

THE “CREDIBILITY CRISIS” OF AUDITING PROFESSION: AN EMPIRICAL STUDY IN ROMANIA

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For decades the accountancy profession has responded to the “credibility crisis” by coining, reciting and hiding behind the phrase “audit expectation gap” — a phrase which denotes the differences between the public’s and Auditors’ perceptions of the role of an audit function. This paper reports the findings of a questionnaire survey on the audit expectation gap conducted in Romania. The aims of the study are to examine whether an expectation gap exists in Romania among the auditors, auditees and audit beneficiaries in relation to the auditors’ duties. The results proved the existence of an audit expectation gap in Romania. 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.

Key words: audit, audit expectation gap

JEL code: M42, G30

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.

The spate of corporate failures (for example Enron and WorldCom in USA), 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. 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”.

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 Romania. The substantial research findings on the audit expectation gap (Chowdhury et al 2005; Epstein & Geiger 1994; Humphrey et al 1993; Leung & Chau 2001; Lin & Chin 2004; Dixon et al 2006) may not be applicable in Romania because the findings are influenced and possibly distorted by economic, social or legal factors unique to those countries in which the studies took place. The purpose of this article consists in identifying the perceptions of the financial reports users regarding the responsibilities of statutory auditors in Romania, in order to ascertain to what extent we can speak of the existence of a certain differences in expectations on the work of statutory auditors in Romania.

2. Literature review

2.1. The concept of audit expectation gap

The definition of the expectations gap varies among researchers. 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 USA 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). 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). 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.”

3. Research methodology

We used the questionnaire technique for collecting the primary data, as it is an efficient means of collecting answers from a large sample size. The questionnaire is adapted according to the one used by Alleyne and Howard (2005). The questionnaire was designed in order to enable us to extract the necessary accurate information from the respondents’ answers, and to make sure that collected information is adequate for achieving the objectives of this study. The questionnaire is divided in two sections, Section I and Section II. Section I consists of 8 questions related to

respondents' demographics. Section II consists 11 questions that targeted 11 duties of auditors in the following areas: i) the duties of auditors under the International Standards on Auditing (ISA), adopted by the Board of Financial Auditors in Romania, ii) a part of the inexistent duties of auditors advanced by Porter's study (1993), which focused on the following areas: i) auditors as guarantors of a company's financial statements accuracy and solvency, ii) auditors give an early warn of the company's failure, iii) the auditors detect fraud and report to the shareholders and iv) they discover illegal activities.

The questionnaire contains Likert-like questions, on a five-point scale, and respondents had to chose from a scale ranging from „strongly agree” to „strongly disagree”. The questions were designed based on a detailed review of the features of prior studies (Alleyne & Howard, 2005; Gay et al., 1997; Innes et al., 1997; Gay et al., 1998; Frank et al., 2001; Best et al., 2001) and subsequent to an in-depth review of audit standards disclosing auditors' responsibilities. Furthermore, the questions are arranged in an order corresponding to the order provided by the Approved Auditing Standards in Romania. The survey is applied at „national” level, as we aim to obtain representative results for entire Romania. The participants in this survey can be divided into four groups, namely: auditors, managers, bankers and financial analysts. Data were collected throughout Romania to avoid territorial subjectivity. On-line questionnaires were sent to all participants.

The auditors' group includes all auditors who may exercise this profession throughout Romania; the auditors are officially recognised by the Chamber of Financial Auditors of Romania, and therefore, they are included in the „Romanian Public Register of Auditors. In terms of the managers' group, the persons were selected from companies listed on the primary and secondary markets of Bucharest Stock Exchange, as these companies have to audit their annual financial statements. In terms of bankers' group, these persons were selected among employees in the credit departments of the major banking institutions in Romania. The fourth category consists of respondents in the category of financial analysts and investment analysts. The category includes all those persons or institutions that could use the information provided by the auditor in his report, for the substantiation of investment decisions, either on their own or on behalf of third parties as a profession.

The responses cover most of the development areas in the country, thus removing subjectivity. In our opinion, the technique adopted for data collection resulted in a very good yield of 38.3% response rate. A detailed disclosure on each category of respondents is presented in table 1.

Table 1 Situation of responses by category of respondents

Interviewed groups	Sample	Successfully sent	Returned	Answers received	% response rate / successfully sent
Auditors	978	889	89	319	35.88%
Managers	651	575	76	221	38.43%
Bankers	121	89	32	43	48.31%
Financial analysts	178	131	47	62	47.33%
TOTAL	1928	1684	244	645	38.3%

In terms of percentage, the most representative group is the one of the financial auditors, with 30.2%, followed by the group of managers, with 27.3%, and the one of bankers, with 21.2%.

The analysis of the general answers related to respondents (first section) enabled us to observe that most of the respondents have accounting qualifications and audit experience. Furthermore, more than 90% of the respondents claimed that they were aware of what auditors do. The high level of awareness, combined with their accounting qualifications and audit experience, should add credibility to the findings of the study.

After the responses were received, a model developed by Cronbach was applied (meaning the extent to which respondents gave correlated answers). Thus, after applying "reliability analysis", we obtained the following results:

- For the first group of questions on the "function" of the auditor, we obtained a value " $\alpha = 0.867$."
- In the second part, comprising questions about "understanding" the report issued by the auditor, we obtained a value " $\alpha = 0.5287$ ".

4. Findings and discussions

As formerly asserted, the second section was designed to enable us to verify the existence of some discrepancies between expectations and reality in audit activity in Romania. To determine whether in Romania there is a gap of expectations in audit, about the responsibilities of auditors, we first performed the tests of "normality" of distributions that different study groups represent for each variable. To this end, we applied the test of "Kolmogorov-Smirnov" depending on the hypothesis we wanted to oppose. After applying this test separately for each group of respondents, we ascertained that virtually none of the cases is the condition of normality. The next step was to oppose the hypothesis, using the non-parametric test of "Kruskal-Wallis", used in the case of more than 2 independent samples. For this study we used an importance level of 0.05. Respondents' answers are presented in Table 2.

Table 2. Kruskal-Wallis test for the interviewed groups of respondents (first case)

Questions proposed	Mean values of groups of respondents				Chi square	Asymp. Sig.
	A	M	BA	FA		
1. The responsibility of the auditor is:						
1.1. The development of the audited company's financial statements	1,32	3,4	2,59	2,5	113.597	0.000*
1.2. Ensuring the full uprightness of the audited financial statements	2,47	3,63	3,61	3,64	87.583	0.003*
1.3. Checking all accounting transactions	2,76	3,76	3,66	3,85	111.990	0.000*
1.4. Detection of all fraud and error in the financial statements	2,25	3,72	3,64	3,78	159.594	0.000*
1.5. Prevention of all fraud and error within the company	2,25	3,72	3,64	3,78	159.594	0.000*
1.6. Plan accounting and internal control systems	2,1	3,14	2,73	2,64	47.583	0.003*
1.7. Analyzing and presenting the audit report information on the efficiency and effectiveness of internal control of the auditee	2,76	3,76	3,66	3,85	111.990	0.000*
1.8. Confidential reporting to a legislative authority, if the auditors discovered a fraud committed by an employee of the entity that has a leading position	2,77	2,86	3,08	3,15	8.672	0.034 ^{ns}
1.9. Presentation in the audit report of illegal activities committed by the entity's management, which are discovered	3,77	4,11	3,66	3,48	19.097	0.000*

during the audit and have a direct impact on the audited financial statements						
2. The auditor is the one expressing whether the financial statements reflect the company's financial and economic situation	4,83	4,88	4,96	4,88	4.459	0.216 ^{ns}
3. In his report, the auditor only expresses opinions on the annual financial statements	4,69	4,26	4,36	4,33	42.813	0.000*
4. To ensure that accounting standards are met	4,72	4,77	4,86	4,82	9.710	0.021**
5. To audit the semestrial financial statements	3,84	3,95	3,73	4,06	3.621	0.305 ^{ns}
* Statistically significant at 1%, ** statistically significant at 5%, NS = statistical insignificant The average values measured correspond to a scale from 1 - totally disagree to 5 agree. Where: A - Auditors, M - Manager, BA-bankers, BR - brokers						

There is a total of 13 statements and for each statement in part we calculated the mean and deviations of the responses. Responses to an average of less than 3 indicate that users have lower expectations from the auditors on those tasks, whereas responses with a high average value (over 3) indicate that users understand the duties and responsibilities of auditors. The study results indicate that statistically, there are significant differences between the four groups in terms of perceptions on the responsibilities of the statutory auditor, which means that there is an expectations gap between auditors and other groups of respondents related to 10 of the 13 responsibilities.

Moreover the result (claim 1.2 to 5) indicates that users have higher expectations regarding the duties and responsibilities of auditors. Although statistically the differences between the categories of respondents are related to the first statement, it should be noted that the results for each category of respondents in part , the threshold stands below 3, with the exception of the manager, meaning that other categories of users outside managers do not consider preparing financial statements to be the responsibility of auditors. This result is consistent with the results recorded by other researchers (Gay et al., 1998 and Best et al., 2001). Users agreed that the auditors are responsible for preventing and detecting fraud and error (statement 1.4, 1.5). This result is showing the existence of a discrepancy between expectations and reality on the auditor's responsibilities concerning the prevention and detection of fraud.

A discrepancy exists here because the audit standard ISA 240 „Fraud and error” in its revised form which enter into force on December 15, 2009, clearly states that management is responsible for preventing and detecting fraud and error, and the main responsibility of auditors is to detect fraud and errors with significant impact on the financial statements. It is interesting to note responses to statements 1.2. and 1.3, which from our standing-point, highlight some unreasonable expectations (medium levels of response except the auditors', ranks above the average of 3) in so far as it is practically impossible to verify all transactions in an audit mission. This means that by resorting to samples, there is an inherent risk involved, which is why it is impossible for the auditors to ensure full accuracy of the information in the financial statements. Users seem not to understand how an auditor shall perform the tasks of the audit, and that usually sampling is resorted to.

We introduced within the questionnaire questions covering responsibilities that are not reviewed by the auditing standards applicable in Romania but which we found in other studies (Porter,

1993). They regard liabilities related to the reporting and presentation of illegal activities discovered during an audit. The answers to these two claims (claim 1.7, 1.9) should be considered in the context of the requirements of auditing standards applicable in Romania, which do not require the auditor to submit these aspects in his report, but advise the auditor to seek legal aid to initiate proceedings usual in this case.

The results presented lead to the idea of "rejection" of the hypothesis, regarding equal perceptions between groups, in terms of function of the statutory auditors.

5. Conclusions

This study explores the perceptions that different categories of users of audit reports have on the responsibilities of statutory auditors and to the way they understand the information in the auditor's report. Analysis of these perceptions actually seeks to identify differences in expectations on statutory audit work in Romania.

The study highlights that there are significant differences between different categories of respondents in the survey on both responsibilities of auditors and the manner in which they understand the information in the audit report. Thus we should note that some components of this concept that we talked about in the literature analysis are valid in the environment in Romania. Thus we have identified some exaggerated expectations (irrational) such as those related to verification of all transactions or fully guarantee the correctness of the financial statements. From our standing-point, we believe we can also talk about poor standards and we have in mind here the problems caused by understanding the concept of the materiality, whose level would be beneficial if it were stated by the auditors in the audit report in this way each user having the possibility to make decisions advisedly. Thus, users of the audit report would have the possibility of appreciating the suitability of the materiality threshold size from case to case.

In our view, this situation may be improved through different strategies, of which most likely to succeed being: i) educating the users on the role and actual duties of auditors; ii) by expanding the scope of the audit to meet market expectations. Education may help in solving the misconception problem. Expanding the scope of an audit may help to improve the expectation gap. It is hoped that by implementing both approaches, the public expectations and the auditors' duties will be better attuned.

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