Audit and Assurance Services 1st edition Leung Solutions Manual

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Solutions manual

to accompany

Audit and assurance

1st edition

by

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Chapter 1: An overview of auditing

Review questions

1.11 Describe the nature of an audit.

An auditor sets out to achieve enhanced credibility of information disclosed to increase reliability for the users of the financial statements. A definition from the Committee on Basic Auditing is as follows:

An audit is a systematic process of objectively obtaining and evaluating evidence regarding assertions about economic actions and events to ascertain the degree of correspondence between those assertions and established criteria and communicating the results to interested users.

1.12 What does an independent auditor do during a financial report audit?

The auditor will provide a written opinion to the shareholders of a company as to the truth and fairness of the financial report prepared by management. This includes ensuring that the financial report is free from material error and is prepared in accordance with relevant accounting standards and corporate law; in Australia, this means compliance with the Corporations Act and Australian Financial Reporting Standards.

The auditor performs audit procedures, generally performing tests on samples of the company's transactions and balances, to provide sufficient and appropriate evidence upon which to rely in forming the audit opinion. Where the company has an effective internal control system that prevents, detects and corrects potential accounting and reporting errors, the auditor may choose to rely on those internal controls and reduce the amount of detailed testing performed. Where there are no effective internal controls in place, the auditor will perform extensive tests of the company's transactions and balances.

Once the audit work is completed the evidence is assessed and judgments are made as to the possibility of the financial report containing material errors. If the auditor believes that the financial report contains material errors the management will be requested to make any necessary amendments to the report. If management refuse to amend the report the auditor will consider the need to modify the audit opinion to highlight the errors to the users of the financial report.

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1.13 Explain how agency theory results in a demand for auditing.

In an agency relationship, investors (as principals) entrust their resources to managers (as agents). The agent's self-interest is expected to diverge from the principals' interest, giving rise to agency costs. A consequence of this agency problem is that investors will 'price protect' themselves on the assumption that managers are acting for themselves. It is therefore a rational response that there is a demand for a financial statement audit to verify the assertions made by management.

1.14 What are the current implications of the audit expectation gap? Can it be reduced?

The current implications of the audit expectation gap are the same as it has always been. A difference in expectations about what users think they are getting and what they are actually getting is going to be a problem – particularly for a service like auditing that is difficult to observe. There are three important areas where differences in perceptions occur and they are as follows:

1. *Reporting internal control*. Reporting on internal control has not been taken on in the Australian environment – unlike in the US with Sarbanes-Oxley. In fact, the most recent iteration of the audit report actually includes a specific disclaimer on the issue of reporting on internal controls.

2. *Detection of fraud*. This has been an area where auditors have expanded their responsibilities in recent years through the development of ASA 240 *The Auditor's Responsibilities Relating to Fraud in an Audit of a Financial Report* (ISA 240). However, it is still not seen as the core objective of an audit and the only responsibility that still exists in relation to fraud is *material* fraud. As stated by the Chairman of the FRC, Jeff Lucy:
   I would say there is, in fact, now a clear market expectation to this effect – that is, that auditors are bloodhounds not just watchdogs. Simply put, the market expects auditors to pick up instances of fraud.

3. *Evaluation of going concern*. Current auditors' responsibilities include a consideration of going concern. However, they make no positive assurance about what they do in this regard. Despite not commenting on this issue, the fact is that users think auditors are guaranteeing the ongoing financial viability of a firm, which is not currently true.
   Reducing the gap has traditionally focused on educating users about what an audit is actually designed to provide. However, this has not been particularly successful and therefore in the future more substantive changes on what auditors do and provide to users would seem the main way that a reduction in the expectation gap could occur.

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1.15 What are the two major components of the audit expectation gap?

The two major components are the reasonableness gap and the performance gap. The reasonableness gap is the gap between what society expects auditors to achieve and what they can be reasonably expected to accomplish. Whereas the performance gap is the gap between what society can reasonably expect auditors to accomplish and what they are perceived to achieve. The performance gap comprises deficient performance and deficient standards.

1.16 How has case law affected auditing practice?

Case law has been an important influence on what an auditor does and what an auditor reports since the late nineteenth century. One of the first major cases to address some of these emerging issues for the auditing profession was *Kingston Cotton Mill Co.* (1896) 2 Ch. 279, where Lopes made the following comment on what is required of an auditor:

> It is the duty of an auditor to bring to bear on the work he has to perform that skill, care and caution that a reasonably competent, careful and cautious auditor would use.

The emphasis of reasonable skill and care was a downgrading of the perceptions of auditor responsibility up to this time. It meant that the concepts of risk, materiality and sampling could be developed in the knowledge that the auditor was not attempting to provide absolute assurance on a set of financial statements. The term 'reasonable assurance' is still in the current audit opinion. This legal judgement also outlined that the audit role was not to detect fraud. Fraud is difficult to detect because it differs from error in that there is an intention to hide it, thereby making it harder to find than standard 'errors'. This judgement lessened the auditors' responsibility in this area and some have suggested since that it went too far.

Fraud was addressed in the major Australian case of *Pacific Acceptance Corporation v. Forsyth* (1970) 92 WN NSW (29). Moffit J noted that the auditors should pay due regard to the possibility of fraud and actively investigate the possibility of fraud if suspicious circumstances exist. Moffit J also addressed the concept of 'reasonable skill and care' and that it calls for changed standards to meet changed business conditions or changed understanding of the dangers.

Case law has provided important guidance on the auditor's role and responsibility over the years. The courts are still the ultimate adjudicator on these issues although the number of decided cases relating to auditors in recent years is few.

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1.17 There were a number of major corporate collapses in the early 2000s. What was the main Australian regulatory response to these problems?

The main regulatory response was through the implementation of the Corporate Law Economic Reform Program (CLERP) 9 in 2004. Some main changes of CLERP 9 were to expand the requirements on independence for auditors and also the creation of the Financial Reporting Council, which had a significant effect on the role of the accounting profession in the regulatory landscape. No longer would the accounting profession in Australia be responsible for the setting of auditing standards.

1.18 How have corporate collapses influenced the role of auditing in recent years?

The corporate collapses in the US and Australia have had a fundamental impact on the role of auditing in recent years. Recent events have led to closer public scrutiny on the role of the auditor, audit independence, and the methodology on how an audit is carried out.

Significant changes have been made to emphasise the following:

- A clear objective to enhance and maintain the integrity of the profession;
- Clearly address the auditor interest to the public is as important as to the client, such as safeguarding independence by eliminating complex relationship with audit clients (i.e. limit to audit only);
- Reiterate ethical governance;
- A clear distinction of audit and non-audit engagements carried out by the auditor, this leads to legislation and self regulation being established to a ban on certain non-audit services for audit clients;
- Stronger regulation on auditors and audit firms as well as tougher enforcement on non-compliance;
- Increasing the forensic nature of audit and stronger awareness of corporate fraud;
- Relate audit risks to business risk

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1.19 What role does ASIC have in the regulation of auditors?

ASIC has a significant role in the regulation of auditors. ASIC is the statutory administrative body for the enforcement of the Corporations Act 2001 (revised with the CLERP Act). Government regulation is exercised through ASIC's surveillance program which involves the scrutiny of all aspects of the financial statements of listed and some non-listed Australian public companies. The objective of this surveillance program is supplemented by an auditors' review program and a liquidators' review program. Furthermore, ASIC now works closely with the Financial Reporting Council and ASX in exercising governance regulations and assuring the integrity of business reporting. ASIC has the following powers and influence over the regulation of auditors:

- Registration by individuals, firms and companies as auditors;
- The audit inspection program enforced by the ASIC which covers the auditor rotation program, the policies and work practices of auditors; and
- Audit independence issues.

The Companies Auditors and Liquidators Disciplinary Board is a statutory body established under the ASIC Act and has the power to impose a penalty on a registered auditor or liquidator if he/she is found to be guilty of failing to discharge duties properly. If the auditor is deemed to be not a fit and proper person, his/her registration can be cancelled or suspended.

1.20 What role does the ASX play in the financial report audit of a listed company?

For a company to list on the ASX it must follow various listing rules, these rules are enforceable under the Corporations Act.

The listing rules are additional but complementary to the Corporations Act requirements that all companies must follow.

Two key issues for listed companies from the listing rules are:

- The requirement to make a statement of the extent to which the company has met the best practice recommendations of the ASX Corporate Governance Council, and
- Continuous disclosure - the company must inform the market immediately where it becomes aware of any event that a reasonable person would expect to have a material effect on the value of its securities.

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Professional application questions

BASIC

1.21 Is audit failure the same as a corporate failure? Recently you attended a networking meeting for members of the Chartered Accountants Australia New Zealand (CAANZ). While at the meeting you had a conversation with John Black, one of the partners of a local accounting firm. He claimed that: the external auditing process should safeguard against corporate failure. While some believe the quality of financial reporting and auditing in Australia is unsatisfactory, I disagree. Likewise, some see audit as a guarantee to prevent poor management behaviour, bad business decisions and/or corporate collapses. However, I believe an audit enhances a company's accountability to its shareholders. A corporate failure is not the same an audit failure.

Required
Describe what John Black means when he refers to what an audit does.

Audit failure occurs where an auditor gives an opinion that the financial report is free from material error when this is not the case. The auditor has failed to detect and/or report material errors. The risk is that users will make financial decisions based on the information contained in the financial report unaware that they contain material errors. Users place reliance on an audit opinion that is erroneous and can suffer losses as a consequence.

Corporate failure is the failure of the organisation to continue trading. Where a company is unable to meet its debts when they fall due it is insolvent and the company is no longer a going concern. There is likely to be an attempt to save some or all of the business from liquidation to maximise the ability to pay off creditors and possibly the shareholders. Where the business cannot be saved, the assets will be sold to pay off the debts and surplus funds remaining, if any, will be given back to the shareholders. On completion of the liquidation the company no longer exists. When corporate failures occur, it is likely that some, if not all, the creditors will not receive all that is owed to them and the shareholders generally do not get any return.

The auditor only considers going concern to the extent that it is met so that the accounts can be prepared on a going concern basis. The auditor (unlike the directors) makes no positive assertion about the going concern of the company.

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1.22 Level of assurance: Auditors perform audit assurance to enhance the credibility of the financial report. However, it is quite impossible for the auditors to provide an absolute assurance regarding the subject matter on which they express their opinion.

Required

(a) Why is it impossible for an auditor to provide absolute assurance regarding subject matter on which they express their opinion?

(b) Explain what type of assurance an auditor should provide in a financial report audit.

(a) It is impossible for the auditor to provide absolute assurance because there are so many judgements in the audit process. The auditor makes a judgement about the risks of material misstatement and then designs procedures accordingly. These procedures use sampling (discussed later in the text) which will always provide some sort of error rate. Even if there was no constraint on cost or time the auditor could not provide absolute assurance because he or she may misinterpret evidence and because there are so many account balances that are the product of significant professional judgement.

(b) The auditor is required to and should provide a high level of assurance in a financial report audit (ASA 200).

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1.23 Organisations associated with the profession: Several private and public sector organisations are associated with the public accounting profession. The following are functions pertaining to these organisations:

1. **Hear applications from ASIC to determine whether auditors have breached the Corporations Act.**
2. **Promulgate accounting standards and statements of accounting concepts.**
3. **Promulgate auditing standards and audit guidance statements.**
4. **Regulate the distribution and trading of securities offered for public sale.**
5. **Establish a code of professional ethics.**
6. **Oversee the Australian Auditing and Assurance Standards Board.**
7. **Issue auditing standards.**
8. **Take punitive action against an independent auditor.**
9. **Establish accounting principles for state and local government entities.**
10. **Establish quality control standards for audit work.**
11. **Undertake investigation of perceived breaches of the Corporations Act.**
12. **Provide timely guidance on urgent financial reporting issues.**

Required
Indicate the organisation(s) associated with each activity.

1. Companies Auditors and Liquidators Disciplinary Board
2. Financial Reporting Council and the Australian Accounting Standards Board (AASB)
3. Auditing and Assurance Standards Board (AUASB)
4. ASX (Australian Stock Exchange)
5. The Accounting Professional and Ethical Standards Board (APESB)
6. Financial Reporting Council
7. AUASB
8. Companies Auditors and Liquidators Disciplinary Board
9. Public Sector Accounting Standards Board
10. AUASB
11. ASIC
12. AASB

The IFAC also issues relevant international auditing, education and ethics standards which are used as an overriding guide for CPA Australia and CAANZ.

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MODERATE

1.24 Audit objectives: You have obtained employment in the accounting firm of Bing Lee and Partners as an audit assistant. You have heard that the firm is not very modern in its approach. On your first day at work, Mr Tom Lee, Bing Lee's son who is also an audit manager, calls you into his office and tells you that the audit is solely to provide assurance on the assets of the firm. The auditor must focus on this as their primary duty. He also states that the auditor's main role is to support management in ensuring that they properly communicate the financial situation of the firm to users of the financial statements — whoever they might be.

Required
Comment on the audit manager's view of auditing.

There are two assertions in the audit manager's view that should be challenged:

Auditor provides assurance on the assets of the firm
This is part of what is provided by the auditor but the auditor provides an opinion on the whole set of financial statements. Therefore, assurance is also provided on the income statement as well, which requires an examination of revenue and expenses of an entity. The auditor also obviously examines the firm's liabilities and owners equity.

Support management
While there are many possible users of the audit report and the management are the ones that auditors are dealing with mostly on a day to day basis, there is no question that the audit is primarily designed for the current shareholders of a company as a group.

1.25 Review of auditing: In June 2017, ASIC released its audit inspection program report on the review for 2015–16, one conclusion in that report was that there had not been any improvement in audit quality since the last report. The following is included in the Executive Summary of that report:

> **In our view, in 25% of the total 390 key audit areas that we reviewed across 93 audit files at firms of different sizes, auditors did not obtain reasonable assurance that the financial report as a whole was free of material misstatement.**

Required
Discuss the advantages and disadvantages of the responsibility of reviewing audit work being undertaken by ASIC rather than the audit profession.

Advantages
- Reviews will be more independent
- Serious breaches can be appropriately penalised
- Improve perceived quality of the audit process

Disadvantages

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- More understanding of issues by accounting profession
- Potential for ASIC to highlight any problems to justify review process
- Diminish the value of the profession

1.26 Value of auditing: You are the managing director of a start-up company in Australia that is developing an innovative product that will revolutionise heating and cooling for homes in Australia by a unique environmentally friendly system. The company has high expectations of growth and its market research suggests the product will be very well received. The company was financed by several wealthy business people and has only borrowed a moderate amount from a large Australian bank. At this point in time, there is no legal mandate for an audit and none of the key stakeholders have insisted that one be obtained.

Required
Would you obtain an audit for this company? Explain the reasons for your decision.

In an unregulated scenario like this, it is most appropriate to examine some of the theories underpinning the demand for auditing to assess whether it would be rational to obtain an audit.

Agency theory
This is the main theory that underpins auditing. The question is whether there is a significant information asymmetry between the principals and managers to justify the need for an audit. In looking at these facts, there are only a few wealthy businesspeople who have primarily financed the company. Under these circumstances, they are most likely in a position to have a high degree of access to material within the company. Therefore, there may not be sufficient information asymmetry to warrant an audit. The bank only has a claim over a moderate amount of the company and therefore probably could not justify forcing an audit on the company and may just rely on guarantees.

Information hypothesis
This relates to where there is a larger group of investors in a company and is not the case for this company at the moment. However, if the company is thinking of a public listing in the short to medium term future it may be appropriate to get an audit in readiness.

Insurance hypothesis
There is only a limited amount that can potentially be recovered from auditors if the company were to fail. However, given that this is a start up company it may be reasonable to get an audit to provide some sort ‘insurance’ coverage in the event of failure. The shareholders should be aware that the audit is not designed to provide a ‘guarantee’ on the financial viability of the company.

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1.27 Expectation gap: You are an audit senior in an accounting firm and you asked the audit partner about the audit expectation gap. The audit partner provided his opinion on the issue as follows:

There is a so called 'audit expectation gap', and it is associated with unreasonable expectations of users. They want all fraud found, and a guarantee that the company will continue forever! This is quite unreasonable and not what the audit is designed to do! Perhaps we could do more on these issues, but it would be more work, cost more, and I doubt whether the companies would be prepared to pay anyway.

Required
Discuss the views of the audit partner.

The partner is not correct in suggesting that the expectation gap only relates to unreasonable expectations of users. A good definition of the expectation gap was provided by Porter in 1993. She described it as 'the audit expectation-performance gap'. This indicates that the gap has two major components:

1. a gap between what society expects auditors to achieve and what they can be reasonably be expected to accomplish ('reasonableness gap')
2. a gap between what society can reasonably expect auditors to accomplish and what they are perceived to achieve ('performance gap'). The performance gap is further comprised of deficient performance and deficient standards.

The partner is focusing on the first part of the gap. This has been the main component that the profession has focused on in responding to the expectation gap issue. The main measures have been directed at education of the public to dispel their unreasonable expectations. The problem is the expectation gap has not been resolved which suggests that measures taken thus far have not worked and perhaps more consideration should be given to the second component of the expectation gap.

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CHALLENGING

1.28 Independence and reliability: Independence has always been a fundamental aspect of the accountancy profession. A commentary in 2015 suggested the following:

. . . public interest view of audit independence must account for the auditor's real reason for existence based on what stakeholders want and need: reliable audit services that facilitate financial reporting quality and protect the public interest. ... public interest view of auditor reliability is shifting toward a revised view of independence.

Required

Based on the extent of accounting crises and corporate collapses, discuss the importance of maintaining independence (and reliability) by an auditor. What do you think of the above comment?

The corporate collapses of the early 2000s highlighted for many users that there were problems with audit quality. De Angelo (1981) provided an important definition of audit quality that states it is the 'market-assessed joint probability that a given auditor will both (a) discover the breach in the client's accounting system, and (b) report the breach'. It requires that auditors have the ability to pick up errors or irregularities and then they have the independence to do something about it. The regulatory changes in Australia clearly focused on the second part of this definition (independence). One particular issue that was highlighted related to the very large non-audit fees that were being earned by the auditing firms at that time.

There is no question that independence is important but the quality of the audit process to pick up errors is also important.

The comment in the question is alluding to the fact that there may have been too much focus on the independence issue to the detriment of consideration of what is of most importance for users of audited financial statements – reliability. The authors are implying that refocusing on reliability would best serve the public interest. In their article, they note that to achieve reliability it requires: integrity; expertise; and *independence*. [my italics]

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Case study

1.29 **Carla's Coffee Pty Ltd: Carla has developed a business of roasting coffee beans in the inner northern suburbs of Melbourne since 1995. This business has relied on supplying high-quality, fair-trade organic coffee to many of the small cafés in Melbourne. As the number of these cafés has grown and as there has been a growth in demand for organic coffee generally, her business has expanded. The business operates out of a small warehouse in Northcote in Melbourne. In the past five years, Carla has considerably expanded her operations and is now supplying a couple of the major supermarket chains in Australia. The business is very profitable and the balance sheet is strong. During the growth period, the company actually bought a few cafés, which have so far performed well, and also provide a guaranteed customer base for her coffee.**

Carla obtained a moderate loan from Northpac Banking Corporation to assist in funding her expansion. This loan is secured over the company assets. The company recently purchased a much larger warehouse in Preston with the funds from the loan. They plan to move operations to that location in the next financial year. Carla's personal contacts have been instrumental in the growth of the business.

Carla has decided though that it is time to do other things. She would like to sell the business and will depart as Chairman of the Board and Chief Executive Officer. The financial statements have been prepared by Wendy, the Chief Financial Officer. Carla decides to approach a dozen potential investors to offer shares in her business and she gives them a copy of the latest set of financial statements prepared by Wendy. The latest financial statement shows strong growth over the past five years and in particular the current year's performance was very good — resulting in a bonus to the Chief Financial Officer. A number of the senior people in the company were given shares by Carla (including Wendy) and most of them are also considering selling out as well.

There was a recent press report in The Age that suggested that the coffee used by Carla's Coffee was picked by child labour in Colombia working under terrible conditions. This breaches the rules of the fair-trade certification and the publicity is causing some of Carla's customers to rethink their relationship with Carla's Coffee.

Either or both of the following sets of questions can be answered after reading the above case.

Required

a. Who are the various parties with an interest in Carla's Coffees? Outline what you think their interests, motivations and concerns would be.

Carla

- Her primary interest has been in the development of the company. It appears now that she wishes to do other things and divest herself of her shares. It is reasonable to assume that a primary interest for her would be to obtain a good share price.

Customers

- Their primary interest would be in the ongoing supply of high quality, fair trade, organic coffee. The main concern to this group would be the reports from *The Age* suggesting that some of the assertions about this coffee are not true.

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Northpac Banking Corporation
- The primary interest of the bank would be to ensure that the capital value of their loan is secure. They would have a concern about such a major restructuring of the business potentially putting their investment at risk.

Wendy the CFO
- Her interest would presumably be on her ongoing employment. One motivation for her would be the bonus she receives based on profitability targets achieved. Another motivation would be maintenance of the value of the company before selling her shares. A concern would be the uncertainty surrounding the possible new owners of the business.

Dozen Potential Investors
- They would be interested in ensuring the ongoing profitability of the business and the truth in the previously reported financial statements. Their motivation would be to earn a profit on their possible investment. They would have a number of concerns: (1) the departure of Carla; (2) accuracy of previously reported financial statements; (3) the ability of the company to maintain recent high growth; (4) the number of senior people in the company wanting to sell their shares; and (5) recent bad publicity.

b. Who would demand an audit of Carla's Coffee? Why would they want an audit?

The two main parties who would demand an audit would be: (1) Northpac Bank; and (2) the dozen potential investors.

The dozen potential investors would certainly want an audit. There is an information asymmetry between them and the management of the company. An audit provides an independent evaluation of the financial statements on behalf of the investors. This would provide them with assurance as to the reliability of the prior reported financial statements to give them more confidence in investing in the company. Sometimes under these circumstances the investors would ask for a 'due diligence' report which is even more extensive than a normal audit and would include a review of some of the future projections for the company.

Although the bank has first claim on the assets of the company, they would also be interested in an audit of the company in this changing environment. The audit would provide reliability on the prior financial statements which include reporting on the company assets over which the bank has a claim.

Required

a. Assume you have been appointed as an auditor for Carla's Coffee. On what items in the financial report would you be focusing your main attention to provide users with an opinion that the financial report represents a true and fair view of the economic performance of Carla's Coffee?

There has obviously been significant growth in the company's assets. These are important figures because the bank loan has a claim on these assets and it will be the most 'tangible' part of the business purchased by the investors.

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The other aspect of the audit should focus on areas of potential earnings manipulation. Strong growth over five years is impressive but this also creates significant pressure to maintain this growth. Associated with this is the bonus scheme that rewards the CFO based on financial performance. The auditor should therefore ensure that only appropriate revenue has been recorded in the current period and also that all expenses have been properly recorded.

b. Would you have any particular concerns if it was the 'dozen potential investors' who had engaged you to undertake the audit?

Although legal liability is discussed later in the text, being employed by the dozen potential investors does increase the risk for the auditor. They will be making their investment decision based on the audit. This is fine but the auditor should make it clear what exactly is provided by an audit so they do not over-rely on the audited information. The audit does not provide a guarantee on the future viability of a company but enhances the credibility of information disclosed to increase the reliability for the users of the financial statements.

c. What other aspects of the above case study would concern you as an auditor and why?

Auditors need to consider business risks to the extent that they will affect the financial statements. In this case, there are two major risks to the company that the auditor should be aware of and give due consideration to in their planning. The first is the potential departure of the founder of the business. This is a big risk because often for these types of businesses there is significant reliance on the founder. The other risk is the recent bad publicity. An integral part of the development of the company has been associated with the provision of 'high-quality, fair-trade, organic coffee'. If there are serious questions raised about any of these assertions, it could have severe negative consequences for the company.

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Research question

1.30 Auditing and the global financial crisis: In the report 'Audit Quality in Australia', released by the Treasury in March 2010, the following was noted:

Treasury proposes to encourage focused discussion with key stakeholders including ASIC, the FRC, the Auditing and Assurance Standards Board (AUASB), the major audit firms and the professional accounting bodies on strategies to minimise identified audit expectation gaps. Treasury is of the view that any proposals to change the current standard audit report would need to be subjected to rigorous cost/benefit analysis to ensure that the risks associated with any changes do not negate the potential benefits. In that context, Treasury is concerned that because of the wide disparity between the sophistication of retail and more sophisticated investors in terms of their understanding of financial statements and audit reports, any changes to the standard audit report may have the perverse effect of introducing confusion among some users, leading to a widening of the expectations gap.

Required

a. Find recent research on the 'audit expectation gap'. Is changing the audit report the only problem associated with this 'gap'?

The majority of research on the audit expectation gap was conducted in the 1990s and some examples are as follows. Some of this research also examined changes to audit reports that occurred in the late 1980s/early 1990s to evaluate the effect of these changes on user's perceptions. Examples of research follow:

Gay, G. and P. Schelluch. (1993). The effect of the longform audit report on users' perceptions of the auditor's role, *Australian Accounting Review* 3 (2): 2-11.

Gay, G., Schelluch, P., & Baines, A. (1998). Perceptions of messages conveyed by review and audit reports. *Accounting, Auditing & Accountability Journal*, *11*(4), 472-494.

Hatherly, D., J. Innes, and T. Brown. 1991. The expanded audit report - An empirical investigation. *Accounting and Business Research* 21 (84): 311-319.

Innes, J., Brown, T., and D. Hatherly. (1997). The expanded audit report – A research study within the development of SAS 600, *Accounting, Auditing and Accountability Journal* 10 (5): 702-717.

Kelly, A. S., & Mohrweis, L. C. (1989). Bankers' and investors' perceptions of the auditor's role in financial statement reporting: the impact of SAS No.58, *Auditing: A Journal of Practice & Theory,* Fall.

Monroe, G., and D. Woodliff, 1994, 'An empirical investigation of the audit expectation gap: Australian evidence', *Accounting and Finance,* 34, 1: 47-74.

Porter, B. A. (1993). An empirical study of the audit expectation-performance gap. *Accounting and Business Research*, 24(93), pp49-68.

McEnroe, J., and S. Martens. 2001. Auditors' and investors' perceptions of the "expectation gap". *Accounting Horizons* 15 (4): 345-358.

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Research examining the changes to the audit report found the changes to better clarify auditors and managers' responsibilities were picked up by users. However, it left unchanged (and actually made worse) many of the other misperceptions of users in relation to the audit expectation gap.

Further evidence to suggest the expectation gap still existed was due to the fact that another proposed audit report was put forward by the IAASB in 2003 and adopted internationally in 2006.

However, a recent study suggested this did not make much difference as well:

Chong, K. and G. Pflugrath, 2008, 'Do different audit report formats affect shareholders' and auditors' perceptions?', *International Journal of Auditing,* 12: 221-241.

Some studies have suggested that the changes to audit reports have not really addressed the core issues:

Humphrey, C., Moizer, P., & Turley, S. (1992). The audit expectation gap – Plus Ça Change, Plus C'est La Même Chose? *Critical Perspectives in Accounting*, (June), 137–161.

Humphrey, C., Loft, A., & M. Woods (2009). The global audit profession and the international financial architecture: Understanding regulatory relationships at a time of financial crisis. *Accounting, Organizations and Society* 34: 810-825.

This is still a topical issue. From the quote in the research question, as well as a other reports suggesting that more fundamental changes are required:

Audit Quality Forum (AQF). (2007). *Fundamentals – Auditor Reporting* (Report of the Working Group on Auditor Reporting). London: Institute of Chartered Accountants in England and Wales (ICAEW).

European Commission. 2010. Green Paper, Audit Policy: Lessons from the Crisis (October). Available at: http://ec.europa.eu/internal_market/consultations/2010/green_paper_audit_en.htm

b. Does research suggest that the audit report should stay the same because changing it would lead to confusion among users?

A number of the above papers address this issue and it certainly does not. The research does tend to suggest that changes to the audit report will not be effective if the wording still remains 'boilerplate' – which would suggest that more dramatic changes are needed. A review of the literature confirmed this:

Church, B., S. Davis, and S. McCracken. 2008. The auditor's reporting model: A literature overview and research synthesis. *Accounting Horizons* 22 (1): 69-90.

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