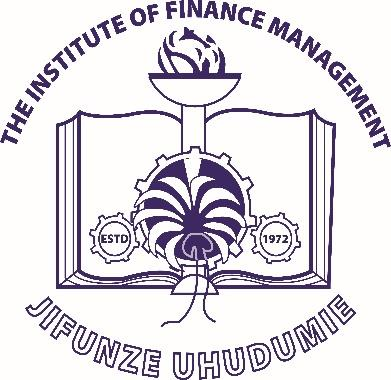
**THE INSTITUTE OF FINANCE MANAGEMENT**



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| **Module Name:** | AUDITING AND ASSURANCE SERVICES |
| **CODE Number:** | AFU08192 |
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**INDIVIDUAL ASSIGNMENT**

**QUESTION ONE:**

Suggest ways of reducing the auditing expectation gap, performance gap, knowledge gap, evolution gap.

**QUESTION TWO:**

To provide examples for **Pressure/Need, Opportunity and Rationalization in FRAUD TRIANGLE**

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**QUESTION ONE**

**EXECUTIVE SUMMARY**

Navigating the intricate landscape of the audit 'expectation gap,' my exploration uncovers a sustained public unease surrounding audits, seemingly unbridled since the concept's inception. This lingering gap, I propose, stems from an unrelenting surge in public expectations, often outstripping the practical capabilities of auditors.

Driven by a burgeoning interest in audits, my independent inquiry aims to dissect the expectation gap into three integral components: the knowledge gap, the performance gap, and the evolution gap. A novel perspective that advocates for tailored and nuanced interventions to address each facet independently.

Supported by an extensive survey spanning 11 countries and encompassing 11,000 respondents, our findings validate the existence of a noteworthy knowledge gap. Intriguingly, the survey also unveils an emerging 'evolution gap,' highlighting areas where the public envisions auditors playing a more extensive role.

To contextualize the performance gap, I draw on the latest audit inspection findings from the International Forum of Independent Audit Regulators (IFIAR). I contend that a strategic, component-specific approach is imperative to narrow each gap. Significantly, I stress the urgency of closing the knowledge gap to ensure public expectations align harmoniously with the operational realities of the audit process. Simultaneously, addressing the performance gap becomes paramount to allay public concerns tied to standards non-compliance.

While acknowledging that closing the knowledge gap isn't a prerequisite for discussions on the evolution gap, I firmly assert that bridging both will catalyze a more constructive discourse on how audits can adapt to meet the ever-evolving expectations of society.

Concluding this exploration, I extend a call to action to all stakeholders tethered to the audit profession—professional accountancy bodies, audit firms, regulators, journalists, and politicians—to actively contribute to the collective effort in diminishing the expectation gap in audit. This collaborative endeavor stands as a cornerstone for the future integrity and efficacy of the audit profession, aligning it with the dynamic needs of society.

**BACKGROUND OF THE AUDIT EXPECTATION GAP**

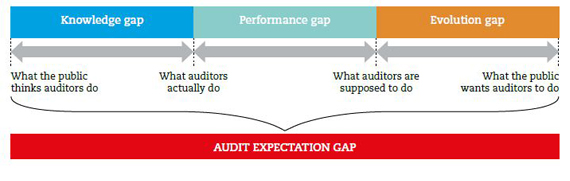
The concept of the audit expectation gap has recently gained prominence in public discussions, but its roots trace back nearly half a century to a 1974 academic paper by Carl Liggio, then general counsel for Arthur Young & Company. Liggio's definition emphasized the difference between what independent accountants anticipated in their performance and the expectations held by users of financial statements.

Over time, subsequent definitions have emerged, with one highlighting the gap between public expectations of the auditing profession and what the profession actually delivers. In this report, you'll find a redefinition of the expectation gap, casting it in the broadest terms possible – the difference between what the general public perceives auditors to do and what they wish auditors would do. This definition recognizes that public policy on audit is fundamentally influenced by the difference between public perception and desire, necessitating a holistic approach that encompasses public knowledge, audit standard-setting, auditor performance, and potential areas for expanded auditor responsibilities.

The corporate landscape has undergone significant changes since the inception of the expectation gap in audit. From corporate scandals to financial crashes and global economic crises, you witness shifts in financial reporting, corporate governance, auditing standards, and audit regulations. The journey from the 'Great Inflation' to the Sarbanes–Oxley Act and the global financial crisis has spurred changes in international financial reporting and auditing standards.

In historical context, the existence of a knowledge gap has sometimes been exploited to resist change by attributing the issue to the perceived lack of understanding among the public. This line of reasoning is dismissed in this approach. The persistence of the expectation gap is not a result of stagnation in audit practices; instead, it is propelled by the dynamic interplay between increased auditor responsibilities and the escalating expectations of the public.

Recent events, such as the collapse of Carillion in the UK, have triggered reviews of the audit profession and regulations, thrusting the expectation gap into the spotlight. The research, founded on a survey of 11,000 members of the public, introduces a new perspective on tackling the expectation gap. The aim is to contribute to redefining the conversation around the audit expectation gap and instigating meaningful changes that bridge the divide between public expectations and the ever-evolving landscape of audit practices.



**KNOWLEDGE GAP IN THE AUDIT EXPECTATION GAP**

The persistence of the audit expectation gap, despite substantial changes in the audit landscape, suggests a need for further efforts to address this gap. To comprehensively tackle the expectation gap, ACCA proposes breaking it down into three distinct components: the knowledge gap, the performance gap, and the evolution gap.

**Knowledge Gap:**

The knowledge gap represents *the difference between what the public thinks auditors do and the reality of auditors' responsibilities.* This acknowledgment stems from the understanding that the public might misinterpret certain aspects of audit, such as the extent of auditors' responsibility in preventing company failure or the limitations on auditors selling non-audit services to the entities they audit. Historically, the knowledge gap has been exploited by some in the profession to resist change by attributing the issue to the public's lack of understanding. ACCA rejects this stance, emphasizing that the existence of a knowledge gap doesn't negate calls for auditors to enhance their roles, nor does it justify the performance gap.

Addressing the knowledge gap is crucial to understanding the true evolution gap, as misinformation may lead to demands for restrictions that are already in place. ACCA introduces this knowledge gap component as a unique contribution to the literature on the expectation gap in audit.

**Strategies for Reducing the Knowledge Gap:**

Reducing the knowledge gap is vital for ensuring public debates about the evolution of audit address actual issues rather than perceived ones. The profession can play a role by clearly explaining the audit process, with initiatives such as the introduction of key audit matters for listed companies by the International Auditing and Assurance Standards Board (IAASB) serving as important steps.

However, narrowing the knowledge gap requires a collective effort. Stakeholders connected to the audit process, including regulators, standard setters, professional accountancy bodies, audit firms, audit committees, investors, governments, and the media, need to commit to informing the public in a fair, balanced, and understandable way about audit regulations and standards. ACCA emphasizes that reducing the knowledge gap is in the public interest, as the survey results indicate that the public sees audit as a crucial process in improving corporate reporting.

That is to say, bridging the knowledge gap necessitates a multifaceted approach involving all stakeholders, fostering informed public understanding of audit processes and regulations.

**PERFORMANCE GAP IN THE AUDIT EXPECTATION GAP**

The **'performance gap'** within the audit expectation gap is a *focal point addressing areas where auditors deviate from auditing standards or regulatory requirements.* This discrepancy may arise due to various factors, such as insufficient emphasis on audit quality, the complexity of certain auditing standards, or differences in interpretation between practitioners and regulators.

**Performance Gap Overview:**

Audit firms are obligated to establish systems and processes to ensure the quality of their engagements. Audit regulators play a crucial role in regularly reviewing completed audit files to monitor and assess the attainment of quality. The performance gap, therefore, surfaces when there is a deviation from the prescribed standards or when the complexity of these standards leads to disparities in interpretation.

**Strategies for Addressing the Performance Gap:**

Addressing the performance gap involves a two-fold strategy:

**1. Response to Audit Inspections:**

Responding to the findings of audit inspections is a fundamental step in narrowing the performance gap. Audit firms need to be diligent in addressing any shortcomings identified during these inspections to enhance overall audit quality.

**2. Role of Standard-Setters:**

There is a crucial role for standard-setters in mitigating the performance gap. The clarity and precision with which standards are drafted play a pivotal role in avoiding biases and potential group-think within engagement teams. Standards should be formulated in a way that minimizes subjectivity and ensures objective implementation by practitioners.

**Interplay with the Knowledge and Evolution Gaps:**

Reducing the knowledge and performance gaps is integral to facilitating a clearer focus on how the public envisions the evolution of audit practices. By addressing these gaps, stakeholders can engage in a more informed discussion on the necessary evolution of the audit profession.

In essence, efforts to bridge the performance gap involve a collaborative approach, encompassing the diligence of audit firms in response to inspections and the conscientious drafting of standards to avoid biases and subjective interpretations. This strategy aims to enhance the overall quality of audits and contribute to a more constructive dialogue about the evolution of the audit profession.

**EVOLUTION GAP IN THE AUDIT EXPECTATION GAP**

The 'evolution gap' is a critical dimension within the audit expectation gap, representing areas where the audit profession needs to evolve to align with public demands, technological advancements, and the potential enhancement of the overall audit process to add more value. While addressing the evolution gap is essential, ACCA underscores the importance of first understanding and mitigating the knowledge and performance gaps.

**Evolution Gap Overview:**

The evolution gap arises from the dynamic nature of societal expectations, technological advancements, and the evolving landscape of corporate environments. This dimension emphasizes the need for the audit profession to adapt and meet the changing demands and complexities of the contemporary business environment.

**Interplay with Knowledge and Performance Gaps:**

Prioritizing the reduction of the knowledge and performance gaps is pivotal before engaging in discussions about how the audit profession should evolve. A reduced knowledge gap ensures that discussions focus on actual issues, avoiding unnecessary regulations or developments. Simultaneously, addressing the performance gap is crucial to maintain the integrity and compliance of auditors with established standards.

**Strategies for Addressing the Evolution Gap:**

Efforts to reduce the evolution gap are contingent on narrowing the knowledge and performance gaps. Key strategies include:

**1. Broad Stakeholder Discussion:**

Initiating a comprehensive discussion among closely connected stakeholders, including auditing standard setters, regulators, professional accountancy bodies, audit firms, audit committee members, investors, governments, and the general public. This collaborative dialogue ensures diverse perspectives and insights contribute to the evolution of the audit profession.

**2. Informed Public Understanding:**

Clearing the knowledge gap is essential to ensure that public discussions on the evolution of audit address genuine concerns rather than misconceptions. This involves a collective commitment from all stakeholders to inform the public in a transparent, balanced, and understandable manner about audit regulations and standards.

Therefore, Addressing the evolution gap in the audit expectation gap requires a holistic and informed approach. By first mitigating the knowledge and performance gaps, stakeholders can engage in meaningful discussions about how the audit profession should evolve. This strategic sequence aims to foster an environment where the audit process aligns seamlessly with public expectations, technological advancements, and the ever-changing dynamics of corporate landscapes.

**CONCLUSION AND WAY FORWARD**

The comprehensive exploration undertaken in this report introduces a fresh perspective on closing the expectation gap in audit. By delineating the expectation gap into three distinct components—knowledge gap, performance gap, and evolution gap—a nuanced understanding emerges. Drawing insights from the gathered evidence, several key messages underscore the public's perspective on audit:

**1. Audit as a Preventive Solution:**

The public views audit as an integral component in averting company failure, positioning it as part of the solution to ensure corporate stability.

**2. Demand for Enhanced Auditor Responsibilities:**

There is a significant demand from the public for auditors to take on more responsibilities, particularly in identifying and reporting fraud, reinforcing the role of auditors as guardians of financial integrity.

**3. Call for Evolution to Prevent Company Failure:**

The public envisions the evolution of audit practices to actively contribute to preventing company failure, highlighting the need for progressive changes in the audit profession.

**The Way Forward:**

In addressing the expectation gap comprehensively, it is imperative to recognize and bridge the knowledge and performance gaps as integral components of the evolution process within the audit profession. Collaboration among key stakeholders closely linked to the audit profession is pivotal for success. ACCA proposes the following actions for various stakeholder groups:

**KNOWLEDGE GAP:**

**Audit Firms and Professional Accountancy Bodies:**

Develop strategies to enhance communication, making updates to audit requirements easily accessible to the general public through broader platforms, such as social media.

**Regulators and Standard Setters:**

Inform the public about changes in audit regulations or standards, elucidating the rationale behind these changes. This ensures public awareness and understanding of existing requirements and any evolution in progress.

**Media:**

Play a crucial role in accurately describing audit requirements when reporting on the profession, contributing to a more informed public discourse.

**PERFORMANCE GAP**

**Audit Firms:**

Ensure consistent audit quality by understanding and addressing areas of persistent low performance.

**Audit Regulators:**

Encourage innovation among audit firms to enhance audit quality, steering clear of a rigid 'box-ticking' approach.

**Standard-Setters:**

Remain responsive to audit quality issues by updating standards and providing implementation support.

**EVOLUTION GAP**

**Public Survey Insights:**

Identify potential areas for evolution based on public survey insights, such as expanding auditors' responsibilities in fraud identification and prevention of company failure.

**Detailed Research:**

Recognize the link between the knowledge and evolution gaps, necessitating more detailed research to understand this connection thoroughly.

**Policy-Makers:**

When implementing new policies and regulations, policymakers should be cognizant of the interplay between the knowledge and evolution gap components, aligning them with public demand.

In conclusion, fostering collaboration and implementing these suggested actions will pave the way for a more informed, responsive, and evolved audit profession, meeting the expectations of both the public and the dynamic business landscape.

**QUESTION TWO**

**Pressure/Need:**

**Financial Pressure:** This aspect of the Fraud Triangle encompasses situations where an individual faces significant financial challenges such as mounting debts or medical expenses. The strain of financial difficulties may push an employee towards fraudulent actions as a perceived solution to alleviate their economic burdens. Additionally, individuals with aspirations for a higher **standard of living** beyond their current means may also feel the pressure to commit fraud to fulfill these lifestyle desires. In some cases, employees struggling with **addiction or gambling problems** might resort to fraudulent activities as a means to fund their habits, further intensifying the financial pressure they experience.

**Opportunity:**

**Weak Internal Controls:** When an organization has inadequate segregation of duties, it creates an opportunity for employees to manipulate financial records without detection. This weakness in internal controls allows individuals to exploit their positions and engage in fraudulent activities. Similarly, a lack of oversight, whether due to insufficient supervision or monitoring of employees' activities, provides an opportunity for fraudulent behavior to go unnoticed. **Unmonitored access to sensitive financial information** also contributes to the opportunity for employees to misuse their positions for fraudulent activities.

**Rationalization:**

**Temporary Loan:** Rationalization involves individuals convincing themselves that their fraudulent actions are justified or acceptable. For instance, someone might perceive their illicit actions as a temporary loan, intending to repay the misappropriated funds when their financial situation improves. Another form of rationalization occurs when an individual believes they are experiencing perceived injustice, feeling justified in committing fraud as a way to correct what they perceive as unfair compensation. Additionally, the rationalization that the company owes them something may lead an employee to engage in fraudulent activities if they believe they have been mistreated or inadequately compensated.

Understanding these elements of the Fraud Triangle is crucial for auditors and organizations to identify and address potential risks, implementing measures to strengthen internal controls, reduce opportunities for fraud, and foster an ethical organizational culture.

REFERENCE

ACCA. (2019). Closing the expectation gap in audit. ACCA Student Accountant, 1(1), 10-15. [www.accaglobal.com]