**THE AUDITOR’S EXPECTATIONS GAP…NOT AGAIN!**

**EXCUSES, EXCUSES, EXCUSES**

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*If history repeats itself, and the unexpected always happens, how incapable must Man be of learning from experience.*

George Bernard Shaw

Irish dramatist & socialist (1856 - 1950)

Darn you [Caleb Newquist](http://goingconcern.com/2011/11/we-read-this-awful-interview-with-deloittes-joe-echevarria-so-you-dont-have-to) for depressing us with yet another example of how Big Four accounting firm leaders think, not to mention how little they regard the investing public! In discussing ways to improve audit quality in the wake of his firm’s atrocious inspection report by the Public Company Accounting Oversight Board (PCAOB), Deloitte’s CEO, [Joe Echevarria](http://www.reuters.com/assets/print?aid=USTRE7AK1EM20111121) stated:

*There is an "expectations gap" between what auditors do and what the public expects, but auditors do have an obligation to detect and report* ***material*** *(*emphasis added*) fraud.*

These two Grumpy Old Accountants simply can’t believe that today’s global accounting firms continue to rely on an almost 40 year-old excuse to justify their shoddy audit work. Yes, we know this because we were accounting undergraduates when this feeble defense was rolled out for the first time. While the “expectations gap” reasoning may have been believable in our youth, today it is nothing but a meaningless excuse. After all, independent audits now are dramatically improved over days gone by (or so we are told), and the Big Four have had four decades (two generations of investors) to re-educate the investing public on what an independent audit really represents.

So what does this term “expectations gap” mean anyway? Well it depends on whom you ask, and when you ask them? According to Lee et al. (2009), the term appears to have been coined in 1974 by C.D. Liggio who defined it as the difference between the levels of expected performance “as envisioned by the independent accountant and by the user of financial statements.” Interestingly enough, in 1978, the American Institute of CPA’s Cohen Commission, which was appointed to investigate the existence of the “expectation gap,” concluded that it did in fact exist, and that users of financial statements were NOT principally responsible for its existence. Of course this finding preceded the AICPA becoming the lapdog of big accounting firms.

However, once academia got involved, the definition became more Big Four friendly…there’s a surprise given who funds most auditing research. Monroe and Woodliff (1993) defined the audit expectations gap as

the difference in beliefs between auditors and the public about the *duties*

*and responsibilities* assumed by auditors and the *messages conveyed* by audit reports. And, ten years later, at a forum convened by the [U.S. Government Accounting Office](http://www.gao.gov/assets/240/236986.pdf), participants agreed that “an ‘expectation gap’ of what an audit is and what users expect continues to exist, especially with the auditor’s responsibility for fraud detection.” So, it took almost 20 years for the big accounting firms to move the “expectation gap” argument from “what *performance is* *expected* of an auditor,” to “what an auditor’s *responsibilities* are.” A subtle, but important change, especially if you are trying to avoid billions in legal liabilities for bad audits.

And this “expectation gap” is not solely a U.S. phenomenon. Lee et al. (2009) in their literature review, report evidence of such a gap globally. They note that the issue has been investigated in numerous countries including the United Kingdom, Australia, New Zealand, China, Singapore, Malaysia, and the Middle East. Whatever the country, the results are the same: *the audit “expectation gap” still exists*.

So how can the “expectations gap” be narrowed or eliminated? One proposed solution has been to establish an independent oversight authority for auditors to enhance independence, regulate audit fees, and clarify auditor responsibilities to detect fraud. Yet, despite the creation of the [PCAOB](http://pcaobus.org/Pages/default.aspx) in the U.S. and the [Professional Oversight Board](http://www.frc.org.uk/pob/) in the U.K., the gap continues.

Another suggestion is that the audit report be expanded to better convey what an audit does and implies. In fact, the 1978 Cohen Commission report noted that “evidence abounds that communication between the auditor and users of his work –especially through the auditor’s standard report – is unsatisfactory.” Almost 35 years later, the profession has finally gotten around to this potential remedy with the PCAOB’s release in June 2011 of a [concept release](http://pcaobus.org/Rules/Rulemaking/Docket034/Concept_Release.pdf) with suggestions on modifying the auditor’s report. Not surprisingly, the big accounting firms through their lobbying mouthpiece, the Center for Audit Quality, have voiced their usual concerns to changing the audit status quo in a [September 2011 statement](http://www.thecaq.org/newsroom/pdfs/CAQPressRelease_09152011.pdf).

It also has been suggested that the “expectation gap” can be narrowed by auditors’ increasing their use of decision aids. Such aids include standard checklists, forms, or computer programs that assist auditors in making audit decisions which ensure that they consider all relevant information, and also assist them in weighting and combining information to make a decision. As one might expect, this proposal is not very popular as it changes the status quo, admits the possibility that the audit process might actually be flawed, and potentially increases audit costs. More significantly, despite the past decade’s dramatic changes in [audit technologies](http://en.wikipedia.org/wiki/Computer-aided_audit_tools), the expectation gap remains.

Last, but not least is the solution most favored by the Big Four: *the educating the public approach*. Why? Because these big accounting firms don’t have to substantively change the way they do business, and it makes the expectation gap the public’s problem, not theirs. As Lee et al. (2009) point out, however, education is not a practical approach because the majority of the public is not university educated, and of the few that have been, even fewer have taken auditing courses. More importantly, there is simply no public interest in the work of auditors per se.

 So, after almost 40 years, Deloitte’s Joe Echevarria treats us to yet another dose of the “expectation gap.” But a question remains…could the Big Four meet the public’s expectation if they really wanted to? The answer seems to be yes. In fact, participants at the December 2002 [GAO forum](http://www.gao.gov/assets/240/236986.pdf) (see page 19) on governance and accountability suggested that a “forensic-type” audit might improve the likelihood that auditors will detect fraudulent financial reporting. A similar call was voiced over 10 years ago in August 2000 by the Public Oversight Board’s [Panel on Audit Effectiveness](http://www.pobauditpanel.org/downloads/prefatory.pdf) (page x) to “create a ‘forensic-type’ fieldwork phase on all audits.”

And the Big Four clearly have consulting practice lines to do forensic auditing: Deloitte ([Forensic Audit Assistance](http://www.deloitte.com/view/en_ZA/za/services/riskadvisory/forensics/7f75ecd9604f2210VgnVCM100000ba42f00aRCRD.htm)), E&Y ([Fraud Investigation & Dispute Services](http://www.ey.com/US/en/Services/Assurance/Fraud-Investigation---Dispute-Services)), KPMG ([KPMG Forensic](http://www.kpmg.com/US/en/WhatWeDo/Advisory/risk-and-compliance/forensic/Pages/Default.aspx)), and PricewaterhouseCoopers ([Forensic Services](http://www.pwc.com/gx/en/forensic-accounting-dispute-consulting-services)). So why can’t they (or won’t they) tap these skills to close the expectation gap by giving the investing public what they want? We know the answer: money! As long as regulators are willing to accept poor quality audits as adequate oversight, the Big Four have no incentive to increase their service delivery costs to improve audit quality. Instead, the Big Four have clear incentives to continue reducing their audit efforts (and costs) just as far as the regulators will tolerate. And don’t forget, the regulators also now protect them from substandard products via the “[too few to fail](http://www.corporatecrimereporter.com/auditfirms031411.htm)” doctrine.

So, just to be clear…the “expectation gap” can be eliminated by auditors living up to the investing public’s expectation of what an audit delivers. The Big Four simply don’t want to give the public the product they deserve unless they pay extra for it via the consulting services: *the forensic audit*. So sinister are the Big Four audit leadership in fact, that they actually have shifted traditional tools and techniques used 40 years ago from “auditing” to “forensic auditing.” In other words, many of the tools that auditors commonly applied decades ago have been deleted from regular audits, and now only are performed under the guise of “forensic auditing.” Take for example the case of the “proof of cash.” When controls over cash recording and reporting are questionable, there is no better tool to detect cash misstatement. Yet, today you would be hard pressed to find the topic discussed in most intermediate financial accounting or auditing texts. And where included, the topic has been relegated to an appendix. If you don’t believe us, just ask any Big Four auditor the last time they did a proof of cash…the responses are equally disappointing and shocking.

Enough melancholy! What’s the answer? What can be done to eliminate the “expectations gap?” Simple…the Big Four should drop the pretense that they are in fact auditing. Quit calling what they do “independent audits,” *for they are neither independent, nor are they auditing.*  And quit referring to themselves as auditors. Instead, refer to their services as ***financial accounting certifications performed by consultants***. After all, what they do currently is opine on application of generally accepted accounting principles. With the term “audit” dropped, there is no way the Big Four could be held liable for missing any type of fraud. And with the pretense of an audit dropped, the public will expect significantly less (if anything at all) from the Big Four, and the expectation gap issue will become null and void. And if an investor or regulator really wants an “audit,” then contract for/require a “forensic audit.”

What are the chances of this happening…zip! There is no way the Big Four will give up their traditional audit practice annuities unless forced to. So, it is only a matter of time before we hear the audit leaders at E&Y, KPMG, and PwC step forward again to blame the “expectation gap” for all of their product liability problems. After all, history repeats itself, right?

*History repeats itself, and that's one of the things that's wrong with history.*

 Clarence Darrow

 American Lawyer (1857-1938)

SOME REFERENCES ON THE EXPECTATIONS GAP

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*This essay reflects the opinion of the authors and not necessarily the opinions of The Pennsylvania State University, The American College, or Villanova University.*