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Theory of Assessment and Practical Aspects of Audit Expectation Gap in Hungary

Thesis statements of the dissertation

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1. JUSTIFICATION OF THE RESEARCH TOPIC AND RESEARCH OBJECTIVES

My field of research is the practice and theory of auditing. The topic of my research was chosen after I had obtained the relevant theoretical and practical knowledge of the subject. The constant regulatory changes in accounting and auditing activities as well as the new challenges stemmed from this provided bases for conducting research into several sub-areas of accounting and auditing.

The audit expectation gap has preoccupied the finance and accounting profession for a long time. A great number of studies have been performed on this issue and attempts have been made to provide an accurate definition of audit expectation gap, model this concept and assess the possibilities of its narrowing. Also, numerous of studies investigate the existence of an audit expectation gap in several researched regions. The objectives of the empirical studies on the structure and nature of the audit expectation gap are to identify the existing and expected roles and responsibilities of auditors as well as the factors, which contribute to the existence of the audit expectation gap in a society.

The findings of international studies on the audit expectation gap cannot directly be applied to a particular country without further investigation. Nor can they be applied in Hungary. This is because economic, social and legal factors of a specific country have a considerable impact on research results and might even distort them.

Therefore, this research study aims at identifying the causes and the typical composition of the audit expectation gap in Hungary to enable us to find appropriate combinations of solutions for narrowing the expectation gap.

Also, through an analysis of the literature –national and in particular, international literature on audit expectation gap – this study aims at getting a deep insight into the theoretical background of this empirical research in sufficient detail. Then the study attempts to create a Hungarian model of the audit expectation gap and conduct an empirical analysis of important areas of this gap, which are closely related to expectations towards auditors and their performance such as:

- the information content of the audit report, its usability in decision-making processes and
- the perception of auditors' independence in Hungary.

2. RESEARCH METHODOLOGY

2.1. ANALYSIS OF THE THEORETICAL BACKGROUND TO THE EMPIRICAL STUDY

2.1.1. DEFINITION, EVOLUTION, INTERNATIONAL AND HUNGARIAN REGULATIONS ON AUDITING

In order to support the hypotheses about the audit expectation gap formulated in the current study, it is critical to conduct a detailed analysis of the existing audit systems and the international and Hungarian national standards to enable us to identify any regulatory inconsistencies or overlaps hidden in legislation. The primary aim of analysing the regulatory and professional aspects of audit is to test the following hypothesis:

Hypothesis H1

Hungarian legislation clearly defines the purpose and the scope of the audit based on regulatory requirements and specifies the auditors' responsibilities and duties in order to assist the interest groups in interpreting their content and significance.

Procedures and methods used for
testing the hypothesis

The Hypothesis H1 was tested by a detailed analysis of international and Hungarian auditing standards and related legislation.

Hungarian rules on auditors' responsibilities are of two levels. The most significant national rules – governmental laws and regulations – are written, whereas the detailed rules on auditing are specified by the Chamber of Hungarian Auditors, which sets mandatory auditing standards and requirements.



Source: author's own elaboration based on mandatory auditing standards

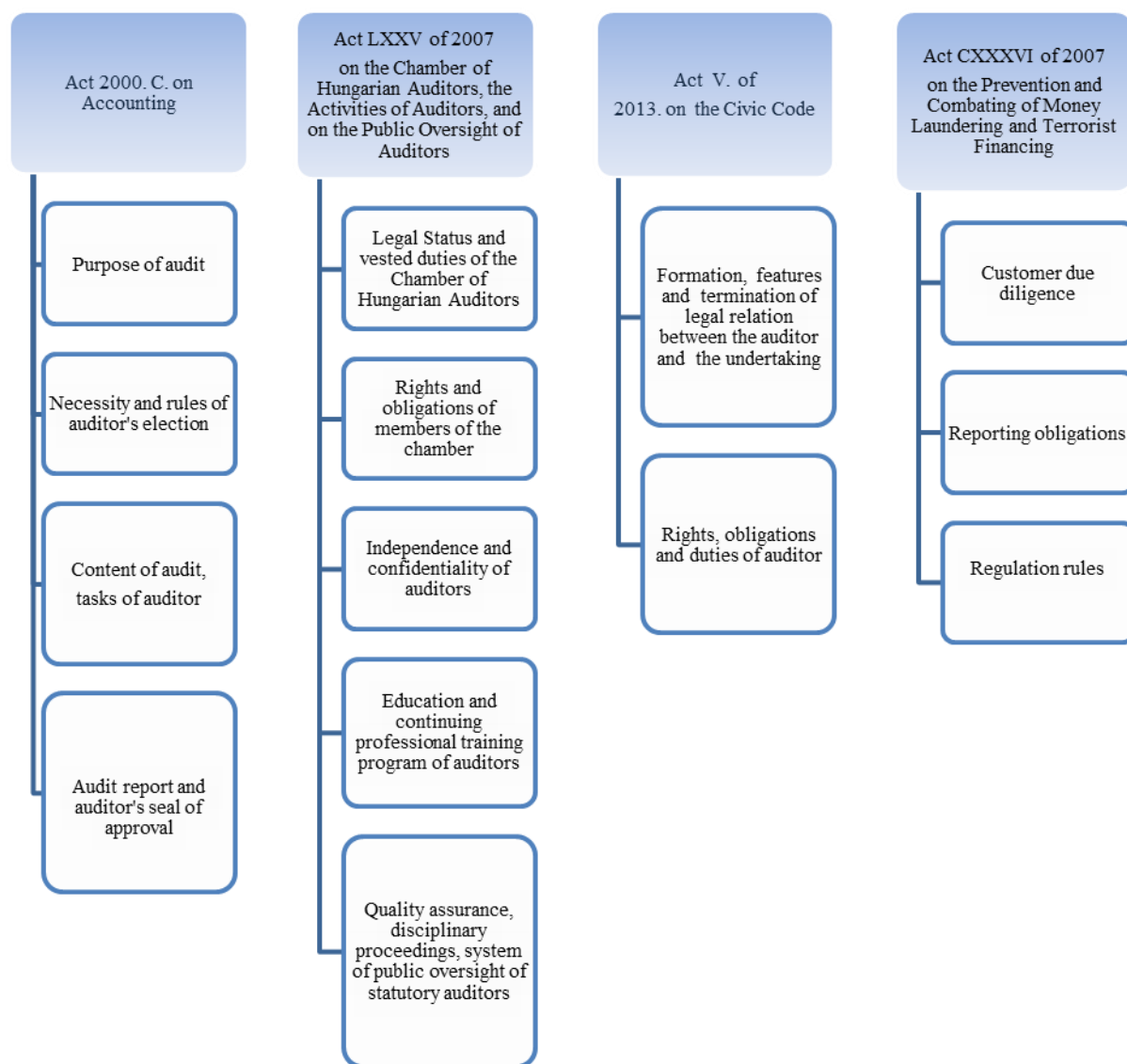
Figure 1: Hungarian model of auditing rules.

The legislation lacks a uniform and comprehensive definition of auditing, which would cover the whole control process. The legislation only specifies audit objectives and duties

as well as auditors' responsibilities (Szekeres, 2007). This provides grounds for investigating audit regulations in Hungarian legislation.

One of the fundamental issues of corporate laws – also from conception aspects - is to provide an appropriate legislative framework for rules on auditing.

Figure 2 shows the essential elements of auditing in specific – the most essential – legislation:



Source: author's own elaboration based on the legislation referred to in this study

Figure 2: Significant legislation on auditing in Hungary

The detailed analyses of the relevant audit rules show that the legislation on auditing has several overlapping topics. Hence, the overlaps occur in audit topics stipulated in various rules on auditing and in rules mostly with the same content or with a supplementing content, which makes it difficult for practitioners acting in good faith to interpret the regulatory requirements.

Table 1 illustrates the aggregation of rules in regulations on auditing by researched topics and by rules.

Table 1. Aggregations of rules in regulations on auditing in the Hungarian legislation

Researched topics	Szt.	Ptk.	Kkt.	Btk.
	Auditors' functions			
certification of the annual accounts' compliance with the regulations, providing a true and fair view of the economic entity's assets and liabilities, financial position and profit or loss;	155. § (1)	3:129. § (1)	3. § (1)	
review of the annual accounts specified in the Accounting Act, certification of its compliance with the regulations, its reliability and authenticity	156. § (1),(4)		3. § (1) a)	
compilation of independent auditor's report	156. § (1), (4)	3:129. § (1)		
	Auditors' duties			
confidentiality	157. § (3)		66. § (1)-(2)	223. §, 413. § 418. §
warning of the undertaking in case of occurring or due to happening certain occurrence	157. § (2)	3:38. § (2)	24. § (1)-(2)	
attending the meeting of the audited entity's supreme body that has on the agenda the annual account prescribed under accounting regulations.		3:131. § (2)	25. §	
	Auditors' rights			
request of data and information	157. (1)	3:38. § (2)		
	Auditors' responsibilities			
professional, financial and criminal liability		2:53. §	60. § (1)-(2)	403. §
	Auditors' independence			
requirement of independence and incompatibility	155/A. § (1)	3:129. § (3) 3:130. § (2) 3:131. § (1)	61. § (1)-(2), 63. § (1), 64. § (1), 53. §, 54. § (3) - (4)	

Source: author's own elaboration based on the legislation referred to in this study

The detailed analysis of the legislation and standards on auditing show that the statement formulated in H1 require correction due to overlaps in audit legislation. Hence, based on the conclusions drawn from the analysis, the following thesis has been formulated:

Thesis T1/a

The aim and the scope of audit based on the legislative compliance obligations as well as the auditors' responsibilities and duties are clearly defined in the Hungarian legislation. However, the overlaps occurring in audit topics stipulated in various rules on auditing and in rules mostly with the same content or with a supplementing content make it difficult for interest groups to interpret the regulatory requirements

In addition, the analysis of the statement about the legislation on auditing formulated in T1/thesis - closely linked with this – and the standards set and continuously updated by professional organisations provide bases for drawing further conclusions. The key audit areas can be identified. The knowledge and the interpretation of these areas as well as the

appropriate application of the audit results are fundamental for performing auditing activities. Hence, the following thesis can be formulated:

Thesis T1/b

In order to provide clarity in the interpretation of audit expectations, the following audit issues are to be addressed and appropriately communicated towards the groups interested in auditing:

- **auditors' duties and tasks;**
- **auditors' assurance, reliability and relevance;**
- **auditors' responsibilities;**
- **auditors' independence, objectivity, neutrality and conflict of interests;**
- **correct interpretation of the terminology, information content, up-to-datedness of audit reports and their usability in decision – making processes.**

After reviewing the legislation and standards on auditing, this study focused on the literature and research findings related to audit expectation gap.

2.1.2. DEFINITION, NATURE AND STRUCTURE OF AUDIT EXPECTATION GAP. REVIEW OF MAJOR RESEARCH STUDIES AND KEY FINDINGS

The audit expectation gap has preoccupied the finance and accounting profession for a long time. Considerable research has been conducted into this issue and attempts have been made to provide an accurate definition of audit expectation gap, model this concept and assess the possibilities of its narrowing. Also, a number of studies investigate whether there is an audit expectation gap in several researched regions. The objectives of empirical studies on the structure and nature of the audit expectation gap aim at recognising the actual existing and expected roles and responsibilities of auditors as well as identifying the factors, which contribute to the existence of the audit expectation gap in a society.

The hypotheses about the literature on audit expectation gap in this study were formulated based on the reviewed literature and the prior research findings of other studies. The hypotheses were tested by a detailed review of the existing literature on the topic.

Hypothesis H2

Studies carried out on providing a definition, modeling and seeking the possibilities of narrowing the audit expectation gap are in the focus of attention in countries with different audit regulations and at different stages of economic development.

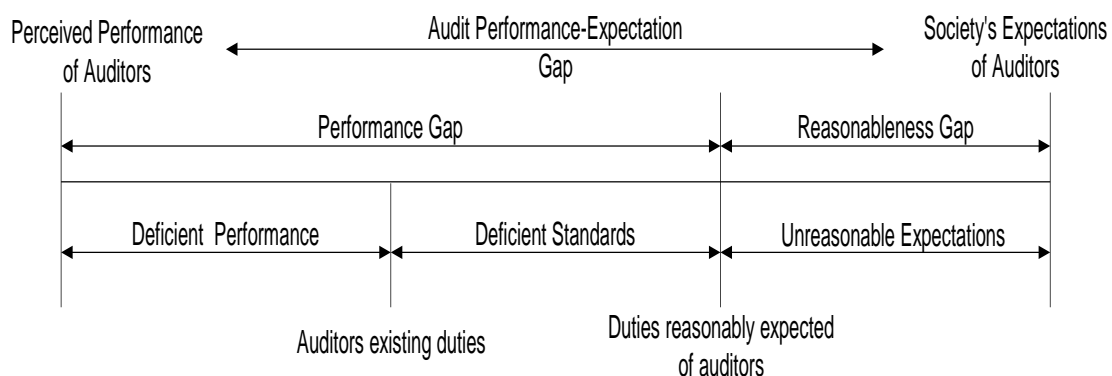
Procedures and methods of testing the hypothesis

The Hypothesis H2 was tested by a detailed review of the existing literature and of the available prior research findings on the audit expectation gap

The definition given to the audit expectation gap by scientists has undergone considerable evolution over the time. The concept of expectation asymmetry in audit was first formulat-

ed by Liggio (1974), who defined it as the difference between the levels of ‘expected performance as envisioned by auditors and by users of financial statements’. In 1978, Liggio’s definition was further extended by the Cohen Commission (CAR), which defined it as a gap, which ‘may exist between what the public expects or needs and what auditors can and should reasonably expect to accomplish’ (Cohen Commission on auditors responsibilities, 1978).

Porter considered Liggio’s and CAR’s definitions to be too narrow because they failed to realise that auditors might not accomplish the expected performance level (Liggio, 1994), or the level they can or should reasonably expect to accomplish, as defined by CAR. Based on the empirical research, she preferred and suggested adopting the term ‘audit expectation-performance gap’ because of the recent criticism of auditors. She defined the gap as the difference between society’s expectations of auditors and society’s perceptions of auditors’ performance. Porter distinguished two major components of the audit expectation-performance gap. First, the *reasonableness gap*, which is *the difference between what the public expects of auditors to achieve and what they can reasonably be expected to accomplish*. Second, the *performance gap*, which is *the difference between what the public can reasonably expect auditors to accomplish and what auditors are perceived to achieve*. The performance gap was further subdivided into deficiencies in standards (regulations), that is, *the difference between what can reasonably be expected of auditors and auditors’ existing duties and auditors’ deficient performance, that is, the difference between the expected standard of performance of auditors’ existing duties and auditors’ perceived performance* (Porter, 1993, 2.).



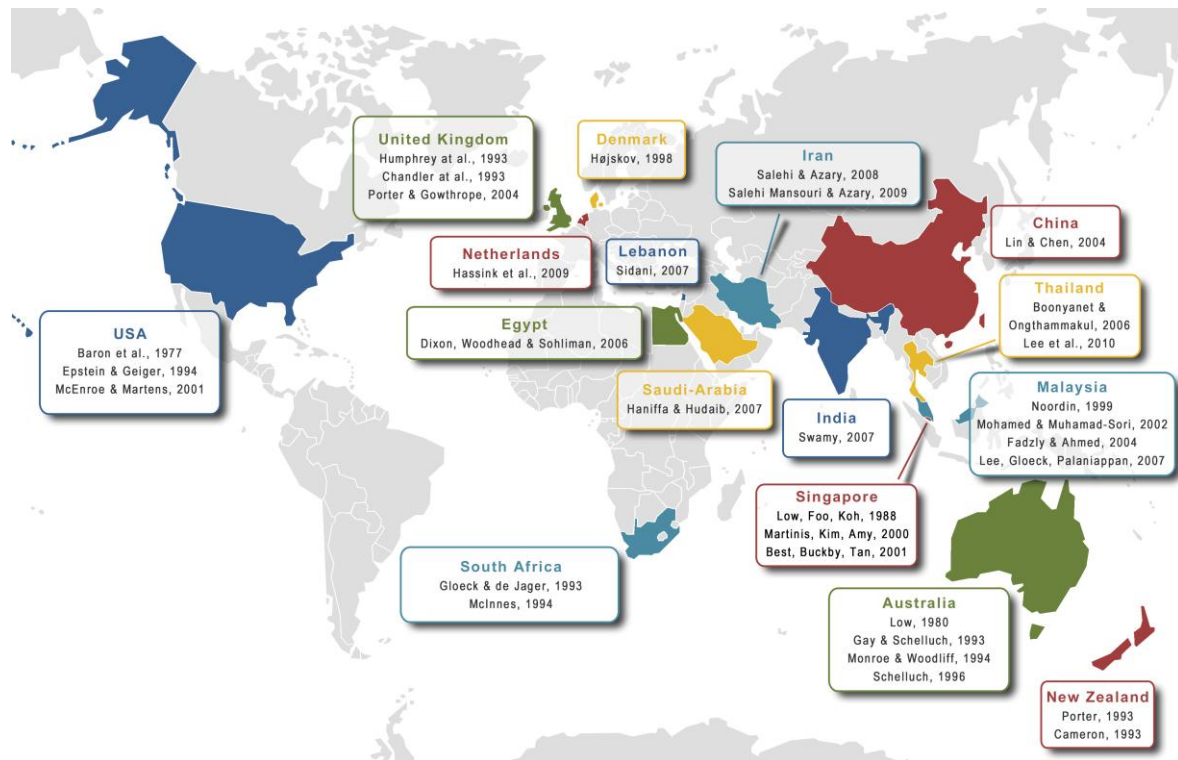
Source: Porter, 1993, 2.

Figure 3: Structure of the Audit Performance-Expectation Gap

From the consideration in Chapter 3, the definition given to the audit expectation gap by scientists has undergone considerable evolution over the time. However, the Porter’s definition was considered the basic definition and the research into the gap shifted from the definition towards the nature, structure and cause of the audit expectation gap and audit expectation-performance gap as well as towards indentifying the possibilities of narrowing the gap.

The research results confirmed the existence of the audit expectation gap in the United States of America, the United Kingdom, Australia, New Zealand, South African Republic, Singapore, Denmark, Malaysia, Thailand, China, Egypt, Lebanon, South Arabia, India, Iran, and the Netherlands.

The following map shows the countries where surveys on audit expectation gap have been conducted:



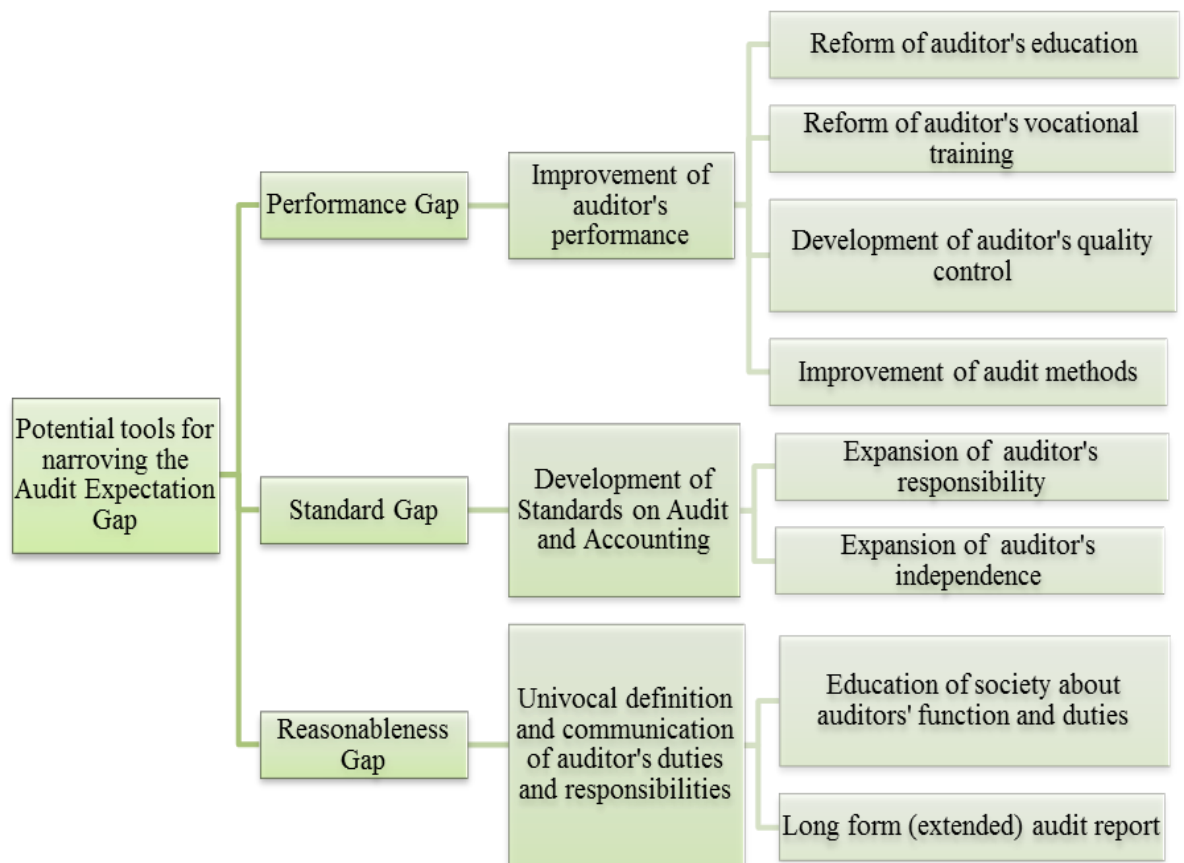
Source: author's own elaboration based on the reviewed literature
Figure 4: Studies justifying the existence of the audit expectation gap

The review of the prior literature – presented in chapter 3.3 of the thesis – reveals that after identifying the typical components of the audit expectation gap, the studies conducted recently in different economic and political environment and in various countries and societies have focused on the extent and composition of the gap. Since the studies have found evidence of expectation gap in different countries, we can speak of a global audit expectation gap.

Most researchers agree that audit expectation gap encompasses several issues. The greatest emphasis is laid on the auditors' role and responsibility (Porter, 1993, Fadzly & Ahmad, 2004, Dixon et al., 2006.), nature and meaning of the message communicated by an audit report (Monroe & Woodliff, 1994; Gay, Schelluch & Baines, 1998.) and auditor's independence (Sweeney, 1997; Lin & Chen, 2004; Alleyne et al, 2006).

Identifying components of the audit expectation gap is critical because problems arising from different components require different solutions. Possible tools to reduce the gap can be assigned only after the audit expectation gap and its components in a specific society have been identified.

The next figure summarizes possible tools that have been identified based on research results and can narrow some components of the audit expectation gap.



Source: author's own elaboration based on the reviewed literature

Figure 7: Potential tools for narrowing the audit expectation gap based on the results of former research studies

The hypotheses formulated based on the reviewed literature and the prior research findings of other studies on the audit expectation gap are considered supported and accepted as follows:

Thesis T2

Studies carried out on providing a definition, on modeling and on seeking the possibilities of narrowing the audit expectation gap are in the focus of attention in countries with different audit regulations and at different stages of economic development.

As over-mentioned, the findings of international research on the audit expectation gap cannot directly be applied to a particular country without further investigation. Nor can they be applied in Hungary. This is because economic, social and legal factors of a specific country have a considerable impact on research results and might even distort them. Therefore, the objective of this research is to identify the causes and the typical composition of the audit expectation gap in Hungary to enable us to find appropriate combinations of solutions for narrowing the expectation gap.

2.2. DEFINITION, DESIGN AND IMPLEMENTATION OF THE EMPIRICAL RESEARCH METHOD

The aim of the quantitative research conducted by primary research is to design a Hungarian model of the audit expectation gap, which focuses on the analyses of four coherent sets of questions, such as:

- Is there an audit expectation gap in Hungary in terms of the selected issues?
- What are the causes of evolution of the audit expectation gap?
- What are the structure and the composition of the audit expectation gap in Hungary?
- What are the possibilities of narrowing the audit expectation gap?

In order to support the stated hypotheses in the current study, active players of economic life were invited to provide the information on these issues on a regular basis. The primary source of this empirical study was generated from a well-structured questionnaire, which was sent electronically to participants. The survey instrument also included a paper questionnaire with the aim to reach the widest possible target groups.

As for the time-period, the research attempted to record the state of audit in an economic, social and regulatory environment in Hungary at the time when the research study was conducted. The groups involved were surveyed and their opinions were summarised.

The questionnaire consisted of two parts. Part 1 of the questionnaire contained questions related to demographic data and general questions to elicit information such as respondents' age, level of education and their feelings about audit. Part 2, the main part of the questionnaire in terms of content, gathered information about auditors' functions, tasks, responsibilities and independence. The structure of questions compiled to support the stated hypotheses are as follows:

Table 2: Structure of professional issues of the questionnaire

Structure of professional issues	
Number of the questions in the questionnaire	Subject searched by the questions
2.1-2.12	Existence and causes of evolution of audit expectation gap
3.1-3.5	Assessment of performance of audit and auditors
4.1-4.26	Judgement of auditor's duties
5.1-5.20	Interpretation of terminology used in audit reports
6.1-6.15	Usefulness of information communicated in audit reports and of the auditors' opinions in investors' decision-making processes
7.1-7.10	Perception of auditors independence

Source: author's own elaboration

DEFINITION OF RESEARCH POPULATION

The reviewed literature revealed that while conducting analyses of the audit expectation gap, researchers surveyed a wide range of users of financial statements such as investors (Fadzly & Ahmad, 2004), bankers (Best et al., 2001), financial directors (Haniffa & Hudaib, 2007), senior managers (Alleyne & Howard, 2005), investment analysts (Haniffa & Hudaib, 2007; Humphrey et al., 1993), educators (Lin & Chen, 2004), government officials (Haniffa & Hudaib, 2007; Lin & Chen, 2004), brokers (Fadzly & Ahmad, 2004), credit managers (Haniffa & Hudaib, 2007), judges (Lowe, 1994) and jurors (Frank et al., 2001).

In the process of the research design, groups involved in an audit were identified as possible target groups of the questionnaire survey. Within the framework of this approach, and from the population of interest groups consisting of preparers, analysts and beneficiaries of financial statements, a sub-population was selected, whose opinion seemed to be valuable and suitable for analyses. Time and feasibility limits were also taken into account.

Finance and accounting managers and accountancy service providers in the capacity of preparers of financial statements liaise very closely and are responsible for financial statements. They are well informed about auditing processes, auditors' roles, accomplished work and the applicability of the work, which provides sound bases for a more reliable assessment of deficiencies in potential performance and standards. Consequently, less emphasis is laid on potential reasonableness gap. The sample was selected from the public database of accounting service providers, who were listed in the register held by the Ministry for National Economy. The questionnaire was mailed to 3,800 addresses and 184 responses were obtained.

Bankers and financial consultants were selected to represent beneficiaries of financial statements. It is fundamental to elicit information from different users since users are linked to monitored businesses in different ways. These users face a larger information asymmetry and may have different expectations of auditors. They may benefit from auditors' activities, without paying for audit services. In terms of cost-benefit implications, the users taking advantage from free services may expect auditors to further intensify their efforts. As a result, their opinion may differ from finance and accounting managers'. The Hungarian Banking Association provided assistance with establishing contacts with its forty-seven members and electronically forwarded the questionnaire to accounting and database divisions. As many as ten responses were received.

Auditors were selected from the population to represent the opinion of the audit profession, which is most involved in the audit expectation gap. The Chamber of Hungarian Auditors assisted with forwarding the questionnaire to its 5,306 registered active and passive auditors and 268 members sent back the filled questionnaire. In addition, a national control authority, a representative of the Borsod-Abaúj-Zemplén country, however, not in the capacity of an authority, also provided assistance with distributing 100 paper questionnaires to the population involved in the control, to people dealing with preparing and using financial statements. As many as 48 responses were received.

The online responses were registered, stored and summarised by EvaSys automation software that implemented the survey, assessed the responses and forwarded them to the author, who analysed them.

Altogether 510 responses, which accounted for 5.50 % of usable response rate, were obtained.

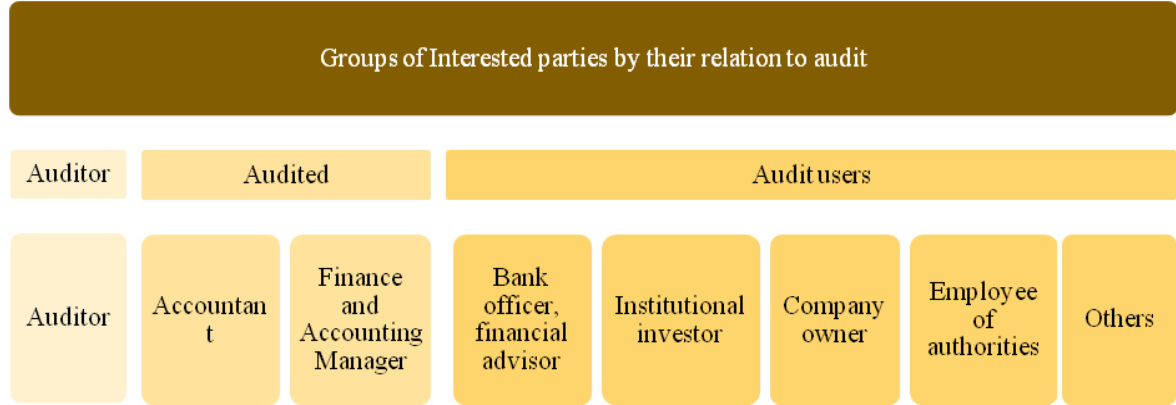
EVALUATION OF THE OBTAINED SURVEY SAMPLE

The responses from active and passive auditors registered with the Chamber of Hungarian Auditors amounted to 53% and the response rate of accounting service providers registered by the Ministry for National Economy accounted to 36%. As many as 9% respondents dealt with audited financial statements and worked for audit authorities. Experts working for member institutions of the Hungarian Banking Association filled the remaining responses of 2%.

The objective of this study was to sample four different groups of population with similar relationships with audit. However, the responses to the demographic questions revealed a

surprising picture. For instance, only 69% respondents from the population of the Chamber of Hungarian Auditors indicated that they were involved in audit activities. Similarly, respondents, who were accounting service providers listed in the register held by the Ministry for National Economy, could not be considered to be a homogenous group in terms of their activities for as many as 26% did not pursue the career of an accountant or a financial manager at the time of the survey. Consequently, in order to support the hypotheses stated in the study, another, not the originally planned sub-population was taken into account in the process of analyses. The classification and division was made based on the questions related to the respondents' own activities.

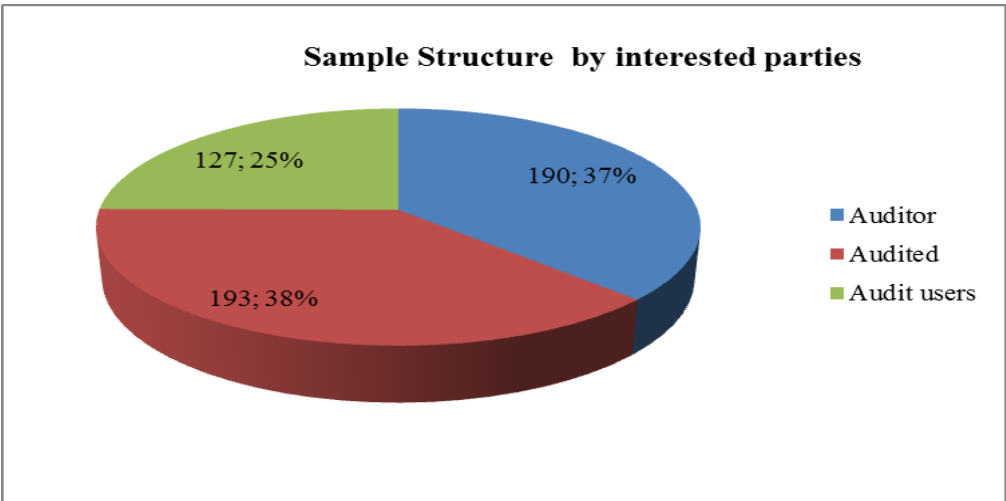
The table below illustrates classification of the respondents by their activities mentioned above into three main groups, which may provide grounds for eliciting differences or similarities in opinions:



Source: author's own elaboration

Figure 9: Groups of interest parties by their relation to audit

The following pie chart shows the distribution percentage of the number of items within the total sample in the three developed and examined groups.



Source: author's own elaboration based on the data processed by EvaSys Education Survey Automation Suite

Figure 10: Sample structure by interest parties

Survey responses were used to test the hypotheses.

3. EMPIRICAL TESTING OF THE HYPOTHESES AND RE-SEARCH CONCLUSIONS

The research hypotheses about the audit expectation gap were formulated after the available literature had been synthesised. The hypotheses were empirically tested by evaluating the findings of the collected survey responses, which reflected the opinion of the groups interested in auditing.

3.1. EMPIRICAL TESTING OF THE HYPOTHESIS ABOUT THE EXISTENCE OF THE AUDIT EXPECTATION GAP

Hypothesis H3

The evaluation of the responses of groups interested in financial statements show no significant difference in the perception of the existence and causes of evolution of the audit expectation gap in Hungary.

Procedures and methods used for testing the hypothesis

The Hypothesis H3 was tested by evaluating the responses given to the relevant questions with the Pearson's Chi-square (χ^2) Test for Independence, by comparing the differences between two probabilities (a two-sample Z-test equation), by analysing the differences between two expected values and by single-factor analysis of variance.

As for the existence of the audit, expectation gap perceived by the interest groups and discussed in Chapter 5.1. of the study, it can be claimed that the majority of respondents in each interest group agreed that there is an audit expectation gap. However, the audit users - the indirectly concerned groups - perceive little of the problems arising from audit expectations. The analysis shows that the investigated factors are independent from each other, that is, the perception of the existence of the audit expectation gap is independent from the group the respondents belong to. Also, the differences in perceptions of the gap by the auditors and by non-auditors are insignificant.

While evaluating the responses regarding the perception of the audit expectation gap, the study also seeks for evidence of the gap. If the responses reveal that there is an audit expectation gap in Hungary, the study has to focus on investigating the causes of its evolution and widening in the country. This is because the causes have to be directly mapped first. The respondents choose from the provided possible causes, which are checked later with the help of indirect means when the responses related to audit functions, usability and performance are evaluated.

The most frequent causes of the evolution and existence of the audit expectation gap indicated by respondents are as follows:

- corporate crises and financial reporting scandals, which result in new professional expectations and responsibilities of the auditing profession (Question 2.3);
- misunderstanding, ignorance of audit users –who rely on the information in the audit reports when making economic decisions - about auditors' responsibilities and audit limitations (Question 2.9)
- unreasonable expectations of audit users –who rely on the information in the audit reports when making economic decisions - about audit functions (Question 2.10)

The respondents consider non-audit services provided by auditors to be the least determining factors of the audit expectation gap (Question 2.8). As for this factor, the whole sample is homogenous in terms of the investigated criterion since there are no significant differences in responses of interest groups.

The conducted analysis fails to support the initial hypotheses fully. The analysis shows that the initial hypothesis has not been supported fully. However, the research findings enable us to formulate the following hypothesis:

Thesis T3

The groups interested in financial statements show no significant difference in the perception of the existence of the audit expectation gap in Hungary.

Each interest group attributes the audit expectation gap to corporate crises, audit and report scandals, which results in new professional expectations and responsibilities of the auditing profession. However, they do not consider non-audit services provided by auditors to be a common cause.

Also, the interest groups attributes the audit expectation gap to misunderstanding and ignorance of audit users about auditors' responsibilities and audit limitations as well as unreasonable expectations of audit users about audit functions. There is a significant difference between the perceptions of different groups regarding the extent to which these factors contribute to the evolution of the audit expectation gap.

3.2. EMPIRICAL TESTING OF THE HYPOTHESIS ABOUT THE STRUCTURE OF THE AUDIT EXPECTATION GAP

Among the many theories that look at the audit expectation gap discussed in Chapter 3 in this study, Porter's model of 'audit performance-expectation gap' stands out for its comprehensiveness. This study attempts to validate its amended version in Hungary by a primary analysis. This is because the audit expectation gap can be the result of not only performance and reasonableness implication, but also the result of false interpretation of the specific audit terminology by groups interested in audit. This study assumes that this is closely linked with the conclusions drawn from audit results stipulated in the standards, which auditors comply with. However, the interest groups misinterpret their meaning. The hypothesis was formed on the basis of the above-mentioned considerations:

Hypothesis H4/a

In Hungary the audit expectation gap stems from the combination of the deficient performance of auditors, deficiencies in audit standards, unreasonable expectations and false interpretations of audit functions, the mapping of which enable us to identify the possible tools required for narrowing the gap.

Procedures and methods used for
testing the hypothesis

The Hypothesis H4/a was tested by evaluating the responses to the relevant questions in the questionnaire and by hypothesis testing relating to the population ratio (Z-test equation)

In order to achieve the research objectives of this hypothesis, namely identifying the causes of the audit expectation gap and typical components of its nature, the respondents were requested to assess auditors' performance based on the provided assessment criteria - auditors' professional competence, preparedness, independence, responsibility for the audit report and reliability and usability of their work, - and to express their opinions about the statements of the study related to auditors' responsibilities and duties. The respondents were asked whether auditors could perform the entrusted tasks efficiently (the invested work, the achieved results, pay for work with special focus on the ratio between them) and bear the responsibility for the performed work. In addition, they had to indicate whether the listed tasks, duties and responsibilities were expected of auditors in Hungary. If they were, the respondents had to indicate how auditors met these expectations. If they were not, the participants of the survey were invited to indicate whether auditors would need to meet the expectations related to their tasks, duties and responsibilities in the future.

From the consideration above it follows that auditors' responsibilities can be classified as follows:

- the requirements for auditors laid down in the Hungarian legislation;
- auditors' responsibilities adopted in Hungary and specified in the Hungarian National Standards on Auditing and Quality Control; and
- not existing auditors' responsibilities based on Porter's study (1993), which encompassed the following main issues:
 - auditors should bear responsibilities for accuracy of corporate financial statements and sustainability of corporate solvency;
 - auditors should provide early warnings and issue alerts concerning mistakes made by companies;
 - auditors should detect possible tax fraud or any other financial fraud and other financial illegal acts and report them both to the stakeholders of the company and to the appropriate authorities.

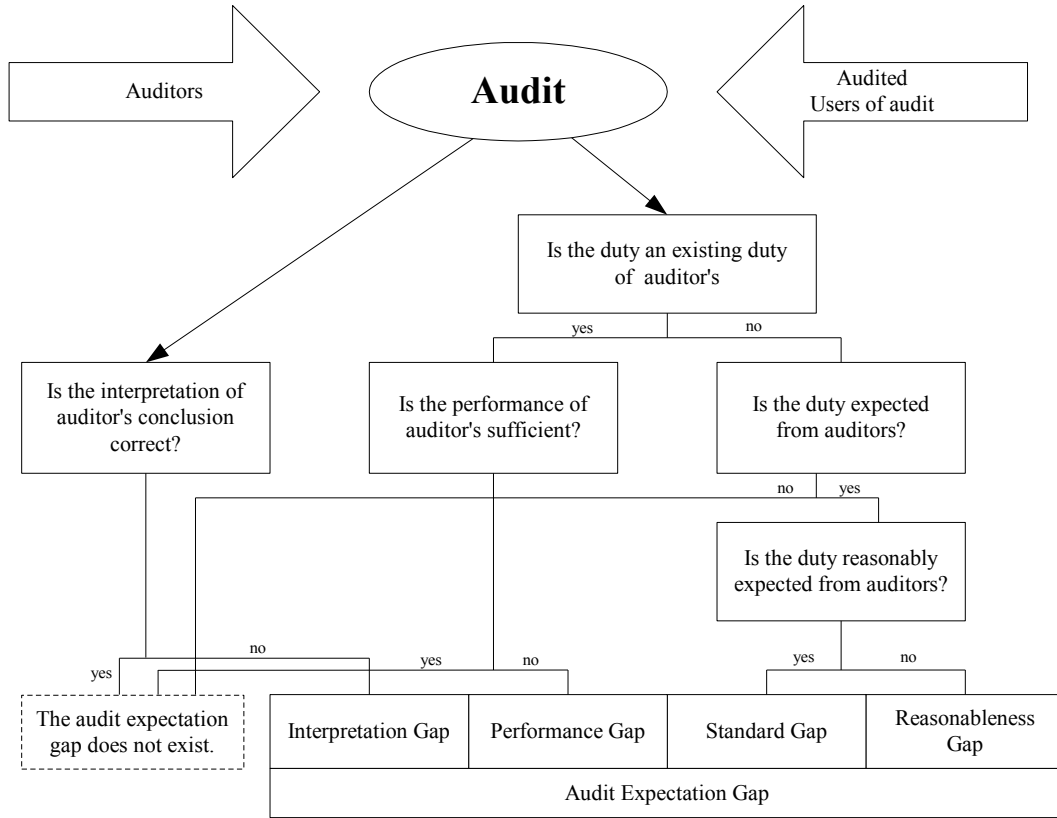
The responsibilities belonging to the first two categories and determined by audit legislation in Hungary and stipulated in the Hungarian National Standards on Auditing and Quality Control hereinafter are called 'auditing standards requirements'

From the consideration above it follows that the structure of the audit expectation gap in Hungary, that is which duties and responsibilities contribute to which component of the gap, can be identified. The classification principles are as follows:

- I. Deficient performance gap are the responsibilities set down by auditing standards requirements, but:
 - auditors do not consider them to be their duties or responsibilities, or
 - the interest groups perceive that auditors do not perform their responsibilities to a satisfactory level.
- II. Deficient standards gap encompasses responsibilities that are not defined by standards, but can reasonably be expected of auditors to accomplish.
- III. Reasonableness gap is related to responsibilities that are not defined by standards and cannot reasonably be expected of auditors to accomplish.
- IV. Improper interpretation gap, a new component of the audit expectation gap introduced by the author. The existence of the gap has been proved and involve conclusions drawn from audit results which are defined by standards, auditors meet them, but the interest groups misinterpret their meaning.

For classification purposes, an analysis of interest groups' opinions was conducted, which could prove the existence of performance, standard, reasonableness and improper interpretation gap. This depended on whether the specific responsibility was reasonably expected not existing, reasonably not expected not existing or improperly interpreted responsibility by the groups involved.

The process of defining the audit expectation gap in Hungary was modelled as follows:



Source: author's own elaboration based on Porter, 1993

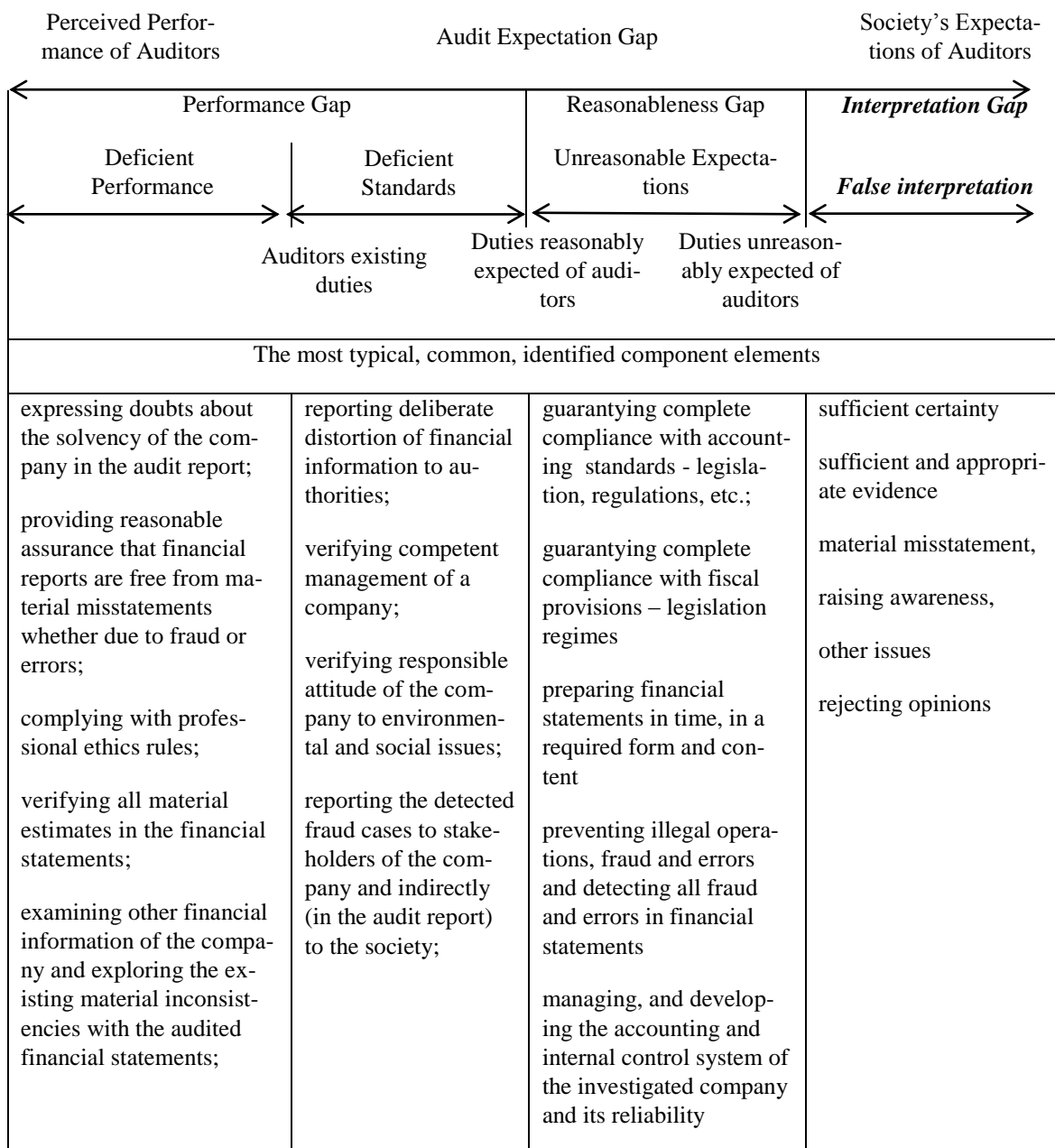
Figure 11: Process of determining the audit expectation gap

Based on the analysis of responses, the specific factors, which contribute to the existence of certain components of the audit expectation gap, may be presented.

In the process of defining the audit expectation gap on the basis of the model illustrated in Figure 11 and evaluating the responses of the interest groups, a numerical criterion is to be established to enable us to clear what position a specific group regarding the above-listed issues take. The reviewed literature offers several solutions to establishing a numerical criterion. Whilst examining the audit expectation gap and identifying the position of the interest groups taken on this issue, Porter (1993) asserts if 20% respondents considered that a duty was reasonably expected and should be performed, it was relevant. Troberg & Viitanen (1999) in their studies suggested a higher rate of 25%, which 'constituted a qualified minority'. This study adopted Troberg & Viitanen's (1999) numerical criterion.

For the purpose of establishing a proper criterion, this research study conducted a hypothesis testing regarding the population rate on the basis of sample characteristics formed by auditors, audit and audit users. Hence, the conclusions formulated in this study are relevant to all interest groups concerned. For the assessment of the hypotheses set in this study (supported or refuted), a Z-test was used to determine a significance level of 5%.

After a statistical evaluation of the responses to the questionnaire and further developing Porter's model of the structure of the audit expectation gap, this study modelled the audit expectation gap in the Table below. The most typical factors characterising the component elements of the audit expectation gap and providing a basis for identifying the measures, which contribute to narrowing the gap in Hungary, are illustrated in the model.



Source: author's own elaboration

Figure 12: Structure of audit expectation gap in Hungary by the perception of audit interest parties

The conducted analyses support the hypotheses set in this research study. Hence, the following thesis can be formulated on the basis of the findings this research:

Thesis T4/a

In Hungary the audit expectation gap stems from the combination of the deficient performance of auditors, deficiencies in audit standards, unreasonable expectations and false interpretations of audit functions, the mapping of which enable us to identify the possible tools required for narrowing the gap.

3.3. EMPIRICAL TESTING OF THE HYPOTHESIS ABOUT AUDITORS' RESPONSIBILITY FOR FRAUD WITHIN A BUSINESS ENTITY

The auditors 'existing and expected role in fraud prevention and detection is a characteristic element in the analysis of audit expectation gap.

Numerous studies conducted in various countries have revealed auditors' role in fraud and deficiency detection perceived by interest groups. (Alleyne & Howard, 2005; Best et al., 2001; Dixon et al., 2006; Epstein & Geiger, 1994; Fadzly & Ahmad, 2004; Frank, Lowe & Smith, 2001; Haniffa & Hudaib 2007, Humphrey et al., 1993; Lin & Chen, 2004; Lowe, 1994; McEnroe & Martens, 2001; Sidani, 2007).

Hence, this study lays a special emphasis on investigating this area of audit expectation gap and formulates the following hypothesis about fraud:

Hypothesis H4/b

Groups interested in audit expect greater responsibilities of auditors for fraud prevention, detection and communication of the detected fraud in Hungary.

Procedures and methods used for
testing the hypothesis

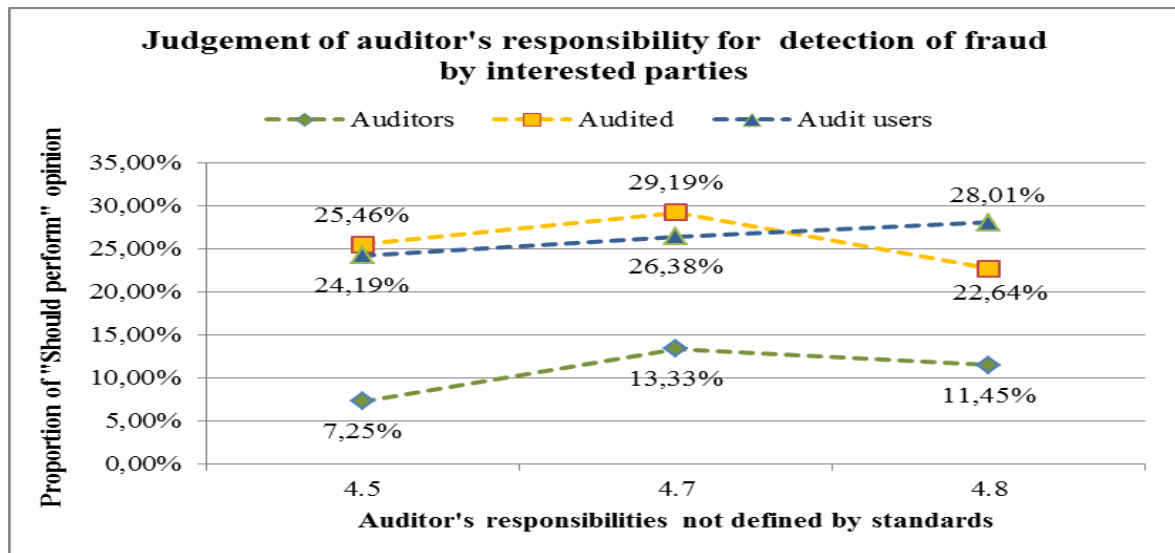
The Hypothesis H4/b was tested by evaluating the responses to the relevant questions in the questionnaire and by using the results of previous studies

In order to obtain a more comprehensive picture of the beliefs of interest groups and to support the formulated hypothesis, the responses to questions related to auditors' responsibilities for prevention of audit fraud and other illegal acts are evaluated.¹

The findings reveal that audit users have the greatest demand and auditors have the lowest demand for modification of the existing audit regulations and standards in terms of auditors' responsibilities for prevention of audit fraud and other illegal acts.

Whilst identifying the characteristic components of audit expectation gap in Hungary – in Sub-chapter 5.2 - this study focuses on three factors related to prevention, detection and communication of detected audit fraud and expected responsibilities. In order to test the hypothesis 4/b, auditors' responsibility for detection of fraud is investigated in detail.

¹ Questions 2.6, 4.5, 4.7 and 4.8 in the questionnaire.



Source: author's own elaboration based on the data processed by EvaSys Education Survey Automation Suite, University of Miskolc

Figure 13: Perception of auditors' responsibilities for audit fraud by interest groups

This study defines the expectations related to auditors' responsibilities for preventing illegal acts, audit fraud audit errors and detecting fraud and errors in every audit report (Question 4.5) – despite the fact that the standard gap complied with all the assessment criteria – as a component of reasonableness gap. This is because the accomplishment of the expected duties is incompatible with original audit functions and auditors' possibilities and would presume a full investigation of entities 'economic activities, accounting, cost calculations, cost prices and of the whole compilation process of the audit report. The high demand for accomplishing these tasks – altogether 25% of audited and audit users believe that this obligation can be fulfilled – indicates that interest groups expect changes in this field.

Taking into account the author's prior findings, this study defines the expected responsibility for reporting the authority the deliberate distortion of financial information (Question 4.7) and communicating the detected fraud to stakeholders and indirectly – by publishing it in the audit report – to the society (Question 4.7) as deficient standards gap. Hence, it is worth considering in what forms these factors can become auditors' duties.

The responses to the question about the existing and expected auditors' responsibilities for communicating the detected fraud (Question 4.7 and Question 4.8) show surprising results. Auditors believe that it is more important to report the deliberate distortion of financial information – which is actually fraud by auditors themselves – to appropriate authorities than publishing this in an audit report. Preferences of audit users in terms of fraud are less surprising. It is more important for audit users that auditors should communicate the detected fraud to stakeholders and indirectly – by publishing the fraud in the audit report to make this accessible for audit users - to the society than to appropriate authorities.

The auditors' opinions reveal that they are unwilling to take responsibility for reporting their client fraud and publishing this in an audit report.

The tests fail to fully support the initial hypotheses. However, on the basis of the research findings the following hypothesis can be formulated:

It is the audited and audit users from the groups interested in audit who expect greater responsibilities of auditors for fraud prevention and detection within an economic entity and for communication of the detected fraud.

3.4. EMPIRICAL TESTING OF THE HYPOTHESIS ABOUT THE USEFULNESS OF AUDIT REPORTS IN INVESTMENT DECISIONS

Apart from the above considerations, the aim of the questionnaire survey was to conduct empirical analyses of other key aspects of auditing, which are closely related to expectations towards auditors and performance expected of them such as:

- content and usability of audit reports and
- Perception of auditors' independence in Hungary.

Hence, the following hypothesis has been formulated:

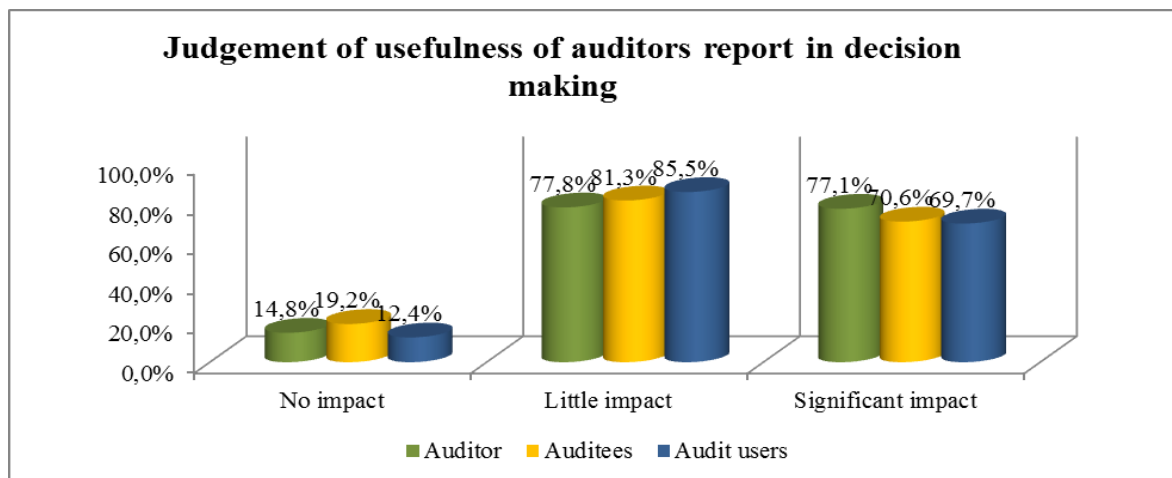
Hypothesis H5/a

Significant differences exist in the perception of usefulness of audit reports in investment decisions between different interest groups in Hungary.

Procedures and methods used for testing the hypothesis

The Hypothesis H5/a was tested by evaluating the responses given to the relevant questions with the Pearson's Chi-square (χ^2) Test for Independence and by comparing the differences between two probabilities (a two-sample Z-test equation)

The testing of Hypothesis H5/b was conducted by requesting the respondents to judge the quality of the information in audit reports and the usefulness of auditors' opinions in making investment decisions. Figure 14 illustrates the respondents' firm opinions about the current usefulness of audit reports.



Source: author's own elaboration based on the data processed by EvaSys Education Survey Automation Suite

Figure 14: Judgement of information usefulness in audit reports and audit clauses in investment decisions

The analysis shows that that the investigated factors are independent of each other. Belonging to a specific group is independent of perceptions about usefulness of audit reports. On the other hand, the results clearly show that a significant majority of respondents with firm opinions in each group think that both the information in the audit reports and the rating of the audit clause have an impact on investment decisions and increase the reliability of audit data and information. However, neither of them is enough to support the investment decisions.

The findings fail to support the initial hypothesis. The hypotheses tested in pairs show that the difference in perception of usefulness of audit reports in investment decisions between the different interest groups is insignificant. The response distribution in the sample highlights that audit users are the least satisfied with the content of audit information in terms of supporting investment decisions.

Based on the conclusion drawn from the performed analysis, the following thesis has been formed:

Thesis T5/a

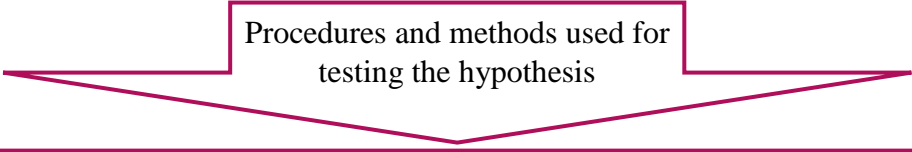
There is no significant difference in the perception of usefulness of audit reports in investment decisions between the groups interested in audit in Hungary.

A significant majority of respondents with firm opinions in each group think that both the quality of the information contained in the audit reports and the auditors' opinions have an impact on investment decisions and increase the reliability of audit data and information. However, neither of them is enough to support the investment decisions.

The initial presupposition and the statement of Thesis T5/a – namely, the information contained in audit reports is insufficient to support investment decisions – induced another related hypothesis the aim of which is to determine the scope of information used for increasing usefulness of audit reports by perceptions of interest groups.

Hypothesis H5/b

The usefulness of audit reports in investment decisions can be enhanced by increasing the information content of audit reports.

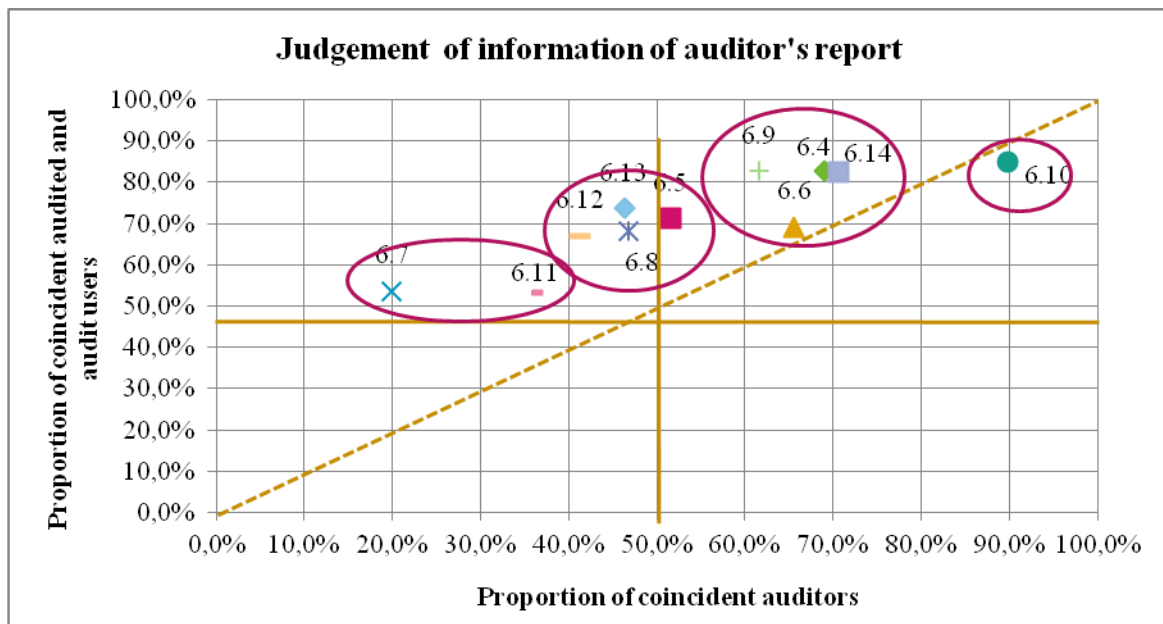


Procedures and methods used for
testing the hypothesis

The Hypothesis H5b was tested by a detailed analysis of responses to the relevant questions in the questionnaire and by categorizing the examined factors – following the order of usefulness perceived by respondents.

The testing of Hypothesis H5/b was conducted by requesting the respondents to indicate in the questionnaire whether the usefulness of audit reports in investment decisions could be increased by providing supplementary information in audit reports.

Figure 15 shows how the expected usefulness of supplementary information² to be potentially included in audit reports was categorized by usefulness order – approximated by the increase of the expected proportion of interest groups' usefulness based on the responses of interest groups



Source: author's own elaboration based on the data processed by EvaSys Education Survey Automation Suite

Figure 15: Judgement of the content of the required information in audit reports

Figure 15 clearly shows that each interest group shares the same perception about audit information and indicates that the usefulness of audit reports can be increased if auditors express their opinion about entity's ability to continue as a going concern (Question 6.10). The distribution of interest groups' responses reveals that the majority of respondents agree that it could be useful if auditors:

- declare that they have not received all the necessary information and explanation enabling them to form their opinion about the audited financial statement (Question 6.14);
- Declare that the audited financial statement complies with applicable accounting criteria (standards, legislation, etc.) (Question 6.4);
- use clear terminology, which everybody can understand because current audit reports fail to meet this need (Question 6.6);
- express their opinion about the efficiency and efficacy of accounting and other internal controls (Question 6.9).

Only two information requests comply with previous research findings. On the one hand, interest groups expect auditors to bear responsibilities for full compliance of audited financial report with applicable accounting criteria (standards, legislation, etc.) (Question 6.4). This was completely incompatible with audit nature and the study defines it as a component of reasonableness gap. Hence, this statement would be unreasonable to include in audit reports. On the other hand, a significant number of interest groups require the use of audit terminology that everybody can understand, because the current audit reports fail to meet this need (Question 6.6). This supports the research findings about audit expectation gap, that is, interest groups have insufficient knowledge about the real content of the ter-

² The information examined in the questionnaire is assigned the serial number used in the questionnaire.

minology used in audit reports. Hence, the usability of audit information is also inappropriate.

Interest groups believe that it would be useful if auditors disclosed that they had not received all the necessary information and explanation enabling them to form their opinion about the audited financial statement (Question 6.14). This could be achieved since its implementation would result in a more stringent application of the current audit scope limitations, even of immaterial items.

Also, interest groups indicated that it would be beneficial if auditors expressed their opinions on the efficiency and efficacy of accounting and other internal controls (Question 6.9).

Currently, the audit report shall describe an audit by stating that the auditor is considering a relevant internal control essential for preparing a financial statement by the entity in order to design audit procedures that are appropriate in the circumstances and not for the purpose of expressing an opinion on the effectiveness of the entity's internal control (ISA700. 31a)³. However, the standard does not exclude the possibility that auditors may express their opinion on the effectiveness of the entity's internal control. In this case, the auditor shall omit the phrase that the auditor's consideration of internal control is not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Expressing this opinion would result in auditors' undertaking additional responsibilities, benefit of which is the subject of a separate analysis.

The conducted analysis shows that financial statements contain potential supplementary information. The overwhelming majority of interested groups believe that if this supplementary information was published in audit reports, the usability of audit reports in making investment decisions would considerably increase. However, this paper also takes into consideration the risks of publishing supplementary information in audit reports. Since audit procedures, determining the materiality threshold, significant accounting estimates and introducing the challenges experienced in the course of audit may also contribute to misinterpretation of audit reports without providing any extra benefits.

The above considerations support the initial hypothesis. By supplementing this hypothesis, the study forms the following thesis:

Thesis T5/b

Based on the interested groups' opinion, the usefulness of audit reports can further be enhanced by improving its content value in the following way:

- **auditors express their opinion about entity's ability to continue as a going concern;**
- **auditors declare that they have not received all the necessary information and explanation enabling them to form their opinion about the audited financial statement**
- **auditors use terminology that everybody can understand because the current audit reports fail to meet this need;**
- **auditors express their opinion about the efficiency and efficacy of accounting and other internal controls.**

³ International Standard on Auditing 700 and Forming an Opinion and Reporting on Financial Statements

3.5. EMPIRICAL TESTING OF HYPOTHESIS ABOUT INDEPENDENT AUDIT

Independent audit is critical both from regulatory aspects and practical aspects. It has a dual character since auditors need to form an objective and usable opinion about the financial statement prepared by entities that shortlisted and hired them. The aim of research into independent audit is to test the following initial hypothesis:

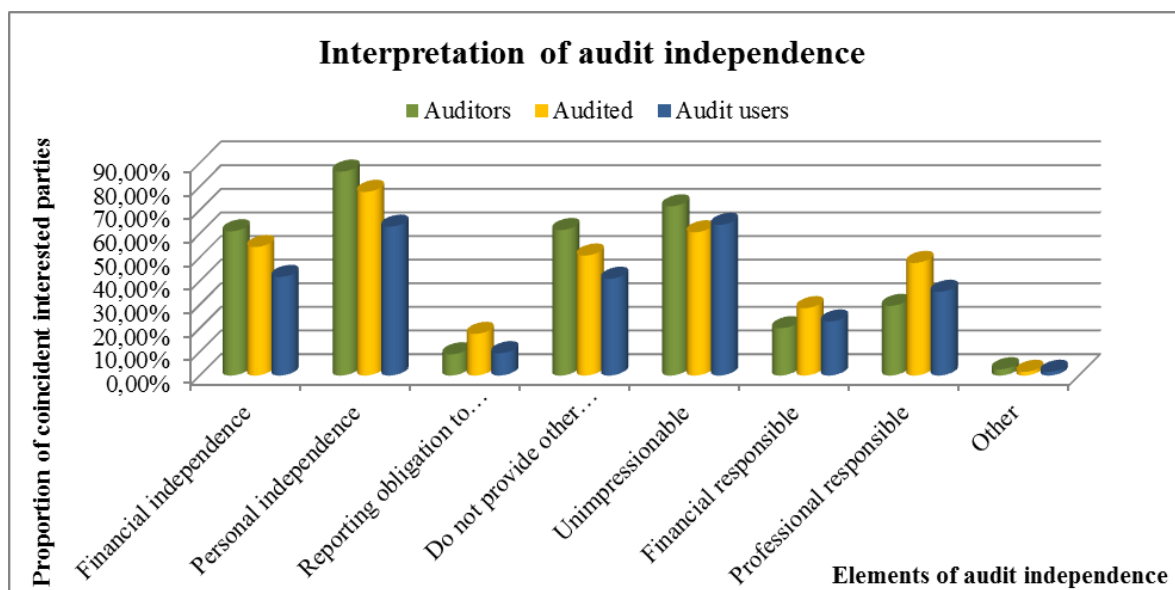
Hypothesis H6

Audit independence is a phenomenon which can be interpreted from different aspects and involves various risk factors.

Procedures and methods used for testing the hypothesis

The hypothesis was tested by evaluating the distribution percentage of the responses given to the relevant questions

This study investigated the respondents' perception of audit independence by different factors. The respondents were asked to indicate what they meant by independent audit (they were allowed to choose several factors). Figure 16 illustrates the percentage of responses that considered a specific element could ensure audit independence by interest groups.



Source: author's own elaboration based on the data processed by EvaSys Education Survey Automation Suite, University of Miskolc

Figure 16: Interpretation of audit independence

The majority of respondents considered auditors' independence to be personal independence – which excludes maintaining interpersonal and family relationships with stakeholders, managers and relatives of audited companies as well as audited companies. The independence is less ensured when auditors are responsible for reporting to third parties who are involved in fraud or other illegal acts. A considerable proportion of respondents agreed that audit independence could be ensured if stakeholders and managers of audited compa-

nies had no influence on auditor independence and did not receive non-audit services from their auditors, which would underpin the auditors' professional judgement in the course of audit. This is closely linked with another criterion, namely that auditors should be financially free from audited companies, their stakeholders and managers.

After clarifying the meaning of auditor independence, the respondents expressed their opinion whether auditors are able to express independent and credible opinion on financial statements of entities that selected and hired them.

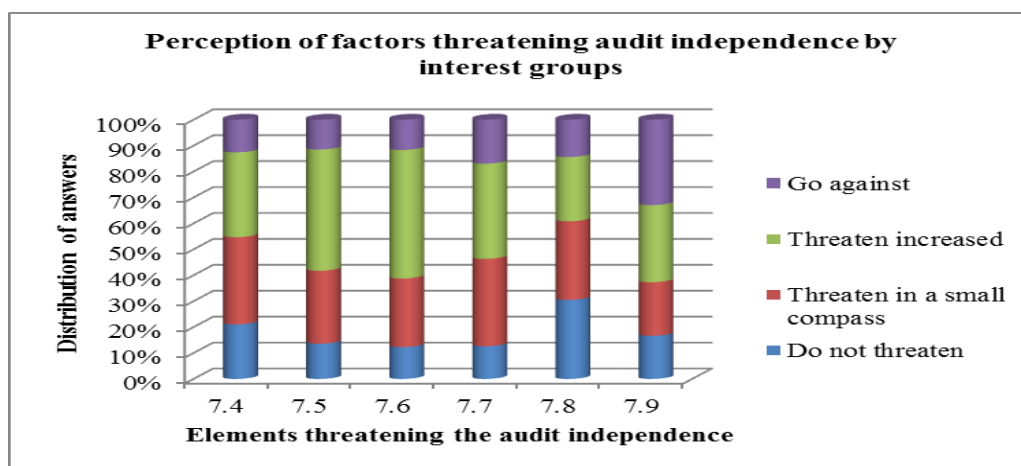
The evaluated responses show that a significant majority of respondents in each interest group, who have firm opinions, agreed that auditors were able to form an independent opinion on financial statements of entities hiring them.

Auditors' responses indicate that it was the auditors who gave the best appraisal of their independent work. The audit users were the least satisfied with the audit independence. This is interesting because they had the least information about the independence of auditees and auditors, which was supported by the fact that the percentage of those in this group who believed that they failed to make judgements about audit independence, was the highest. In addition, this could undermine the users' confidence in audit reports on financial statements or in other audit aspects. The obtained results are similar to the ones in terms of audit independence in Chapter 5.2.1 of this study.

After this, the respondents were requested to indicate how much the listed factors threatened auditor independence.

The responses revealed that auditors naturally considered that the listed factors threaten their independence very little. The difference between the responses of interest groups in terms of threatening was insignificant.

Figure 17 shows the percentage distribution of firm responses regarding elements threatening audit independence:



Source: author's own elaboration

Figure 17: Perception of factors threatening audit independence by interest groups

Low percentage of respondents – less than one-fifth – felt that the listed factors do not threaten audit independence. Based on the responses, the extent of threat factors to audit independence may be determined. The overwhelming majority of respondents considered the provision of non-audit services to audit clients to be the greatest threat to audit independence. The provision of accounting services and internal audit were viewed as increasingly threatening factors (Question 7.9). Interest groups ranked audit fees – within the total audit turnover - generated from specific stakeholders of businesses to be the second greatest threat due to a large proportion of total fees creating financial dependence (Question 7.6). Almost the same ranking was given to a threat that arises when audit fees generated

from a client represent a large proportion of an audit firm's total fees resulting in high financial dependence (Question 7.5). Respondents viewed simultaneous pursuit of such non - audit services as provision of tax consultancy services, information technology consultancy, property valuation, etc. to audit clients the least offensive and threatening to audit independence (Question 7.8).

The thesis formed based on the conducted analysis of responses is as follows:

Thesis T6

Audit independence is a phenomenon which can be interpreted from different aspects and interest groups associate it with auditors' personal independence – excluding audited companies and their stakeholders and family and friendly relationships with entity management.

Procedures and methods used for testing the hypothesis

The hypothesis was tested by evaluating the distribution percentage of the responses given to the relevant questions

There are several factors that give rise to threats to audit independence. Interest groups felt that the provision of non – audit services to audit entities

Respondents considered simultaneous provision of such non - audit such services to a particular entity as accounting services and internal control to be the most offensive and the greatest threat to audit independence. They viewed simultaneous pursuit of such non - audit services as provision of tax consultancy services, information technology consultancy, property valuation, etc. to audit clients as the least offensive and threatening to audit independence.

It should be noted that the author of this study is fully aware of the limitations of previous and the current research conducted into the audit expectation gap. This study attempts to express general and homogeneous opinion about a profession, which requires a high level of professional knowledge and constant evolutionary development even though the author is aware that this profession is a total of individuals, whose professional knowledge, attitude to their profession and reliability may differ. Contrary to individuals pursuing this profession, audit interest groups also consider the audit profession to be a homogeneous total when they make decisions about the audit future, duties and responsibilities to be performed.

It should be highlighted that criticism of competence and professionalism of the interest groups involved in audit, including auditors, auditees and audit users, did not belong to the aim of this study. The current study rather attempted to identify possible ways of reaching compromises and consensus and provide them to interest groups to enable auditors having extremely high professional knowledge to meet expectations of its users.

It is envisaged that the findings reported in this research study would provide useful information to all three interest groups. Auditors should consider making some modifications concerning certain aspects of regulatory character and identifying ways of further increasing audit performance. Auditees and audit users should further improve their knowledge on audit functions and limitations, the lack of which results in unreasonable expectations and false interpretations of the true content of independent audit reports in some cases.

4. FUTURE POTENTIAL RESEARCH DIRECTIONS

The existing literature on audit expectation gap in Hungary is surprisingly scarce. However, it is evident from the international literature that research into similar issues has been conducted in several countries.

The under-researched area of audit expectation gap in Hungary and the scarcity of the Hungarian literature on this topic fully justify the need for conducting further investigations into this matter, which would receive support from practitioners.

The questions and the challenges formulated in the course of writing this dissertation suggest several directions for further research in this area. Also, the compiled questionnaire and the responses to the questions provided by interest groups create a valuable information data base, which determine the main directions for further research.

When the Hungarian model of the audit expectation gap was investigated, the first three steps were analysed, which are as follows:

- Is there an audit expectation gap in Hungary?
- What are the causes of the audit expectation gap in Hungary?
- What is the structure and composition of the audit expectation gap in Hungary?

Conducting further research into the last step built on the previous two steps is exciting. Identifying an appropriate tool combination used for narrowing the mapped audit expectation gap requires further research. Both the reviewed existing international literature on this topic and the conducted empirical research provide a sound basis for this.

Much research also remains to be done on viewing the decisions of the European Union on audit changes as a tool for narrowing the audit expectation gap in Hungary. Also, it is worth investigating whether the adopted measures – so far exclusively statutory audits of public-interest entities - fit in with the Hungarian model of the audit expectation gap.

The long-term research goal is to expand the current research to Visegrad Countries because this geographical region lacks reliable information about audit expectation gap supported by rigorous empirical research, which could also be conducted there.

The author of the current study believes that the finding of this research study contributes to further developing audit and accounting rules and regulations and can be beneficial in strengthening the knowledge of participants in higher education and interest groups. Hence, it becomes one of the tools of narrowing the audit expectation gap in Hungary.

The author of the current research believes that this dissertation and her further studies will make a positive contribution to making the importance of audit known to a wider audience. Also, the scientific explanations of the problems encountered in the course of research and the theses formed on their bases as well as the research recommendations will constitute useful input to other researchers and economic players.