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Audit Expectation Gap in Kenya: Literature Review of Causes and Remedies

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Abstract:

The audit expectation gap is a major concern in Kenya's accounting profession, where auditors are expected to identify and prevent financial fraud and misstatements. The disconnect between what the general public anticipates from an auditor's report and what the audit actually offers is often referred to as the audit expectation gap. Several factors, including limited resources and the complexity of auditing, increase the complexity of addressing this gap. The literature reviewed evaluates a variety of factors, including audit committee characteristics, auditor characteristics, sustainability auditing, and audit education, which contribute to this gap. Overall, the literature suggests that there is a significant discrepancy between the expectations of the public and the actual responsibilities of auditors, implying that auditors need to improve their interactions with their clients and the general public. This study establishes that it is necessary to address a number of audit expectation gaps in Kenya, which include those related to performance, standards, communication, and legal requirements. Regulators are required to provide clear standards and guidelines for auditors so as to maintain the standard of audit quality. This paper recommends that the effectiveness and credibility of auditing in Kenya be enhanced through a multidimensional strategy that encompasses regulatory oversight, public education, and auditor independence, thereby improving stakeholders' confidence in the financial reporting system. The findings from this research may inform the development of policies and regulations that will close the audit expectation gap and improve public trust in the accounting profession.

Keywords: Audit Expectation Gap, Auditors perceptions, Public perceptions, Audit regulation, Audit transparency

1. Introduction

The discrepancy between what is expected of auditors and what they actually deliver is commonly referred to as the "audit expectation gap." Individuals and organizations in Kenya have been concerned about this gap for quite some time since they expect auditors to offer a higher degree of confidence than they can. The audit expectation gap describes the variance between what the general public expects from an auditor's report and what the audit actually provides. In Kenya's accounting profession, where there are enormous expectations on auditors to identify and prevent financial fraud and misstatements, this gap is a major concern. Nonetheless, auditors might not always be able to achieve these expectations due to several factors, such as restricted scope, limited resources, and the inherent constraints of the audit process. This gap is an ongoing challenge in the auditing profession and has been debated for a number of decades by academics, regulators, auditors, and other stakeholders.

After several high-profile business failures and financial scandals, including the bankruptcy of Equity Funding Corporation of America and the collapse of the Penn Central Railroad, the audit expectation gap first became apparent in the 1970s. The auditing profession has come under more scrutiny as a result of these occurrences, which raised questions about the efficiency of auditing and the validity of financial accounts. The audit expectation gap still exists and is difficult for auditors to manage in spite of their efforts. The gap can be caused by a number of things, including the complexity of auditing, the general public's lack of awareness of what an audit comprises, and stakeholders' potential erroneous expectations regarding the role of auditors in uncovering fraud and other irregularities.

Auditors have been striving to enhance stakeholder communication and increase transparency regarding the auditing process' limitations in order to narrow the audit expectation gap. Regulators have also been putting measures in place to improve the standard and effectiveness of auditing, including stricter reporting requirements for auditors and the introduction of new technologies that will improve audit processes. The audit expectation gap is an ongoing issue for the auditing profession in Kenya and has attracted the attention of regulators, academia, and stakeholders. Stakeholders continue to have inflated expectations regarding the role of auditors in identifying fraud and other anomalies in financial statements despite the implementation of several regulatory measures aimed at enhancing the standard and efficacy of auditing. As a result of this, there is a rising perceptions that audits fail to adequately guarantee the accuracy of financial statements, which in turn damages the reputation of the audit profession and stakeholders' confidence in the system of financial reporting.

Addressing the audit expectation gap is essential for strengthening the quality of financial reports and guaranteeing the trust of stakeholders in the system for reporting finances in Kenya. In order to fill the audit expectation gap, Kenyan auditors should strive to enhance their stakeholder communications, be transparent about the auditing procedures' limitations, and manage stakeholder expectations.

2. Literature Review

Studies have been carried out in Kenya to explore the audit expectation gap and its influence on the public's opinion of the accounting profession. For example, Kamau's (2022) research examined how the Kenyan general public perceived the functions of auditors and the disparity between actual and expected findings from audits. The study indicated that although the public has high expectations for auditors to identify fraud, they might not be fully aware of the audit process' specified limits. The research also made apparent the necessity for auditors to manage the expectations of their clientele and the general public through improved communication.

The focus of this study by Gacheru et al. (2019) was on the effect of the characteristics of audit committees on the audit expectation gap in Kenya's public sector. The purpose was to enhance the proactive oversight of the processes for financial compliance, reporting, and disclosure. The research results demonstrated that the audit expectation gap in Kenyan state firms was significantly influenced by the audit committee's qualities. The study's theoretical underpinnings were agency theory and institutional theory. According to a separate study by Kamau (2013), an auditor's responsibility is to guarantee that financial statements accurately reflect the financial health of a business. However, there is a disconnect between what the general public expects from auditors and what auditors actually perceive to be their duties. Many factors have a bearing on this discrepancy. According to a study done in Kenya, some of these variables have significant effects on the audit expectation gap, whereas others do not. Multiple linear regressions and correlation analysis were utilized in the study to evaluate assertions and arrive at results.

The research conducted by Fossung et al. (2020) explores the role of auditing in encouraging sustainable business practices. It emphasizes the value of auditors in recognizing and evaluating how social and environmental issues affect business performance. According to the authors, auditing may support sustainable development by assuring the veracity of sustainability reporting and pointing out areas where businesses can enhance their sustainability policies. The article additionally discusses the difficulties auditors have when evaluating sustainability and offers recommendations to increase the efficiency of sustainability auditing. The researchers come to the conclusion that auditors have to adapt their procedures so that they meet the needs of the evolving business environment and that auditing has a critical role to play in encouraging sustainability practices in organizations.

In Salehi et al.'s (2020) study, the potential effect of auditor characteristics on the gap in users' expectations is examined. The study makes use of an innovative measurement that takes stock price swings into account when evaluating the current expectation gap among information users. The study concludes that the audit expectation gap is not significantly correlated with typical audit fees. Allocated audit prices in financial statements, however, offer useful information for both internal and external parties because audit fees are adversely correlated with the audit expectation gap. The study also reveals that the independence of directors, board members, and audit committee members fills in the customer expectation gap. The audit expectation gap has an inverse relationship with the audit firm rating, but the audit firm record significantly and positively influences the audit expectation gap. The study indicates that the extent of the expectation gap differs across different organizations.

The accounting and audit professions have to transform, and this has been acknowledged by both regulators and accounting practitioners. To determine if audit education has had an effect on the audit expectation gap's existence, Fulop et al. (2019) carried out a research study. In order to accomplish this, they surveyed students who served as proxies for several stakeholder groups. According to the survey results, narrowing the audit reasonableness gap requires a large investment in audit education. Therefore, it is essential to take additional steps in this direction. The objective of Rostami's (2019) study was to examine how financial statement users in Iran and Iraq manage the audit expectations gap. The study looked at three coping mechanisms, such as the kind of audit report, user training, and regulations and standards. Questionnaires, distributed evenly among bank employees, investors, and university students in Iran and Iraq, were used in the study to collect data. The study's findings demonstrate that none of the coping mechanisms were able to close the audit expectations gap between Iran and Iraq.

3. Causes and types of audit expectation gap

The lack of specific regulations and guidelines for audits constitutes one of the main contributors to the audit expectation gap in Kenya. As a result, there are variations in the level of quality of the audits performed by various firms, with some audits being of a higher standard than others. The lack of awareness among stakeholders of what an audit truly encompasses is another factor contributing to the audit expectation gap in Kenya. While many stakeholders inaccurately assume that audits ensure the accuracy of financial statements in terms of fraud, in reality they only offer an acceptable degree of assurance. To bridge the audit expectation gap in Kenya, there is a need for stakeholders to be educated on the role of auditors and the limitations of audits. Additionally, there is a need for regulators to develop clear guidelines and standards for auditors to ensure consistency in the quality of audits conducted. Stakeholder awareness of the function of auditors and the constraints of audits is crucial for addressing the audit expectation gap in Kenya. To maintain consistency in the quality of audits carried out, regulators also need to establish clear standards and processes for auditors.

The audit expectation gap in Kenya is a difference between stakeholders' expectations and what is actually accomplished by auditors. In Kenya, there are various forms of audit expectation gaps, including: first, the performance gap, which occurs when stakeholders anticipate auditors to carry out tasks that are outside of their scope of expertise, leading to a discrepancy between expectations and the audit's actual performance. The second gap is the Standards Gap, in which discrepancies result from stakeholders' and auditors' divergent understandings of the auditing standards, which causes discrepancies in both stakeholders' expectations and the actual audit procedures carried out.

A communication gap is another form that occurs when stakeholders' expectations and actual communication of audit results differ from those of the auditors in the communication of audit findings, recommendations, and limitations. The fourth type is the Legal Gap where discrepancy occurs when stakeholders erroneously believe that auditors are offering legal advice when, in fact, they are merely offering an opinion on the financial statements. Stakeholders have to understand the function of auditors and the constraints of audits in order to bridge these gaps. To maintain consistency in the quality of audits performed, regulators must also create clear criteria and procedures for auditors.

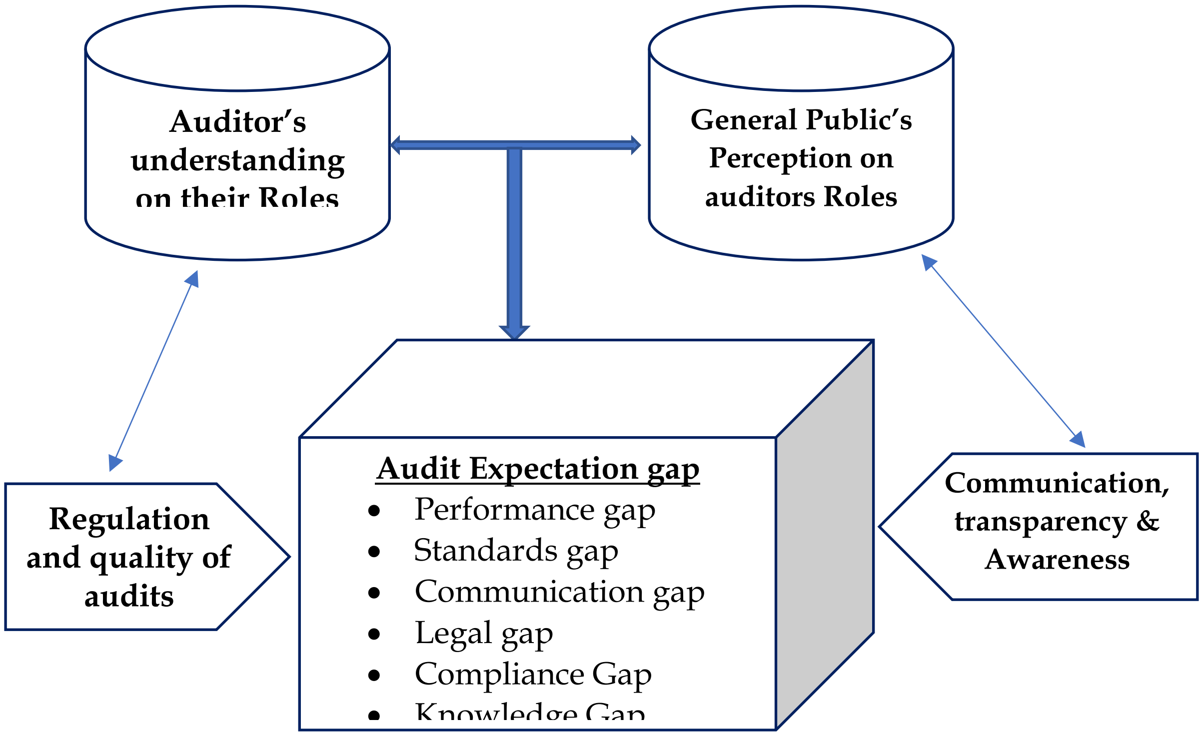

Figure 1: Audit expectation gap Framework

Figure 1 illustrates the interconnection between audit expectation gap sources, types, and possible remedies. The diagram shows that the audit expectation gap is the difference between the general public's perceptions and auditors understanding of their roles, more so when it comes to fraud detection. It further illustrates the different types of gaps that exist between the two groups. The framework also suggests possible remedies to assist in bridging the audit expectation gap.

4. Conclusion

A combined effort from an array of stakeholders, including auditors, regulators, and users of financial statements, is necessary to bridge the audit expectation gap in Kenya. Here are some steps that can be taken to address this issue: First and foremost, Improved communication and transparency can help. Auditors should communicate more effectively with stakeholders about the nature and scope of auditing, the audit's limitations, and the elements that can influence the accuracy of financial statements. Improved communication and transparency: Auditors should communicate more effectively with stakeholders about the nature and scope of auditing, the audit's limitations, and the elements that can influence the accuracy of financial statements. This can be managed by establishing more elaborate reporting guidelines for auditors and by providing audit reports that are simple and easy to comprehend for people who are not experts.

The regulatory structure governing audits in Kenya can be strengthened by regulators in order to increase the efficiency and quality of audits. Increased enforcement efforts, the acceptance of globally recognized auditing standards, and the creation of a powerful, independent audit oversight body can all help achieve this. Enhancing public awareness can also assist in addressing the audit expectation problem. There is a need for outreach and increased public knowledge about the limitations of auditing as well as the role of auditors in financial reporting. Public awareness efforts and the distribution of informational documents to the general public, including investors, creditors, and other stakeholders, are two ways to accomplish this. Enhancing auditor independence: There is a need to strengthen auditor independence to enhance the credibility and effectiveness of auditing. This can be achieved through the adoption of strict independence rules and the provision of guidance to auditors on how to maintain independence.

In conclusion, overcoming the audit expectation gap in Kenya calls for a multifaceted strategy that includes expanding regulatory monitoring, raising public awareness, and strengthening auditor independence. The credibility and efficiency of auditing in Kenya can be improved by taking these steps, which will increase stakeholders' confidence in the system of financial reporting. The audit expectation gap is an issue of concern in Kenya's accounting profession, and regulators and auditors must work together to manage public expectations and enhance the audit process.

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