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Regulatory Effectiveness on Auditing and Taxation, Corporate Reporting and Contemporary Issues

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President's Message

I am delighted to share this message to the third Research Journal of the Institute of Chartered Accountants of Sri Lanka (CA Sri Lanka).

CA Sri Lanka has always taken the leadership as a professional accounting organization and played an influential role in developing the profession in the current climate of several challenges in regulatory and technological areas.

With this objective in mind, the Institute ventured into research activities with the aim of further enhancing the profession which will also have a positive bearing on not our profession alone but also our country as a whole.

Transformation and disruption are words that are very relevant to our profession in the current context, and there is an underlying need to focus on research and to be privy to these changes that are taking place revolving our profession. It is important for us as a profession to adapt to these changes, if we are to remain relevant and be in demand. Our third Research Journal is part of a continuing endeavor to help our members understand the importance and requirement of remaining pertinent despite the challenges.

This publication carries eight research papers covering Corporate Reporting, Contemporary Issues and Regulatory Effectiveness on Auditing and Taxation. I believe this journal will be very insightful to the readers, while also giving them an important perspective on these pertinent areas which are most relevant to the accounting profession today.

Any publication needs a commitment team, and the journal is the result of the hard work from a cross section including that of the committee and contributors. Therefore, I wish to express my sincere appreciation to the Research Committee led by its chairman Mr. Nishan Fernando and the members, as well as the researchers and the staff who have all contributed to ensure the success of this publication.

Jagath Perera
President
The Institute of Chartered Accountants of Sri Lanka

09th December 2019

Chairman's Message

It is my honour and privilege to issue this message in my capacity as the Chairman of the Research Committee for the CA Journal of Applied Research, which is published for the consecutive third year. This Journal carries 8 research papers on contemporary issues in relation to the accounting profession which will be presented at the conference. The key areas addressed in this Journal are Corporate Reporting, Contemporary Issues and Regulatory Effectiveness on Auditing and Taxation.

Research is an area which is somewhat lacking in most professional accounting curricula but is an important element that a comprehensive professional accountant should possess. I am certain that this initiative will open new avenues for CA Members, CA Students, SAB Graduates as well as Academia to engage in research and publish the research papers in a recognized research journal.

I have been fortunate to have an excellent committee and immense blessings of the President, Vice President and the Council. The contribution made by Dr. Roshan Ajward, Editor in Chief in getting this journal at this level of quality is invaluable. It is also my pleasure to appreciate the excellent coordination of all activities connected to the journal and the conference displayed by Mr. Thilan Malinga, Secretary to the Committee. I trust that the research papers will provide valuable findings in the respective areas which could be useful in various means. I am certain that this initiative would prosper in the coming years.

I wish the research conference all success.

Nishan Fernando
Chairman
Research Committee

09th December 2019

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INVESTORS' PERCEPTION AND AUDIT EXPECTATION- PERFORMANCE GAP (AEG) IN THE CONTEXT OF LISTED FIRMS IN SRI LANKA

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Abstract

Corporate failures around the globe in recent times have placed the auditing profession in the spotlight. The profession is beset by confusion and crises caused by the differences in the beliefs held by auditors and the public concerning the auditor's duties, which have even led to lawsuits against auditors. This situation is the result of what is known as the 'Audit Expectation–Performance Gap' (AEG). In the light of the contemporary importance of the subject, lack of theoretical underpinnings of the causes of AEG and the dearth of studies on it in Sri Lanka, the present study attempts to ascertain the status of AEG and to examine the factors contributing to AEG, in the Sri Lankan context. A positivist approach was adopted and a structured questionnaire survey done involving professional auditors and investors of listed firms. The results of independent sample *t*-test indicated a statistically significant difference between the perceptions of professional auditors and investors regarding the duties of auditors in the context of listed firms in Sri Lanka. The relative contribution to the overall AEG was that much of the gap (50 per cent) in AEG was attributable to deficient standards, 16 per cent to unreasonable expectations of society about auditors' duties, and 34 per cent was due to the perceived sub-standard performance of auditors. On the other hand, in terms of the contributory factors, the mean ranking with one sample *t*-test results found that 12 factors contributed significantly to AEG. The main contributory factors highlighted by respondents were the lack of auditing education and lack of auditing experience among users. Thus, as regards policy implications, it was noted that policymakers and regulators need to increase community awareness through audit education to reduce AEG in Sri Lanka as one of the main measures.

Key words: Audit Education, Audit Expectations Gap, Duties of Auditors, Factors, Institutional Theory, Porter Model (1993).

1. INTRODUCTION

1.1 Introduction

Accounting is the “process of identifying, recording, and communicating economic information to interested parties for their decision making” (Kumar & Sharma, 2005, p.5). In addition, auditors examine the final output of the accounting system, and on the basis of his/her examination and accumulated audit evidence, express their impartial opinion on

whether the accounting information is properly recorded and reflects fairly the financial affairs of the firm (Gray & Manson, 2010; Adeniji, 2004). The firms' owners have to rely on external audits in order to gain a 'reasonable assurance' that the financial statements are free of material misstatements and that they present a true and fair view of the affairs of the company (CA Sri Lanka, 2017). Thus, statutory audits can benefit shareholders, who have specific expectations regarding the scope of the statutory audit and auditors' services. This has been proven in the past in the case of listed firms (Ruhnke & Schmidt, 2014). The Securities and Exchange Commission of Sri Lanka, having recognized the importance of the role of the external auditor, especially in the case of listed companies that come within its purview, requires the companies to maintain complete and accurate financial reports on a continuing basis (CA Sri Lanka, 2004). It has been noticed, however, that in the context of listed firms in Sri Lanka, there may be differences in the views of auditors and of investors. Thus, auditing has been largely recognized as a 'social phenomenon' because its functions are constantly subject to change, depending on the outcome of interactions between the auditing profession and the public (Power, 1998). Further, Shelahi et al. (2009) have pointed out that the auditor is essentially entrusted with the task of reporting reality in financial statements and this is what the users really expect from the accounting information. However, the auditors may not deliver this reality and so the results may differ from user expectations (Porter, 1993). This difference in expectations from an audit is broadly considered as an audit expectation-performance gap (AEG). On many occasions, users of financial statements may consider an auditor's report to be unclear. When this happens, an expectation gap occurs because there are differences between what society expects from the auditor and what the auditor actually provides (Shelahi et al., 2009).

Following the exposure of unexpected corporate collapses (Enron, WorldCom, Tyco International, Parmalat, Arthur Andersen, etc.) as well as frauds, financial scandals and 'retouched' audited reports widened AEG, prompting debates on the global stage with waves of questions being raised regarding the duties of auditors (Osazevbaru, 2018). Further, some auditors in Sri Lanka also were also brought to court in the recent past and the auditors' duties were questioned. In addition, the fall of Sri Lankan companies including Pramuka Savings Bank, and Golden Key Credit Card Company caused considerable harm to the auditing profession in Sri Lanka (Gunathilaka, 2012).

Numerous studies of AEG have been conducted since 1970 in many countries of the world. But they have only learned about the existence, structure, and components of AEG (Osazevbaru, 2018; Masoud, 2017; Ruhnke & Schmidt, 2014; Porter et al., 2012). Though the long existence of AEG had been acknowledged, its causes had not been identified properly by either auditors or researchers. This stands as evidence of the auditing profession's inability to bridge the gap (Shakish & Thalha, 2003). This study attempts to ascertain the investors' perception of the Audit Expectation-Performance Gap (AEG) in Sri Lanka.

1.2 Problem Justification and Problem Statement

The gap between society's expectations of auditors and society's perception of their performance has been and continues to be an important issue for the auditing profession (Osazevbaru, 2018).

1.2.1 Existence of AEG and Its Consequences

In the early 1970s, Liggio first used the word ‘Audit Expectation Gap’ in the literature, and it continues to be discussed until today (Porter, 1993). In a review of AEG, it was noted that AEG is not new nor is limited geographically (Porter et al., 2012). Numerous empirical studies have been done in many countries on the issue of AEG internationally (Osazevbaru, 2018; Masoud, 2017; Ruhnke & Schmidt, 2014). Some of them have also confirmed the existence of AEG in Sri Lanka (Kumari et al., 2017; Gunathilaka, 2012; Abayadeera, 2005). Based on the literature review performed by the authors, AEG has a long history and its pervasiveness of AEG is not in doubt.

AEG diminishes the value of the accounting information that can potentially make an important contribution to decision making. If users do not have sufficient confidence in audit reports, they will certainly disregard them when making decisions (Osazevbaru, 2018). AEG tends to diminish the value of the audit report that is expected to confirm that a true and fair view of a company’s financial affairs is being presented in its financial statements. This can have negative repercussions for the company concerned because both society and the Companies Act accord great importance to the audit report. Therefore, the value of a financial audit depends on society’s confidence in the audit function (Ruhnke & Schmidt, 2014). Further, Lee et al. (2009) reviewed the reliability and credibility challenges to the audit function and the auditing profession resulting in large- scale corporate financial scandals in and the collapse of many multinational corporations shortly after clean audit reports were issued on them. Similarly, Ojo and Akkeren (2017) pointed out that AEG is an issue that is detrimental to the auditing profession because the greater the gap in expectations, the lower is the credibility, earning potential and prestige associated with auditing work. Further, AEG is an issue not only for auditors in general but also for the public and investors in particular, since wealth creation and political stability depend heavily on confidence and accountability; and it is an independent external audit that is supposed to provide such confidence and accountability (Ojo & Akkeren, 2017).

Furthermore, there is evidence of the existence of AEG in Sri Lanka. According to Arjuna Herath, a past President of CA Sri Lanka and a Partner of Ernst and Young Sri Lanka, auditors are causing the profession some distress and creating an expectations gap. “AEG will undermine the reputation and credibility of the entire profession. This expectation deficit will lead to a trust deficit that could undermine the entire financial system” (Deven, 2016, p.4).

Accordingly, the foregoing observations indicate that AEG exists in both developed and developing economies and in both cases it arises from differences in beliefs between auditors and users regarding the duties of auditors. The pervasiveness of AEG is proving to be a huge issue to the auditing profession. The widening AEG causes a lot of harm to the reputation of the auditing profession. If the profession is serious about addressing the problems relating to the expectations gap, it needs to acknowledge the reasons for such a gap (Porter et al., 2012).

1.2.2 Reasons for the Audit Expectation-Performance Gap

Different studies have examined the different reasons for AEG (Masoud, 2017; Enes et al., 2017; Litjens, Buuren & Vergoossen, 2015). In fact, over time many scholars have canvassed for an expanded auditor’s report to address the expectation gap (Litjens et al., 2015). However, Bik and Wijnmaalen (2017) pointed out that even in an extended audit report, it is

impossible to see how the audit firm conducted the audit and therefore, it is difficult to assess the audit quality in order to reduce the gap. Gold, Pott and Gronewold (2012) have also confirmed that an AEG will still exist in the new auditor's report. Further, they have suggested that "wording changes alone are not the solution needed to overcome the expectations gap, possibly because users' demands are based on rather entrenched preconceptions" (p.7). It has been suggested in some studies that the expectation gap can be narrowed by public awareness of the nature and limitation of an audit and that it is lack of education that has made the public harbour a wrong notion about audit (Enes et al., 2017). In contrast, Humphrey et al. (1993) argued that it was not proper to expect the public to abandon their hope in auditors through education, or modify the length of the audit report, or pretend that highly publicized audit failures are exceptions. Gray and Manson (2010) also emphasize that the audit expectation gap is caused by the unrealistic expectations of the public while Pierce and Kilcommins (1996) argue that misinterpretation and misunderstanding on the part of users of the financial reporting method are responsible for the existence of AEG.

Further, several studies that examined the reasons for AEG identified the following factors as causing the expectation gap after reviewing the extant literature: the complex nature of the audit function, lack of audit education, the conflicting role of auditors, technical wording in the audit report, retrospective evaluation of auditors' performance, time lag in responding to changing expectations, the self-regulation process of the auditing profession and unreasonable expectations (Masoud, 2017; Lee, Ali & Kandasamy, 2009).

The extant studies discussed above have yielded mixed findings regarding the causes of AEG, making it difficult to draw clear conclusions. As mentioned earlier, even though the prolonged existence of AEG had been acknowledged by many, its causes had not been identified properly by either regulators or researchers.

In addition, a few researchers have also explored and quantified AEG in Sri Lanka (Kumari et al., 2017; Gunathilaka, 2012; Abayadeera, 2005). The preliminary literature review reveals a dearth of research on assessing AEG in the Sri Lankan context. The models used in previous studies to measure AEG have not been updated in line with recent changes in the accounting and auditing regime. Moreover, a review of the extant literature indicates that factors contributing to AEG have not been examined according to a broad-based theory. Contributory factors mainly reviewed in the present study are based on elements of Institutional theory, such as coercive, normative and mimetic isomorphism (DiMaggio & Powell, 1983). Further, factors affecting AEG have not been adequately examined, particularly in the South Asian context. Most of the AEG studies have focused on establishing whether or not a gap exists in the country where the study was undertaken and in identifying some of the contributory factors. The studies by Lin and Chen (2004) in China, and by Haniffa and Hudaib (2007) in Saudi Arabia (Ruhnke & Schmidt, 2014; Porter et al., 2012) are two notable examples.

Thus, in view of the contemporary importance of AEG, the lack of theoretical underpinnings of the causes of AEG and the dearth of studies on it in Sri Lanka, the present study attempts to assess the status of the audit expectation-performance gap among auditors and investors in the Sri Lankan context and to examine the factors contributing to such a gap. Accordingly, the problem statement of this study is: "whether there is an Audit Expectation-Performance Gap in the context of listed firms in Sri Lanka and if so, the causes for such a gap?".

1.3. Research Objectives

Based on above problem statement, the research objectives of the study could be stated as follows:

- i. To ascertain whether there is any difference between auditors' perceptions and investors' perceptions regarding auditors' duties in listed firms in Sri Lanka.
- ii. To determine whether there is an Audit Expectation-Performance Gap (AEG) in Sri Lanka.
- iii. To examine the significant factors that impact on AEG in Sri Lanka.

2. LITERATURE REVIEW

This section discusses the regulatory background of accounting and auditing in Sri Lanka, providing the history and background of auditing regulations, theoretical perspectives of the Audit Expectation-performance Gap (AEG). Then it presents on expectations about performance of duty and analyzes the AEG based on previous research studies of the auditing environment in order to present evidence of the existence of an audit expectation gap in Sri Lanka and in the international context too. The next part elaborates on the factors that contribute to the gap, including theoretical foundations and its empirical studies.

2.1 Regulatory Background of Accounting and Auditing in Sri Lanka

Sri Lankan accounting and auditing systems were directly influenced by the British, and more recently by International Conventions and Practices. In 1948, the newly independent country of Ceylon did not automatically accept the inherited arrangements as adequate and so a post-independence Commission recommended the creation of an indigenous professional accountancy body with improved financial reporting requirements (Asian Development Bank, 2002). The statutory framework established the requirements for accounting and auditing standards and other legal requirements according to which all listing companies had to prepare and present their financial statements. It also empowers CA Sri Lanka to adopt suitable accounting and auditing standards from time to time. On the other hand, external auditors play a key role in the listed companies. The above mentioned statutory requirements which recognized the importance of the role of the external auditor, especially in the case of listed companies that come within its purview, require the companies to maintain complete and accurate financial reports on a continuing basis (SEC, 2004). Thus, it has published guidelines to assist listed companies to easily determine the criteria for selecting their external auditors and also provided guidance to these companies on managing conflict of interest situations that may be prejudicial to the company and its stakeholders.

2.2 Auditors' Duties

The legal obligations of auditors require them to follow the statutory framework based on the prevailing laws and regulations relating to accounting and auditing. The set of financial statements of every listed firm is audited by a member of the Institute of Chartered Accountants of Sri Lanka holding a certificate to practice issued by CA Sri Lanka. The auditors assure in their audit report that the audit has been conducted in accordance with the Sri Lanka Auditing Standards and that the financial statements have been prepared and presented in accordance with Sri Lanka Accounting Standards (CA Sri Lanka, 2017).

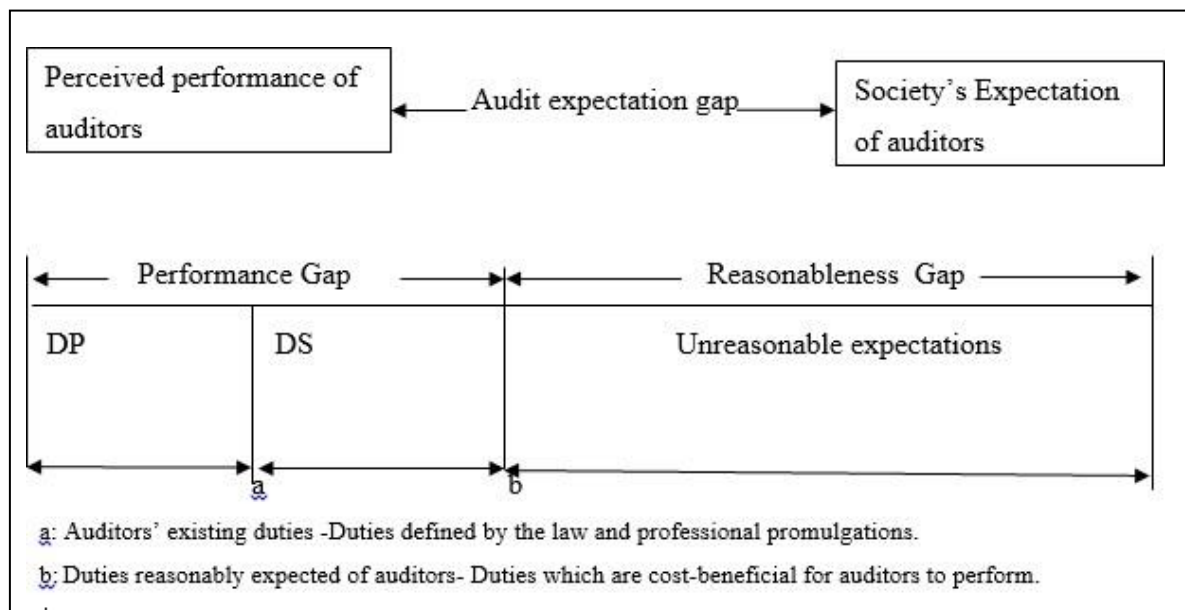
The duties of external auditors have been identified by researchers and professional bodies (Masoud, 2017; Porter et al., 2012; Porter, 1993). The areas of major concern to most people were fraud detection, assurance of a going concern, guarantee of the accuracy of financial information, and reporting to the regulatory authorities. As a result, many changes have been made to expand the role and the responsibilities of an auditor. Almost all studies have recognized that with respect to fraud and going concern reporting, the auditor should play a more active and responsible role. The studies also assert that the duties of auditors need to be changed in accordance with changes in the regulatory environment.

2.3 Audit Expectation-Performance Gap

Liggio (1974) defined AEG as “the difference between the actual and the expected performance”. This definition was extended by the Cohen Commission on auditors’ duties in 1978, where the expectation gap is represented as the gap between the performance of auditors and the expectations of the users of financial statements. However, Porter (1993) argued that the definitions used by Liggio (1974) and by the Cohen Commission Report (1978) were quite different. She stated that Liggio, who was the first to apply the phrase ‘expectation gap’ to auditing, saw it as the difference between the levels of expected performance ‘as envisioned by the independent accountant and by the user of financial statements’. The definition of Liggio (1974) was adopted to some extent in the Cohen Commission’s (CAR, 1978) terms of reference as ‘to consider whether a gap may exist between what the public expects or needs and what auditors can and should reasonably expect to accomplish. However, it is considered that both of these definitions are too narrow in that they do not recognize that auditors may not accomplish ‘expected performance’ or what they ‘can and reasonably should’. They do not allow for sub-standard performance. Further, Humphrey et al. (1993) argued that the ‘audit expectation gap’ debate was triggered by major financial scandals that regularly placed the audit function under close public scrutiny. He defined the expectation gap as ‘a representation of the feeling that auditors are performing in a manner at variance with the beliefs and desires of those for whose benefit the audit is carried out’ (p.138). This definition is stated more narrowly as a “role perception gap”, that is, the expectations of users can be considered a predetermined notion of what auditors can reasonably be expected to provide.

As explained at the beginning of this section, in a later study, Porter (1993) arguably refined the components reported by CAR (1978) and suggested that the expectation gap can be divided into two components, namely, the audit expectations gap, which consists of the performance gap and the reasonableness gap. As for the former, i.e., performance gap, Porter (1993) referred to it as the difference between “what society can reasonably expect auditors to accomplish and what they are perceived to achieve” (p.50). In respect of the latter, i.e., reasonableness gap, Porter referred to it as the difference between “what society expects auditors to achieve and what they can reasonably be expected to accomplish” (p.50). Total AEG comprises of two components: the reasonableness gap, i.e., “the gap between what society expects auditors to achieve and what the auditors can reasonably be expected to accomplish”, p.50) and the performance gap (i.e., “the gap between what society can reasonably expect auditors to accomplish and what auditors are perceived to achieve”, p.50). The performance gap is further subdivided into “deficient standards” (i.e., the gap between the duties that can reasonably be expected of auditors and auditors’ existing duties as defined in the law and by professional promulgation), and deficient performance (i.e., the gap between the expected standard of performance of auditors’ existing duties and auditors’

performance, as perceived by society). Thus, the Porter model (1993) is a comprehensive framework for defining the components of AEG (Figure 1).



DP: Deficient Performance
 DS: Deficient Standards

Figure 1: Porter Model (1993)

Source: Porter (1993)

2.4 Empirical Studies of AEG

2.4.1 Empirical Studies in Sri Lanka

The differences in beliefs held by auditors and the public about the duties of auditors may create an audit expectation gap. This section discusses the empirical studies of AEG in the Sri Lankan context. Abeyadeera (2005) examined the Audit Expectations Gap between auditors and investors in Sri Lanka by using 12 areas of duties in examining the gap. Specifically, detection of frauds, of errors, of irregularities, and of illegal acts, investors' trust in the audit opinion, auditors' support for preparing financial statements in the management's interest, auditors' support for selecting aggressive accounting policies rather than assertive policies, adequacy of evidence, auditor's independence, auditor's honesty and impartiality, prediction of business failure and prediction of company bankruptcy (Abeyadeera, 2005). The study reported that gap is very high in the detection of frauds and errors. . Similarly, Gunathilaka (2012) examined expectation differences between auditors and society in terms of auditor responsibility, reliability of audit function and usefulness of audit. The results indicated significant perceptual differences in the detection and prevention of frauds, preparation and presentation of financial statements, assurance in financial statements, objectivity of auditors and auditor's independence in the audit function. The expectations gap is less in the case of respondents with accounting experience. Auditors' reliance on audited financial statements is less than that of the public. Gunathilaka (2012) argued that the auditor's role is of value to society. Kumari et al. (2017) concluded that "an AEG continues to exist in the Sri Lankan context, but audit education has had the effect of reducing the gap" (p.20).

All studies conducted in Sri Lanka have confirmed the existence of AEG, which was measured using the Porter (1993) model. The next section discusses the empirical studies of AEG done in the international context.

2.4.2 Empirical Studies in the International Context

The extant studies have established the existence of AEG in Sri Lanka, which has been investigated in several studies in the international context, too. Studies on AEG (Cohen Commission, 1978; Liggio, 1974) in the international context explained the foundation and origins of the expectation gap (Porter, 1993). Likewise, Porter (1993) introduced several fresh insights by proposing a formal definition of AEG, identifying its structure and composition, and measuring its component parts. This empirical study was done in New Zealand to investigate AEG. The findings of this study revealed that half the gap (50%) is attributable to deficient standards, 34% is the result of society holding unreasonable expectations of auditors, and 16% is due to the auditors' perception of sub-standard performance. In a similar context, Porter's and Gowthorpe's (2004) study also established the existence of AEG in the United Kingdom (UK) and New Zealand (NZ) in a cross-cultural analysis and a comparison of its audit expectation-performance gap with that pertaining to NZ. A mail survey was the research instrument used. Four broad interest groups were first identified. In both countries, deficient performance by auditors accounted for a relatively small proportion of the audit expectation gap and that proportion decreased sharply in NZ in a decade during which auditors' performance was monitored by a professional accounting body. Further, Porter et al. (2012) conducted a study relating AEG to the main objective of ascertaining the structure, composition and extent of AEG in the UK and NZ. Correspondingly, it found that the extent of society's unfulfilled expectations in respect of the responsibilities that constitute the reasonableness, deficient standards and deficient performance components of the audit expectation gap were greater in NZ than in the UK. Overall, AEG was nearly 40 per cent wider in NZ than in the UK. Ruhnke and Schmidt (2014) also confirmed that the prevalence of AEG in Germany had increased. The proportion of auditors confirming its existence had risen from 83.7% in 1996 to 95.5% in 2011 and in the case of public groups, from 77.1% in 1996 to 91.7% in 2011 (Ruhnke & Schmidt, 2014). Similarly, Masoud (2017) examined AEG in Libya. His study built on the frameworks developed by Porter (1993) and Porter & Gowthorpe (2004) to investigate the influence of AEG on the auditing profession in the case of Libya. The findings of the study revealed that AEG prevails and that the gap is a result of the following factors at different percentage levels. Deficiency standards and deficient performance gaps constitute 49% and 15%, respectively, of the audit expectation-performance gap. AEG is derived from society's unreasonable notion that the auditor is responsible for a significant proportion (36%) of the gap.

The above sections indicate clearly the existence of AEG in the national and international context and the classification of duties is almost similar to the Porter model in both contexts.

2.5 Factors Contributing to the Audit Expectation Gap

Institutional theory examines the processes and mechanisms by which structures, schemas, rules, and routines become established as authoritative guidelines for social behaviour (Scott, 2008). However, Institutional theory has experienced a remarkable recovery as it enters the new century as one of the most vigorous and broad-based theoretical perspectives in the social sciences. Further, Institutional theory describes how both deliberate and accidental

choices lead institutions to mirror the norms, values, and ideologies of the organizational field. As a result, organizations that meet the environment's expected characteristics receive legitimacy and prove worthy of using the resources of society and the broader environment (DiMaggio, 1991).

The expectations of stakeholders may deviate with their own insights (Porter et al., 2012). Todeva (1999) pointed out that values, beliefs, preferences, attitudes, and norms are all personal constructs that enable individuals to make sense of their cultural environment and to act according to the circumstances and predicted expectations of 'others'. Further, individuals are under the technical and normative influence of institutionalized environments. Institutions could be seen from both a structural and a social perspective. Institutional factors selected for the present study are based on elements of Institutional theory: coercive, normative and mimetic isomorphism.

Auditing is a profession (CA Sri Lanka, 2017). A profession is considered to be a societal institution that is subject to the same coercive and mimetic pressures as are organizations in which both individuals and organizations are directed by societal norms (Meyer, 2006; DiMaggio & Powell, 1983). Thus, it would seem that the coercive, normative, and mimetic elements of Institutional theory are ideal for identifying the factors contributing to AEG. Factors affecting the expectation gap may be based on the way those factors are perceived by auditors, senior management and other stakeholders. Similarly, the key determinants may be factors such as laws and regulations, corporate governance structures and auditors, compliance with standards, organizational characteristics, characteristics of the individual auditor, and partners of the audit firm. These factors correspond to some extent with the factors of Institutional theory, which some scholars have applied as a theoretical framework in the context of AEG. Institutional theorists have pointed out that the auditing profession is an institution and is affected by cultural, cognitive and regulatory pressures.

2.5.1 Empirical Studies on Factors Contributing to AEG

Little consideration has been given to the influence that institutional and cultural factors may have on the interest groups' expectations. However, two studies, those of Lin and Chen (2004) and Haniffa and Hudaih (2007), demonstrate that such factors may have a significant impact on society's expectations of auditors and its perceptions of their performance (Porter et al., 2012). Based on the extant literature, Lin and Chen (2004) concluded that the differences in the opinions and expectations of auditors and audit beneficiaries in China resulted from the unique institutional setting of auditing there. This suggests that the institutional context in which the audit function is performed may affect society's expectations of auditors and its perceptions of their performance. The findings of a study by Haniffa and Hudaih (2007) indicate that a similar conclusion may be reached in respect of cultural factors. Further, the extant literature suggests a number of other factors that affect the audit-expectation gap. Most notable among them are auditing education as suggested by Enes et al. (2017), Monroe and Woodliff (1994), and the auditor's roles and responsibilities as suggested by Porter (1993), Porter et al. (2012). The nature and meaning of audit report messages were also a factor as suggested by Litjens, Buuren and Vergoossen (2015), and Salesi et al. (2009). Another factor was audit independence as proposed by Lee et al. (2009), and Lin and Chen (2004). With so many factors influencing AEG, Humphrey et al. (1993) found it necessary to classify them into four main categories: audit assurance, audit reporting, audit independence and audit regulation.

However, it seems that factors suggested as being responsible for AEG in previous studies have yielded inconclusive results regarding the reasons for AEG in later studies. Further, the lack of theoretical underpinnings can be observed in the reasons for AEG.

2.6 Theoretical and Empirical Gap

The extant literature shows that AEG has been investigated in several national and international studies. This gap in the beliefs of auditors and the public had to do mostly with the auditors' duties and responsibilities. The results indicated that AEG persists and is, in fact, widening.

Most of the researchers have also examined and explored AEG using several models (Fulop, 2015; Lee et al., 2009; CICA, 1998; Porter, 1993). The model introduced by Porter in 1993 is probably the best to define the components of AEG. However, it seems that most of the duties identified by Porter (1993) and others have not been updated to suit the current accounting and auditing environment that had been subjected to an evolution. The duties of auditors need updating according to the new and revised standards and newly introduced code of ethics. In this study, Porter's model was updated for measuring AEG taking into consideration the duties after a major revision of auditing standards and new codes of ethics.

On the other hand, reporting the presence of AEG also suggests the need to identify the factors that might have contributed to the gap and feasible ways to narrow it (Enes et al., 2017; Humphrey et al., 1993). While most AEG studies conducted since 1970 have focused on whether or not a gap exists in the country where the study was undertaken and on empirically identifying some of its contributing factors. Those of Lin and Chen (2004) in China and Haniffa and Hudaib (2007) in Saudi Arabia indicate that institutional and cultural factors may have a significant impact on interest groups' expectations of auditors and their perceptions of auditors' performance (Porter et al., 2012). However, the extant literature suggests the presence of a number of other factors as well that affect AEG. But the findings of these studies are inconclusive. Thus, uncovering the factors contributing to the expectation gap is one of the main objectives of this study. However, the theoretical foundations of AEG are not covered in the extant studies. Osazevbaru (2018) pointed out that theoretical underpinnings have helped to illuminate the factors contributing to the expectation gap (Osazevbaru, 2018).

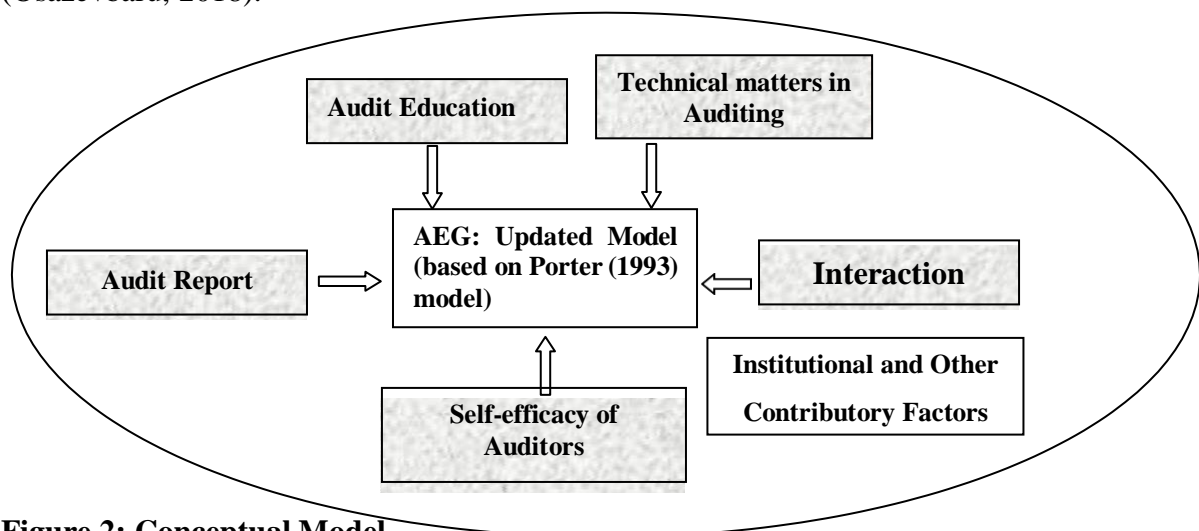


Figure 2: Conceptual Model

Source: Constructed by Authors

On the other hand, reporting the presence of AEG also suggests the need to identify the factors that might have contributed to the gap and feasible ways to narrow it (Enes et al., 2017; Humphrey et al., 1993). While most AEG studies conducted since 1970 have focused on whether or not a gap exists in the country where the study was undertaken and on empirically identifying some of its contributing factors. Those of Lin and Chen (2004) in China and Haniffa and Hudaib (2007) in Saudi Arabia indicate that institutional and cultural factors may have a significant impact on interest groups' expectations of auditors and their perceptions of auditors' performance (Porter et al., 2012). However, the extant literature suggests the presence of a number of other factors as well that affect AEG. But the findings of these studies are inconclusive. Thus, uncovering the factors contributing to the expectation gap is one of the main objectives of this study. However, the theoretical foundations of AEG are not covered in the extant studies. Osazevbaru (2018) pointed out that theoretical underpinnings have helped to illuminate the factors contributing to the expectation gap (Osazevbaru, 2018). Institutional theorists have pointed out that the auditing profession is an institution and is affected by cultural, cognitive and regulatory pressures. According to a conclusion derived from a selection of factors contributing to AEG, it became clear that institutional theory is one of the prominent theories used for a study of the factors contributing to AEG.

Based on the theoretical and empirical gap discussed above, the conceptual framework of this study was constructed to fill the gaps (Figure 1). The selection of factors contributing to AEG was mainly based on Institutional theory, which is the overriding theoretical contribution to this study. Further, an updated model for measuring AEG was introduced that took into consideration the duties after a major revision of auditing standards and new codes of ethics were introduced. Furthermore, there is also a dearth of research on assessing AEG in Sri Lanka. This study explored and quantified the audit expectations gap in Sri Lanka using the Porter Model introduced in 1993 (Kumari et al., 2017; Gunathilaka, 2012; Abayadeera, 2005). However, New and Revised Auditing Standards were introduced in 2010, 2012, and 2017 to enhance the quality and uniformity of the practice worldwide (CA Sri Lanka, 2017). As a result, corresponding duties were passed on to the auditor and managers of entities. They need to take all necessary steps to comply with current auditing requirements. Assessing the audit expectations gap in the theoretical and current regime in Sri Lanka is important for building a favorable image of the auditing profession. Accordingly, based on these observations, the following hypothesis is developed and tested in this study;

H₁: There is a gap between investors' perceptions of auditors' duties and their perception of what auditors actually do.¹

3. METHODOLOGY

This section elaborates on the methodology adopted in addressing the research objectives discussed under Section 1.2 i.e., to ascertain whether there is any difference between auditors' perceptions and investors' perceptions of auditors' duties in listed firms; to examine the status of AEG among auditors and investors; and to examine the significant factors that impact on AEG in the Sri Lankan context. A positivistic research approach was deemed appropriate for achieving the aforementioned objectives and is also supported in the extant literature (Lee et al., 2007; Lin & Chen, 2004). The population of this study included

¹This study considers the stakeholder group: investors as the main constituent due to the importance in the context of listed companies.

practicing auditors (i.e., audit partners, senior audit managers, audit managers, assistant audit managers, audit supervisors and senior auditors) and investors in listed firms in Sri Lanka. Contact details of investors were obtained via stockbrokers that the researchers had contacted. Questionnaires were administered among 200 practicing auditors (the response rate was 81 per cent) and among 200 investors (the response rate was 94 per cent). Further, Section 03 of Part Two of the questionnaire was given to 200 company officers (auditees) in order to measure the reasonableness of auditors' duties. The convenience sampling method was used to select the sample. Population so as to ensure its representativeness of the target population. Part one of the questionnaire was on demographic information of the respondents. Part Two of the structured questionnaire listed 49 duties (i.e., duties 1 to 20 captured the deficient standards gap; 21 to 35 deficient performance gap; and 36 to 49 the unreasonable expectation gap) among auditors (see Appendix 1) as identified by the authors based on the definition of Porter (1993) and updated; the opinions of the respondents were obtained as to whether such duties are auditors' existing duties (Section 01), the level of auditors' performance of these duties (Section 02), and whether such duties should be performed by the auditors (Section 03). Accordingly, Section 01 was based on whether the listed duty 'is' or 'is not an existing responsibility' of auditors, or whether the respondent is 'Not sure', which were coded as +1, -1 and 0, respectively. When the mean of an interest group's responses is positive, it indicates that the group considered that the responsibility is, or should be, (as applicable) a responsibility of auditors. Then, if a respondent had considered a particular duty as an existing duty of auditors' (by indicating 'is' under Section 01), then under Section 2, the respondent is asked 'how well is it performed'. The respondents rated such information on a Likert scale from 'poorly' (1) to 'excellently' (5) performed. Finally, Section 03 inquired about 'Should the duty be performed by auditors?' The answers were 'Yes' (+1), 'No' (-1) or 'Not certain' (0). Part Three of the structured questionnaire listed 19 factors (i.e., lack of auditing education among users, lack of audit experience among users, etc.). In respect of the factors that contributed to AEG, the respondents were asked to select the appropriate response from the choices: 'not applicable', 'strongly disagree', 'disagree', 'average', 'agree', and 'strongly agree'. Once the questionnaire was formulated based on a comprehensive survey of the literature, it was submitted to two academic and professional experts for and their expert opinions, which were used to revise and update the questionnaire. Finally, the questionnaire was pilot tested before it was circulated among the professional auditors and investors. These measures were taken to ensure the validity of the questionnaire.

In terms of the analysis, descriptive statistics was used to understand the demographic profiles of the audit professionals and investors. Next, the independent sample *t*-test was used to test the differences of opinion between the groups, the AEG was analyzed based on the updated model (based on Porter (1993) model) that was introduced in this study and examine the significant factors contributing to AEG examined through mean ranking and the one sample *t*-test to test whether the mean values were significantly different from the neutral value '3' in the 5-point Likert scale.

If significant differences are found between auditors and investors, it may be claimed that an expectation gap exists. Then, AEG is measured in terms of deficient performance, deficient standards and unreasonable expectations based on the updated model (based on the Porter (1993) model). Further, statistically significant factors were identified based on the one sample *t*-test that had contributed to the AEG. The next section presents the findings secured by following the methodology suggested under this section.

4. RESULTS AND DISCUSSION

This section presents the results of the analyses and a discussion of the findings.

4.1 Descriptive Analysis

This section elaborates on the demographic profile of professional auditors. In terms of sample characteristics of professional auditors (not tabulated due to parsimony), the majority of the sample are audit managers (48.4 per cent) while audit partners comprise a minority of 5.0 per cent. 50.9 per cent of the practicing auditors are from the Big 3 audit firms. In terms of gender, the majority of practicing auditors consist of males (71.5 per cent). The majority of auditors who responded had quite strong academic backgrounds, with 74.5 per cent of them having a first degree. Most of the auditors who responded gave their professional qualification as CA Sri Lanka (CA). The reason for this is that practicing auditors had to be members of CA Sri Lanka. They comprised 32 Associate Members and 05 Fellows. As for their audit experience, the majority of auditors had work experience spanning between 3 to 5 years (51.9 per cent). In addition, the majority possessed work experience in their present position of more than one year (40.5 per cent). Further, more than 72.3 per cent of professional auditors belonged to the age group of 21 to 30 years. Furthermore, in terms of the demographic profile of investors, the majority of investors were males (71.8 per cent). The majority of investors who responded had quite strong academic backgrounds, with 41.9 per cent having a first degree. In terms of professional qualifications, 17 investors were members of one or more professional bodies and the majority of investors had a fair knowledge of external audit (52.0 per cent). Further, it was noted that more than 49.7 per cent of the investors represented the age group between 31 to 40 years. The majority of investors had invested in the service sector (55.6 per cent). In terms of monthly gross income, the majority of investors earned below Rs. 50,000 (35.2 per cent).

4.2 Analysis of Differences between Auditors' and Investors' Perceptions regarding Auditors' Duties

As discussed earlier, the present study selected 20 duties as existing duties of auditors (deficient performance) based on the extant literature, expert opinions, Sri Lankan law, rules and professional promulgations and following the definition of Porter (1993). Part 'Two' Section 01 of the questionnaire refers to 49 duties with 20 actual existing duties of auditors. This section was designed to ascertain whether there is a difference between auditors' and investors' perceptions regarding the existing duties of auditors, performance of duties of auditors and duties that auditors should perform. Independent sample *t*-tests were performed to determine the statistical differences between professional auditors' and investors' perceptions regarding the existing duties of auditors, performance of duties of auditors and duties that auditors should perform.

The results of an independent sample *t*-test (Table 1) indicated statistically significant differences ($p < 0.05$) between professional auditors and investors in all existing duties of auditors (Section 01 of the questionnaire) other than the duty to report on the financial statements, and communicate as required by the Sri Lanka Auditing Standards (SLAuSs), in accordance with the auditor's findings (2), to detect illegal acts by company officials which directly affect the company's accounts (4) and to report in the published audit report the early application of new accounting standards (17).

Table 1: Mean Differences – Professional Auditors and Investors Regarding Auditors’ Duties

Duties ¹	Section 01	Section 02	Section 03
1	.348**	.952**	.284**
2	.167	.833**	.209*
3	.214*	1.132**	.117
4	.183	1.179**	.098
5	.302**	1.232**	.336**
6	.471**	1.157**	.223**
7	.352**	1.247**	.385**
8	.363**	1.191**	.234**
9	.445**	1.146**	.232**
10	.314**	.898**	.230**
11	.542**	1.116**	.514**
12	.556**	1.374**	.499**
13	.498**	.945**	.477**
14	.438**	1.045**	.335**
15	.418**	.950**	.250**
16	.631**	1.302**	.519**
17	.064	1.113**	.111
18	.254**	.716**	.159
19	.498**	.842**	.533**
20	.612**	1.221**	.342**

¹See Appendix 1 - Duties of External Auditors

Section 1: Auditors’ Existing Duties; Section 2: Performance of Duties of Auditors; Section 3: Duties that Auditors should Performed

**p<0.01; *p<0.05

Source: Constructed by Authors

It is noted a statistically significant difference ($p<0.05$) exists between professional auditors and investors in regard to auditors’ performance of all of their existing duties (Section 02 of the questionnaire). Further, there are significant mean differences ($p<0.05$) between auditors and investors in respect of nearly all existing duties of auditors (Section 03 of the questionnaire) except the following duties: disclosing in the audit report a deliberate distortion of financial information (03); detecting illegal acts by company officials which directly affect the company’s accounts (04), duties of SLAUS 706: report in the published audit report early application of new accounting standards (17), report in the published audit report any major catastrophe, or a significant effect on the entities’ financial position (18).

Table 2 presents the results of the analysis on the mean difference between auditors and investors in all three sections (Objective One).

Table 2: Overall Mean Difference between Auditors and Investors

Sections	Mean Difference
<i>Section 01: Are auditors required to perform this duty?</i>	.137**
<i>Section 02: Extent to which existing duties are performed well.</i>	.983**
<i>Section 03: Should auditors perform this duty?</i>	.146*

*p<.05; **p<.01

Source: Constructed by Authors

The results of independent sample *t*-tests (Table 2) indicate that there is a statistically significant difference ($p < 0.05$) between professional auditors and investors in terms of all three sections i.e., recognizing existing duties, performing duties of auditors, and duties that auditors should perform. These findings are consistent with the extant literature (Masoud, 2017, Porter et al., 2012, Porter, 1993).

4.3 Audit Expectation-Performance Gap

Both groups correctly identified the 20 existing duties of auditors. Perceived sub-standard performance by auditors was identified by applying two measures: the mean of interest group responses of 2.9 or less and 20 percent or more of a stakeholder group (i.e., investors) signifying that auditors perform their duties poorly (Porter, 1993).

Table 3 shows that, by applying these two measures, the investors overall considered the standard of auditors' performance of their existing duties to be satisfactory (mean was 3.0 or above of non-deficient performance gap duties). Reviewing the duties for which the investors signaled unsatisfactory or borderline performance (Table 3), and it is pertinent to note that ten 'unsatisfactorily performed' duties were listed. According to Table 3, eight duties contributed to the deficient performance component of the audit expectation-performance gap. Further, auditors as a group acknowledged that less than 20% of auditors perform their duties poorly with respect to all of their duties. As might be expected, the group of investors acknowledged that 20% (parentages of the addition of column 'poorly' and 'can't judge' are more than 20%) or more of the auditors perform their duties poorly (Table 3).

To differentiate between the deficient standards gap and the unreasonable expectations gap, it is necessary to recognize that only certain duties can reasonably be expected of auditors. This can be explained in detail with the data in Section 03 of Part 'B' of the structured questionnaire used in this study. Although the perception of the stakeholder groups regarding the duties that auditors should (or should not) perform is interesting, this part of the research is particularly important for the guidance it provides in identifying the duties that are reasonable to expect of auditors.

Accordingly, the succeeding section explains how to analyze the duties reasonably expected of auditors. In order for the duties reasonably expected of auditors to be acknowledged as such by them, they must be cost-beneficial for auditors to perform.

According to Porter (1993) and confirmed in almost all relevant studies (Masoud, 2017; Porter et al., 2012), in the absence of a formal cost-benefit analysis, for the purposes of the research, the duties identified by both company officers (auditees), and financial community audit beneficiaries (investors) as 'duties auditors should perform' are considered as an acceptable surrogate for cost-benefit analysis².

² Further, Section 03 of Part Two of the questionnaire was given to 200 company officers (auditees) in order to measure the reasonableness of auditors' duties (The response rate is 89%).

Table 3: Assessment by Investors¹ of Auditors' Performance of Their Duties

	Mean of Responses ²	Poorly ⁴ %	Can't judge ⁴ %	Deficient Adequately %	Satisfactory %	Completely Satisfactory %	Contributing to Performance Gap ⁵ %
<i>Suggested Duties of Auditors³</i>							
Duty No. <u>Deficient Performance Gap Duties</u>							
03	2.9	04	36	31	25	04	11
04	2.8	11	29	30	23	06	11
05	2.7	18	30	23	27	02	13
11	2.9	08	31	30	27	04	10
12	2.7	13	42	17	20	09	14
16	2.6	06	57	14	17	06	17
17	2.8	10	35	21	29	05	12
20	2.9	16	32	21	14	18	12
<u>Non- deficient Performance Gap Duties</u>							
01	3.1	06	21	33	34	06	-
02	3.3	05	16	34	37	08	-
06	3.0	08	29	28	31	06	-
07	3.0	13	21	32	24	10	-
08	3.0	05	35	21	27	12	-
09	3.0	09	29	24	28	09	-
10	3.2	05	29	25	25	16	-
13	3.0	07	33	20	37	03	-
14	3.0	04	36	28	22	10	-
15	3.0	06	33	21	35	05	-
18	3.2	04	31	19	20	16	-
19	3.1	05	32	23	22	18	-

¹ Investors ²The duties as shown here are abbreviations of their description in the questionnaires (Annexure 1). ³ 2.9 has been adopted as the point of differentiation between satisfactory and unsatisfactory performance (calculated from responses to Options 1-5) ⁴ Represents the response options 'less than adequately'. ⁵ Based on the proportion of the society group who signified that auditors perform their duty poorly.

Source: Constructed by Authors

Thus, these stakeholder groups may be assumed to be reasonably knowledgeable about the audit function, but their perspectives are from the opposing direction. Company Officers (Auditees) are subject to the auditor's examination and are likely to be particularly cognizant of the costs involved. As a result, this stakeholder group may be expected to lean towards limiting the duties delegated to auditors. Financial community audit beneficiaries, on the other hand, rely on the auditor's work and are therefore likely to be particularly conscious of the benefits that may flow therefrom. Thus, in contrast to company officers (auditees), this stakeholder group may be expected to lean towards extending the auditors' duties.

An interesting (and unexpected) finding of the survey is that (not tabulated), notwithstanding the differing perspectives of auditees and financial community audit beneficiaries whose potential biases are in opposite directions, these two interest groups identified the same 49 duties as duties auditors should perform. These same 49 duties identified by auditees and financial community audit beneficiaries are identified as duties auditors should perform. On the basis of the above reasoning, all duties listed in the questionnaire are identified as duties that are reasonable to be expected of auditors. These coincide with the duties shown in Table 4 as duties auditors should perform. A detailed analysis of society expectations was done in order to validate the reasonableness of duties discussed in the next section. As observed above, duties identified by at least 20% of an interest group as duties auditors should perform are considered to warrant further examination to ascertain whether these are duties that are reasonable to expect of auditors. In the absence of a formal cost-benefit analysis, hat for the purposes of the research, the duties identified by both company officers (auditees) and financial community audit beneficiaries (investors) as duties auditors should perform are considered as an acceptable surrogate for cost-benefit analysis. Of the 49 duties qualifying for further examination, six duties were found not to be duties reasonably expected of auditors (44, 45, 46, 47, 48 & 49) as they do not meet the cost-benefit criterion explained above (Table 4).

As noted above, all 49 duties were identified by 20% or more of a non-auditor interest group as duties auditors should perform, and all accepted it in lieu of a cost-benefit test (not tabulated). It is clearly reasonable to expect auditors to perform these duties (all the listed duties of deficient standards, from No. 21 to No. 35), each of which contributes to the reasonableness gap component of the AEG in this study (Table 4).

An estimate of the relative contribution of each duty to the reasonableness gap may be derived from the proportion of the society group (all non-auditors) who stated that the duty in question should be performed by auditors (Table 4). The higher the proportion of the group that (unreasonably) expects auditors to perform the duty, the greater the level of unfulfilled expectations attaching to the duty, and thus, contribution to the reasonableness gap. The reasonableness gap and the relative contribution of each of the duties are shown in Figure 2.

Of the 49 duties that meet the cost-benefit criterion, and thus qualify as duties that are reasonable to expect of auditors, 20 are existing duties of auditors (not tabulated). Another 15 duties (satisfactory cost-benefit results for 15 duties) that can reasonably be expected but not currently required of auditors (Table 4) contribute to the deficient standards component of AEG. Auditing standards need to be extended to encompass these duties. 29 duties listed in the questionnaire (out of 49 duties), eight were found to contribute to the deficient performance gap, fifteen to the deficient standards gap and six to the reasonableness gap (see Figure 2).

Table 4: Cost-benefit Criterion for Duties of Reasonableness Gap

Duty No ¹ .	Company Officers ²	Audit Beneficiaries ³
	Mean ⁵	Mean ⁶
Cost-benefit Satisfied ⁴		
21	55	44
22	54	51
23	41	34
24	53	39
25	48	34
26	46	49
27	52	34
28	49	24
29	49	38
30	43	25
31	51	40
32	43	20
33	50	62
34	47	29
35	46	44
36	30	45
37	22	53
38	13	49
39	16	20
40	16	27
41	04	29
42	25	48
43	17	32
Cost-benefit Not Satisfied		
44	0	27
45	-5	33
46	-8	20
47	-5	40
48	-18	26
49	-7	34

¹The duties as shown here are abbreviations of their description in the questionnaires (See Annexure 1).

²Company officers (auditees) are subject to the auditor's examination and are likely to be particularly cognizant of the costs involved

³Investors: rely on the auditor's work and are, therefore, likely to be particularly conscious of the benefits which may flow therefrom.

⁴the duties identified by both auditees and financial community audit beneficiaries as duties auditors should perform provide.

⁵mean value of company officers

⁶mean value of audit beneficiaries (investors)

Source: Constructed by Authors

Members of the investors who indicated that a particular duty, not currently performed by auditors, should be performed, and those who signified that auditors perform an existing duty poorly, have expectations of auditors that are not being fulfilled. Thus, a measure of investor's unfulfilled expectations attaching to each duty contributing to the reasonableness, deficient standards or deficient performance components of the audit expectation-

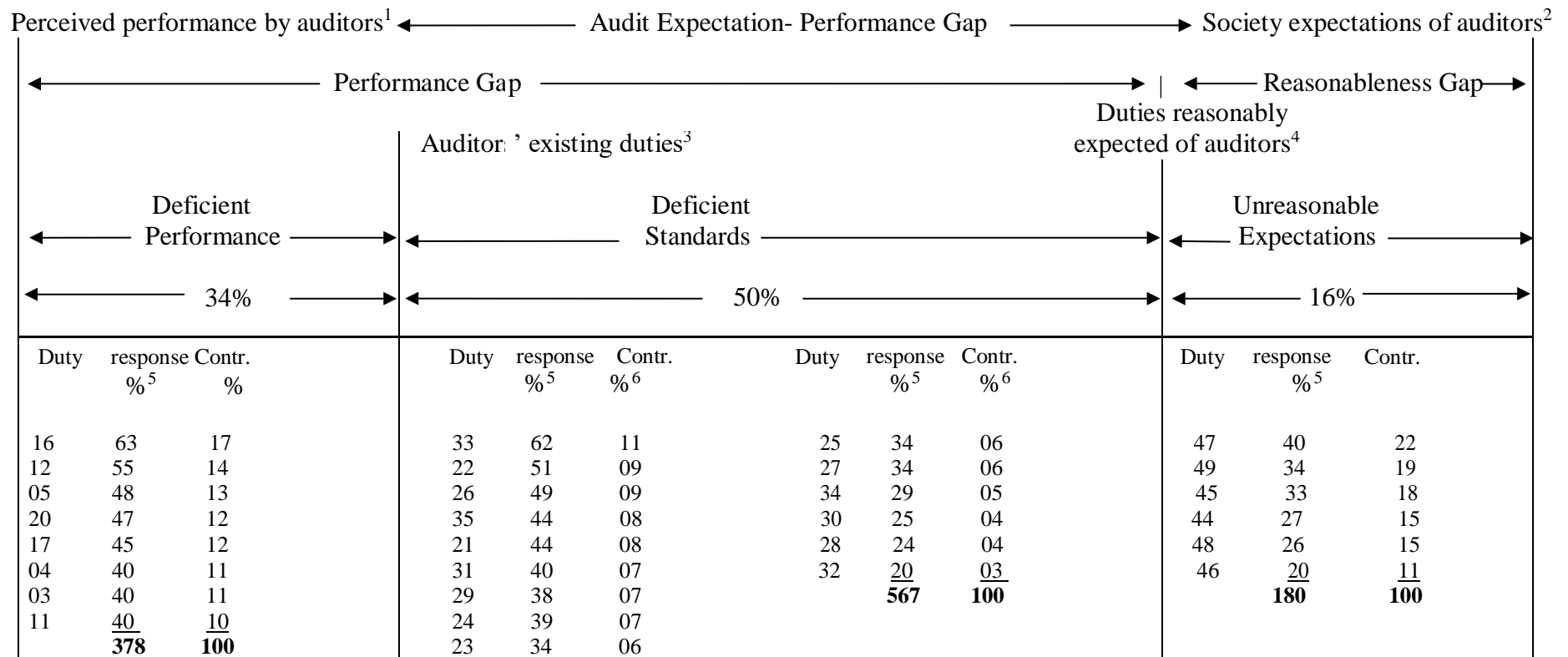
performance gap may be derived from the proportion of the investors group who indicated that a duty not currently required of auditors should be performed, or an existing duty is performed poorly. The relevant proportions for the audit expectation-performance gap's components in the are shown in Figure 2, in the columns headed 'Reasonableness gap', 'Deficient standards gap' and 'Deficient performance gap'. From this, the relative contribution of each component of the overall gap between society's expectations of auditors and auditors' perceived performance could be calculated. From Figure 2, calculated in this way, it appears that half of the gap (50 per cent) is attributable to deficient standards (i.e., $567/(378+567+180)$), 16 per cent (i.e., $180/(378+567+180)$) results from society holding unreasonable expectations of auditors, and 34 per cent (i.e., $378/(378+567+180)$) is derived from perceived sub-standard performance by auditors. It is noted that the current widespread criticism of, and litigation against, auditors is a ramification of auditors failing to meet society's expectations of them and, further, that such failure serves to undermine confidence in auditors and the work they do. If irreparable damage to the profession's standing in society is to be prevented, urgent and effective action to narrow the AEG is needed (Porter, 1993).

4.4 Analysis of Empirical Research Results Relating to Contributory Factors for AEG

The results of objective one highlighted that there is a significant difference ($p < 0.05$) between the perceptions of auditors and of other stakeholders regarding the duties of auditors in Sri Lanka. Further, the results indicate that 20% or more of investors (non-auditors) perceived auditors as performing their duties poorly. The present study found evidence of an audit expectation gap in Sri Lanka arising from differences in the perceptions of auditors and of investors. Thus, factors contributing to AEG need to be examined in order to bridge such gap. In regard to factors contributing to AEG, the nineteen factors (i.e., that were derived from a comprehensive literature survey and refined via expert opinions and pilot-testing) that were listed in the questionnaire had to be marked by the respondents on a Likert scale ranging from 'not applicable' to 'strongly agree'.

Table 5 presents the results of mean rankings with one sample *t*-test in regard to factors contributing to AEG. The mean values derived were interpreted based on the Likert scale used in the questionnaire; i.e. *not applicable*-0, *strongly disagree*-1, *disagree*-2, *average*-3, *agree*-4 and *strongly agree*-5. The main contributory factor highlighted by the respondents was the lack of auditing education among users (mean value of 3.693).

Further, significant factors highlighted include lack of auditing experience among users, higher user needs of external audit, narrow scope of external audit, lack of auditor independence, users' unawareness of new and revised auditing standards, complex nature of the audit function, lack of interaction between auditors and intended users, frequent changes in accounting requirements, lack of knowledge of auditing practitioners, too technical wording used by auditors in the audit report and self-regulation of the auditing profession. It should be noted that based on one sample *t*-test performed, 12 factors were found to be statistically significant ($p < 0.05$) with a test value of 3 and their respective mean values (Table 5).



¹Duties perceived by the society group to be performed deficiently by auditors. ²Duties expected of auditors by 20% or more of a non-auditor interest group. ³Existing duties defined by reference to the law and professional promulgations. ⁴Duties which are cost-beneficial for auditors to perform. ⁵Proportion of the society group whose expectations with respect to the duty are not being fulfilled. ⁶Relative contribution of duties to the component.

Figure 3: The Relative Contribution of Duties to Components and of Components to the Audit Expectation-Performance Gap

Source: Constructed by Authors

However, the mean value is more than 3 in respect of the following factors: lack of quality control in audit firms, time lag in responding to changing expectations, lack of information content in the audit opinion, inadequate audit methodologies of external audit and frequent changes in the ethical requirements of the auditing profession' where a statistical significance does not exist. Further, contributory factors like low auditor efforts and low auditor skills have low levels of mean value (i.e. mean value less than 3) without statistical significance.

Table 5: Descriptive Statistics of Factors Contributing To AEG

	Factors	N	Mean	SD	Min	Max
1	Lack of auditing education among users	150	3.693**	.897	0.00	5.00
2	Lack of audit experience among users	150	3.626**	.847	1.00	5.00
3	Higher user's needs of external audit	145	3.472**	.815	1.00	5.00
4	Narrow scope of external audit	148	3.335**	.905	0.00	5.00
5	Lack of auditor's independence	146	3.308**	.965	0.00	5.00
6	Users' unawareness of new and revised of auditing standards	146	3.280**	1.161	0.00	5.00
7	Complex nature of audit function	142	3.267**	.890	1.00	5.00
8	Lack of interaction between auditor and intended users	148	3.236**	1.077	0.00	5.00
9	Frequent changes in accounting requirements	146	3.198**	1.099	0.00	5.00
10	Lack of knowledge of auditing practitioners	147	3.195**	1.021	0.00	5.00
11	Too technical wording used by auditors in audit reports	149	3.187**	.995	0.00	5.00
12	Self-regulation of the auditing profession	148	3.174**	1.044	0.00	5.00
13	Lack of quality control in audit firms	148	3.162	1.166	0.00	5.00
14	Time lag in responding to changing Expectations	148	3.128	1.138	0.00	5.00
15	Lack of information content of the audit opinion	148	3.114	1.059	0.00	5.00
16	Inadequate audit methodologies of external audit	149	3.080	1.036	0.00	5.00
17	Frequent changes in ethical requirements Of the auditing profession	147	3.039	.974	0.00	5.00
18	Low auditor skills	146	2.945	.937	0.00	5.00
19	Low auditor efforts	146	2.876	1.144	0.00	5.00

^a Based on the one sample *t*-test performed; the significance of the difference between the test value of 3 and the mean values are also indicated, where ***p*<.01 and **p*<.05.

Source: Constructed by Authors

5. DISCUSSION AND CONCLUSIONS

The current study was conducted to examine whether there is an Audit Expectation-performance Gap in Sri Lanka and the factors contributing to such a gap. The present study applied a positivist approach which is deemed appropriate for achieving these objectives, which is also supported in the extant literature (Kumari et al., 2017; Masoud, 2017; Porter et al., 2012). Previous studies mostly used a structured questionnaire and was administered

among the practicing auditors and other stakeholders in collecting data (Kumari et al., 2017; Porter et al., 2012; Porter, 1993; Liggio, 1974). The duties of external auditors were identified according to the new and revised standards and newly introduced code of ethics. However, following discussions with experts in the area (leading auditing practitioners and senior auditing academics), the questionnaire was revised. Next, a pilot test was carried out to finalize the final version of the questionnaire. Thus, the survey instrument of this study included 49 suggested duties of auditors. For each of these, the respondents were asked to indicate “(i) whether the duty is an existing duty of auditors, (ii) if so, how well it is performed, and (iii) whether the duty should be a duty of auditors.” Further, the wordings of the original questionnaire were changed to make it very clear for the non-accounting respondents.

The results of the analysis strongly confirmed that there is a difference between auditors’ and investors’ perceptions regarding auditors’ existing duties, auditors’ performance of their duties and additional duties that auditors should take on, in the context of listed firms in Sri Lanka. These findings are consistent with the extant literature (Kumari et al., 2017; Masoud, 2017;; Enes et al., 2017;; Gunathilaka, 2012; Porter et al., 2012; Abeydeera, 2005; Porter & Gowthorpe, 2004; Porter, 1993). Masoud (2017) revealed “an expectation gap reflected in the perceptions of users within diverse users, and they do express the need for legal incentives and the need to adopt international standards for taking corrective action to narrow the audit expectation-performance gap more effectively” (p.13). Half of the gap (50 per cent) in AEG is attributable to deficient standards, while 34 per cent results from society (all non-auditors) holding unreasonable expectations of auditors, and 16 per cent is derived from the perceived sub-standard performance of auditors in Sri Lanka. The findings of this study are consistent with the extant literature, confirming that the deficient standards gap forms the largest component of AEG (Masoud, 2017; Porter et al., 2012: Porter, 1993).

According to the results of present study, half of the gap (50 per cent) is attributable to deficient standards, 16 per cent results from society holding unreasonable expectations of auditors, and 34 per cent derives from perceived sub-standard performance by auditors. Further, there were 12 factors significantly impacting on AEG and the main contributory factor highlighted by the respondents was the lack of auditing education and lack of audit experiences among users (Kumari et al., 2017; Pierce & Kilcommins, 1996).

There are theoretical, empirical, and practical implications in this study. In this study, an updated model was introduced to ascertain the Audit Expectation-Performance Gap based on the contemporary changes in the current accounting and auditing regimes, which is expected to derive theoretical and methodological value. Further, the contributory factors used in the study were mainly based on the broad-based theory, namely, Institutional theory. In terms of the practical implications and based on the findings of this study, relevant regulators, educators, and auditing professionals need to take necessary steps to minimize the audit expectation-performance gap in Sri Lanka. The accountancy profession, universities, other educational institutions and regulators need to build an appropriate policy framework for increasing awareness of the nature and limitations of an external audit through audit education. Further, the present study contributes to the *current* auditing literature in Sri Lanka by addressing the vital contemporary issue of AEG and causes for such a gap, and thereby attempts to fill the gap in knowledge to a certain extent.

The study is subject to certain limitations. First, the study considers only the duties of external auditors of listed firms in the CSE in determining AEG irrespective of the duties of public

sector auditors, as it was not possible to measure certain gaps with the latter. Yet, to mitigate the impact of being restricted only to the duties of external auditors, future research could test AEG by including the duties of public sector auditors in Sri Lanka, as well. Further, in terms of future research, the expectation gap among more stakeholders could be undertaken by broadening the scope of the present study. Further, AEG and contributory factors were examined only in the Sri Lankan context. Yet, to mitigate the impact of being restricted to only Sri Lanka, further research could be conducted by applying different contexts (i.e., South Asia, Developed Countries).

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Appendices

Appendix 1 – Duties of External Auditors

1. Obtain reasonable assurance that the financial statement taken as a whole are free from material (significant) misstatement, whether due to fraud or error.
2. Report on the financial statements, and communicate as required by the Sri Lanka Auditing Standards (SLAuSs), in accordance with the auditor's findings.
3. Disclose in the audit report deliberate distortion of financial information.
4. Detect illegal acts by company officials which directly affect the company's accounts.
5. Disclose in the audit report illegal acts which directly affect company's accounts.
6. Verify the accounting estimates in the financial statements which are material (significant).
7. Comply with Code of Ethics for professional accountants.
8. Maintain confidentiality and safe custody of the audit working papers.
9. Express doubts about the solvency of the company under audit in the published auditor's report (if applicable).
10. Express an opinion on whether the financial statements are prepared, in all material (significant) respects, in accordance with an applicable financial reporting framework.
11. 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.
12. 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. Examine the other information in the company's published annual report (e.g. the director's statement) to determine the existence of material (significant) inconsistencies with the audited financial statements.
14. Identify and assess of risks of material (significant) misstatement whether due to fraud or error, at the overall financial statement level and the individual balances and transactions level.
15. Obtain an understanding of an entity and its environment (information system; business process, financial reporting and communication) including entity internal control.
16. Report in the published audit report uncertainty relating future outcomes of exceptional litigation or regulatory action.
17. Report in the published audit report of early application of new accounting standards.
18. Report in the published audit report of a major catastrophe with a significant effect on the entities' financial position.
19. Determine whether the comparatives comply in all material (significant) respects with the financial reporting framework applicable to the financial statements being audited.
20. Disclose (based on audit evidence) whether a material (significant) uncertainty exists about events or conditions that may cast significant doubt on the entity's ability to continue as a going concern (i.e., the ability to operate for a foreseeable future period).
21. Examine and report on the company's internal controls.
22. Examine and report on the fairness of financial forecasts in the financial statements.
23. Disclose in the audit report embezzlement of auditee's assets by directors/senior management.
24. Examine and report to auditee's directors (or equivalent personnel) on the adequacy of auditee's risk management procedures.
25. Report to the relevant authorities that the auditee had engaged in bribery (i.e., of local or foreign government officials for purposes of securing large contracts), fraud or corruption.

26. Report to the relevant authorities of regulated entities about matters of such significance as to affect their license to operate.
27. Report to the relevant authorities of entities listed on the securities exchange that the matter could result in adverse consequences in the fair and orderly market in the entity's securities or pose a systemic risk into the financial markets.
28. Report to relevant authorities regarding the products that are harmful to public health or safety would likely be sold by the entity.
29. Report to relevant authorities when the auditee is promoting a scheme to its clients to assist them in evading taxes.
30. Report significant breaches of environment laws and regulations to the appropriate authorities.
31. Report to relevant authorities that the auditee engaged in money laundering, terrorist financing and/or handing proceeds of crime.
32. Consider and report on the company's impact that are significant on its local community.
33. Communicate in the audit report the areas of higher assessed risk and significant risks.
34. Communicate in the audit report the areas of significant management judgment and having estimation uncertainty.
35. Communicate in the audit report of significant transactions or events.
36. Examine & report in the audit report on the effectiveness of auditee's non-financial internal controls.
37. Perform the audit to prevent the fraud in the auditee.
38. Perform the audit to detect all frauds in the auditee.
39. Examine and report in the audit report on the reliability of information in client's entire annual report.
40. Examine and report on the efficiency and effectiveness of the company's management.
41. Prepare the auditee company's financial statements.
42. Make an assessment of the entity's ability to continue as a going concern (i.e., the ability to continue for a foreseeable future) in preparing financial statements.
43. Provide related disclosures in the financial statement in connection with going concern (i.e., the ability to operate for a foreseeable future period).
44. Guarantee audited financial statements are accurate.
45. Guarantee the auditee company is solvent.
46. Verify every transaction of the auditee company.
47. Guarantee auditee (with a clean audit report) is financially sound.
48. Detect minor (but not petty) theft of the client's assets by non-managerial employees.
49. Audit all interim financial statements issued by the auditee.

