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**AUD 09: THE EFFECT OF CHANGES IN AUDITOR
REPORTING STANDARDS ON AUDIT QUALITY**

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ABSTRACT

The expectation and information gaps have driven many changes in the auditing profession over the last few decades. These gaps combined with corporate collapses involving auditors and the more recent financial crisis have called for changes to restore credibility to the auditing profession. The response has been a series of changes to the auditing standards. The new *Framework on Audit Quality* issued in 2013 is aimed at addressing performance deficiencies in auditors thereby decreasing the expectation gap. The series of changes to reporting standards issued in 2015 are designed to allow users to gain insights on the company through the eyes of the auditor so as to reduce the expectations of users and bridge the information gap. This paper analyses the impact of the changes in auditing standards on the expectation and information gaps and audit quality. The method used was a literature review on the events that precipitated the issue of the new auditor reporting standards and the *Framework on Audit Quality* and a literature analysis of how these standards have bridged the expectation and information gaps. The analysis found that as the *Framework on Audit Quality* is not prescriptive and is dependent on the auditors' commitment to quality while simultaneously promoting transparency on audit quality, the *Framework* addresses only some components of the expectation gap. The study further found that changes in reporting standards do not reduce components of the expectation gap but reduce the information gap by providing entity-specific information to users of the financial statements in the form of Key Audit Matters.

Keywords: *audit quality, information gap, expectation gap, audit report*

INTRODUCTION

At the start of the millennium the auditing profession underwent global change following the collapse of Enron and with it one of the largest auditing firms, Arthur Andersen (Fisher, 2003). Litigation against Arthur Andersen created the need to restore public confidence in the auditing profession. The result was the globalisation and acceptance of International Standards on Auditing (ISA), specific independence and ethical requirements and greater regulation for auditors (Fisher, 2003). Despite these measures, which bolstered the reputation of the auditing profession, the spate of lawsuits against audit firms since the demise of Arthur Andersen has spiked (Porter, 2009). Lawsuits against auditors most commonly follow corporate collapses or corporate malpractice and arise from the auditors' failure - either through poor quality audits, negligence or fraud - to provide early warning signals to users (Porter, 2009).

The rise in lawsuits against auditors is attributed to the gap between auditors' understanding of their function and the role users and society at large expects auditors to play (Leung & Chau, 2001). This gap, called the 'expectation gap', is particularly prevalent in users' perceptions about the auditors' ability to detect financial statement fraud and the auditors' responsibility regarding fraud under existing standards (IAASB, 2011). Prior academic research suggests that the expectation gap is a consequence of the manner in which audit findings are communicated to users (IAASB, 2011). The only communication from the auditor to the user is the current standardised audit report, which does not explain the full extent of the audit effort (IAASB, 2011). Other academic research indicates that user perceptions of audit quality are also impacted by the communicative value of the audit report (IAASB, 2011). Due to the standardised wording of the current audit report, the current audit report does little to influence or change user perceptions about the extent of audit work performed and the quality of the audit (IAASB, 2011).

Users of audited financial statements identify a gap between the information needed to make investment and fiduciary decisions and the information available to them, creating the 'information gap' (IAASB, 2011). This information gap impacts the efficiency of capital markets and affects the allocation of scarce economic resources (IAASB, 2011). While some research suggests that this relates to deficiencies in the financial reporting framework adopted by the company, there is a perception that more transparency about the audit performed and key areas of audit risk would narrow the gap (IAASB, 2011).

The worldwide financial crisis of 2008 brought into question the role of the auditor (Welch, 2010). While the financial crisis is not generally viewed as being triggered by audit failure nor has deficient auditing standards been identified as a contributing factor; changes in auditing standards and regulations are an inevitable response from auditors to maintain their influence and enhance their credibility (The future of audits –

PwC, 2013). The International Auditing and Assurance Standards Board (IAASB) responded by issuing the Framework on Audit Quality in January 2013, a revised standard on the auditors' report in January 2015 (ISA 700 - Forming an Opinion and Reporting on Financial Statements) (Handbook of international standards on auditing and quality control, 2015) which included a revision of a suite of standards affected by the revision of the auditors' report) and a revised standard on auditors' responsibilities regarding other information in April 2015 (ISA 720 - *The Auditor's Responsibilities Relating to Other Information*) (Handbook of international standards on auditing and quality control, 2015).

Problem statement

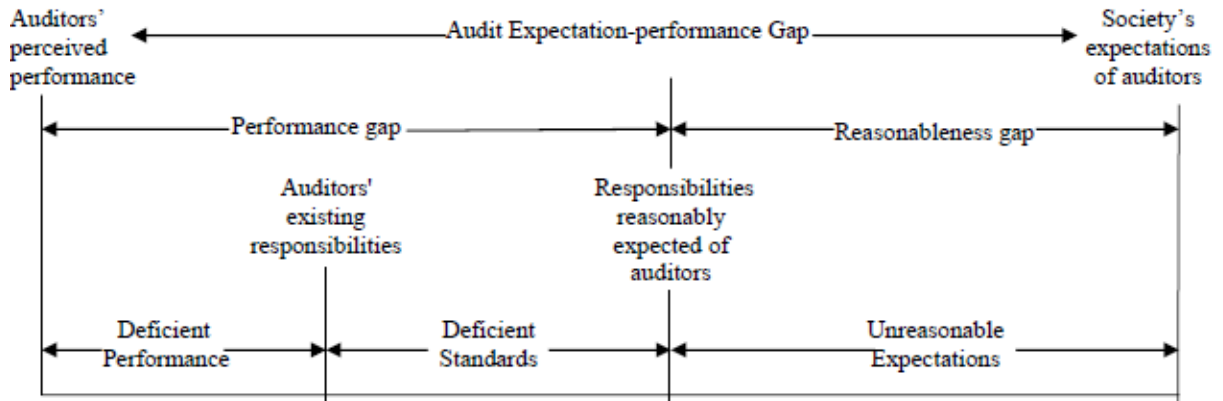
This paper discusses whether the changes in standards - being the Framework on Audit Quality, the revised standard on the auditors' report (*ISA 700 Forming an Opinion and Reporting on Financial Statements*) (Handbook of international standards on auditing and quality control, 2015) including other affected standards, and the revised standard on auditors' responsibilities regarding other information (ISA 720 - *The Auditor's Responsibilities Relating to Other Information*) (Handbook of international standards on auditing and quality control, 2015) – addresses the expectation and information gaps. This paper further explores how these changes will enhance audit.

The audit expectation and information gap

The audit expectation gap can be defined as the difference between what the public and other financial statement users perceive auditors' responsibilities to be and what auditors believe their responsibilities to be (Chye & Woo, 1998). Liggio (1974) was the first to apply the term 'expectation gap' to auditing, even though the concept has been around for over a 100 years (Humphrey, Moizer & Turley, 1992).

Porter (2009) further elaborated on the expectation gap by identifying two distinct components; the reasonableness gap and the performance gap. The reasonableness gap is the difference between the duties financial statement users expects auditors to perform and those duties which are reasonable for the auditor to perform (Porter, 2009). The performance gap is the difference between those duties financial statement users expect auditors to perform and those that auditors actually deliver (Porter, 2009). The performance gap can further be broken down into the deficient standards gap, (which is the difference between auditors' responsibilities in terms of ISAs, statute or regulation and users' perceptions) and the deficient performance gap (which is the difference in the quality of audits performed and users' perceptions) (Porter, 2009). Figure 1 below depicts the expectation gap as:

Figure 1- Expectation gap

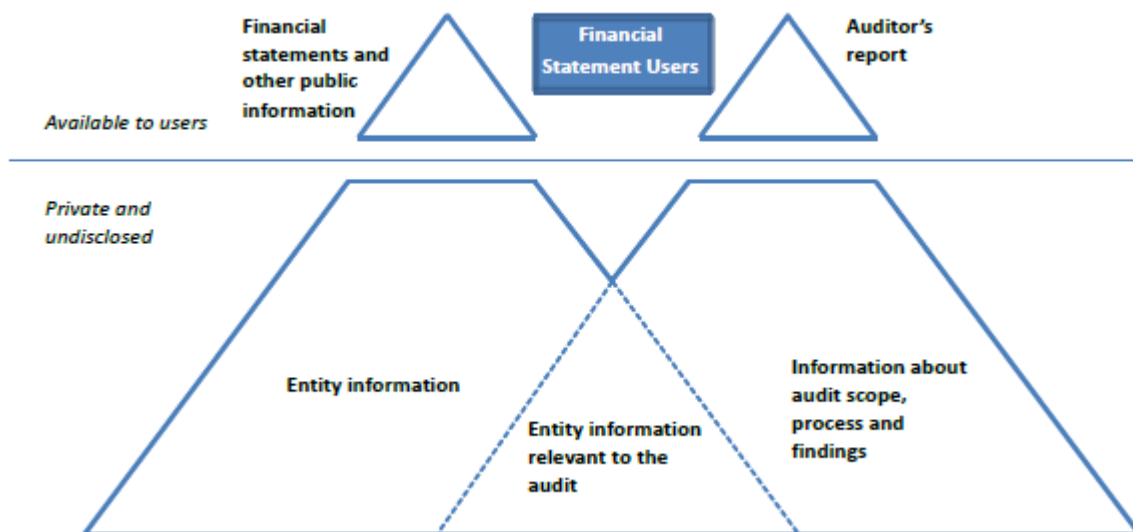


Source: Porter (2009)

The information gap is defined as the gap between the publicly available information provided by companies and the information required by users to make informed investment or fiduciary decisions (IAASB, 2011). The information gap is also seen as the challenge in providing information on the overall picture of a company's financial condition, performance and sustainability through its audited financial statements and other information (IAASB, 2011). Research suggests that the information gap is a result of deficiencies in financial reporting frameworks, particularly disclosures that are vital to a users' understanding of the financial statements (IAASB, 2011). Despite this, there is wide acknowledgement that audited financial statements alone are insufficient to provide the information that users' need (IAASB, 2011).

While users are aware that financial information available to them is only part of a wider set of information available to management and the company's auditors, users point out that the audited financial statements should be a concise summary of information relevant for decision making (IAASB, 2011). Figure 2 below illustrates the information gap:

Figure 2 - Information gap



Source: IAASB (2011)

Method

The following sections will discuss whether the Framework on Audit Quality as issued by the IAASB in January 2013 addresses the expectation performance gap (deficient performance and deficient standards gap) and whether the revised standard on the auditor's report (ISA 700 - *Forming an Opinion and Reporting on Financial Statements*) (Handbook of international standards on auditing and quality control, 2015) and the revised standard on auditors' responsibilities regarding other information (ISA 720 - *The Auditor's Responsibilities Relating to Other Information*) (Handbook of international standards on auditing and quality control, 2015) addresses the expectation reasonableness gap and the information gap. The discussion is based solely on review of the above literature.

The Framework on Audit Quality

The Framework on Audit Quality was issued in January 2013 by the IAASB in response to the financial crisis of 2008 which highlighted the critical importance of high-quality and credible financial information (IAASB, 2013). One of the objectives of the Framework on Audit Quality is to challenge auditors on how they can increase audit quality (IAASB, 2013). Another objective is to prompt discussion on whether there are areas in the currently issued ISAs and International Standard on Quality Control (ISQC) 1 which require revision (IAASB, 2013).

This far no globally recognised and accepted definition or analysis of audit quality exists, mostly due to its complexity and multi-faceted nature (IAASB, 2013). The IAASB's definition of audit quality is described as:

'...a quality audit is likely to be achieved when the auditors' opinion on the financial statements can be relied upon as it was based on sufficient, appropriate audit evidence obtained by an engagement team that: exhibited appropriate values, ethics and attitudes; was sufficiently knowledgeable and experienced and had sufficient time allocated to perform the audit work; applied a rigorous audit process and quality control procedures; provided valuable and timely reports; and interacted appropriately with a variety of stakeholders.'
(IAASB, 2013)

As can be seen from the above definition, many factors contribute to a quality audit being performed (IAASB, 2013). The Framework on Audit Quality describes the input, processes and output factors which affect audit quality and also demonstrate the importance of interactions with stakeholders and contextual factors (IAASB, 2013). These will be discussed in more detail below.

Inputs

Inputs refer to the qualities an auditor takes into the audit such as the knowledge, skill and experience and includes the values, ethics and attitudes of each auditor (IAASB, 2013). Another input to audit quality is the time available for the audit team to complete the audit and is influenced by the culture in an audit firm (IAASB, 2013).

Deficient audit performance occurs when there is a deterioration of input qualities at an audit engagement, audit firm or national level (IAASB, 2013). For example, poor quality audits would result if audit teams are not adequately staffed in terms of relevant levels of knowledge, skills and experience, and if audit firms incentivise staff based on recoveries (which would result in audit teams compromising quality to achieve targeted recoveries) and if regulators perform infrequent reviews (IAASB, 2013).

Processes

The audit process is fundamental to the quality of the audit but is dependent on the quality of the inputs (IAASB, 2013). Factors that influence audit quality processes at the audit engagement level are compliance with ISAs and ISQC1 and interactions between the audit team and experts (IAASB, 2013). Interactions between the audit team and management are also crucial to a quality audit process as this will determine the efficiency and effectiveness of an audit (IAASB, 2013).

Audit firms promote compliance with auditing standards and quality control standards by ensuring that firm methodology and practices complies with these standards (IAASB, 2013). However, deficient audit performance still occurs even if firm methodology and performance complies with ISAs and ISQC 1, due to the high level of judgement exercised by auditors (IAASB, 2013).

Nationally, standard setters influence audit quality by making clear the minimum audit requirements and the underlying objectives of those requirements (IAASB, 2013). Regulators can influence audit quality by inspecting compliance with standards and also challenging judgements made by auditors (Redmayne & Bradbury, 2010). Disciplinary action meted out by regulators to auditors for poor judgements and non-compliance with ISAs may provide an incentive to audit firms to increase quality (Redmayne & Bradbury, 2010; IAASB, 2014).

Outputs

Outputs at an audit engagement level are the only tangible documents widely available from which audit quality can be deduced (IAASB, 2013). These include outputs from the auditor such as the audit report, reports to Those Charged With Governance, reports to management and reports to financial and prudential regulators; outputs from the entity such as audited financial statements and reports from Those Charged With Governance (like Audit Committees); and outputs from regulators on individual audits (IAASB, 2013).

The audit report is not considered to be an indicator of audit quality due to its generic nature, however, the revision of ISA 700 - *Forming an Opinion and Reporting on Financial Statements* (Handbook of international standards on auditing and quality control, 2015) has seen the inclusion of Key Audit Matters which will provide users with the auditor's insight into matters of audit significance and may enhance audit quality (Redmayne & Bradbury, 2010). The auditors' reports to Those Charged With Governance and management are not widely available but robust and elaborate disclosures in these reports influence perceptions of audit quality (IAASB, 2013).

Users of audited annual financial statements deduce audit quality from the quality of the financial statements (IAASB, 2013). Financial statements which contain arithmetical errors, inconsistencies and vague disclosure may lead users to deduce that a poor quality audit was performed (IAASB, 2103). Financial statements which are restated for changes in estimates or to correct prior period errors are not differentiated and are often perceived by users to be as a result of audit failure (IAASB, 2013). Outputs at an audit firm and national level include transparency reports, annual and other reports and aggregate results of firm inspections (IAASB, 2013). The more widely available these reports, the greater their influence on audit quality (IAASB, 2013).

Key interactions with the financial reporting supply chain

As part of the audit process, this paper mentioned interactions between the auditor and management as crucial to audit quality (IAASB, 2013). There are several other key interactions, namely interactions between the auditor and Those Charged With Governance, users and regulators; interaction between management and Those Charged With Governance, users and regulators; interactions between Those Charged With Governance and users and regulators; and interactions between users and regulators (IAASB, 2013).

Most of these interactions are already in existence, some in more detailed capacity than others which creates potential for each of these interactions to be improved and to specifically include an agenda of audit quality (IAASB, 2013). Meaningful interactions between all parties listed strengthen the cohesion of the audit process and may be the first step in reducing the information gap (IAASB, 2013).

Contextual factors

There are several contextual factors affecting audit quality which vary from jurisdiction to jurisdiction depending on the sophistication of the economy and the business culture (Francis, 2011). Contextual factors include business practices and commercial law, laws and regulations relating to financial reporting, the applicable financial reporting framework, corporate governance, information systems, broader cultural factors, financial reporting timelines, attracting talent, litigation environment and audit

regulation (IAASB, 2013). All these factors lead to varied perceptions about audit quality (IAASB, 2013).

The Framework on Audit Quality was not issued as guidance or as a prescriptive standard which should be applied by all auditors, but rather a departure point from where auditors can reflect on the quality of their current audits and use those reflections to engage within the audit firm and with stakeholders outside the audit firm on how to improve the quality of audits (IAASB, 2013). As such The Framework on Audit Quality addresses the expectation performance gap by promoting the transparency of the audit process through formal conceptualisation of the factors which influence both users' perceptions of audit quality and audit quality itself.

The revised ISA 700 - Forming an Opinion and Reporting on Financial Statements and affected standards

Until the 1990's, the auditing profession sought to address expectation reasonableness gap of financial statement users through educating users about the nature and limitations of an audit (Porter, 2009). The standard auditors' report was used as a tool to educate users (Porter, 2009). Before 1988, the 'short form' audit report did little more than identify the financial statements which had been audited and expressed the audit opinion thereon (Porter, 2009).

In 1988, the Cohen Commission sought to educate users and reduce the expectation reasonableness gap and recommended the introduction of the 'long form' audit report which included a paragraph explaining the respective responsibilities of the auditees management and the auditor for the financial statements (Porter, 2009). By the 1990's the long form report was widely adopted and became the international norm (Porter, 2009). Research on whether the long form report met its educational objectives found that users had an increased understanding of the auditors' role and function in financial reporting (Porter, 2009). Critics, however, questioned whether a few sentences in an audit adequately conveyed the essence of the audit process (Porter, 2009).

The long form audit report was expanded further over the years, particularly with regards to the auditors' responsibilities and new requirements by company law and stock exchange listings making the audit report long and complex (Porter, 2009). In 2004, the IAASB issued a revised ISA 700 (Revised) – *The Independent Auditors Report on a Complete Set of Financial Statements* (Handbook of international standards on auditing and quality control, 2015). The revised report had a two-part structure; the first relating to the audit of the financial statements, and the second to the auditors' legal and regulatory responsibilities (Porter, 2009). In addition to the two-part structure the word 'independent' was introduced in the title of the audit report and the description of the audit process was expanded to include that the selection of audit

procedures involved auditor judgement and that the auditor considers internal control relevant to the financial statements when designing audit procedures (Porter, 2009).

Critics of the revised auditors report were mainly concerned about the continued standardised wording which did not differ from year to year or from company to company and made shareholders feel excluded from what they perceived to be the 'real' findings of the audit (Porter, 2009). The audit report had come to be treated as a symbol, rather than read as Porter (2009) quotes one critic:

'One effect of using a standard report is that as a person becomes familiar with its words, he tends to stop reading it each time he sees it. He relies on his memory of what it says and his impression of what it means and merely glances to see that it is included and that it does not contain a departure from the usual language, that is, an exception. The entire report comes to be interpreted as a single, although complex, symbol that is no longer read.'

Research conducted on auditor reporting after 2004 found that shareholders believed that they should be provided with much of the information auditors provide to the Audit Committee which included: more information about emphases of matter and references to uncertainties and future risk; discussion of material issues encountered during the audit and how they were resolved; tailored company-specific information rather than standardised reports; discussion of alternative accounting treatments considered and the reasons for selecting the treatments adopted; and more information on material areas of judgement and difficult, sensitive or contentious issues (Porter, 2009). There was also a call for the auditor to make more positive statements in the audit report, such as 'adequate accounting records have been kept' (Porter, 2009). Another research recommendation was to change the format of the auditor report so that important information such as the audit opinion would be displayed first (Porter, 2009).

Further research conducted on the audited report found that detailed explanations in the audit report of auditor and management responsibilities as well as the nature, scope and procedures of the audit did not reduce the expectation gap (Gold, Gronewold & Pott, 2012). This indicated that either explanations need to be more explicitly or clearly formulated or that users' perceptions were not influenced by explanations in the audit report (Gold *et.al*, 2012). The latter indication is supported by Gray, Turner, Coram & Mock (2011) who found that financial statement users only consider the actual opinion and disregard all other information, which suggests wording changes in the audit report is not the solution to reducing the expectation gap.

The new auditors report was issued in January 2015 as a revision to ISA 700 - *Forming an Opinion and Reporting on Financial Statements*, and with it one new standard was issued being ISA - 701 *Communicating Key Audit Matters in the Independent Auditor's Report* in response the call for the auditor's report to be more informative and relevant

(IAASB, 2015a). Four other standards were revised as a result; namely, ISA 705 - *Modifications to the Opinion in the Independent Auditor's Report*, ISA 706 - *Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report*, ISA 720 *The Auditor's Responsibilities Relating to Other Information*, ISA 570 *Going Concern* and ISA 260 *Communication with Those Charged with Governance* (Handbook of international standards on auditing and quality control, 2015; IAASB, 2015a).

Key changes in the new auditors' report are split between those applicable only to listed entities and those applicable to all entities (IAASB, 2015a). Changes pertaining to listed entities are the introduction of a new section to communicate non-standard, Key Audit Matters (KAM) which the auditor judges to be of most significance for the current year audit; and disclosure of the name of the engagement partner responsible for the audit in the signature (IAASB, 2015a). Changes which apply to all entities are: a restructuring of the audit report which allows the audit opinion section to be presented first; followed by the Basis of Opinion section to allow prominence to the opinion; enhanced reporting over going concern; a positive statement confirming the auditors' independence and fulfilment of ethical responsibilities; and enhanced description of the responsibilities of the auditor (IAASB, 2015a).

The introduction of KAM has emphasised the debate of consistency versus relevance as KAM's will differ from entity to entity (IAASB, 2015a). The IAASB has acknowledged that there should be consistency in determining which matters should be reported as KAM, whilst the communication of KAM should be as entity-specific and relevant as possible (IAASB, 2015a). ISA 701 *Communicating Key Audit Matters in the Independent Auditor's Report* aids this by setting out a decision framework for auditors with the starting point being the communication with those charged with governance (IAASB, 2015a). From the matters communicated to those charged with governance, the auditor should determine those matters which required significant auditor attention, paying particular attention to: areas of higher material misstatement or areas of significant risk as determined using ISA 315 (Revised) - *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment*; significant auditor judgement on areas in the financial statements over which management exercised significant judgement, particularly areas of high estimation uncertainty; and significant transactions or events that occurred during the year (IAASB, 2015a). KAM are therefore the most significant matters that required audit attention during the year and the auditors' process at determining a KAM is depicted in Figure 3 below (IAASB, 2015a):

Figure 3 - Determination of Key Audit Matters



Source: IAASB (2015a)

The auditors' description of a KAM in the audit report should include why the matter was determined to be of most significance during the audit and must include how the matter was addressed during the audit (IAASB, 2015a). Wording is not prescribed and allows for auditor flexibility in providing entity-specific information (IAASB, 2015a).

Enhanced reporting over going concern was promulgated as a result of users' requesting explicit disclosure or 'early warning signals' if there is uncertainty about the entity's ability to continue as a going concern (IAASB, 2015a). While going concern is still primarily the responsibility of management, the auditor now has increased responsibilities regarding the evaluation of those disclosures when material uncertainty exists (IAASB, 2015a). The revised ISA 570 – *Going Concern* extends audit procedures on management's disclosures and requires the auditor to refer to those disclosures in the audit report under the heading 'Material Uncertainty Related to Going Concern' (IAASB, 2015a). If management's disclosures are inadequate, the audit report should contain a modified opinion as would be disclosed in the first two paragraphs of the audit report (IAASB, 2015a). Other required going concern disclosures in the audit report include explicit statements about management and the auditors' responsibility regarding going concern.

Auditor disclosure of KAM is not a completely new concept (Bédard, Gonthier-Besacier & Schatt, 2014). Auditors' in France have been providing commentary, called 'Justification of Assessment' in their audit reports since 2003 (Bédard *et.al*, 2014). The concept of a Justification of Assessment is similar to that of a KAM in that it provides users with additional information as to why the auditor arrived at a specific opinion (Bédard *et.al*, 2014). In a survey conducted in France, the perceived benefits of a Justification of Assessment were requested from financial statement users (Bédard *et.al*, 2014). The perceived benefits varied significantly among users (Bédard *et.al*,

2014). Some of the advantages of Justification of Assessment disclosures included: an increased in the communicative value of the audit report and a complement to the nature of the audit opinion; assisted users in navigating complex and voluminous financial statements; alerted readers to the more judgemental areas in the financial statements; and enabled the auditor to better explain the focus of the audit (Bédard *et.al*, 2014). Among the disadvantages of the Justification of Assessment disclosures were: the technical language of the disclosures made it difficult for users' not schooled in accounting and financial reporting to understand what was being said; were sometimes complex to read; and became standardised over time in relation to an entity. The survey further indicated that auditors should be careful not to provide information already disclosed in the financial statements which means that the auditor would need to engage extensively with management and those charged with governance to clear disclosures in the audit report (Bédard *et.al*, 2014).

By expanding the auditors reporting responsibilities, particularly with regards to KAM and going concern, the auditor may be forced to focus on these issues which are critical to users' understanding of the financial statements, thereby enhancing perceptions of audit quality (IAASB, 2011). Critics have debated the benefit of additional reporting disclosures versus the cost to the auditor and have concluded that even though there are no changes in the scope of the audit, the additional reporting responsibilities increase cost (IAASB, 2011). If these increased costs do not translate to higher fees, it may create pressure to reduce work in other areas thereby negatively impacting audit quality (IAASB, 2011).

The inclusion of KAM in the new audit report is a measure to reduce the information gap and provide transparency in the audit process (IAASB, 2011). Users' are able to make more informed decisions as a result of a better understanding of corporate reporting using specific information about the entity as provided by the auditor (IAASB, 2011). There is, however, concern that additional information may cloud, instead of clear, users' understanding of the entity by adding to the complex and voluminous information already provided (IAASB, 2011). KAM, if disclosed properly, should improve the quality of information received by users rather than just its quantity (IAASB, 2011). Another concern is that the additional disclosures by the auditor in the audit report may widen the expectation gap, however, this may be mitigated by greater transparency about the audit process which would improve perceptions about audit quality as well (IAASB, 2011). For example, if users were informed through a KAM about a significant area of auditor judgement in the financial statements, and the thought process followed by the auditor in arriving at the judgement, the user would have a better understanding of the audit opinion on the financial statements as a whole as well as a better perception on the quality of the audit that was conducted (IAASB, 2011).

The revised ISA 720 - The Auditor's Responsibilities Relating to Other Information

Other information refers to:

'... information that accompanies financial statements as part of an entity's financial reporting. It explains the main trends and factors underlying the development, performance and position of the entity's business during the period covered by the financial statements. It also explains the main trends and factors that are likely to affect the entity's future development, performance and position' (IASB, 2005 p.15)

The provision of other information is in response to concerns from financial statement users that financial statements do not provide sufficient information to enable them to understand the performance and position of modern companies (Rowbottom & Lymer, 2010). The most common examples of other information are the Management Discussion and Analysis (MD&A) required by Securities Exchange Commission in the United States and Operating and Financial Review (OFR) required by the London Stock Exchange in the United Kingdom (Rowbottom & Lymer, 2010). The collapse of Enron in the early 2000's prompted regulatory responses from stock exchanges which lead to revisions in narrative reporting guidance in an attempt to strengthen corporate reporting (Rowbottom & Lymer, 2010). The enactment of Sarbanes Oxley legislation in 2002 resulted in an increase in the scope, content and disclosures of the MD&A (Rowbottom & Lymer, 2010).

Over the last few years, there has been significant development in corporate reporting, especially with regards to the extent of other information contained in the annual report (IAASB, 2015b). Other information disclosed ranges from descriptions of the entity's business model to risk exposures and uncertainties (IAASB, 2015b). Other information, through sheer volume, has the ability to undermine the credibility of the financial statements and the auditor's report if not consistent with information disclosed in these documents (IAASB, 2015b). ISA 720 - *The Auditor's Responsibilities Relating to Other Information* was revised so as to reflect the changes in corporate reporting and to align users' expectations and auditors' responsibilities (IAASB, 2015b).

The key changes to ISA 720 - *The Auditor's Responsibilities Relating to Other Information* are the improved scope of the standards clarifying what other information is; providing explicit guidance on the extent of the auditors work effort relating to other information; and providing transparency by requiring reporting on the auditors' work relating to other information (IAASB, 2015b). The scope clarifies other information as financial and non-financial information which accompanies the annual financial statements and the audit report, as either one document or a collection of documents (IAASB, 2015b). The extent of auditor effort is a consideration of material inconsistencies between other information and the financial statements and between

other information and the auditors' knowledge of the entity (IAASB, 2015b). The revised auditor reporting on other information will include a statement that management is responsible for the preparation of other information; identification of other information; a statement that the audit opinion does not cover the other information; a description of the auditors' responsibility to read other information for material inconsistencies with the financial statements and auditors report; and the results of the auditors reading, namely, if material inconsistencies were identified or not (IAASB, 2015b).

The revised ISA 720 - *The Auditor's Responsibilities Relating to Other Information* reduces the information gap as it provides auditors' assessment on the consistency of other information with the financial statements (IAASB, 2015b). Critics have challenged whether the wording of the extent of the work performed by auditors could potentially widen the expectation gap (IAASB, 2015b).

Conclusion

The 'expectation gap' as applied to the auditing profession by Liggio (1974) indicates that the role of the auditor is not in congruence with the expectations of the users (Chye Koh & Woo, 1998). Porter (2009) has identified three main causes of the expectation gap: firstly, the nature of auditing, its various roles and responsibilities and the probabilistic nature of audit practice is not understood by users resulting in users having unrealistic expectations about an audit (called the expectation-reasonableness gap); secondly, there are time lags between the economic conditions and the auditing profession's response in the form of revised standards applicable to the audit process resulting in the deficient standards performance gap; and thirdly, the perception of poor quality audits resulting in corporate collapses (called the deficient performance gap) (Porter, 2009). Another gap was identified and explained by the IAASB, being the information gap (IAASB, 2015a). The information gap is the difference between the information needed by users to make decisions and the information available to them (IAASB, 2015a)

This paper explored to what extent the Framework on Audit Quality as issued by the IAASB addressed the deficient performance gap. The findings indicated that the Framework on Audit Quality is a document that conceptualises the factors that affect audit quality and was issued to challenge auditors to reflect on the factors identified and improve on factors identified to improve overall audit quality. As this Framework on Audit Quality is not prescriptive, the extent to which auditors reflect on their audit quality shortcomings and implement corrective measures will depend on the auditors' commitment to quality. The Framework addresses the deficient performance gap by promoting transparency of the drivers of audit quality which provides users of financial statements and audit committees with information to better engage with auditors on the auditors' responsibility to improve audit quality. The Framework for Audit Quality is

not issued to auditors as guidance and due to its non-prescriptive nature does not address the deficient standards gap.

This paper continued to the assessment of whether the auditors' report addressed the expectation reasonableness gap and the information gap. Findings indicate that the change in auditor reporting from the short-form to the long-form report in 1988 did much to increase the understanding of the auditors' role and function in financial reporting for users of the financial statements, thereby addressing the expectation reasonableness gap (Porter, 2009). Since 1988, there were several revisions to the auditors' report and, in particular, expansion of the auditors' role and responsibility but this did not increase users' understanding of roles and responsibilities, in fact the standardised wording had the effect of the auditor report being treated as a symbol, rather than being read (Porter, 2009). The new ISA 700 - *Forming an Opinion and Reporting on Financial Statements* and the assessment of the introduction of Key Audit Matters in the audit report (ISA - 701 *Communicating Key Audit Matters in the Independent Auditor's Report*) issued in 2015 does not reduce the expectation reasonableness gap but reduces the information gap by providing entity-specific information to users of the financial statements in the form of Key Audit Matters. There is, however, concern that the new auditors' report may widen the expectation gap, however, this may be mitigated by greater transparency about the audit process which would improve perceptions about audit quality as well (IAASB, 2011).

The revision of ISA 720 - *The Auditor's Responsibilities Relating to Other Information* further reduces the information gap, by mandating that the auditor; firstly, identifies other information and secondly, reports on other information in the auditors' report (IAASB, 2015b). This indicates to users that other information is consistent with the financial statements. While reporting on other information may reduce the information gap, there is concern that the extent of the auditors' work on other information may be misinterpreted, thereby widening the expectation reasonableness gap.

The expectation and information gaps have proved resilient against solutions in the past and may reduce for a short period of time before widening again (Humphrey, *et.al*, 1992). The above measures put in place by the IAASB to reduce the expectation and information gaps may prove effective for the short to medium term; however, auditors need to continually be alert for economic, regulatory and political changes which may, again, widen the gap.

Future researchers may wish to obtain empirical evidence from users of audit reports and auditor regulators regarding the effect of the new auditor reporting standards and the *Framework on Audit Quality* on the expectation and information gaps.

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