

REDUCING AUDIT EXPECTATION GAP? THE ADOPTION OF INTERNATIONAL STANDARDS ON AUDITING (ISA 700) IN NIGERIA



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ABSTRACT

The International Standards on Auditing 700 (ISA 700) has been widely adopted in many developed countries. However, in developing and emerging economies, the adoption is still at its early stage. This paper discusses whether the adoption of such standards could possibly reduce the issue of audit expectation gap (AEG) in Nigeria. This paper reviews previous literature on AEG and adoption of ISA 700 in the context of globalization of financial reporting practices. The paper concludes that ISA 700 increases the understanding of users of financial statements with regards to the function of an audit and the responsibility of auditor and management. The review also indicated that ISA 700 has a significant influence in reducing the AEG in Nigeria. It is expected that the Financial Reporting Council of Nigeria (FRCN) and the Institutes of Chartered Accountants of Nigeria (ICAN) as the regulatory bodies will provide adequate measures for policy deliberations on the adoption of ISA 700 in auditing reporting with a likelihood of success in reducing the AEG problems in Nigeria.

Keyword: Audit Expectation Gap, Adoption, International Standards on Auditing, Reporting, Nigeria

I. INTRODUCTION

The prevalence of global financial crisis and complexity in financial reporting has prompted the attention of investors and other users of financial statements to demand more informative auditor's reports [1]. In response to this issue, the International Federation of Accountants (IFAC) through the International Auditing and Assurance Standards Board (IAASB)¹ issued the ISA 700. The ISA 700 is a standards auditors' report forming an opinion and reporting on financial statements. The ISA 700 delivers an explicit explanation of the respective responsibility of auditors and management with detailed explanation on the nature, scope and procedures of an audit which shareholders view as the most significant [2]. The aim of ISA 700 is to enhance the quality of corporate financial reporting and encourage consistency in the auditing standards worldwide [3]. Significantly, the ISA 700 is expanded auditor's report in nature which views as most significant in addressing the issues of AEG in financial reporting. For examples, the adoption of standard auditor's report in most of the developed countries such as Statement on Auditing Standards (SAS) No 600 in the UK and SAS No 58 in the US derived a substantial benefit in reducing the AEG problem [4,5-6]. The AEG is defined as the difference between what users of financial statements expect as the auditors' role and responsibilities and the actual auditor's statutory responsibility.

As part of the global harmonization of more informative auditor's report which could improve the financial reporting model with harmonized standards in the public interest, most of the developing countries including Nigeria have adopted the ISA into their national standards auditing practice [7]. The body that has legal and statutory power for setting, regulating and adopting the practice of accounting and auditing in Nigeria is the FRCN [8]. The FRCN was established under FRCN Act of 2011, the body jointly with the ICAN which founded under the Act of parliament No. 15 of 1965 are authorized to adopt the standards issued by the global body to promote professional accounting practice in Nigeria [9]. The ICAN adopted the use of ISA in 2013 through the Nigerian Standards on Auditing (NSA). Thus, the adoption is to be applied as compulsory in all financial reporting practice. The adoption of ISA in Nigeria is aimed to promote users' of financial statements understanding the auditor's reporting process towards attainment to the global objectives for more informative auditors report [10].

In developing countries, it was noticed that the need for harmonized global standards ISA 700 is still receiving the attention of the regulatory bodies. For example, in Nigeria, the ICAN [11] expressed concern for use of ISA 700 into financial reporting practice in the country. The ICAN noticed that the traditional one-page auditor's report is perceived to be in-adequate and does not properly communicate to the audit stakeholders. This makes the institute's call for more details auditor's report in a manner that could meet user's huge expectation in the country. Though the ICAN specified that the acceptance of ISA 700 into financial reporting practice in Nigeria is at a cost to a client. The ICAN [11] further indicated that the expectation gap gave rise in Nigeria as a result of users' lack of understanding the auditor responsibility. It is against this background the study focused on whether adoption of ISA 700 in developing countries will reduce the AEG, with particular reference to Nigeria. The paper is divided into four sections. Beginning with a discussion on the adoption of ISA 700, this is followed by a discussion on relevant literature. Lastly, conclusion and the proffered recommendations.

¹ The IAASB is aimed to serve the interest of the public towards providing high quality International Standards on Auditing (ISA) that would enhance the quality and consistency of audit practice worldwide and strengthening the public confidence in the global auditing profession. For more details (see <http://www.iaasb.org/>).

II. THE ADOPTION OF ISA 700

The adoption of ISA 700 into auditing reporting model has received many stakeholders attention. According to [12], report on adoption and enhancement of auditors reporting model stated that most of the developed countries such as the UK, Ireland, Netherland, US, and the European Union have been widely adopted ISA 700 into their financial reporting practices. The adoption derived substantial benefit to investors in understanding the auditors' communication to the users of financial statements [13]. Specifically, the UK Financial Reporting Council (FRC) research and consultations on the adoption of ISA 700 (UK and Ireland) in 2013 had received a significant recognition from a number of respondents. For instance, the responses from [14] and [15] in the UK respectively have fully supported the views of adoption on standards form of auditor's report. The report acknowledged that the adoption of ISA 700 could usefully be allowed the auditors to go further with detailed information and explanation of an entity's financial statements. In the same background, the response of the Institutes of Chartered Accountants of England and Wales (ICAEW) in 2016 has a positive relationship with that of PwC and KPMG report. Furthermore, according to [16], stated that the adoption of ISA 700 an extended audit report in the UK enhanced the users' perception of the value of audited financial statements.

In the same way, the Public Company Accounting Oversight Boards (PCAOB) in the US has considered the adoption of the standard audit report in performing an audit. For example, the PCAOB [17] conducted a survey through the Chartered Financial Analyst institutes (CFA) in three successive years 2008, 2010 and 2011 to determine the respondents' perception on the adoption of standards audit reporting model. The results of the survey indicate that the majority of the participants acknowledged that auditor's report needs to improve. The report shows that standards audit reporting model provide more specific information on the company's financial reporting. Being part of the global harmonization under the ISA 700 expanded auditor's reporting model, the auditors are able to communicate Key Audit Matters (KAM)¹ which perceive to be important in aligning the users of financial statements with the actual responsibilities of the auditor and management as well as the consistency on the audited financial statements [1,13]. Therefore, the ISA 700 auditor's report improves the communications between auditors and investors as well as between auditors and those charged with governance. It is, therefore, acknowledged that the aim of adoption ISA 700 was to formulate uniform and consistent global accounting standards which will reduce the inconsistencies in accounting principles and reporting practice.

As described by the IAASB [1], the mandatory elements of ISA 700 is that; an auditor's report should have a separate paragraph on the following matters: Opinion; Basis for Opinion; Key Audit Matters; Going Concern and Other Information. These can be further explained below:

1. Opinion Section: This is the first section under ISA 700 independent auditor's report. Therefore, the section starts with heading "**Opinion**" and to include the details below:

- Should identify the organization whose the financial statements have been audited;
- Should declare that the financial statements have been audited;
- Should identify the heading of every statement containing the financial statements;
- Should include a summary of accounting policies and further explanatory information.

III. LITERATURE REVIEW

The issue of AEG has for long been characterized as the circumstances which arise by users of financial statements lack of understanding the auditor’s statutory roles and responsibilities. Specifically, previous researchers have confirmed the existence of AEG through the users’ different perceptions regarding the auditor actual responsibility in a company [19, 20-22]. On this note, most of the previous studies in developed countries such as the US, UK and Ireland shows the impact of standard auditor’s report on increasing users understanding of the function of an audit. For example, [5] in the US analyzed the perception of 104 respondents on standards form of auditor’s report. The study found that the new auditor’s report largely increases users understanding. Similarly, another study conducted by [23] who examined the perceptions of auditors, investors and lenders regarding their understanding of the message conveyed in the standard audit reports on the financial statements. In the same way, the result of the study revealed a significant increase in users understanding within the standard audit report. In addition to that, the study further reveals that when the audit is conducted through ISA it gives the users of financial statements degree of confidence to the company’s financial reporting.

The influence of applying ISA 700 into auditor’s reporting with more informative information was also documented from a more recent study in the UK. For example, the work of [24] also examined the impact in new auditing reporting model ISA 700 (UK and Ireland) on the communicative value of auditor’s report. The findings of the study revealed that ISA 700 auditor’s report improved users understanding of the nature, scope and procedure of an audit. The study indicates that within the ISA 700 expanded reporting the users of financial statements found more meaningful information about the respective responsibilities of both management and auditors. Thus, ISA 700 is important for improving the users understanding of the function of an audit.

One of the important aspects of ISA 700 was that; the auditors are able to clarify technical terms in the audit which will immensely contribute to narrowing the expectation gaps from part of the public and at the same time improves the auditor’s report [2]. For this note, [4] investigated whether the expanded audit report within the development of SAS 600 will reduce the AEG issue. The study found a significant impact on the expanded audit report and increased the user’s perceptions closer to the auditors. The study indicates that auditor’s report using long-form brought users’ expectation closer with regards to the function of the audit. This impact on the standards audit report in reducing AEG was also acknowledged by [25] who posit that extended audit report has a significant influence in reducing the existence of AEG. The study suggests the adoption of extended audit report ISA 700 is a way forwards to decrease the existence of AEG and improve the users understanding of the function of an audit. Another study conducted by [26] who investigated the effect of the standard audit report ISA 700 on AEG. The findings reveal that a standard audit report had significantly reduced the existence of AEG. Additionally, the study finds ISA 700 provides better quality auditing reporting and good engagement teams which are dedicated to providing details information which can increase the degree of confidence to the users.

More evidence from previous researchers on AEG has highlighted the impact on the improvement of auditor’s report. For example, a study by [27] examined the communication of auditors to the users of financial statements in relation to the content of the auditor’s report as a means of reducing the AEG in Nigeria. The study findings revealed that there is the existence of AEG in Nigeria. This idea of improving the content of auditor’s report has been supported by the works of [28] and [29] in their empirical investigation on AEG they suggested that the auditor’s responsibility need to be expanded and clearly

2. The basis for Opinion Section: This section also provides a heading showing “**Basis for Opinion**” under the heading the following statement should be presented:
 - Should declare that the financial statements have been conducted in accordance with ISA and applicable to the relevant law governing the auditor’s responsibilities in the country;
 - Should indicate that the auditor is independent of the company in accordance with the applicable ethical requirements relevant to the financial statements audits.
3. Key Audit Matters: This section provides a heading “**Key Audit Matters**” is a description of the matters which auditors view as significant also to form an opinion on that matter. For examples, regarding Key Audit Matters, see “Footnote 2” below.
4. Going Concern: This paragraph should provide a heading “**Going Concern**” is the audit evidence obtained by the independent auditor regarding the company going concern status. The following are the summary of the details information enclosed under the heading:
 - A conclusion on the appropriateness of management use of going concern assumption;
 - A report on whether the material uncertainties linked with going concern have been identified.
5. Other Information: This section also should have a heading indicating “**Other Information**”. The section provides the following information below:
 - Respective responsibilities of directors and those charged with governance;
 - Respective responsibilities of the auditors in relation to financial statements;
 - Information about legal and regulatory requirements.

Equally important, the introduction of the audit opinion at a top in the auditor’s report is described as a better in providing users of financial statements with clear and more understandable information [1]. Moreover, [18] in their investigation on the impact of extended auditor’s report found that putting the audit opinion at the beginning of the report serves as a basis that allows readers to link the audit opinion with the following information surrounded in the audit report. Such an effort of improving the audit report with additional information could likely be seen to enhance the status and reputation of the auditing profession [4].

¹ According to IAASB [13], Key Audit Matters (KAMs) are matters involve in the auditor’s professional judgment which viewed as most significant in the audit of financial statements of the current period. For examples, Revenue recognition relating to long term contract, valuation of financial instruments, goodwill and intangible assets.

defined in order to reduce the unreasonable expectation among users of financial statements. Specifically, these studies highlighted the need for more informative auditor's report with details information regarding the auditors' duties.

IV. CONCLUSION

The discussion in this paper indicates that the adoption of ISA 700 in financial reporting presented a significant shift in the auditor's reporting model. Importantly, the additions of information in the ISA 700 that contained five separate paragraphs that users of financial statements view as a more user-friendly and suitable for understanding the respective responsibilities of auditors and management have considerably increased their understanding. The ISA 700 adoption is already making its ways around the world as a single set of harmonized financial reporting globally. The developed countries are closely following the efforts taken by IFAC and IAASB of 'ISA 700' into their financial reporting practice. However, in developing countries, it could be noticed that some countries are ahead than others in terms of adopting the ISA 700 into the respective country auditing standards. Thus, our study contributes to the AEG literature by highlighting the impact of ISA 700 towards reducing the AEG. Therefore, this study presents a picture to the regulatory bodies in Nigeria such as FRCN, ICAN and Association of National Accountants of Nigeria (ANAN) for policy formulation and deliberations on the adoption of ISA 700 in auditing reporting practice in the country.

In the light of this discussion, the following recommendations are offered. These recommendations may serve as a useful imputes for adopting and implementing the ISA 700 in Nigeria.

1. The FRCN and ICAN as a regulators and standards setters of accounting and auditing practice should make a consultation on the adoption of ISA 700 to the various stakeholders.
2. The regulators should also improve the regulatory framework for accounting and auditing in Nigeria to protect the public interest as undertaken in other developed countries.
3. Also, disseminating audit practice information developed by IFAC and IAASB to the relevant stakeholders which will further harmonize auditing practice in Nigeria.

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ADVANCE RESEARCH JOURNAL OF MULTIDISCIPLINARY DISCOVERIES

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