THE NEW AUDITORS’ REPORTING STANDARDS AND THE AUDIT EXPECTATION GAP

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Abstract

This paper examined how the new auditors’ reporting standards have attempted to reduce the audit expectation gap. Desk review research approach was adopted; a review of the some of the “new auditors’ reporting standards” and other empirical literature on the subject were carried out. This paper found that the new auditor reporting standards are the right steps and may be a reasonable response to the expectation gap only if there is full compliance. Our evaluation revealed that the new auditors’ reporting standards have far reaching provisions to bridge the expectation gap in areas of performance and communication including liabilities gap. However, the paper suggests that auditors and the professional accountancy bodies should accept greater responsibility for bridging the audit expectation gap through improved quality control systems and ethical engagement teams that are committed to quality.

Keywords: Expectation gap, Reporting standards, Going Concern, Emphasis of matter.

1. Introduction

The debate has continued on the extent of the auditors’ responsibility for a business failure after issuing a clean opinion just a few months back. Some commentators insist the auditor should be held responsible. Some others argue that would amount to imputing on the auditor duties and responsibilities that far exceed the current practice in the profession and indeed beyond the scope/bounds defined by the statutes and professional standards. This group believes that the role of the auditor is limited to expressing an opinion while it is the role of the management to keep proper records and maintain appropriate levels of internal control procedures to achieve best practices for the organization.

The indictment of Arthur Anderson in the Enron case readily reminds everyone of how far the judicial interpretation could go in the absence of specific statutory and professional regulation (Asein, 2007). The case was a huge eye opener that got the world of accounting professional re-evaluating how business was hitherto carried out. This case has heightened the discussion of what is the role of the auditor. The public still expects that the auditor’s role is to uncover fraud and catch the thief. The auditor is saying it is the management that should put proper internal control measures to prevent errors and fraud.

Managements are asking how could the huge investment in the audit budget, from time to time, be explained if the role of the auditor is just that limited and narrow? These divergent views have marked a wide gap in the expectations of the different stakeholders of the organization that,
today, the phenomenon has become known in different quarters as the Audit Expectation Gap. Akinbuli (2010) affirms it is not the responsibility of the auditor to detect fraud. He is only expected to plan and execute his assignment with a good level of professional skepticism and due care. The question here is, have the public accepted this position and could they so totally accept?

In response to the growing expectations, the various accountancy and auditing regulatory bodies world-wide have had to review the ways of conducting business and revised some of the reporting standards in an attempt to arrest the situation. The revised standards that are of interest to this study include: ISAs 200 Overall objectives of the independent auditor and the conduct of an audit in accordance with international standards on auditing; 210 Agreeing the terms of audit engagement; 260 Communication with those charged with governance; 265 Communicating deficiencies in internal control to those charged with governance and management; 570 Going Concern; 700 Forming an Opinion and Reporting on Financial Statements; 705 Modifications to the Opinion in the Independent Auditor’s Report and 706 Emphasis of matter paragraphs and other matter paragraphs in the independent auditor’s report. In addition, a new standard, equally of interest to this study, that is, ISA 701 Key Audit Matters, was issued. These new and revised standards, referred to as the new auditor reporting standards released by the International Auditing and Assurance Standards Board (IAASB) have been described by experts as truly game changing for stakeholders and the profession. Any of these revised standards and the new one will be effective for periods ending on or after 15 December 2016. But how closely these newly introduced auditing and reporting standards have attempted to bridge the expectation gaps portends a high degree of important study interest.

The objective of this paper is to evaluate whether the new auditors’ reporting standards can be said to be a sufficient response to the audit expectation gap. In doing this, we try to identify what is ‘new’ in the new auditors’ reporting standards and how they have attempted to bridge the audit expectation gaps. However, this paper argues that the introduction of ISA 701 and the required elements/content of the independent auditor’s report per ISA 700 is a bold step in bridging the communication gap. Sufficient reduction in performance gap still lies largely with the quality control system of the auditing firms and particularly with the people that carry out the engagement. The quality of the audit cannot rise above the quality, in terms of ethical values, competence and skill of the engagement team members. This paper has contributed to available literature on the audit expectation gap and particularly to the body of knowledge by establishing a nexus between the new auditor reporting standards and the efforts in reducing the audit expectation gap.

The rest of this paper is presented as follows: Section 2 gives our approach to the study; section 3 provides a review of extant literature on the audit expectation gap; section 4 evaluates what is ‘new’ in the reporting standards and the extent they have bridged the expectation gap while section 5 concludes the study.

2. Methodology
In this study, desk review research approach was adopted, relevant and related literature in the published works of other researchers and practitioners were carried out. Materials were sourced from scholarly journals, library sources and database and other reputable online resources
relevant to this paper. The study was based on a review of the various new international auditing standards. The presentation approach is largely discursive. However, at the end appropriate recommendation will be made on the way forward.

3. Literature Review

3.1 Conceptual Review

Hines (1988) stated that “accounting is socially constructed and socially constructing.” This implies that accounting influences the society and also accounting is in reverse being influenced by the society. The far reaching implication is that accounting ought to have regard for the needs and expectations of the user-society.

Researches in the last few decades have shown that the auditing profession has been faced with a lot of challenges in past history which has spanned over hundred years (Smith, 2002). Although failures of businesses and corporations resulting from deficiencies of financial reporting are not new, recent high profile audit failures which were as a result of audit performance expectation gap has been of great concern to the investors, regulators and the accounting profession. Therefore, great attention is being paid to the issue of the audit expectation gap and ways of mitigating its adverse effect on the credibility of the auditors’ work.

Though, the concern about audit expectation gap and its associated problems are believed to have existed for over 100 years, this concern appears to be a heightened phenomenon following the ugly fall of WorldCom, Enron and the audit giant Arthur Anderson. The audit expectation gap stems from misunderstanding of the role of the auditor as separate from the responsibilities of the management with regard to the audit engagement. Thus, the expectation gap is based on differing beliefs and perceptions of the users of auditor’s services and the auditors and the profession. From this perspective, Monroe and Woodliff (1993) described the audit expectation gap as “the difference in beliefs between auditors and public about the duties and responsibilities assumed by auditors and the messages conveyed by audit reports.” For Ojo (2006), the audit expectation gap is “the difference between what users of financial statements, the general public perceive an audit to be and what the audit profession claim is expected of them in conducting an audit.” Some studies, for example, Appah (2010), suggest that the audit expectation gap is a summation of users’ reasonable expectations of audits and their unrealistic perceptions of the performance of the audit profession. In line with this thinking Porter (1993) had earlier submitted that the audit expectation gap should more appropriately be described as “the audit expectation – performance gap” since there appears to be a gap between “society’s expectation of auditors and auditors’ performance, as perceived by society.”

Many works, for example, Olowookere (2007), classify audit expectation gaps into two broad groups, namely, communication gap and performance gap. Communication gap arises when users misunderstand the role of the auditor and the information conveyed by the auditor’s report. Many users misinterpret the content of the auditors’ report and misconstrue it to mean that an unqualified audit opinion is a certification of the financial health of the company (a clean bill of health). This expectation is heightened by their perception that auditors prepare and issue financial statements after the audit and therefore ought to detect all fraud, errors and other irregularities. As a result of this, they hold the strong belief that auditors guarantee the continued
existence of the company. Hayes, Dassen, Schilder, and Wallage (2005) in dealing with the expectation gap submitted that the gaps are wide in the following areas of auditor’s duties, namely:

Giving an opinion on the fairness of financial statements: A large percentage of users of audit services expect that financial statements with an unqualified audit opinion are completely free from errors and misstatements. The inherent limitations of auditing expressed in materiality and audit risk are not entirely accepted and/or understood by all groups of users.

Giving an opinion on the company’s going concern status – It is appropriate to warn users of financial statements about significant uncertainties and threats of distress but should such disclosure be made when future course of events is hard to predict (e.g. close calls)? Going concern matters is whose responsibility – management’s or the auditor’s?

Giving an opinion on the company’s internal control – Auditing standard requires the auditor to obtain an understanding of the company’s accounting and internal control systems, sufficient to plan the audit and develop an effective audit approach. Again, are the design, maintenance and implementation of adequate internal controls management’s responsibility or the auditor’s?

Giving an opinion on the occurrence of illegal acts – Given the auditor’s confidentiality responsibility, should all illegal acts detected be made public? The standards, legislations and other regulatory frameworks have given guidance on how to report and whom the auditor should report to.

Giving an Opinion on the occurrence of fraud - The Government and all users of audit services expect the auditor to find existing fraud cases and report them. Many are unaware that the responsibility for the prevention and detection of fraud rests with directors and management of the entity.

The communication gap is said to be caused by lack of education on the part of the public about the role of the auditor.

In performance gap, public expectation is reasonable, the auditor’s opinion is not misinterpreted but the auditor’s performance fell short of the required standard. This gap thus, is created when the quality of an audit fails to measure up to standard as a result of compromised professional judgment, integrity, objectivity or technical incompetency. Thus, performance gap is said to occur as a result of the lapses exhibited by the auditor. This could be due to poor technical skills, like using none qualified hands to carry out the audit task; or outdated knowledge or forming an opinion based on insufficient audit evidence.

Most of the high profile corporate and audit failures fall within this category. Porter and Gowthorpe, (2004) defined audit performance gap as “that gap between expectations of society from auditors and the actual performance of auditors.” They broke the gap into two major components which are

‘reasonableness gap’ – the gap between what society expects of auditors and what auditors can reasonably be expected to accomplish; and the ‘performance gap’ – the gap between what society can reasonably expect of auditors and what it perceives they deliver. The performance gap can be divided into the ‘deficient
standards gap’ – the gap between the responsibilities society reasonably expects auditors to perform and auditors’ actual responsibilities, as defined by statute, case law, regulations and professional promulgations; and the ‘deficient performance gap’ – the gap between the expected standard of performance of auditors carrying out these responsibilities and auditors’ actual performance of these duties.”

Some authors have also distinguished audit expectation gap into three main elements namely, a standards gap which occurs because of a perception that auditing standards are more prescriptive than they actually are, and that auditors have wide-ranging rules that they must follow; a performance gap that arises because of a perception that audit work has fallen below the required standards and a liability gap which arises from a lack of understanding about the auditor’s liability and who the auditor may be liable to (ICAN, 2014).

Whatever the categorization of the audit expectation gap, it is important to note that the continuing widening of that gap portends danger to the accounting and auditing profession and therefore needs to be contained.

3.2 Theoretical Considerations

3.2.1 Agency theory

The central idea behind the Principal-Agent model is that by the nature of modern corporations, ownership and control are separated. The principal (owner) hires the agent, who exercises control. But often times, conflict of interest may arise in firms when managers’ (agents’) personal interests override their obligations to comply with principal-agent contract of “maximizing shareholders’ wealth.” Agents are expected not only to maintain the value of property (capital) but also add value to property (capital). More worrisome is the fact that management has more information about the company than the principals (information asymmetry) and they exploit this gap to their personal advantage. Davis, Schoorman and Donaldson (1997) submitted that the divergent interests can be brought more into alignment through proper monitoring (resulting in monitoring costs) and a well-planned compensation system (bonding costs).

This monitoring is done on behalf of the principal by an independent party, hired by the principal to report on the stewardship account of the agent. There lies the importance of the work of the auditor and where the expectation gap is wide; he may not be able to effectively perform the ‘umpire’ function he is expected to perform.

3.2.2 Lending Credibility Theory

Another public perception is that the primary function of auditing is the addition of credibility to the financial statements. We may think of this as the lending credibility theory. Audited financial statements are used by management to enhance the stakeholders’ faith in management’s stewardship. If stakeholders such as stockholders, government, or creditors have to make their judgments based on the information they receive, they must have faith that the reports are a fair representation of the economic value and performances of the organization (Nwaobia, 2015). In audit research terms an audit reduces the “information asymmetry” created by the separation of
ownership and management; particularly where managers often times are opportunistic in their actions.

Where there is an expectation gap (communication or performance), the expected credibility to be lent to the audited financial statements will not materialize.

3.2.3 Empirical Review

A number of studies have been conducted to examine the causes of audit expectation gap. Some of these studies highlight the following as factors responsible for the expectation gap: the complex nature of audit function, conflicting role of auditors, retrospection evaluation of auditors’ performance, time lag in responding to changing expectations, self-regulation process of the Auditing profession and the unawareness and unreasonable expectations (Lee and Ali, 2008).

On their part, Gray and Manson (2000) are of the opinion that the differences between the auditor’s perception of what functions the audit role should play in the financial reporting process and the public’s perception is the “audit expectation gap” where the role of an auditor as perceived by the auditor and the expectations of the users of financial statement differs.

Pierce and Kilcommmins (1996) and McEnroe and Martens (2001), argue that the gap exists due to misinterpretations and misunderstanding of the meaning of financial reporting quality by the users. These studies suggest that users do not understand the audit functions and the role of auditors. A number of commentators have attributed this gap to users’ perception (Lange 1987) widespread misunderstanding (Ellis & Shelly 1988), ignorance (Manson and Zaman, 2000) and lack of education (Cockburn, 1986).

Garcia-Benau and Humphrey (1992) investigated the expectation gap in both the UK and Spain. Auditors, finance directors and users were asked, whether audit firms should not provide quality and dependable financial report to their audit clients. In both countries, the average response was close to neutral for all groups except UK auditors who expressed strong disagreement.

Lin and Chin (2004) examined auditors’ obligation to detect and report fraud and third party liability of auditors in China. The study documented evidence of expectation gap, as users of accounting information believe that the auditors are in a better position to unravel frauds, inefficiencies or irregularities more than management and therefore should be held responsible for detecting and reporting frauds and errors and by extension, liable for fraudulent information contained in audited reports.

Best, Buckby and Tan (2001) surveyed users’ perception of auditors’ responsibilities with regard to fraud prevention and detection as well as maintenance of accounting records. The results supported a change in the form and content of the auditors’ report; a call for it to be more explanatory in its wording than it was as at the time of study.

The Egyptian study of Dixon, Woodhead and Sohliman (2006) sought the perceptions of auditors, bankers and investors in relation to auditors’ responsibility on financial statements. Results revealed a wider expectation gap on the area of the auditors’ responsibility and lesser expectation gap with regards to reliability and usefulness of audit.
Ubaka (2016) in his study titled “Audit expectation gap and fraud detection in Nigeria: The public servants’ perception” found no significant difference between public servants’ perception of fraud detection and expectation gap.

Koh and Woo (1998) studied the nature and structure of audit expectation gap and concluded that the gap can be reduced through expanded audit reports, education, and structured audit methodologies.

These reviewed studies confirm existence of the audit expectation gap and give indication of the common areas of expectation gap that need addressing by legislation, regulatory framework and professional practice.

4. New auditor reporting standards and the audit expectation gap

There have been numerous steps taken by the profession and legislation to respond to the audit expectation gap. These include recommendations and even legislation to rotate either the audit firm or the engagement partners (Asein, 2007; Sox Act 2002), practice monitoring of Audit firms by the professional bodies and accounting oversight boards, for example, ICAN and FRCA in Nigeria and PCAOB in USA, prohibition of auditors from engaging in certain non-audit services for their clients; mandatory continuing professional education of accountants by the professional bodies including sanctioning of professionals for infractions to code of ethics and poor quality services.

Akinbuli (2010) in his work has made a long list of recommendations towards the reduction of the audit expectation gap among which are the need for audit firms to improve the quality of their audit work by engaging personnel who are qualified; the professional bodies setting up new standards and renewing existing ones and enhancing the syllabus of training of new members in line with the new realities; the use of audit committee to check the quality of audit reports; engaging users of the audited statement in dialogue about the materiality standards in the financial statement and putting in place such audit controls capable of improving the audit work quality in a company. Several researchers agree with Akinbuli’s (2010) suggestions. He cites Lee, Ali, and Kandasamy (2008) as concluding that quality of the audit can be improved by establishing an independent office to oversee the appointment of auditors and to regulate the audit fee. They believe the statutory duties of the auditors can be expanded to accommodate some of the expectations of the public. This is also corroborated by Humphrey (1983) and Omally (1983) as cited by Akinbuli (2010) who agree that imposing additional responsibilities on the auditor would mitigate the audit expectation gap.

But in a further and renewed effort to reduce the audit expectation gap as well as improve audit quality, the International Audit and Assurance Standard Board (IAASB) undertook the revision of a number of the existing auditing standards and issued a new one on Key Audit Matters. In this section, we highlight what is new in these revised standards and evaluate their contribution in reducing the expectation gap.

ISA 200, among other provisions requires the auditor to use the objectives in other ISAs to take a decision on whether any additional audit procedures are needed, beyond those required by the ISAs and on evaluating if sufficient appropriate evidence has been obtained (Paragraph 17). The
provisions of the standard also include explanation of some important concepts relating to audit such as management’s responsibilities, professional skepticism, professional judgement as well as the inherent limitations of an audit (paragraphs 15 - 16).

The amendment to ISA 210 requires the auditor to perform specific procedures to ascertain whether the preconditions for an audit are present. That is, he needs to determine that the financial reporting framework is acceptable and obtain management’s confirmation that they understand their responsibility for the preparation and fair presentation of the financial statements. Management also has the responsibility of implementing controls that will enhance the preparation of financial statements that are free from material misstatements; they should also give the auditor unrestricted access to all relevant information and to the employees.

Revisions to ISA 260 include requirements to document matters communicated orally, communicating any significant difficulties encountered during the audit, communicating any significant matters arising from the audit that were discussed or subject to correspondence, with management and explain why significant accounting practices, which are acceptable under the applicable framework, are not the most appropriate in the circumstances of the entity (pars. 14 – 17).

ISA 265 requires that the auditor determines whether identified deficiencies in internal control constitute significant deficiencies and communicating such significant deficiencies and their possible effects in writing to those charged with governance (paragraphs 7 – 11).

Revisions to ISA 570, like the other reporting standards, are designed to align with the far-reaching revisions made on the content and presentation of the independent auditor’s report. One major requirement of ISA 570 is that the auditor needs to remain alert during his risk assessment of the entity, of conditions that cast significant doubts on the ability of the entity to continue as a going concern (Par. 10). In terms of reporting, if the auditor finds the use by management, of the going concern basis inappropriate in preparing and presenting the financial statements, he should express an adverse opinion (par.21). Where the use of the going concern basis in preparing and presenting the financial statements is appropriate but a significant uncertainty exists, the auditor without modifying his opinion, should make this known to users in his report, under the heading, “Material uncertainty relating to going concern” (par.22). The auditor should draw attention to the note on the financial statements as to the conditions indicating that significant uncertainty exists. Paragraph 23 of ISA 570 requires that where there is non-disclosure of the conditions that indicate significant uncertainty by management, the auditor should express a qualified or adverse opinion depending on the materiality and pervasiveness of the condition(s).

An evaluation of the requirements of these standards reveals that the letter and spirit of these provisions are improvement in the quality of audit and reduction in both performance and communication gaps. These requirements are appropriate guide to the auditor on how to approach and conduct the audit assignment and the form and content of his communication with the users of his services.

But while the standards reviewed thus far in this section contribute in different degrees to addressing the audit expectation gap question in both the performance and communication dimensions, the revision to ISA 700 and the requirements of ISA 701 appear to be a significant
response to the audit expectation gap. Over time some scholars have canvassed for expanded auditor’s report to address the expectation gap, (for example, Nair and Rittenberg 1987; Gay and Schelluch, 1993), but the standard setting body thus far has not responded to such calls until the issuance of these new and revised standards.

In regard to the performance of the audit, the auditor is required to give an opinion on the financial statements based on an evaluation of the conclusion drawn from the audit evidence obtained. He then expresses opinion clearly through a written report (ISA 700 revised, para. 6 (a) and (b). Paragraphs 10, 11, 12 and 13 provide in detail requirements for forming an opinion on the financial statements). The auditor is required to form an opinion on whether the financial statements are prepared in all material respects in accordance with the applicable financial reporting framework. The auditor is expected to form that opinion having obtained reasonable assurances about whether the financial statements as a whole are free from material misstatement due to fraud or error. He is required to state whether sufficient audit evidence has been obtained, whether uncorrected misstatements are material and whether further evaluation is required. He would also disclose the significant accounting policies applied, that the accounting policies applied are consistent with the applicable financial reporting framework and appropriate, the accounting estimates made are reasonable, the evaluation that the information presented in the financial statements is relevant, reliable, comparable and understandable, the financial statements provide adequate disclosures to enable the intended users to understand the effect of material transactions and events on the information conveyed in the financial statements and the terminology used as well as the title of each financial statement is appropriate (ISA 700 revised, Para. 10 – 13 (a) – (b). The regulation further requires the auditor to form an opinion which is unmodified informing that the financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework (para. 16, ISA 700).

In further display of transparency of the audit process and to enhance the communicative value of the engagement the auditor is required to communicate key audit matters in the auditor’s report per ISA 701. This regulation also helps to throw light on the auditor’s judgment as to what to communicate in the auditor’s report and the form and content of such communication. The outstanding place of this communication is the impetus it confers on the intended users of the financial statement, to engage the management and those charged with governance, about certain matters relating to the entity, the financial statements, or the audit that was carried out. “Key audit matters are selected from matters communicated with those charged with governance” (ISA 701, para. 8). Of significant audit attention are areas such as “areas of higher assessed risk of material misstatement, or significant risks” identified in accordance with ISA 315 revised; “significant auditor judgments relating to areas in the financial statements that involved significant management judgment, including accounting estimates that have been identified as having high estimation uncertainty”; and “the effect on audit of significant events or transactions that occurred during the period.”

Paragraph 10 of the regulation holds the auditor responsible for determining which of the matters were considered to be most significant in the audit of the financial statements of the period under review. However, the paragraph defined what may constitute key audit matters as “those matters that, in the auditor’s judgment, were of most significance in the audit of the financial statements.” These “matters were addressed in the context of the audit of the financial statements
as a whole, and in forming the auditor’s opinion thereon, and the auditor does not provide a separate opinion on these matters.”

The paragraph 17 requires the auditor to communicate with those charged with governance on those matters the auditor has determined to be the key audit matters, or depending on the prevailing circumstances, the auditor’s determination that there are no key audit matters to communicate in the auditor’s report.

The enhanced and extended description of the responsibilities of the auditor and key features of an audit in the new reporting regime (paragraphs 36 – 39) is worthy of note because of its intended effect in bridging the communication gap. This section of the independent auditor’s report requires the auditor to:

- State his objectives for the audit which are to “obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error; and issue an auditor’s report that includes the auditor’s opinion.”
- Make known to the user “that reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs will always detect a material misstatement when it exists”.
- “State that misstatements can arise from fraud or error” but only those misstatements that “could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements” are of great concern to the audit.
- Indicate “the auditor exercises professional judgment and maintains professional skepticism throughout the audit”.
- Give full description of an audit and the auditor’s responsibilities thereon viz.
  1. “to identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error; to design and perform audit procedures responsive to those risks; and to obtain audit evidence that is sufficient and appropriate to provide a basis for the auditor’s opinion.”
  2. “to obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity’s internal control.”
  3. “to evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.”
  4. “to conclude on the appropriateness of management’s use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the entity’s ability to continue as a going concern.”
  5. “to evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation” if prepared in accordance with fair presentation framework.

For a group audit, the auditor also accepts responsibility for the direction, supervision and performance of the group audit and that he is solely responsible for the auditor’s opinion. This provision deals with liabilities gap. The auditor is also required to indicate his communications
with those charged with governance including the scope and timing of the audit, and significant audit findings, his compliance with ethical and independence requirements and key audit matters.

The provisions of ISA 706 as revised bring the impetus of the emphasis matter paragraphs and other matters paragraphs to further cement the disclosure and communication of the audit outcome to the management and the board. The objective of the ISA 706 regulation is to ensure that the auditor, having formed an opinion on the financial statements, is to draw user’s attention by way of clear additional communication.

An emphasis of matter is a paragraph included in the auditor’s report referring to a matter appropriately presented or disclosed in the financial statements that in the auditor’s judgment, is fundamental to users’ understanding of the financial statement. An Other Matters paragraph points out a matter other than what has been disclosed in the financial statement which the auditor believes to be relevant to the users’ understanding of the audit, the auditor’s responsibilities or auditor’s report (ISA 706 revised, para. 7 (a) – (b)).

Also, paragraph A60 of ISA 701 links ISA 260 as revised pointing out that the auditor should communicate with those charged with governance on a timely basis. The section, however clarifies that the appropriate timing for the communication will vary according to the circumstances of the engagement. According to this regulation, key audit matters may be discussed during the meeting to determine the scope and timing of the audit. This is at the beginning of the audit engagement. Another time for communicating such is when communicating about the findings. This time is the end of the audit performance. This engagement will help to facilitate a two way dialogue with those charged with the responsibility of governance when the financial statements are being finalized. The auditor may provide the board members and/or management with a draft financial statement that would be basis of further discussion before the finalization of the auditor’s report. Paragraph A64 requires the auditor to document sufficiently such that an experienced auditor, having no previous connection with the audit, could understand the significant professional judgments reached in carrying out the assignment. The auditor also has responsibility to communicate the board of governors with the audit documentation. All the above provisions have among others the single purpose of narrowing the gap in the expectations of the users of the financial statement and the auditor.

Pwc (2015), in their review of the new Auditor reporting standards had put forward some value-adding potential of the changes introduced by IAASB in the new standards. According to them, the most significant innovation in the new standards, without doubt, is the introduction of ‘key audit matters’ (ISA 701). This section sheds light on those matters that, in the auditor’s judgment, were of the most significance in the audit of the financial statements of the current period.

The introduction of an explicit statement regarding the auditor’s independence in all audit reports and to identify the engagement partner’s name in audit reports for listed entities is a bold step towards enhancing transparency. Both are already part of the auditor’s report in many parts of the world – but it is not the practice everywhere.

Under the new standards, the auditor’s report has been restructured to put audit and entity-specific information at the front of the report - in particular, putting the audit opinion first. Standardized wording in the report such as the descriptions of the auditor’s responsibilities and
what is involved in an audit can be placed at the end of the report, or some might even decide to put it in an appendix or refer to a common website (such as that of a standard-setter or regulator). Also, when the auditor is not otherwise required to communicate key audit matters, ISA 210 explains that it may be helpful for the auditor to make reference in the terms of the audit engagement to the possibility of communicating key audit matters in the auditor’s report. This presentation structure enhances both the readability and understandability of the report and its essence.

Management and, where appropriate, those charged with governance accept responsibility for the preparation of the financial statements in accordance with the applicable financial reporting framework, including, where relevant, their fair presentation. Management also accepts responsibility for such internal control as it determines it necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error. The description of management’s responsibilities in the auditor’s report includes reference to both responsibilities as it helps to explain to users the premise on which an audit is conducted.

IAASB (2015) states that the new and revised standards intend to enhance communication between auditors and investors, as well as between auditors and those charged with governance.

The Standards board further posited that one of the benefits of the new reporting standards is the “increasing attention paid by management and those charged with governance to disclosures in the financial statements to which reference is made in the auditor’s report.”

This no doubt will lead to increase in financial reporting quality and by extension reduction in the audit expectation gap. The new and revised Auditor reporting standards in essence, represent and support an important change in practice.

The new reporting regime will enhance user confidence in audit reports and financial statements. It will result in increased transparency, improved audit quality, and enhanced information value. It may therefore, be safe to believe that the new auditor reporting standards are going to reduce information asymmetries that impede efficient and timely corporate investment decisions. Moreover, renewed auditor focus on matters to be reported could result in an increase in professional skepticism (IAASB, 2015), which will result in a win-win situation for the auditor, the auditee- institutions and the investing public.

It is believed that the new reports will arouse more robust dialogue between the auditor and those charged with governance. It is expected to enhance communications between the auditor and the users, including regulators, as well as communications between the users and the entity. Therefore, this study affirms the auditor’s position as the mediator/umpire in the principal- agent relationship and fully supports the lending credibility theory of auditing.

5.0 Conclusion and Recommendations

The quality of the auditor’s report is critical to the value of the financial statement and to the continued relevance of the auditing profession. According to International Auditing and Assurance Standards Board (IAASB, 2015), the new and revised Auditor Reporting Standards lay the foundation for the future of global auditor reporting and improved auditor communications. The requirements of the accounting standards, has become more complicated over time, leaving some stakeholders and shareholders out of their depths when it comes to
analyzing financial statements. The auditor’s report is the auditor’s means of communication with an entity’s stakeholders, and as such, it has to be meaningful and be of value to them. The current auditor’s report is often perceived by the users of the financial statements as not providing meaningful insights or information of value. The new Auditor Reporting standards are responsive to calls from investors and other users of audited financial statements for more informative and relevant auditor’s reports based on the audit that was performed.

In conclusion, we submit that although the new requirements do not change significantly the underlying work effort required in the audit, it will however, improve the focus by the auditor on significant areas of the audit, including going concern, impacting audit quality and the auditor’s professional skepticism. Furthermore, the quality of financial reporting is expected to improve as there will be increased focus on the disclosures in the financial statements to which the auditor’s report makes reference towards meeting the stakeholders’ expectations. The requirements of the new auditor reporting standards are adequate and could be a sufficient response to the audit expectation gap, but there lies the moral burden on the preparers and auditors to completely apply and ensure total compliance with the letter and spirit of the standards. The human element and strict implementation of excellent quality control systems at both firm level and in every audit engagement are still key to resolving the expectation gap.

This study therefore, recommends that the audit profession should intensify the monitoring of the professional performance of their members and regulate disciplinary issues to keep their members in practice on appropriate check. The provisions of ISA 706 requiring the auditor to communicate more frequently with the management and the people charged with governance of the entity must be underscored. The pressure this would mean on the auditor may not be undermined, but the greater benefit would go to the audit profession in the form of higher regards for the financial reports produced by the auditor. Finally, the professional bodies should embark on repeated education of both its members and the public to deepen the understanding of everyone on the respective responsibilities of the auditor and the management.
References


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