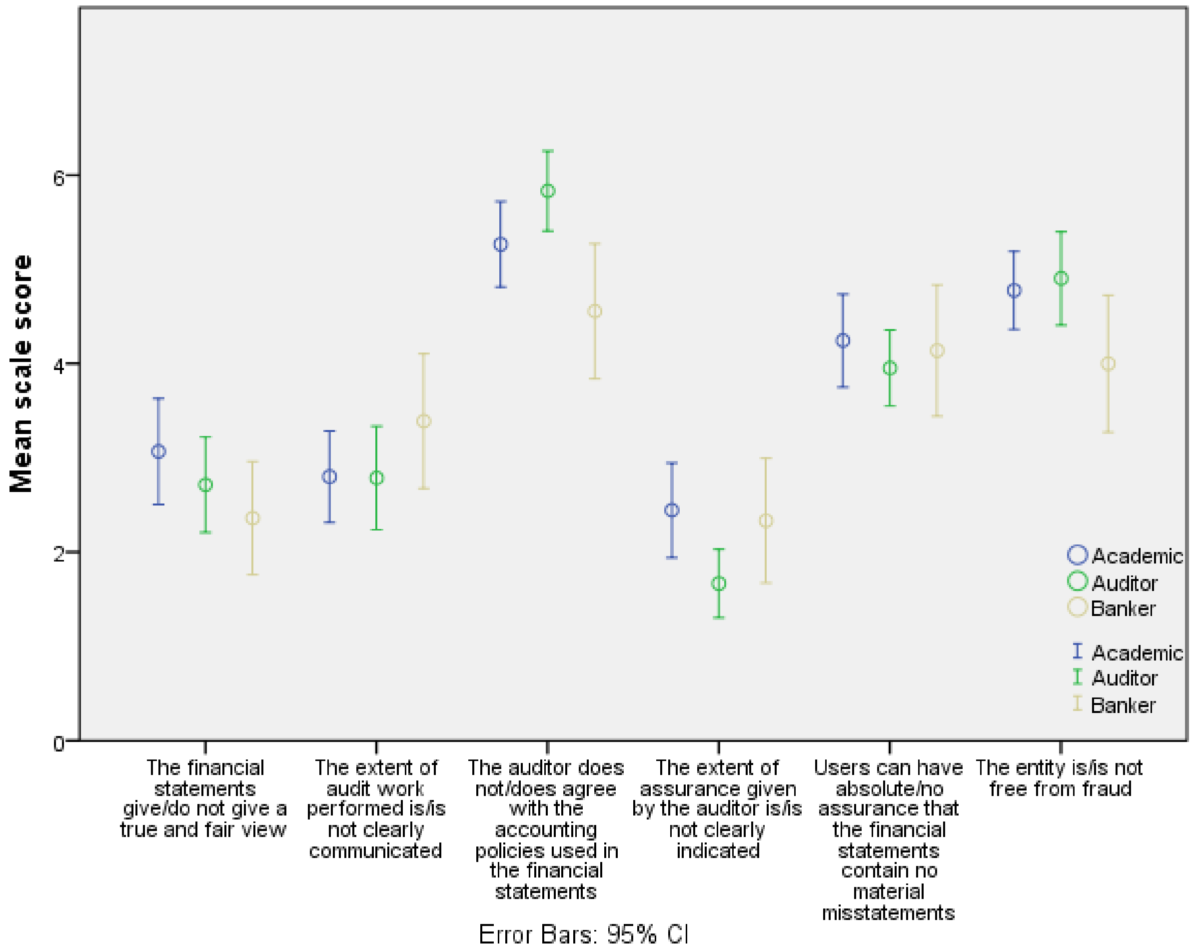

Frequency
Academic
Auditor
Banker
Which of the following best describes your present occupation?
Reliab: The extent of assurance given by the auditor is/is not clearly indicated


Frequency
20.0
15.0
10.0
5.0
0.0
0
2
4
6
8
Academic
Auditor
Banker
Which of the following best describes your present occupation?
Reliab: Users can have absolute/no assurance that the financial statements contain no material misstatements


Frequency
20.0
15.0
10.0
5.0
0.0
0
2
4
6
8
Academic
Auditor
Banker
Which of the following best describes your present occupation?
Reliab: The entity is/is not free from fraud

Due to the non-normality of the data, non-parametric tests were used to test for mean differences among the occupation groups.

Visual inspection of differences



Visually, it appears to be the case that the mean scale scores do not differ significantly among the three occupation groups, except maybe for the third statement, where bankers differ from auditors but not from shareholders. There could also be a marginal difference for the fourth statement, with auditors differing from shareholders.

Due to the non-normality of the data a non-parametric test, in this case the Kruskal-Wallis H test, was used to test the mean differences among the occupation groups. The results of Kruskal-Wallis H test of the mean differences relating to reliability statements are shown on Table 6.2 below:

Table 6.2: Kruskal-Wallis H test: Mean Ranks

Reliability statements	Which of the following best describes your present occupation?	N	Mean Rank
13. The financial statements give/do not give a true and fair view	Shareholder Auditor Banker Total	46 43 37 126	70.75 63.92 54.00
14. The extent of audit work performed is/is not clearly communicated	Shareholder Auditor Banker Total	46 43 36 125	60.85 60.22 69.07
15. The auditor does not/does agree with the accounting policies used in the financial statements	Shareholder Auditor Banker Total	45 43 37 125	61.58 74.70 51.14
16. The extent of assurance given by the auditor is/is not clearly indicated	Shareholder Auditor Banker Total	46 43 37 126	71.73 53.34 65.08
17. Users can have absolute/no assurance that the financial statements contain no material misstatements	Shareholder Auditor Banker Total	46 43 37 126	67.68 60.57 61.70
18. The entity is/is not free from fraud	Shareholder Auditor Banker Total	46 42 37 125	65.58 69.30 52.65

Table 6.3: Test Statistics

Reliability statements	Chi-Square	df	Asymp. Sig.
13. The financial statements give/do not give a true and fair view	4.577	2	.101
14. The extent of audit work performed is/is not clearly communicated	1.484	2	.476
15. The auditor does not/does agree with the accounting policies used in the financial statements	9.002	2	.011
16. The extent of assurance given by the auditor is/is not clearly indicated	6.658	2	.036
17. Users can have absolute/no assurance that the financial statements contain no material misstatements	1.010	2	.603
18. The entity is/is not free from fraud	4.723	2	.094

The results on Table 6.3 show that for two of the statements at least one pair of means is significantly different, at the 5% level of significance. For the last statement, at least one pair of means differs significantly at the 10% level of significance.

Mann-Whitney U Tests

Due to violation of the equal variances assumption, the non-parametric Mann-Whitney U test was used for each pair of means for statements three, four and six, to see which pairs are responsible for the significant results found by the Kruskal-Wallis test for these statements. The results of Mann-Whitney U tests are shown below.

Table 6.4: Ranks and Test Results: Auditor vs. Shareholder

Which of the following best describes your present occupation?		The auditor does not/does agree with the accounting policies used in the financial statements	The extent of assurance given by the auditor is/is not clearly indicated	The entity is/is not free from fraud
Shareholder	N	45	46	46
	Mean Rank	39.68	51.52	43.03
	Sum of Ranks	1785.50	2370.00	1979.50
Auditor	N	43	43	42
	Mean Rank	49.55	38.02	46.11
	Sum of Ranks	2130.50	1635.00	1936.50
Total	N	88	89	88
Mann-Whitney U		750.500	689.000	898.500
Wilcoxon W		1785.500	1635.000	1979.500
Z		-1.877	-2.655	-.581
Asymp. Sig. (2-tailed)		.060	.008	.561

Ranks and Test Results: Auditor vs. Shareholder

Which of the following best describes your present occupation?		The auditor does not/does agree with the accounting policies used in the financial statements	The extent of assurance given by the auditor is/is not clearly indicated	The entity is/is not free from fraud
Shareholder	N	45	46	46
	Mean Rank	44.90	43.71	46.04
	Sum of Ranks	2020.50	2010.50	2118.00
Banker	N	37	37	37
	Mean Rank	37.36	39.88	36.97
	Sum of Ranks	1382.50	1475.50	1368.00
Total	N	82	83	83

Which of the following best describes your present occupation?	The auditor does not/does agree with the accounting policies used in the financial statements	The extent of assurance given by the auditor is/is not clearly indicated	The entity is/is not free from fraud
Mann-Whitney U	679.500	772.500	665.000
Wilcoxon W	1382.500	1475.500	1368.000
Z	-1.457	-.757	-1.734
Asymp. Sig. (2-tailed)	.145	.449	.083

Ranks and Test Results: Auditor vs. Banker

Which of the following best describes your present occupation?		The auditor does not/does agree with the accounting policies used in the financial statements	The extent of assurance given by the auditor is/is not clearly indicated	The entity is/is not free from fraud
Auditor	N	43	43	42
	Mean Rank	47.15	37.31	44.69
	Sum of Ranks	2027.50	1604.50	1877.00
Banker	N	37	37	37
	Mean Rank	32.77	44.20	34.68
	Sum of Ranks	1212.50	1635.50	1283.00
Total	N	80	80	79
Mann-Whitney U		509.500	658.500	580.000
Wilcoxon W		1212.500	1604.500	1283.000
Z		-2.840	-1.477	-1.977
Asymp. Sig. (2-tailed)		.005	.140	.048

Table 6.5: Reliability statements

Statement	Mean responses			
	Shareholder	Auditor	Banker	Across Groups
13. The financial statements give/do not give a true and fair view	3.130	2.791	2.405	2.802
14. The extent of audit work performed is/is not clearly communicated	2.804	2.860	3.389	2.992
15. The auditor does not/does agree with the accounting policies used in the financial statements	5.267	5.791	4.486*	5.216
16. The extent of assurance given by the auditor is/is not clearly indicated	2.478*	1.651	2.378	2.167
17. Users can have absolute/no assurance that the financial statements contain no material misstatements	4.261	3.953	4.054	4.095
18. The entity is/is not free from fraud	4.761	4.905	3.919	4.560
Note: * Significantly different from auditors at p≤0.05				

According to results in Table 6.4, which are summarized in Table 6.5, it can be concluded that, on the question of whether auditors' agree with accounting policies used in the financial statements, bankers differ significantly from auditors, at the 5% level of significance. Shareholders differ significantly from auditors at the 5% level of significance, on whether the extent of assurance is clearly indicated in the audit report.

The second objective aimed to determine whether the new audit report would reduce the expectation gap regarding the reliability of audited financial statements. The results in Table 6.4, and summarized in Table 6.5 (above) show that, with regard to the reliability of the audited financial statements, an expectation gap exists between users and auditors. However, it is considered marginal.

Research Question 3: Decision-making factor

Table 7.1: Tests of normality

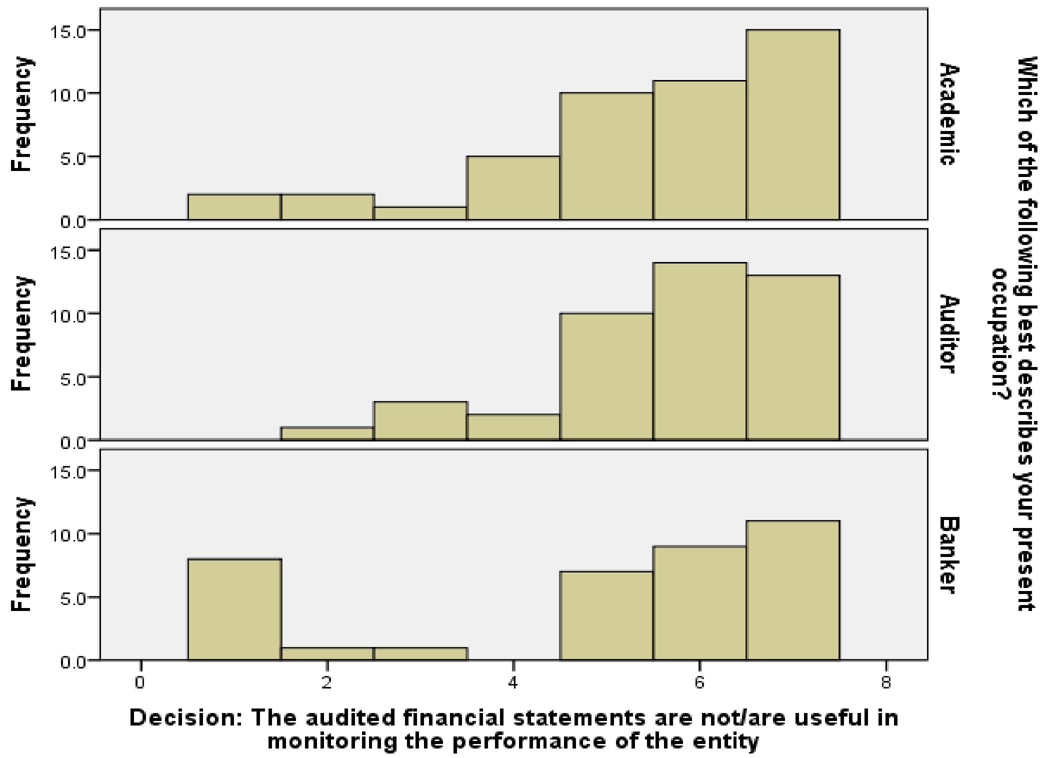
Decision-making statements	Which of the following best describes your present occupation?	Kolmogorov-Smirnov[a]			Shapiro-Wilk		
		Statistic	df	Sig.	Statistic	df	Sig.
19. The entity is/is not well managed	Shareholder	.240	46	.000	.914	46	.002
	Auditor	.298	43	.000	.863	43	.000
	Banker	.172	37	.007	.893	37	.002
20. The audited financial statements are not/are useful in monitoring the performance of the entity	Shareholder	.200	46	.000	.839	46	.000
	Auditor	.228	43	.000	.852	43	.000
	Banker	.258	37	.000	.777	37	.000
21. The audited financial statements are not/are useful for making decisions	Shareholder	.266	46	.000	.761	46	.000
	Auditor	.248	43	.000	.795	43	.000
	Banker	.327	37	.000	.700	37	.000

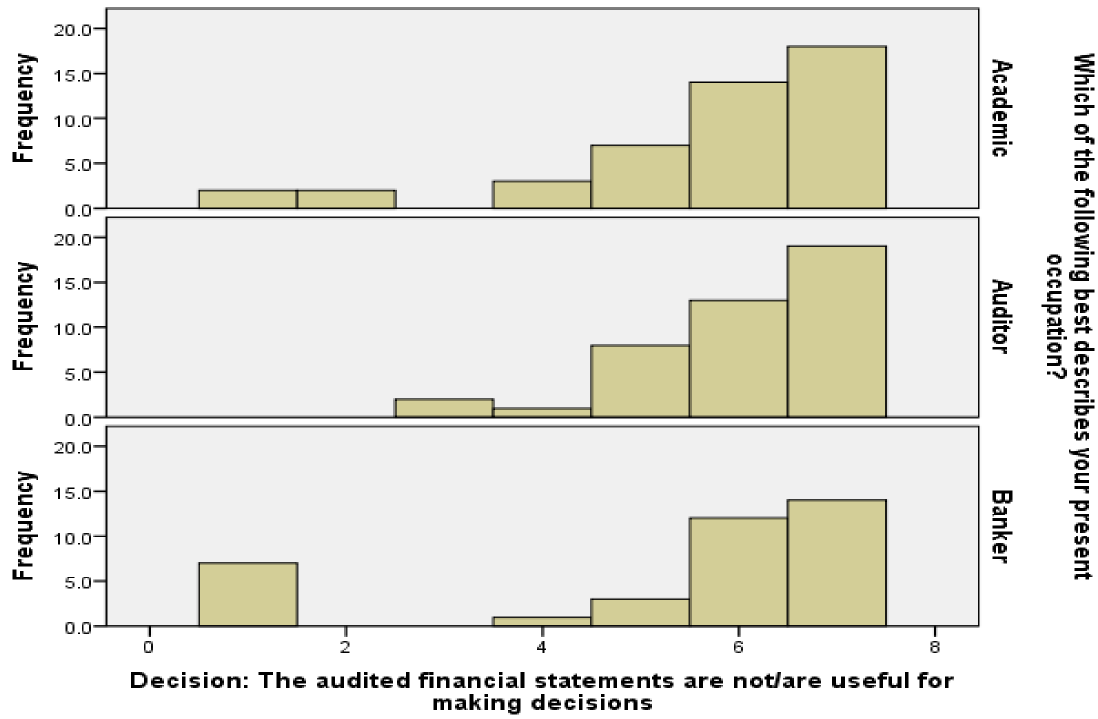
Table 7.1 shows the results of the Kolmogorov-Smirnov and Shapiro-Wilk tests of normality, which both indicate that the distribution of the scale scores deviate significantly from normality. Due to the non-normality of the data, non-parametric tests were used to test for mean differences among the occupation groups. The non-parametric Kruskal-Wallis H test was used to test the mean differences among the occupation groups. The results of Kruskal-Wallis H test of the mean differences relating to responsibility statements are shown on Table 7.2 below:

Table 7.2: Kruskal-Wallis H test

Decision statements	Which of the following best describes your present occupation?	N	Mean Rank
19. Decision: The entity is/is not well managed	Shareholder	46	70.50
	Auditor	43	63.64
	Banker	37	54.64
	Total	126	
20. Decision: The audited financial statements are not/are useful in monitoring the performance of the entity	Shareholder	46	64.10
	Auditor	43	67.15
	Banker	37	58.51
	Total	126	
21. Decision: The audited financial statements are not/are useful for making decisions	Shareholder	46	62.47
	Auditor	43	67.63
	Banker	37	59.99
	Total	126	

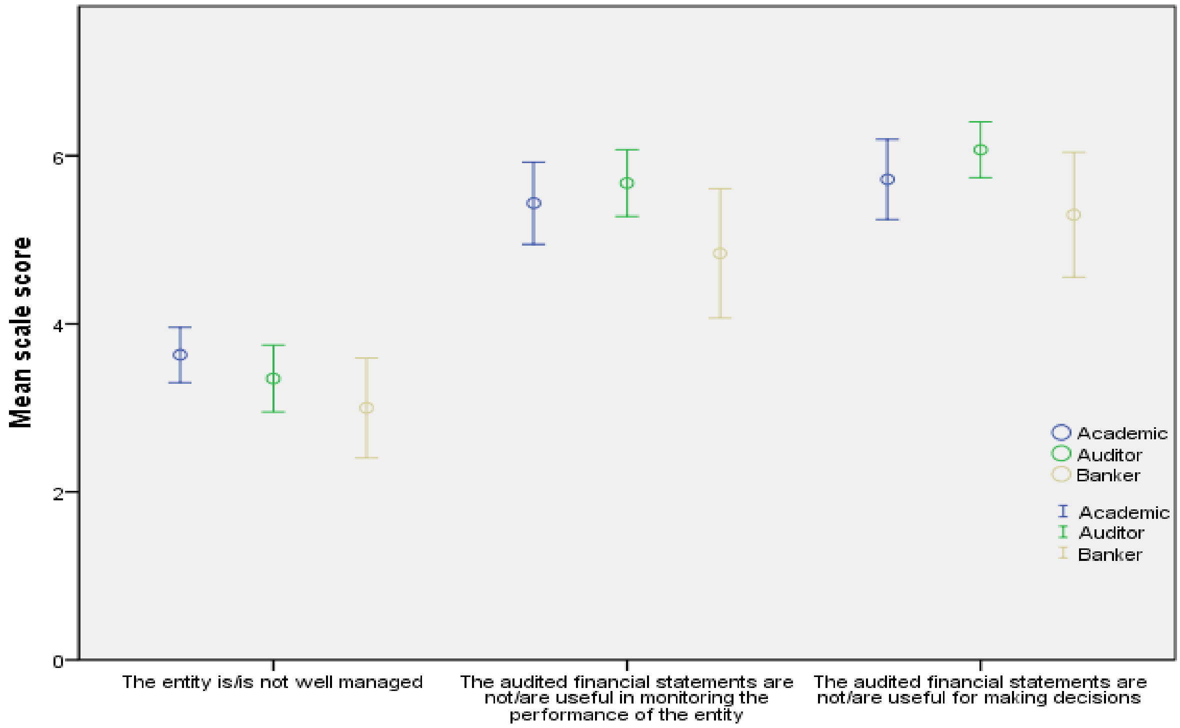
This is presented graphically in the histograms below.





Due to the non-normality of the data, non-parametric tests were used to test for mean differences among the occupation groups.

Visual inspection of differences



Error Bars: 95% CI

Visually, it appears that the mean scale scores do not differ significantly between the three occupation groups for the usefulness in decision-making statements.

Table 7.3: Test Statistics

Decision statements	Chi-Square	df	Asymp. Sig.
19. The entity is/is not well managed	4.178	2	.124
20. The audited financial statements are not/are useful in monitoring the performance of the entity	1.204	2	.548
21. The audited financial statements are not/are useful for making decisions	1.031	2	.597

Table 7.3 shows that none of the pairs of means comparing the different occupation groups differed significantly (as shown by Asymp. Sig. value of >0.05). It was therefore not necessary to do pairwise testing. Hence, the Mann-Whitney U test was not done on this data.

Table 7.4: Decision-making usefulness

Statement	Mean responses			
	Shareholder	Auditor	Banker	Across Groups
19. Decision: The entity is/is not well managed	3.630	3.349	3.000	3.349
20. Decision: The audited financial statements are not/are useful in monitoring the performance of the entity	5.435	5.674	4.838	5.341
21. Decision: The audited financial statements are not/are useful for making decisions	5.717	6.070	5.297	5.714
Note: * Significantly different from auditors at p≤0.05				

The third objective was to determine whether the IAASB's proposed expanded audit report was likely to be deemed useful for decision-making purposes. Table 7.4 shows that no expectation gap exists between users and auditors with regard to the decision-making usefulness of the audit report.

Discussion of research findings

Research question 1

The results show that both users (shareholders and bankers) attribute the responsibility for the detection of all fraud to the auditors. A significantly low mean response by bankers shows they feel very strongly that auditors should detect all fraud. In a study by Gloeck and De Jager (1993), 27.7% of the financially knowledgeable study participants expected South African auditors to detect fraud of all kinds, while 29.1% of the same group expected auditors to search actively for fraud. It appears that South African users still want auditors to assume a very significant role with regard to fraud detection, despite the limitations in its fraud detection capabilities being highlighted in the IAASB's new expanded audit report. This is in line with research findings by Best et al. (2001) and Hatherly et al. (1991), that users want auditors to play a prominent role in fraud detection.

Both bankers and shareholders believe that auditors are (or should be) responsible for detection of any kind of fraud perpetrated by directors and senior management. Bankers further believe that auditors should also detect illegal acts committed by non-managerial employees.

There are two possible explanations for the high expectations South African users have of auditors regarding fraud detection. Firstly, section 45 of the Auditing Profession Act (APA) No.26 of 2005 requires auditors to provide information in the audit report regarding any reportable irregularity (Audit Profession Act, 2005). Therefore, the proposed IAASB audit report was adapted (for the purposes of this study) to include some reporting on reportable irregularities, to better reflect the South African context. This may have been interpreted by user groups to imply that auditors are responsible for detecting all fraud. Secondly, South African society in general may be demanding that auditors expand their scope regarding fraud detection, rather than trying to explain away this duty in the audit report (Sikka et al., 1998).

Other evidence of the expectation gap reveals user misconceptions regarding the nature of auditing. Such misconceptions include users expecting auditors to prevent fraud (statement 4). Other studies have also shown that users attribute fraud prevention responsibility to auditors (Best et al. (2001); Schelluch (1996)). This is clearly a misunderstanding on the part of the users, as the implementation of internal controls to prevent fraud is the prerogative of management (Schelluch et al., 1997). Other misconceptions include bankers' expectation that auditors maintain accounting records (statement 3) and produce the financial statements (statement 6). This finding agrees with Best et al. (2001) only in respect of statement 3, while Schelluch (1996) found no expectation gap on both statements.

A factor contributing to the misunderstanding may be the fact that South African auditors can be appointed as auditors while doing bookkeeping work for the client, provided that the accounting work is not performed regularly or habitually (Trengove, 2013). Although management assumes ultimate responsibility for the contents of the financial statements, the day-to-day experience of bankers receiving financial statements from auditors on behalf of clients applying for loans, may create an impression that it is the auditor's responsibility to prepare the financial statements.

The last misconception relating to responsibilities of auditors is that users believe that the auditor does not exercise judgement in the selection of audit procedures (statement 2). In line with Best et al. (2001), bankers hold this belief significantly more tenaciously than do shareholders. This shows that users are not aware of the uncertainties associated with auditing, and are therefore treating auditing as an exact science. It also shows a lack of awareness regarding the uncertainties associated with most financial statement figures, with which auditors have to contend (Wallison, 2007). This misunderstanding can expose auditors to litigation, based on uncertainties over which they have no control.

On a positive note, users and auditors agree that management is responsible for the soundness of the company's internal controls (statement 5). More importantly, no expectation gap was found to exist on the question of the auditor's objectivity and lack of bias (statement 7). This contradicts the finding by Gloeck and De Jager (1993) that

South African users considered South African auditors to lack independence. However, following the introduction of statutory regulation of the audit profession, Odendaal and de Jager (2008) acknowledged that the strength of the regulations to safeguard the independence of the audit profession, had been significantly improved. Best et al. (2001) found that users believed in auditors' independence. This augurs well for the confidence society has in the audit profession. In fact, Wolf et al. (1999) argue that lack of auditor independence is the primary contributor to the expectation gap. The belief users have in the independence of the South African audit profession may be driven by the prominent position its auditing and reporting standards hold: South Africa has maintained its top spot in global rankings for the past five years (World Economic Forum, 2014).

Research question 2

In general, the results presented in Table 6.4 show that neither users nor auditors question the reliability of audited financial statements. The marginal evidence of an expectation gap shows that bankers have a strong belief that auditors do not agree with the accounting policies used in the financial statements (statement 15). Research results of Best et al. (2001) correlate with this finding, while those of Schelluch (1996) found otherwise. This may reflect South African bankers' lack of understanding of the critical importance of accounting policies in the financial reporting process, and their impact on the reliability of financial statements. The responses of the academic group indicate no expectation gap. This may be explained by the fact that these shareholders understand the role of accounting policies because of their professional and educational backgrounds.

Another gap was found to exist between shareholders and auditors, regarding the communication of the extent of assurance (statement 14). This is congruent with the research finding by (Schelluch, 1996), while Best et al. (2001) found no evidence of such an expectation gap. Concerns have been expressed regarding the communication of the extent of assurance actually achieved by auditors (see Gray et al. (2010); CFA Institute (2010)). Evidence of agreement among the three respondent groups, with almost equal mean responses, that no absolute assurance can be derived from the audit (statement 17) shows that while the proposed audit report may have succeeded by providing a plausible definition of 'reasonable assurance', shareholders are particularly interested in the actual level of audit assurance obtained.

The lowest mean response to the question on whether the financial statements provide a true and fair view (statement 13) shows that relatively speaking, South African bankers have a higher level of confidence in the audited financial statements than either auditors or shareholders do. This is helpful for the audit profession, as it shows that the audit report may be a valuable input in the evaluation of the credit worthiness of companies applying for financial assistance. However, bankers' lowest mean response on statement 18 shows that they have a stronger belief that the audited financial statements imply that the entity is free from fraud than do the audit and academic respondents. This may indicate that their confidence in the audited financial statements, as shown in statement 13, is perhaps founded upon the unrealistic belief that audited financial statements mean that the entity is free from any and all fraud. Their stronger belief that the audited financial statements imply that the entity is free from fraud is consistent with their very strong beliefs that auditors are responsible for the prevention and detection of fraud.

Research question 3

No expectation gap was found among the users of the audited financial statements regarding the statements' decision-making value. This is not surprising because a minor expectation gap on the reliability factor evidences the high level of confidence users have in the reliability of audited financial statements. When users rely on the audited financial statements, they are more likely to utilize them when making decisions. Best et al. (2001) found that an expectation gap on the audited financial statements' usefulness only existed between bankers and investors in regard to monitoring the performance of the business (statement 20). On the decision-making factor, Schelluch (1996) found that auditors had a stronger belief about the usefulness of audited financial statements for making decisions (statement 20), than they did on the decision-making usefulness pertaining to the management of the entity (statement 19).

The lack of expectation gap on the decision-making factor may signal that additional information provided in the IAASB's new audit report (such as that on key audit matters and its going concern status), has enhanced the decision-making value of the audit report. As Schandl (1978) suggested, inclusion of adequate amounts of information can enhance the communication effectiveness. Alternatively, it may demonstrate the high level of trust South African users have in the audit service in the country. The South African audit profession has been relatively free of highly-publicized audit failures, which may explain why SA users appreciate the decision-making worth of audited financial statements.

CHAPTER 5

CONCLUSION AND RECOMMENDATIONS

Introduction

The purpose of this research study was to determine whether the new audit report would lead to a reduction of the expectation gap between auditors and users of financial statements (bankers and shareholders) with regard to:

1. The roles and responsibilities of the auditors;
2. The reliability of the audited financial statements, and
3. The decision-making usefulness of audited financial statements.

The findings of this research have shown that South Africa is not exempt from the expectation gap problem. As was found by the earlier South African study by Gloeck and De Jager (1993), and a host of other studies across the globe (Best et al. (2001); Lin and Chen (2004); Innes et al. (1997); McEnroe and Martens (2001)), this study found that the expectation gap is particularly evident in perceptions regarding the auditor's responsibilities regarding the detection of fraud. This expectation gap has remained immovable across four generations of audit reports (Porter et al., 2009), and this research has found that the new expanded audit report implemented by the IAASB in 2015 has not been successful in reducing users' expectation that auditors should do more to detect and prevent fraud. Despite embodying communication principles suggested by Shandl (1978) in the proposed audit report by using clear language detailing the limitations that apply to auditors' responsibility for fraud detection, expectation gap remains persistent.

The study has also found that there are still serious misconceptions about the audit process. An interesting correlative to this finding is that it is the banker respondent group that showed greatest levels of misconception, which included the expectation that the auditor should maintain accounting records and prevent fraud. The academic respondent group, which comprised people with a significantly higher level of auditing and financial education than in the other groups, did not have misconceptions about the audit process. This is supported by findings of Bailey et al. (1983) and Monroe and Woodliff (1993), which were able to show that knowledgeable users correctly attributed responsibility for the financial statements to management.

The minor gap on the reliability factor and the absence of an expectation gap on the decision-making factor may indicate that the provision of additional information in the proposed audit report has improved the reliability of audited financial statements and enhanced its usefulness in the users' decision-making process. This finding shows that, while the society is expecting more from auditors in the area of fraud detection and prevention, in general it has confidence in the work of auditors. With specific reference to South Africa, it shows that there is no discrepancy between the high status that the South African audit profession enjoys globally, and the levels of trust and confidence that South African users have in their auditors. This bodes well for the audit profession in South Africa.

Recommendations

The significant evidence of user misconceptions regarding the roles and responsibilities of auditors provided by this study suggests that public education is vital. Over the years various approaches to educating the public have been suggested. McEnroe and Martens (2001) suggested the use of the audit report as a public education tool, arguing that the use of auditing standards by the audit profession to educate the users was futile, as the public was not exposed to the auditing standards. However, subsequent research has shown that the use of the audit report as a means for public education regarding the responsibilities of auditors has also not been successful (AQF, 2007). As Porter et al. (2009) suggested, there is a need to go beyond the audit report. The audit profession needs to find other opportunities to educate the public. As the media has the potential to exacerbate any misunderstanding of the auditor's duties when economic crises and major fraud occurs, it is important that the media becomes the primary target for audit-related clarifications (Porter et al., 2009). This educational program may be effectively extended to other professions, such as law, banking and investment management. This may help reduce misinformed accusations being levelled at the audit profession, attributing to audit responsibility for matters over which it has no control or influence.

The persistent attribution of fraud detection responsibilities to auditors shows a need for additional robust debate on this matter. With such overwhelming research evidence confirming that society expects auditors to detect all fraud, the matter cannot be solely ascribed to users' misinformed perceptions. Wolf et al. (1999) argue that the audit profession simply prefers defensive approaches in dealing with societal expectations regarding the audit. Auditing is regarded as a socially-contested concept, whose meaning is derived through interactions between auditors and other members of society (Sikka et al., 1998). Therefore, there is a need for the audit profession to engage in rigorous and constructive debates regarding the societal expectation that it plays a more prominent role in fraud detection. The fact that members of society have generally succeeded in their litigation against auditors in the aftermath of corporate frauds (Wolf et al., 1999) demonstrates the futility of trying to explain away in legalistic terms society's expectations relating to fraud detection. Supporting the position that auditors need to do more than simply reject responsibility for fraud detection, Gloeck and De Jager (1993) state that, "since the origin and existence of auditing is based on the requirements of users of the reporting process, the role of the auditor should be redefined, but with due consideration to the requirements and expectations of users."

Finally, the audit profession needs to change from the pass/fail mode of delivering an audit opinion to a more informative and graded mode. Users need more information regarding the actual level of assurance achieved through the audit (CFA Institute, 2010). Currently, the audit report provides an all-encompassing opinion for all financial statement numbers, without regard to the degree of uncertainty associated with some figures. Therefore, an appropriate solution would start with the introduction of changes to the financial reporting standards that would permit users to distinguish between historically verifiable and those based on forecasts or estimates (PCAOB, 2010). This would then allow auditors to provide varying levels of assurance to the speculative and non-speculative elements of the financial statements. Such a change would require collaboration between the accounting and auditing standards setting bodies.

Suggestions for future research

This study has only explored the phenomenon of the expectation gap as it pertains to the nature and meaning of audit report messages. However, as Humphrey et al. (1992) highlighted, there are many facets to the expectation gap problem, including aspects such as audit quality and the structure and regulation of the profession. For a broader appreciation of the expectation gap, it is imperative that other aspects of the issue be investigated. This will enrich the understanding of the expectation gap within the South African context, and will allow the profession to grow beyond the narrow approaches in current use to resolve the problem.

This study was undertaken before the implementation of the revised ISA 700 audit report. It will be helpful to revisit this study after users have had an opportunity to become accustomed to the now expanded audit report. It is possible that the perceptions of the research respondents to the proposed audit report may be different once they have worked with the revised ISA 700 for an extended period.

Finally, because of the time and budget constraints under which this research was conducted, the study could not cover a representatively broader group of respondents. Therefore, it may be helpful if this study were to be replicated to investigate the expectation gap between auditors and other users, such as lawyers and company directors. Studies of different user groups may discover different focus areas within the reasonableness gap, which may be instrumental in facilitating targeted interventions.

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APPENDIX A

INDEPENDENT AUDITOR'S REPORT

INDEPENDENT AUDITOR'S REPORT

To the Shareholders of ABC Ltd

Report on the Audit of the Financial

Statements Opinion

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of ABC Ltd (the Company) as at December 31, 2013, and of its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards (IFRSs) and the requirements of the Companies Act of 2008 of South Africa.

We have audited the financial statements of the Company, which comprise the statement of financial position as at December 31, 2013, and the statement of comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and the notes, comprising a summary of significant accounting policies and other explanatory information.

Basis for Opinion

We conducted our audit in accordance with International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in the *Auditor's Responsibilities for the Audit of the Financial Statements* section of our report. We are independent of the Company within the meaning of The Independent Regulatory Board for Auditors (IRBA) Code of Professional Conduct for Registered Auditors and have fulfilled our other responsibilities under those ethical requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Key Audit Matters

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the financial statements. Key audit matters are selected from the matters communicated with those charged with governance, but are not intended to represent all matters that were discussed with them. Our audit procedures relating to these matters were designed in the context of our audit of the financial statements as a whole. Our opinion on the financial statements is not modified with respect to any of the key audit matters described below, and we do not express an opinion on these individual matters.

Valuation of Financial Instruments

The Company's disclosures about its structured financial instruments are included in Note 5. The Company's investments in structured financial instruments represent 15% of the total amount of its financial instruments. Because the valuation of the Company's structured financial instruments is not based on quoted prices in active markets, there is significant measurement uncertainty involved in this valuation. As a result, the valuation of these instruments was significant to our audit. The Company has determined it is necessary to use an entity-developed model to value these instruments, due to their unique structure and terms. We challenged management's rationale for using an entity-developed model, and discussed this with those charged with governance, and we concluded the use of such a model was appropriate. Our audit procedures also included, among others, testing management's controls related to the development and calibration of the model and confirming that management had determined it was not necessary to make any adjustments to the output of the model to reflect the assumptions that marketplace participants would use in similar circumstances.

Revenue Recognition Relating to Long-Term Contracts

The terms and conditions of the Company's long-term contracts in its Information Technology (IT) maintenance division affect the revenue that the Company recognizes in a period, and the revenue from such contracts represents a material amount of the Company's total revenue. The process to measure the amount of revenue to recognize in the IT industry, including the determination of the appropriate timing of recognition, involves significant management judgment. We identified revenue recognition of long-term contracts as a significant risk requiring special audit consideration. This is because side agreements may exist that effectively amend the original contracts, and such side agreements may be inadvertently unrecorded or deliberately concealed and therefore presents a risk of material misstatement due to fraud. In addition to testing the controls the Company has put in place over its process to enter into and record long-term contracts and other audit procedures, we considered it necessary to confirm the terms of these contracts directly with customers and testing journal entries made by management related to revenue recognition. Based on the audit procedures performed, we did not find evidence of the existence of side agreements. The Company's disclosures about revenue recognition are included in the summary of significant accounting policies in Note 1, as well as Note 4.

Going Concern

The Company's financial statements have been prepared using the going concern basis of accounting. The use of this basis of accounting is appropriate unless management either intends to liquidate the Company or to cease operations, or has no realistic alternative but to do so. As part of our audit of the financial statements, we have concluded that management's use of the going concern basis of accounting in the preparation of the Company's financial statements is appropriate.

Management has not identified a material uncertainty that may cast significant doubt on the entity's ability to continue as a going concern, and accordingly none is disclosed in the financial statements. Based on our audit of the financial statements, we also have not identified such a material uncertainty. However, neither management nor the auditor can guarantee the Company's ability to continue as a going concern.

Other Information

As part of our audit of the financial statements for the year ended 31 December 2013, we have read the Directors' Report, the Audit Committee's Report and the Company Secretary's Certificate for the purpose of identifying whether there are material inconsistencies between these reports and the audited consolidated and separate financial statements. These reports are the responsibility of the respective preparers. Based on reading these reports we have not identified material inconsistencies between these reports and the audited consolidated and separate financial statements. However, we have not audited these reports and accordingly do not express an opinion on these reports.

Responsibilities of Management and Those Charged with Governance

Management is responsible for the preparation and fair presentation of these financial statements in accordance with IFRSs and the requirements of the Companies Act 2008 of South Africa, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error. Those charged with governance are responsible for overseeing the Company's financial reporting process.

Auditor's Responsibilities for the Audit of the Financial Statements

The objectives of our audit are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion.

Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

As part of an audit in accordance with ISAs, we exercise professional judgment and maintain professional scepticism throughout the planning and performance of the audit. We also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

We are required to communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

We are also required to provide those charged with governance with a statement that we have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

Report on Other Legal and Regulatory Requirements

In accordance with our responsibilities in terms of section 45 of the Auditing Profession Act, we report that we have identified certain unlawful acts committed by the directors of ABC Ltd which constitute reportable irregularities in terms of the Auditing Profession Act, and have reported such matters to the IRBA. The matters pertaining to the reportable irregularities have been described in note 8 of the directors' report.

The directors have responded to the circumstances and conduct in question to the extent that we believe no further loss will be suffered by the parties identified in note 8 and that all amounts owed have been accounted for. The unlawful act described in note 8 is to the best of our knowledge no longer occurring.

Blackwell

APPENDIX B

Blackwell Auditors

Inc. Director: A

Johnson

Registered Auditor

Pretoria

26 April 2014

APPENDIX B

SURVEY

WILL THE EXPANDED AUDIT REPORT MODEL PROPOSED BY IAASB REDUCE THE EXPECTATION GAP IN SOUTH AFRICA?

Expanded Audit Report Model and the Expectation Gap

Dear respondent

The purpose of this study is to obtain the perceptions of ??? regarding the proposed expanded audit report.

Your participation in this study is voluntary. Your individual responses will be held in the strictest confidence.

For the best view of the survey questions, please maximise the window by pressing the F11 key. If you do not see the "Next Page" button on the screen, you need to scroll down.

You may exit the survey at any time if you are interrupted by using the button at the top right corner of the screen. Please click on the "Next Page" button to start the survey questions.

I have read and understand the information provided above. I hereby consent to participate in this study on a voluntary basis.

- Yes
- No

INSTRUCTIONS FOR COMPLETING THE SURVEY

1. Please note that a response is required for every statement.
2. There are no right or wrong answers.
3. Please read all statements carefully before you provide an answer.
4. The integrity of the study depends upon your honest and reliable input.

ACCOUNTABILITY

The following statement pairs can be rated using a seven point scale. One (1) being your answer closest to the statement on the left while seven (7) being your answer closest to the statement on the right.

Example:

With

WILL THE EXPANDED AUDIT REPORT MODEL PROPOSED BY

"The auditor is responsible for guaranteeing the going concern of the company." on the left and

"The auditor is not responsible for guaranteeing the going concern of the company." on the right,

a selection of one (1) would indicate that you consider the responsibility for guaranteeing the going concern of the company to lie solely with the auditor.

The auditor is responsible for detecting all fraud.

1 2 3 4 5 6 7

The auditor is not responsible for detecting all fraud.

The auditor does not exercise judgement in the selection of auditor procedures

1 2 3 4 5 6 7

The auditor exercises judgement in the selection of auditor procedures

The financial statements give a true and fair view.

1 2 3 4 5 6 7

The financial statements do not give a true and fair view.

The entity is well managed.

1 2 3 4 5 6 7

The entity is not well managed.

The extent of audit work performed is clearly communicated.

WILL THE EXPANDED AUDIT REPORT MODEL PROPOSED BY

1 2 3 4 5 6 7

The extent of audit work performed is not clearly communicated.

The auditor is responsible for maintaining accounting records.

1 2 3 4 5 6 7

Management is responsible for maintaining accounting records.

The audited financial statements are not useful in monitoring the performance of the entity.

1 2 3 4 5 6 7

The audited financial statements are useful in monitoring the performance of the entity.

The auditor does not agree with the accounting policies used in the financial statements.

1 2 3 4 5 6 7

The auditor agrees with the accounting policies used in the financial statements.

The audited financial statements are not useful for making decisions.

1 2 3 4 5 6 7

The audited financial statements are useful for making decisions.

The auditor is not responsible for preventing fraud.

WILL THE EXPANDED AUDIT REPORT MODEL PROPOSED BY

*

1 2 3 4 5 6 7

The auditor is responsible for preventing fraud.

The auditor is responsible for the soundness of the internal control structure of the entity.

*

1 2 3 4 5 6 7

Management is responsible for the soundness of the internal control structure of the entity.

The extent of assurance given by the auditor is clearly indicated.

*

1 2 3 4 5 6 7

The extent of assurance given by the auditor is not clearly indicated.

Management has responsibility for producing the financial statements.

*

1 2 3 4 5 6 7

The auditor has responsibility for producing the financial statements.

Users can have absolute assurance that the financial statements contain no material misstatements.

*

1 2 3 4 5 6 7

Users can have no assurance that the financial statements contain no material misstatements.

The entity is free from fraud.

WILL THE EXPANDED AUDIT REPORT MODEL PROPOSED BY

1 2 3 4 5 6 7

The entity is not free from fraud.

The auditor is unbiased and objective.

1 2 3 4 5 6 7

The auditor is biased and not objective.

It is the responsibility of the auditor to disclose in the audit report illegal acts by the client's directors / senior management which directly impact on the client's financial statements (e.g., breaches of tax laws).

1 2 3 4 5 6 7

It is the responsibility of management to disclose in the annual report illegal acts by the client's directors / senior management which directly impact on the client's financial statements (e.g., breaches of tax laws).

It is the responsibility of the auditor to detect theft of material amount (e.g., > 5% of turnover or total assets) of the client's assets by directors / senior management.

1 2 3 4 5 6 7

It is the responsibility of management to detect theft of material amount (e.g., > 5% of turnover or total assets) of the client's assets by directors / senior management.

It is the responsibility of the auditor to detect illegal acts by the client's directors / senior management which directly impact on the client's financial statements (e.g., breaches of tax laws).

1 2 3 4 5 6 7

It is the responsibility of management to detect illegal acts by the client's directors / senior management which directly impact on the client's financial statements (e.g., breaches of tax laws).

It is the responsibility of the auditor to detect theft of a material amount (e.g., > 5% of turnover or total assets) of the client's assets by non-managerial employees.

WILL THE EXPANDED AUDIT REPORT MODEL PROPOSED BY

1 2 3 4 5 6 7

It is the responsibility of management to detect theft of a material amount (e.g., > 5% of turnover or total assets) of the client's assets by non-managerial employees.

It is the responsibility of the auditor to disclose in the audit report embezzlement of the client's assets by directors / senior management.

1 2 3 4 5 6 7

It is the responsibility of management to disclose in the audit report embezzlement of the client's assets by directors / senior management.

YOUR QUALIFICATION

Please indicate your highest academic qualification

- Diploma
- Post-Graduate Diploma
- Bachelor's degree / BTech
- Honours degree
- Master's degree / Master of Technology
- Phd / Doctoral degree / Doctorate of Technology

Other (please specify)

WILL THE EXPANDED AUDIT REPORT MODEL PROPOSED BY

In which of the following fields did you obtain the above qualification?

- Accounting
- Internal Auditing
- Cost and Management
- Accounting Financial
- Management/Finance Risk
- Management
- Banking
- Taxation

Other (please specify)

YOUR OCCUPATION

How many years of working experience do you have?

- 1 - 5 years
- 6 - 10 years
- 11 - 15 years
- 16 years or more

WILL THE EXPANDED AUDIT REPORT MODEL PROPOSED BY

Which of the following best describe your present occupation?

- Academic
- Auditor
- Investment Officer

Other (please specify)

Which of the following best describe your current job designation?

- Lecturer
- Senior Lecturer
- Associate Professor
- Professor
- Team Member
- Team Leader
- Assistant Manager
- Manager
- Senior Manager
- Audit Partner
- Investment Analyst
- Investment Associate
- Principal
- Senior Principal
- Banker
- Loan Officer

GENERAL