The audit expectation gap: an empirical study in Malaysia

TH Lee — International Graduate School of Management, University South Australia

JD Gloeck — Department of Auditing, University of Pretoria, South Africa

AK Palaniappan — International Graduate School of Management, University South Australia

ABSTRACT

The auditing profession believes the increase in litigation against, and criticism of auditors can be traced to an audit expectation gap. This paper reports the findings of a questionnaire survey on the audit expectation gap conducted in Malaysia. The aims of the study are two-fold. Firstly, it examines whether an expectation gap exists in Malaysia among the auditors, auditees and audit beneficiaries in relation to the auditors' duties. Secondly, since such an expectation gap was shown to exist, this study analyzes the nature of the gap using Porter's (1993) framework. The results proved the existence of an audit expectation gap in Malaysia. The study shows that the auditees and audit beneficiaries placed much higher expectations on the auditors' duties when compared with what auditors have perceived their duties to be. The analysis of the expectation gap indicated the existence of unreasonable expectations of the part of users; deficient standards of auditing in Malaysia; and deficient performance of auditors.

Key words

Auditing, audit expectation gap, deficient performance, deficient standards

1 INTRODUCTION

External auditing plays a critical role in the business environment as modern industrial economies are based on capitalism, a system of economy designed to allocate resources using market mechanisms (Watts & Zimmerman 1983). To ensure efficient allocation of resources in a capitalist economy, credible information about the companies' operation should be made available for decision making processes (Koo & Sim 1999). Such information can be obtained through financial statements. According to Pound *et al* (1997), the quality of the information in the financial statement will be enhanced by the added credibility from having been audited. This credibility is, however, called into question after some spectacular and well-publicized corporations (for example Enron and WorldCom in USA) collapsed shortly after an unqualified (in other words: "clean") audit report had been issued.

The auditing profession in Malaysia has been involuntarily placed in the spotlight particularly after the media reported the financial scandals in some of the big corporations in Malaysia. For example, Technology Resources Industries Bhd (TRI) was discovered to have issued fictitious invoices totalling nearly 260 million ringgit (68.4 million dollars) in 1998 and 1999 ("Firm lodges police report alleging RM260mil fraud," 2002). The auditors of TRI, Arthur Andersen & Co, failed to detect the fraudulent transactions and did not qualify the financial statements of TRI for these two years. In addition, Cold Storage (Malaysia) Berhad and its two subsidiaries, claimed that the auditor, Arthur Andersen & Co, has failed to detect and disclose the irregularities which resulted in the misappropriation of their funds and assets, and which subsequently caused massive losses to the company. Cold Storage (Malaysia) Berhad sued Arthur Andersen for more than 350 million ringgit (92.1 million dollars) for failing to detect and disclose irregularities in the company accounts ("3 Malaysian firms sue Anderson," 2002). Furthermore, in late 2004, criminal prosecution was also instituted against the accountant and external auditor of Kiara Emas Asia Industries Bhd, and against the reporting accountant of Energro Bhd for committing various corporate disclosure-related offences ("Smooth Operator," 2005).

The spate of corporate failures, financial scandals and audit failures has led to a significant increase in criticism of and litigation against the auditing profession (Maccarrone 1993). According to Godsell

(1992), this phenomenon may be due to common beliefs that the stakeholders of the company should be able to rely on its audited accounts as a guarantee of its solvency, propriety and business viability. Therefore, if it transpires, without any warning that the company is in serious financial difficulty, it is widely believed that the auditors should be made accountable for these financial disasters. In line with Godsell, Almer and Brody (2002) assert that a business failure is always interpreted as an audit failure in spite of the level of procedures and tests performed by the auditor. Almer and Brody (2002) further claims that an auditor can carry out his audits in accordance with the generally accepted auditing standards and still be found negligent in not preventing risks to financial statement users. Hence it is shown that the nature and objectives of auditing have been perceived differently by the users and these misperceptions are known as the "audit expectation gap".

The term "audit expectation gap" was first introduced to audit literature by Liggio (1974). He defined the audit expectation gap as the difference between the levels of expected performance as envisioned by both the user of a financial statement and the independent accountant. The Cohen Commission (1978) in the United States of America extended Liggio's (1974) definition by taking into account whether a gap may exist between what the public expects or needs and what auditors can and should reasonably expect to accomplish. Porter (1993) claims that the definition of audit expectation gap provided by Liggio (1974) and the Cohen Commission (1978) is too narrow as they fail to recognize that auditors may not accomplish "expected performance" (Liggio 1974) or what they "can and reasonably should" (Cohen Commission 1978). These definitions do not allow for sub-standard performance. Porter (1993) argues that the recent increase in criticism of and litigation against auditors is due to the failure of auditors to meet society's expectations, whose failure in turn undermines confidence in the audit function. Limperg (1932 cited in Porter *et al* 2005 p.119) points out that the "audit function is rooted in the confidence that society places in the effectiveness of the audit and in the opinion of the accountant…if the confidence is betrayed, the function, too, is destroyed, since it becomes useless". Hence, to narrow the audit expectation gap, it is necessary to ascertain: i) the duties society expects auditors to perform; ii) the duties that are reasonable to expect auditors to performance; and iii) the extent to which society's reasonable expectations are satisfied (or, more pertinently, not satisfied) by auditors (Porter *et al* 2005). As such, Porter (1993) proposes that the study of the audit expectation gap should be structured in a more extensive way which allows the different components of the audit expectation gap to be identified. In addition, she claims that it is more appropriate to name the expectation gap "the audit expectation-performance gap" as it represents the gap between society's expectations of auditors and society's perceptions of auditors' performance. Porter's (1993) structure of the audit expectation-performance gap has two major components, namely:

1 Reasonable gap - the difference between "what the public expects auditors to achieve and what they can reasonably be expected to accomplish"; and
2 Performance gap - the difference between "what the public can reasonably expect auditors to accomplish and what auditors are perceived to achieve".

The performance gap is further subdivided into:

2.1 Deficient standards - the gap between "what can reasonably be expected of auditors and auditors' existing duties as defined by the law and professional promulgation."
2.2 Deficient performance – the gap between "the expected standard of performance of auditors' existing duties and auditors' perceived performance, as expected and perceived by the public."

Despite the importance of the audit expectation gap to the auditing profession, there has been a significant lack of scientific study conducted on how to address this issue in Malaysia. The substantial research findings on the audit expectation gap (for example, Chowdhury *et al* 2005; Epstein & Geiger 1994; Gloeck & De Jager 1993; Humphrey *et al* 1993; Leung & Chau 2001; Lin & Chin 2004; Dixon *et al* 2006) may not be applicable in Malaysia because the findings are influenced and possibly distorted by economic, social or legal factors unique to those countries in which the studies took place. To date, the only published audit expectation gap study in Malaysia is by Fadzly and Ahmad (2004). Based on the survey instrument of Best *et al* (2001) and Schelluch (1996), the 2004 Malaysian study examines the audit expectation gap among auditors and major users of financial statements: bankers, investors, and stockbrokers. The study focuses on the positive view of the expectation gap, which compares auditors' and users' perceptions on the duties of auditors. The researchers assert that the comparison of the auditors' and users' perception is able to reveal whether there is a state of "unreasonable expectations" among Malaysian users. The study reveals that an audit expectation gap exists in Malaysia, particularly on issues concerning auditor's responsibility. A wide gap was found regarding auditor's responsibilities in fraud detection and prevention, preparation of financial statements and accounting records, and in internal control.

The current study aims to complement the previous study of Fadzly and Ahmad (2004) in the following ways. Firstly, the study investigates the perceptions among the auditors, auditees[i] and audit beneficiaries[ii] on the issues exemplifying the audit expectation gap which were not covered in the Fadzlay and Ahmad (2004) study.

Secondly, the study ascertains the components of the audit expectation gap using Porter's (1993) framework. It is hoped that the results of the study will provide a comprehensive analysis of the audit expectation gap which in turn will enable the auditing profession in Malaysia to reduce the gap in a more effective manner.

The remainder of this paper is organised into four major sections. The first section outlines the auditing context in Malaysia and the research framework of the study. The second section discusses the research methodology. The third section presents the results and implications. Finally, the concluding section summarises the findings and highlights the implication of the findings.

2 THE RESEARCH FRAMEWORK AND CONTEXT

2.1 The local auditing context in Malaysia

The Companies Commission of Malaysia regulates all companies including public listed and private limited companies incorporated under the Malaysian Companies Act 1965 (CA 1965). Section 169(4) of the CA 1965 requires every company incorporated under the Companies Act to have its financial statements audited before they are presented at the annual general meeting. Section 9 of the Act further requires that the audit must be performed by an approved company auditor as defined under Section 8 of the CA 1965. The auditors in Malaysia are regulated by Malaysian Institute of Accountants (MIA).

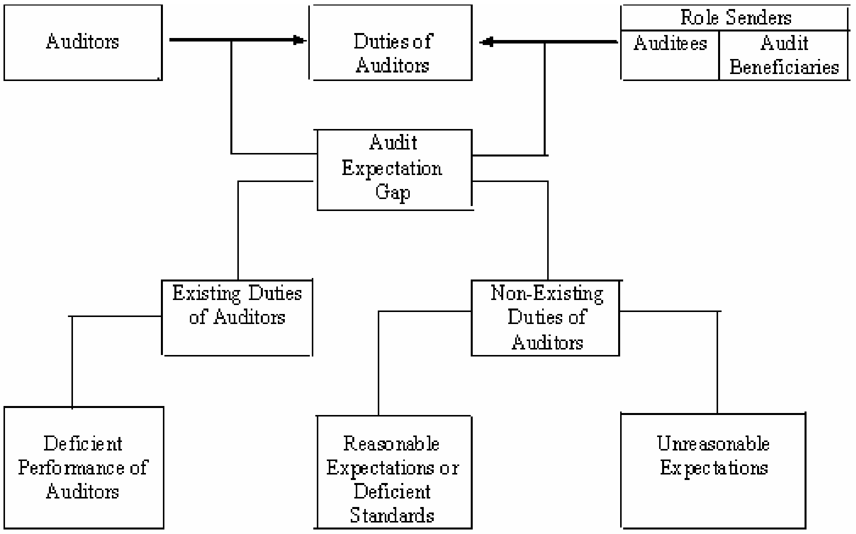
Section 174 of the Company Act 1965 requires the auditors to i) report to the members of the company on the accounts; ii) ensure timely submission of the audit report by the company; iii) express an opinion on the truth and fairness of the financial statements; and iv) ensure compliance with the requirements of the Company Act 1965 and the applicable “approved accounting standards” (Fadzly & Ahmad 2004). The “approved accounting standards” are those standards that are issued or approved by the Malaysian Standards Board (MASB). Under Section 174 (8) of the Company Act 1965, auditors are required to report to the Registrar on any breach or non-observance of any provision of the Company Act 1965. The auditors are required to follow the Malaysian Approved Standards on Auditing (MASA) in the conduct of their audits. Any breach of or failure to comply with MASA could be considered as conduct discreditable to the profession, and this could lead to disciplinary action against the auditors (Arens *et al* 2003).

With effect from 30 September 2004, the MIA has implemented the Anti-Money Laundering Act 2001 (the AMLA, 2001). The AMLA (2001) requires auditors, accountants and company secretaries who are members of the Malaysian Institute of Accountants (MIA) to report suspicious transactions of their clients to the Financial Intelligence Unit in the Bank Negara (Central Bank of Malaysia). In addition, Section 50 of the Securities Industry Act 1983 (SIA) stipulates that auditors are required to report to the Securities Commission any irregularities that are found during the course of the audit which may jeopardise the funds or property of the shareholders.

2.2 The research framework

Based on the role theory (Biddle & Thomas 1979), the role of the auditors can be viewed in terms of the interactions of the normative expectations of the various role senders in society having some direct or indirect relationship to the role position. Davidson (1975) points out that these different groups (for example, management, the security commission, institutional investors, analysts, et cetera) may hold varying expectations of the auditor and these expectations may change from time to time depending on the respecification of their own role requirements and the interaction of other forces in society. Hence, the auditors are placed in multi-role, multi expectation situations. As such, it is suggested that there could be different expectations between the auditors and their role senders which in turn give rise to an expectation gap. For the purpose of the study, auditees and audit beneficiaries will be used as the role senders of the auditors. Porter (1993) and Deflies *et al* (1988) claim that to narrow the expectation gap effectively, the components of the gap need to be ascertained, as different components of the gap require different methods to narrow them. Hence if the results show the existence of the audit expectation gap, the nature of the gap will be ascertained using the three components of the audit expectation performance gap in Porter’s (1993) framework, namely: i) unreasonable expectation; ii) deficient standard; and iii) deficient performance. A diagrammatical representation of the research framework is shown in Figure I.

Figure 1: Research Framework



3 RESEARCH METHOD

3.1 Survey Instruments and Sample Selection

A questionnaire was administered to 1,400 respondents which comprised auditors (200), auditees (400) and audit beneficiaries (800). The audit beneficiaries were represented by bankers (200), investors (200), brokers (200) and general public (200). The auditees were represented by company directors (200) and accountants (200).

There were two parts to the questionnaire. Part 1 examined 42 duties of auditors in the following areas: 1) the legal requirements of auditors in Malaysia (section 174 of Malaysian Company Act 1965); 2) the duties of auditors required by the Malaysian Approved Standards on Auditing (MASA), the Anti Money Laundering Act (AMLA), and other relevant legislations; and 3) the non-existing duties of auditors suggested in the study of Porter (1993) which focused on the following roles: i) auditors as guarantors of the accuracy of a company's financial statements and/or its solvency; ii) auditors giving early warning of company failure; iii) auditors detecting fraud and reporting it to shareholders; and iv) auditors discovering illegal activities. These 42 duties of auditors were covered in 34 questions. Even though these 34 questions were developed based on the best knowledge available in the field of auditing, it is acknowledged that there is no single ideal way of determining all the questions which could be relevant to a survey of the audit expectation gap (Troberg & Viitanen 1999).

Three questions were asked in two different sections in Part 1 with respect to the 42 duties of auditors mentioned above. In Section 1, respondents were asked to indicate whether the duties stated should, or should not be, a duty of auditors, or whether they were not sure. The options "yes", "no" and "not sure" were provided. They were coded +1, -1, 0, respectively. The objective of Section 1 was to determine the existence of an audit expectation gap. To ascertain the components of the gap, two additional questions were asked in Section 2. In Section 2(a), respondents were asked to indicate whether they considered the duties were, or were not, an existing duty of auditors, or whether they were not sure. The options "yes", "no" and "not sure" were also provided. Similarly, they were also coded +1, -1, 0, respectively. If respondents answered "yes" to Section 2(a), respondents were directed to proceed to Section 2(b). In Section 2(b), respondents were requested to indicate their assessment of auditors' performance of their existing duties. A three-point scale, labelled "poorly", "adequately" and "well" was provided, together with the option "unable to judge" to evaluate the auditors' performance. Part 2 of the questionnaire was used to gather personal information from the respondents for demographic analysis.

4 FINDINGS AND DISCUSSION

4.1 Demographic of respondent groups

There were 323 respondents who responded to the survey, yielding a 23.1 per cent response rate. The demographic details are shown in Table 1. The response rate of this study was deemed acceptable in the Asian environment as the response rates for most mail questionnaire surveys have usually been low in Asian countries [for example, Hong Kong, (Lee 1990), 23%; Malaysia, (Fadzly & Ahmad 2003), 30%; Singapore, (Best *et al* 2001), 32.3%]. To further substantiate the acceptability of the low response rate of the current study, a chi-square test was employed to compare the response rate of the current study with the previous studies in Asia (for example, Lee 1990; Fadzly & Ahmad 2003; Best *et al* 2001). The results (χ^2 = 3.452, p = 0.3266) show that, at significant level of 0.05, there is no significant difference in the response rate among the current and the previous studies.

The results from Table 1 also indicate that many of the auditees and audit beneficiaries possess either qualifications or experience in accounting. This shows that they are well informed on the issues being studied. In addition, more than 90 per cent of the respondents claimed that they were aware of what auditors do; hence, they should be able to evaluate the performance of the auditors as well as to determine what duties should be expected from the auditors. The high level of awareness combined with the accounting qualifications and experience should add credibility to the findings of the research.

4.2 Audit expectation gap analysis

To determine whether an audit expectation gap exists in Malaysia with respect to the duties of auditors, respondents were asked to answer 34 questions in relation to 42 duties of auditors. The respondents were asked to answer "yes", "no" or "uncertain". The existence of the audit expectation gap was demonstrated when there was a significant difference between the responses of the auditors and their role senders, represented by the auditees and audit beneficiaries. The chi-square test was used to confirm the significance or otherwise of apparent differences of perception between and within the auditors and non-auditors. For the purpose of the study, a significance level of 0.05 was used. The responses of the respondents are shown in Table 2. The chi-square test statistic presented in Table 2 indicates that the expectation gap does exist between the auditors and their role senders with respect to 31 of the 42 duties examined. The results of the study show different expectations exist between the auditors and their role senders with respect to the duties that should be performed. Hence, the findings are consistent with the explanation given in the research framework of the causes of an audit expectation gap.

Consistent with the audit expectation gap literature [for example Chowdhury *et al* 2005; Epstein & Geiger 1994; Gloeck & De Jager 1993; Humphrey *et al* 1993; Leung & Chau 2001; Lin & Chin 2004; Dixon *et al* 2006], this study found that the auditees and audit beneficiaries expected the auditors to perform more duties than most auditors would consider as normal. The results in Table 2 show that the expectation gap exists with respect to all 23 non-existing duties of auditors. Based on the cross tabulation analysis of the responses, such a gap exists because most of the auditees and audit beneficiaries expected the auditors to perform these duties, while the auditors regarded otherwise. Similarly, an expectation gap was also found with respect to 8 out of 19 existing duties of the auditors. The cross tabulation analysis shows that many of the auditors believe that they should not perform these 8 out of the 19 existing duties (mainly due to low awareness[iii]). However, the auditees and audit beneficiaries expected them to do so.

The results of this study confirmed those of the previous study of Fadzly and Ahmad (2004) that the audit expectation gap exists in Malaysia. The study also found that the auditees and audit beneficiaries have a much higher expectation of the duties of the auditors than the auditors themselves have perceived them to be. According to Deflies *et al* (1988), it is important to appraise the realism of the public expectation because if the reasonable expectations of the public are not met by the existing professional standard or the performance falls short of its standards, the standards and/or the performance should be improved. But if the public has unreasonable expectations, the profession should attempt to improve the public understanding. Therefore, it is crucial to ascertain the nature of the expectation gap.

4.3 Reasonable and Unreasonable Expectation Analysis

Porter (1993) asserts that in order for duties to be reasonably expected of auditors it must be cost-beneficial for such duties to be performed. In the absence of formal cost-benefit analysis, Porter's (1993) study used duties identified by both the auditees and financial community audit beneficiaries as duties that should be performed by the auditors. Porter (1993) claims this is an appropriate approach to surrogate the cost-benefit analysis as auditees and financial community audit beneficiaries are considered well-informed about the audit function and they hold opposing perspectives. She explains that the auditees are subjected to the auditors' examination; consequently, they are likely to be particularly cognisant of the costs involved. Hence, they are expected to limit the duties ascribed to auditors. On the other hand, audit beneficiaries rely on the auditors' work and they are likely to be particularly conscious of the benefits which they wish to extract from auditors.

For the purpose of this research, the duties that satisfy the cost-benefit analysis are similar to those identified by Porter (1993). However, unlike Porter's (1993) study, this research uses the responses from the audit beneficiaries that rely on audit report in their decision making process and the accountants that had previous working experience in auditing to determine the duties that should be performed by the auditors. This basis of selection is for the following two reasons. Firstly, only those audit beneficiaries who use audit reports have benefited from the work of auditors. As such, they know what to expect from the auditors. Secondly, accountants are among the auditees who are in contact with the auditors. In addition, those accountants with previous experience in auditing are more familiar with the work of auditors and hence they are in a better position to identify what duties "should" or "should not" be performed by the auditors. Based on the study of Porter (1993), a duty is considered reason able to be performed by the auditors when a "significant portion" (in other words: 20 per cent or more) of an identified interest group signify such duty should be performed. According to Troberg and Viitanen (1999) the cut-off point of 20 per cent is rather low as it could lead to more duties being considered as reasonably expected. They proposed a higher rate of 25 per cent as they felt that this percentage constituted a qualified minority. Hence, consistent with Troberg and Viitanen (1999), a cut-off point of 25 per cent was adopted in this study. Put succinctly, for the purpose of this study, a duty is considered to be reasonably expected of auditors when more than 25 per cent of both the auditees and audit beneficiaries are of the opinion that such a duty should be performed.

Table 3 shows that 18 auditees and 57 audit beneficiaries met the selection criteria as mentioned above. The responses of selected respondents were used to ascertain duties that are “reasonably” and “unreasonably” expected of auditors.The results in Table 3 indicate that 6 of the non-existing duties were regarded as duties that are unreasonably expected of auditors and 17 were regarded as reasonable. The unreasonable expectations include: i) to prepare the company’s financial statement; ii) to guarantee the complete accuracy of the audited financial statement; iii) to verify every accounting transaction; iv) to prevent fraud and errors in the company; v) to detect all fraud and errors in the company; and vi) to plan the accounting and internal control system. The analysis indicates that less than 25 per cent of the selected auditees regarded these 6 duties as duties that should be performed by the auditors. The possible reason for these responses may be due to the selected auditees’ past experience in auditing. They may not have found these duties to be cost effective to be performed by the auditors although more than 25 per cent of the selected beneficiaries felt that these 6 duties should be performed by the auditors. Hence, based on the measurement criteria of cost-benefit analysis in this study, these 6 duties were regarded as “unreasonable” expectation of auditors.

The analysis in Table 3 shows that 17 of the non-existing duties were regarded as reasonable expectations of auditors as they satisfied the cost-benefit analysis since more than 25 per cent of the selected auditees and audit beneficiaries were of the opinion that they should be performed by the auditors. These duties were added to those classified as “deficient standards” as they are reasonable expectations with regard to auditors but are not required by the current legislations and auditing standards. To satisfy society’s expectation, future Malaysian legislation and auditing standards need to be extended to encompass these duties.

4.4 Deficient performance analysis

The results in Table 2 indicate that an expectation gap exists in the existing duties of auditors. The existence of an expectation gap in relation to the existing duties of auditors may be due to the fact that auditors fail to recognise some of the existing duties of auditors. As a result of this ignorance, it is likely that the auditors could have underperformed these existing duties. This assertion is consistent with Porter (1993), who posits that the auditors may not have accomplished the expected performance required by society, and that the possibility of sub-standard performance among auditors exists. Therefore, to reduce the expectation gap and the criticism of the auditors, it is important to ascertain the perceived standard of performance of the auditors on these existing duties. To evaluate the performance of the auditors, the respondents were asked to rate the performance of auditors as “poorly”, “adequately” or “well” performed. For the analysis of the deficient performance of auditors, the responses of the auditees and audit beneficiaries were used and the responses of auditors were excluded. The exclusion of auditors was to ensure that the results would not be biased.

For the purpose of this research, the perceived sub-standard performance of auditors was identified when 25 per cent of the respondents indicated that a particular duty was poorly performed. The basis used is similar to Porter (1993) although a lower rate of 20 per cent was adopted by Porter. Troberg and Viitanen (1999) claim that a higher threshold should be used to prevent duties of auditors from being unnecessarily regarded as deficient performance. Hence, consistent with Troberg and Viitanen’s (1999) assertion, a threshold of 25 per cent was adopted in the current study.

The results in Table 4 show that perceived deficient performance was found in 9 of the existing duties of auditors. Out of these 9 deficient performance duties, 7 of them were found to have audit expectation gap (based on the results in Table 2). A further analysis of the 9 duties revealed that more than 40 per cent of the auditors failed to recognise these duties as existing duties required by legislation and auditing standards. The auditors failed to recognise these existing duties because most of the duties are related to the requirements of the new *Anti Money Laundering Act*. This Act was implemented in September 2004. This Act requires auditors to report privately to the Financial Intelligence Unit in the National Bank of Malaysia when they suspect or find any irregular, illegal or unlawful activities during the course of an audit.

Similarly, Porter and Gowthorpe (2001) found that, in 2000, about 15 per cent of auditors were uncertain or incorrect about their existing duties. The ignorance of the auditors (as explained earlier) may account for their poor performance. To mitigate this problem, Porter (1993) suggests improved education is required for auditors so that they are aware of their existing duties under the law and professional promulgations.

The duties of auditors that are perceived to be performed deficiently are: i) to detect deliberate distortion of figures (or other information) presented in the company’s financial statement; ii) to report privately to a regulatory authority, if the auditors discovered that theft has been committed by non-managerial employees; iii) to report privately to a regulatory authority, if the auditors discovered that the senior management has misappropriated company assets; iv) to report privately to a regulatory authority, if the auditors discovered the results presented in the financial statements have been deliberately distorted; v) to disclose in the audit report, if the auditors discovered that senior management has misappropriated the company assets; vi) to disclose in the audit report, if the auditors discovered that the information presented in the financial statements has been deliberately distorted; vii) to report to a regulatory authority, if during the audit, suspicious circumstances are encountered, suggesting that theft or deliberate distortion of the financial information may have occurred in the company; viii) to disclose in the published auditor's report, illegal acts committed by the company's management which are discovered during the audit which directly impact on the company's accounts; and ix) to report privately to a regulatory authority, if during the audit it is discovered that illegal acts have been committed by the company officials.

Overall, the findings of deficient performance of auditors in the current study are consistent with previous studies of Cameron (1993) and by Porter and Gowthorpe (2001). Cameron (1993) found the actual performance of auditors in New Zealand was generally perceived to fall below the expected levels. Similarly, the research of Porter and Gowthorpe (2001) indicates that 6 of the auditors' 13 existing duties were considered by society to be performed satisfactorily while seven were perceived to be performed deficiently. The findings among the studies in various countries for the past decades may uncover the reasons for the increase of the accusation against the auditor, as performance of auditors have always been perceived to be performed deficiently.

5 CONCLUSION

The increase in litigation against and criticism of the auditors has left little room for doubt that the auditors are facing a liability and credibility crisis (Russell 1986). Lim (1993) and Wolf (1985) assert that the blame should not be placed on the auditors totally as the nature and objectives of auditing are perceived differently among the auditors, auditees and audit beneficiaries. These differences in perception caused the existence of the audit expectation gap. An expectation gap is detrimental to the auditing profession as highlighted by Limperg (1933 cited in Porter & Gowthorpe 2001) that:

> If auditors fail to identify society's expectations of them, or to recognize the extent to which they meet (or, more pertinently, fail to meet) those expectations, then not only will they be subject to criticism and litigation but also, if the failure persists, society's confidence in the audit function will be undermined and the audit function, and the auditing profession, will be perceived to have no value (p.5)

However, Porter & Gowthorpe (2001) assert that when the auditors' performance is better aligned with the expectations of society, the confidence in the auditing profession should gradually be restored and hence the criticism and litigation against the auditors should be gradually be reduced.

The existence of an audit expectation gap identified in this study confirmed the previous study of Fadzly and Admad (2004). The study also found the expectation gap in Malaysia is due to an unreasonable expectation of auditors; deficient standards; and deficient performance by auditors. The analysis of the expectation gap would enable the auditing profession to take corrective action in narrowing the audit expectation gap in a more effective manner as knowledge of the structure and composition of the expectation gap provides insight into how the gap may be narrowed (Porter *et al* 2005). For example, unreasonable expectation among the auditees and beneficiaries can be reduced by creating awareness through mass communication about the nature and function of an audit (Darnill 1991). On the other hand, strengthening the monitoring of auditors' performance and improving the quality control in audit firms could be implemented to ensure quality performance of the auditors which in turn reduce the deficient performance gap (Porter & Gowthorpe 2001). Finally, to reduce the deficient standards gap, the existing auditing standards should be reviewed on a regular basis to ensure the auditing standards encompass duties that could be reasonably expected of auditors. According to Porter *et al* (2005), auditing standards need to be extended to encompass the duties that are not required of auditors, but which are cost effective and reasonable for auditors to perform.

It is envisaged that the study will contribute meaningfully towards future studies in audit expectation gap in Malaysia. Moreover, the analysis of the nature of the expectation gap would provide useful information in identifying effective means to bridge this gap. With concerted effects on the part of the auditing profession to adopt such an approach, this audit expectation gap should in effect be narrowed. Society's expectation of auditors and auditors' actual performance would in turn be brought into closer accord; hence, alleviating the criticism and litigation levied against the auditors.

ENDNOTES

[i] Auditees are the clients who receive audit or assurance services in an audit engagement (Glascock 2002).

[ii] Audit beneficiaries are users who look for faithful information from the audit reports to assist them in making their decisions (Lee 1994).

[iii] The data on knowledge of auditors' existing duties are available from the authors upon request.

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APPENDIXES

Table 1: Demographics of respondents

		Responses received		Accounting qualification		Accounting experience		Awareness of auditors' duties	
Subject group	No. of survey	n	%	Yes %	No %	Yes %	No %	Yes %	No %
Auditors	200	71	36	100	0	70	30	100	0
Bankers	200	35	18	29	71	42	58	92	8
Brokers	200	24	12	50	50	46	54	95	5
Investors	200	42	21	41	59	41	59	98	2
Publics	200	71	35	24	76	25	75	92	8
Directors	200	39	20	62	38	67	33	100	0
Accountants	200	41	20	98	2	100	0	100	0
Total	1,400	323	23.2	-	-	-	-	-	-

Table 2: The Cross Tabulation and Chi-Square Test Statistics on Duties of Auditors

	Role Senders of Auditors						Auditors			Chi-Square
	Auditees n=172			Audit Beneficiaries n=80			n=71			Test Statistics
	No	Un-certain	Yes	No	Un-certain	Yes	No	Un-certain	Yes	(Note 1)
1 To prepare the company's financial statements	48	7	45	49	5	46	72	1	27	13.654*
2 To guarantee the complete accuracy of audited financial statements	22	5	73	28	0	72	56	3	41	33.421*
3 To verify every accounting transaction	30	8	62	34	0	66	73	3	24	47.478*
4 To verify the accounting estimates in the financial statement	14	11	75	10	5	85	11	3	86	3.456
5 To state whether or not the audited financial statements give a correct picture of the company's financial affairs	9	7	84	1	1	98	7	4	89	0.230
6 To prevent fraud and errors in the company	21	8	71	31	4	65	56	4	40	30.490*
7 To detect all fraud and errors in the company	21	11	68	33	1	66	69	7	24	58.895*
8 To detect deliberate distortion of the figures (or other information) presented in the company's financial statements	13	6	81	5	0	95	10	1	89	1.136
9 To detect theft (other than petty theft) which has been committed by:										
a) non-managerial employees	30	20	50	26	14	60	54	18	28	17.390*
b) company directors/senior management	13	14	73	19	7	74	40	15	45	24.052*
10 To report privately to a regulatory authority, such as the Securities Commission in Malaysia and the Bank Negara (Central Bank of Malaysia) , if during the audit it is discovered that:										
a) theft has been committed by non-managerial employees	27	14	58	35	22	43	46	13	41	7.327
b) company directors/senior management has misappropriated company assets	15	13	72	20	11	69	39	9	52	16.957*
c) the information presented in the financial statements has been deliberately distorted	14	16	70	16	10	74	37	14	49	17.745*
11 To disclose the fact in the published auditor's report if during the audit it is discovered that:										
a) theft has been committed by non-managerial employees	17	12	71	28	11	61	42	20	38	21.229*
b) company directors/senior management have misappropriated company assets	11	8	81	15	8	77	37	15	48	30.707*

c) the information presented in the financial statements has been deliberately distorted	9	9	82	6	4	90	23	8	69	11.378*
12 To report privately to a regulatory authority, such as the Bank Negara (Central Bank of Malaysia), if during the audit suspicious circumstances are encountered, suggesting that theft or deliberate distortion of the financial information may have occurred in the company	13	16	71	16	9	75	30	18	52	11.527*
13 To detect illegal acts committed by the company's management:										
a) which directly impact on the company's accounts (such as bribery and political payoffs)	16	9	75	14	5	81	34	42	62	12.788*
b) which DO NOT directly impact on the company's accounts (such as environmental laws and regulations and breaches of occupational safety)	19	17	64	22	15	63	38	13	49	9.571*
14 To disclose in the published auditor's report illegal acts committed by the company's management which are discovered during the audit:										
a) which directly impact on the company's accounts (such as bribery and political payoffs)	12	15	73	15	14	17	30	11	60	10.813*
b) which DO NOT directly impact on the company accounts(such as environmental laws and regulations and breaches of occupational safety)	16	17	67	17	19	64	41	41	18	20.502*
15 To report privately to a regulatory authority such as the Bank Negara (Central Bank of Malaysia), if during an audit it is discovered that illegal acts have been committed by company officials	12	15	73	19	9	72	31	14	55	11.841*
16 To guarantee that a company whose financial statements have been given an unqualified ('clean') audit report is financially sound	20	13	67	21	5	74	47	6	47	23.319*
17 To report in the published auditor's report the compliance of audited financial statement to the Approved Accounting Standards in Malaysia and the Company Act 1965	9	8	83	6	4	90	10	1	89	0.247
18 To report breaches of tax laws to the Inland Revenue Board (IRB)	18	16	66	25	19	56	44	13	43	16.087*
19 To plan the accounting and internal control system	34	18	47	40	10	50	52	10	38	6.101*
20 To report in the auditor's report the efficiency and effectiveness of the accounting and internal control system	19	12	69	18	5	77	37	8	55	10.828*
21 To comply with Code of Ethics for professional accountant	12	5	83	6	1	93	11	1	88	0.894
22 To maintain confidentiality and safe custody of the audit working papers	7	6	87	5	1	94	13	0	87	5.534
23 To report in a published auditor's report on the impact (good and bad) which the company has on its local community	26	23	51	22	19	59	51	17	32	18.164*
24 To guarantee the solvency of the company	34	15	51	30	8	62	59	7	34	16.085*
25 To report in the published auditor's report the future prospects of the company	33	14	53	25	8	67	52	16	34	14.799*
26 Where the auditor has doubts about the solvency of the company under audit, to express such doubts:										

	a) privately to a regulatory authority, such as Company Commission of Malaysia (ROC) or the Central Bank of Malaysia	21	18	61	24	16	60	46	27	27	26.067*
	b) in the published auditor's report	16	15	69	9	6	85	10	15	75	1.131
27	To express an opinion on the company's accounts to shareholders in a general meeting	19	13	6	14	5	81	18	10	72	0.061
28	To examine and report in the published auditor's report the efficiency and effectiveness of the company's management, its plans, policies and administration	23	15	62	29	14	57	49	14	37	17.063*
29	To report in the published auditor's report on failures of auditors in obtaining all the information and explanation in forming their opinion on the company's accounts	13	14	73	6	5	89	21	9	70	5.426
30	To report in the published auditor's report on any deficiencies or failure on the manner proper accounting and other records (including registers) are kept by the company	15	15	70	5	1	94	17	7	47	7.041*
31	To audit published quarterly company's reports	19	17	64	21	10	69	52	10	38	30.337*
32	To examine and report in a published auditor's report on the fairness of financial forecasts included in the annual reports of companies	16	14	70	17	10	73	41	4	55	21.235*
33	To examine the other information in the company's published annual report (e.g. the director's statement) to determine the existence of material inconsistencies with the audited financial statements	10	9	81	9	9	82	13	8	79	0.600
34	To examine and report in the published auditor's report on the fairness of non-financial information contained in the company's annual report (e.g., information about employees, product and occupational safety records)	22	16	62	21	21	58	38	13	49	8.217*

Note:

1 Chi-square test measure the degree of disagreement between the data and null hypothesis.

H0: The expectation of the role senders and auditors are independent.
H1: The expectation of the role senders and auditors are dependent.

2 * Significance at 0.05 significant level.

3 Existing duties of the auditors required by the Malaysian legislations and Auditing Standards Question 4, 5, 8, 10a, 10b, 10c, 11b, 11c, 12, 14a, 15, 17, 21, 22, 26b, 27, 29, 30, 33.

4 Non-existing duties of auditors
Question 1, 2, 3, 6, 7, 9a, 9b, 11a, 13a, 13b, 14b, 16, 18, 19, 20, 23, 24, 25, 26a, 28, 31, 32, 34.

Table 3: Analysis of Expectation Gap on Non-Existing Duties of Auditors

Non existing duties of auditors	Duty should be performed		Nature of the gap	
	Auditees n=18	**Audit Beneficiaries n=57**	**Unreasonable expectation**	**Reasonable expectation**
1 To prepare the company's financial statements	11	38	*	
2 To guarantee the complete accuracy of audited financial statements	17	75	*	
3 To verify every accounting transaction	17	67	*	
6 To prevent fraud and errors in the company	17	66	*	
7 To detect all fraud and errors in the company	11	68	*	
9 To detect theft (other than petty theft) which has been committed by:				
a) non-managerial employees	28	53		*
b) company directors/senior management	39	75		*
11 To disclose the fact in the published auditor's report if during the audit it is discovered that:				
a) theft has been committed by non-managerial employees	44	74		*
13 To detect illegal acts committed by the company's management:				
a) which directly impact on the company's accounts (such as bribery and political payoffs)	56	88		*
b) which DO NOT directly impact on the company's accounts (such as environmental laws and regulations and breaches of occupational safety)	50	79		*
14 To disclose in the published auditor's report illegal acts committed by the company's management which are discovered during the audit:				
b) which DO NOT direct impact on the company accounts (such as environmental laws and regulations and breaches of occupational safety)	44	75		*
16 To guarantee that a company whose financial statements have been given an unqualified ('clean') audit report is financially sound.	56	63		*
18 To report breaches of tax laws to the Inland Revenue Board (IRB)	28	72		*
19 To plan the accounting and internal control system	22	49	*	
20 To report in the auditor's report the efficiency and effectiveness of the accounting and internal control system	61	88		*
23 To report in a published auditor's report on the impact (good and bad) which the company has on its local community	39	63		*
24 To guarantee the solvency of the company	28	53		*
25 To report in the published auditor's report the future prospects of the company	50	53		*
26 Where the auditor has doubts about the solvency of the company under audit, to express such doubts:				
a) privately to a regulatory authority, such as Company Commission of Malaysia (ROC) or the Central Bank of Malaysia	39	65		*
28 To examine and report in the published auditor's report the efficiency and effectiveness of the company's management, its plans, policies and administration	44	67		*
31 To audit published quarterly company's reports	44	72		*
32 To examine and report in a published auditor's report on the fairness of financial forecasts included in the annual reports of companies	39	81		*
34 To examine and report in the published auditor's report on the fairness of non-financial information contained in the company's annual report (e.g., information about employees, product and occupational safety records)	67	66		*

Table 4: Analysis of deficient performance of auditors on their existing duties

	Non- Auditors n = 252				
	Unable to judge	**Poorly**	**Adequately**	**Well**	**Deficient performance**
4 To verify the accounting estimates in the financial statement	12	10	53	15	
5 To state whether or not the audited financial statements give a correct picture of the company's financial affairs	12	11	44	33	
8 To detect deliberate distortion of the figures (or other information) presented in the company's financial statements	13	25	43	19	*
10 To report privately to a regulatory authority, such as the Securities Commission in Malaysia and the Bank Negara (Central Bank of Malaysia), if during the audit it is discovered that:					
a) theft has been committed by non-managerial employees	18	27	38	17	*
b) company directors/senior management has misappropriated company assets	16	27	40	17	*
c) the information presented in the financial statements has been deliberately distorted	15	28	42	15	*
11 To disclose the fact in the published auditor's report if during the audit it is discovered that:					
b) company directors/senior management have misappropriated company assets	16	33	39	12	*
c) the information presented in the financial statements has been deliberately distorted	18	27	43	12	*
12 To report privately to a regulatory authority, such as the Bank Negara (Central Bank of Malaysia), if during the audit suspicious circumstances are encountered, suggesting that theft or deliberate distortion of the financial information may have occurred in the company.	17	31	38	14	*
14 To disclose in the published auditor's report illegal acts committed by the company's management which are discovered during the audit:					
a) which directly impact on the company's accounts (such as bribery and political payoffs)	12	29	45	14	*
15 To report privately to a regulatory authority such as the Bank Negara (Central Bank of Malaysia), if during an audit it is discovered that illegal acts have been committed by company officials	14	27	46	13	*
17 To report in the published auditor's report the compliance of audited financial statement to the Approved Accounting Standards in Malaysia and the Company Act 1965	7	13	49	31	
21 To comply with Code of Ethics for professional accountant	14	8	50	28	
22 To maintain confidentiality and safe custody of the audit working papers	12	7	42	39	
26 Where the auditor has doubts about the solvency of the company under audit, to express such doubts:					
a) in the published auditor's report.	11	20	53	16	
27 To express an opinion on the company's accounts to shareholders in a general meeting	7	18	53	22	
29 To report in the published auditor's report on failures of auditors in obtaining all the information and explanation in forming their opinion on the company's accounts	11	17	54	18	
30 To report in the published auditor's report on any deficiencies or failure on the manner proper accounting and other records (including registers) are kept by the company	13	14	55	18	

33 To examine the other information in the company's published annual report (e.g. the director's statement) to determine the existence of material inconsistencies with the audited financial statements	11	14	55	20	

Note:

Duties of auditors required by Anti *Money Laundering Act*
Q10a, Q10b, Q10c, Q12, Q15.