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The Determinants Of Client's Audit Expectations Gap: A Study From Pakistan

Khalid Hussain[1], Ahtasham Khalid[2], Adnan Ashraf[3]

1. *College of Commerce/Government College Unviersity Faisalabad /Pakistan.*
2. *College of Commerce/Government College Unviersity Faisalabad /Pakistan.*
3. *Layalpur Business School/Government College Unviersity Faisalabad /Pakistan.*

Corresponding Author: Khalid Hussain

ABSTRACT:*Audit, being a mandatory part of the disclosure of financial information towards the shareholders and other stakeholders, must accord to the client satisfaction. This satisfaction is compromised because of mismatch of expectation, called Audit Expectation Gap, from the view point of client. It is necessary, therefore, to explore the factors causing this gap to decrease. In this study a client perspective of the said problem is addressed through administering a questionnaire to the shareholders and directors of listed companies to explore the major factors causing the problem. Failure to detect errors and frauds found to be a significant contributor towards audit expectation gap in addition to the failure to detect illegal acts.*

KEYWORDS:*Audit Expectation Gap, Audit Assessment, Audit Risk , Errors and Frauds,Going Concern Opinion, Illegal Acts*

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I. INTRODUCTION

It is the fact that every work should be monitored so that the efficiency and effectiveness level could be maintained. This process is called auditing. Audit definition by AAA (American Accounting Association) in 1973 as an organized method of gaining and evaluating signs with respect to statements about monetary activities and proceedings to determine the level of communication between those statements and standards and collaborating the results to concerned users.The purpose of an audit is the clarification of the company's position. The first purpose of audit is certification (Ball, et. al., 2000). The second purpose of audit is conformance, that means the comparison of performance with standards. Fivephases of an audit are preparation, performance, reporting, follow-up and closure. So, the companies hire some autonomous bodies that check the efficiency and effectiveness of its financial statements. These autonomous bodies are called auditors. There are two types of auditors, first is the internal auditors, being the employee of the companies and responsible for looking the accuracy of the financial procedures throughout the year and second is the external auditors, responsible for the historical audit, they are independent third parties as nominated by the shareholder or other party as the case may allow(Power, 2003). Theauditor general of Pakistan is the autonomous body of Pakistan that regulate the auditing process, appointment, duties, rights and removal of external auditors. It is a supreme authority of Pakistan to ensure the credibility and transparency of audited financial statements of companies(Auditor General of Pakistan, 2012).

The expected and actual performance difference is Audit Expectations Gap (AEG). It means the conflict between auditors perceptions about his duties and expectation of the client. Further different authors had explained it in different manners which is explained in detail in the following sections of this document. In this study, Audit Expectations Gap (AEG) is used as dependent variable. Adeyemi & Uadiale, (2011)explained that Audit expectation gapmeans the difference between forthcoming two statements, first,Auditors' responsibilities with respect to the audit work from the perspective of client and second what these are with the consideration of auditors.This conflict of opinion received much attention in the accounting literature and it is a point of our concern in this study.

Basically, audit has three types according to its characteristics, product audit, process and system audit. Product audit is associated with the audit of a specific product that confirm the product's ability to meet the qualities of that product. For example, a company produces a product named alpha. So, now the company wants to know its reliability and validity in the market and also want to know that whether the customer is satisfied with their product or not. Process audit is conducted for checking the competence and usefulness of process control flowcharts, training schedules, procedures, instructions or process specifications. Third type of audit is system audit. As it is known by its name, this is used for checking the credibility of a specified system. It may include the audit of a management system. A document verification of performance by inspection and indication that have applicable standard of the appropriateness and effectiveness of a system. The most common system audits include quality management system audit

Lack of knowledge is a main factor in Pakistan that is caused by principle of continuity, that effect the audit expectations gap because in literature it is clearly stated that if the auditor has not much information about the financial statements and about how to check the credibility of the books of accounts than he can't pass correct views on it (Afza & Nazir, 2014). Furthermore, detection of illegal acts and detection of error and frauds are used as independent variable in this study.

Later part of this documents is divided as follow, in section two, literature review is given to get some background of the study, in section three, methodology is explained, in section 4 results are discussed, in section 5 work is concluded.

II. LITERATURE REVIEW

Need, importance and application of audit and the emergence of audit expectation gap is identified on the basis of different theories namely policeman theory, credibility theory, agency theory, theory of inspired confidence, quasi-judicial theory and moderator of claimant's theory. These theories describe the audit and explain the reasons of audit expectations gap. (Kingsley, et. al., 2015).

Audit is the main factor that is very important for an organization to work effectively. The audit is conducted by the auditors who are a representative of the client. One problem that is very common in audit is the expectations gap between the auditors and the client. The auditor expects that the company/ management/ client will give him the independence to explain its views and the company/ management/ client except that the auditor will give its opinion according to their wishes. When the expectations of the both parties are different to each other, then problem audit expectations gap (AEG) arises . Differences between the interests of auditor and its client associated to a problem is named audit expectations gap (AEG). Differences in believing standardsof auditor and its client with respect to audit profession are known as audit expectations gap (Jennings et. al.,1993). Furthermore, AEGis divided into four groups includingfirstly the responsibilities of auditors Secondly, the value of the audit function,Thirdly, the structure and regulation of the audit profession and lastly the nature and meaning of audit reports.

Monroe and Woodliff, (1994)divided audit expectations gap into three main issues: auditors' responsibilities, reliability of the financial statements, responsibilities and reliability of the financial information. He concludedthe belongings of the expectation gap to the professioncorrespondedalong withhiddenexplanations that had market forces by way of substances.

Leung and Chau, (2001) found that audit reportsextensively serve to make better the perception of shareholders about the financial information, in relationsto its capacityto communicate true and fair result.So, the audit expectation gap can be specifically initiated on the substances of the responsibilities of auditor, for fraud detection and prevention, and the responsibilities of auditor for checking the books of accounts and paractice of finding the selection of audit procedures.Furthermore, the reports made by qualified accountant provided less differences in perceptions as compared to the report which is made by a non-qualified accountant. With reference to US, Sarbanes Oxley Act, relationship of audiotr with shareholders also effect the quality of audit reports in sense of detection of frauds that may cause AEG.

Fadzly and Ahmad, (2004)acknowledged eight assertions on obligationthat highlighted the issues of detection and prevention of frauds, accounts and financial statements, scope of auditor's legal responsibility, auditor's independence, internal control and liability of auditor in fraud-related business catastrophe.

The audit 'expectation gap' is a crucial issue that has significant implications on the development of auditing standards and practiceswhich is associated with the independent auditing function(Lin & Chen, 2004). Adams and Evans, (2004) stated that the incompleteness of reports and absence of credibility of audit reports had a direct link for the accountbility of social reports. Shafie et. al., (2004)stated that lengthy tenure will cause going concern opinion in Malaysia. Yet literature statedconflictingopinions, for example in the USA, audited financial reports are supposed as more dependable for industries with longer auditor tenure.

Investors may have had different beliefs about the responsibility of an independent accounting firm that took an audit of financial statements of its client.According toHaniffa and Hudaib, (2007)the technical knowledge of auditors' effect the business and social environment of audit performance.

Kaplan and Mauldin, (2008)stated that (i) shareholders hadrational perceptions about auditors which rangeout there auditors' legal and specialized responsibilities (i.e., deficient standards); (ii) shareholderssupposed that auditors did not performed their dutieswhich were compulsory for them as per the standard (i.e., deficient performance).Mahadevaswamy and Salehi, (2008) found that AG lies in responsibilites of auditors that states less difference between the view of auditors and investors.

Mansoury and Azary, (2009) examined the auditor independence and AEG, he stated that separation of ownership from the management is effected by the auditor independence and the independent audit factor is the base of the public accounting profession.Noghondari and Foong, (2009)indicated that the accounting prerequisite is a significant interpreter (or vindicating factor) of the AEG. Hassink, et. al., (2009)obtain the findings assessed an indication of a considerableAEG in the framework of deception, both laid down in existing standards by the meanof performance of auditor andformal obligations of the auditor. Freely audited accounts caused a result of accounting materialsthat will help shareholders to supposebalanced expectations about thecommpanies and reduce the conflicts.

Lee, et al., (2010) reported that statutory responsibilities of auditors are well considered by the selected auditors and these statutory responsibilities are the true represent of deficient performance.Salehi, (2011)explored the basicmagnitudes of AEGand stated thatAEG can be minimized by the auditor himselfthroughrefining audit obligations, training various shareholders and delegating new benchmarks.Sometime, the duties allocators were not satisfied by the evidence discussed in audit reports which suggest the differences in the perceptions of public audit and the working of the auditors for the company.

The Audit Expectation Gap is perilous to the auditing career because, the less the trustworthinessproducingprobability and reputation linked with the effort of auditors cause the more the frustrated anticipations from the general public(Olowookere, 2011).Almeida, (2012)conducted a study in Portugal to know about the determinantes those causedan audit expectation gap and found that AEG is based on the failure to detect illegal acts and frauds. Porter, et. al., (2012) also stated that auditors had not performed their duties as allocated by the regulatory authorities. In Libya, Abonawara, (2013) concluded thatthere was the absenceofauditing principles that resulted in errors in the culpability and accountability of outside auditors. Agyei, et. al., (2013), found that expectations gap in Ghana exists and had significant impact concering responsibilities of the auditors relevnt to fraud detection and sound structure of internal audit.Okafor and Otalor, (2013) showed that the shareholders may ignore the responsibilities of the auditor and this leads to the lack of knowledge which showed the responsibility for unreasonable perceptions of the shareholders from auditors.

Low, et. al., (2013) elaborated that accounting education haa an effective role in the establishment of proficiencies to accounting graduates, and affection of these proficiencies by the recent changes in academic. Ihendinihu and Robert, (2014)findings gave credence thataudit education had substantial impact on Audit Expectations Gap in Nigeria and that the policies were made to increase the knowledge of financial statement users. The auditorsthose had not any auditing experience could perform alike well on chores those required assertion and technical knowledge, but by theadversative association between performance and intellectual aids required as linked to the technicalerrands.

The AEG is categorized in literature as complex social procedure by comprising a determined display and the changings which occurred in accounting requirements that rose up the reservations in accounting techniques. Kingsley, et. al., (2015)showedthat a higher value of audit expectation gap lessens the reliability of the financial statements.In Pakistan, Ali et. al., (2015) expressed that audit expectations gap is caused by the differences in perceptions of auditors and all the respective parties that were linked to the auditors directly or indirectly. The going concern concept is much important for the audit expectations gap that directly related tothe audit profession, which lead to the requirement of importantmodification and advances.

Kose and Erdogan, (2015) concluded that complex reporting standards and perception in market develop the differences in perceptions of third party that what they perceive about the responsibility of auditors. DiGabriele, (2016) concluded that there was significant relation between shareholders and auditors due to fiinancial valuation fitness and this factor (fiinancial valuation fitness) also had a great impact on accounting eduction and the shareholders.Audit expectations gap in audit quality explain through the experience level of auditing profession and level of duties shared by the professionals themselves.Salehi, (2016) studied the relationship between audit responsibility and audit expectations gap in Iran and concluded that AEGis effected by the deficient standards, audit ethics, financial reporting assurance and audit rotation.The differences of beliefsappearedbecause of the perception of the society with respect to the, first audit quality, secondauditors performance, thirdresult and their objectives; in contrast to expected arrangements from the auditors.The audit education had a great impact on the audit expectations gap because this knowledge improves the perceptions level of shareholders in managing their duties (Adafula, et. al., 2016). The researchers stated that the audit expectations gap will arise by the role and responsibilities of auditors, nature of audit reports and the response of auditors on their responsibilities(Dilmaghaniy & Nazemi, 2016).

Kangarluie and Aalizadeh, (2017)found some significant variance between theshareholders and auditor's perceptions with reference to the roles of auditors and their responsibilities. Masoud, (2017) concluded that the misunderstanding of audit regulations is due to the lack of knowledge about illegal acts about auditing and accounting practices in Jordan, such as directors/senior management who directly impact the dependability of the company's financial statements and audit process. The strategicconsequencesof this research specified the importance of replacement of old regulations with the new rules those clearly define the appointment, remuneration and auditor's duties to the concerning government and law developers.

Boterenbrood, (2017) found the level of materiality percieved by the accountants was low than the level of materiality that was actually applied by the auditors. Onulaka and Samy, (2017) stated that the reason for the audit expectations gap were theappointment, remuneration and removal of external auditor policies. The government have to made changes in their act and revise the standardss define by the regulatory authorities. Bashir, (2017) enlighten the cultural aspects impact on the audit expectations gap. Culture is different in each country that's why in every country situation is very different from other countries which give rise to the need of a focused research.

2.1: **Hypothesis Development**

Adeyemi and Uadiale, (2011)concluded that duties of auditors have inverse relationship with the audit expectations gap. The quality of auditors is divided into two segments. First is to detect the problem that mislead the financial statements of shareholders and second is to represent those problems(Masoud, 2017; Kingsley, et. al., (2015). Audit reports may decrease the expectations gap (Adeyemi & Uadiale, 2011). Different researchers had checked the impact of audit reports on audit expectations gap. In literature review, there is a lot of discussion on audit reports. Literature also supports the words that audit reports relates to the audit expectations gap.

$H_{1o.}$ Detection of error and frauds has no impact on the audit expectations gap.

$H_{1.}$Detection of error and frauds influences the audit expectations gap.

Role theory helps to develop the following hypothesis for the inadequate performance and audit expectations gap.The distressed companies prefer to hire a new auditor as compare to non-distressed companies' due to financial disturbances and they try to hire a quality auditor who is more efficient than the previous one.

$H_{2o.}$ Detection of illegal acts has no influences the audit expectations gap.

$H_{2.}$Detection of illegal acts influences the audit expectations gap.

III. METHODOLOGY

In this study perspective of shareholders being the real owner of the business was selected to know about the determinants of audit expectation gap. Data from the shareholders of the Pakistan Stock Exchange 100 Index listed companies was collected by administering the questionnaire. Pakistan Stock Exchange 100 Index was selected because of its validity in the context of Pakistan because it is a true representative of the companies.

3.1:Dependent Variable

According to Sekaran and Bougie, (2010), the dependent variable is the variable of main concentration to the researcher. The researcher's objective is to realize and define the dependent variable, or to explain its capriciousness, or envisage it.

Audit Expectation Gap:Audit expectations gap was measured through some questions under the head of communication between the auditors and users of financial information. This head was created because previous studies direct the researcher than lack of communication is a major cause and indication of AEG. (Agyei, et. al., 2013). In other words it can also be stated that communication plays an important role for the identification of audit expectations gap.

3.2: **Independent Variables:**

According to Sekaran and Bougie, (2010), independent variable is one that effects the dependent variable whether that impact is in positive way or in negative way. In this study, following are the independent variables used: -

Detection of Error and Frauds: The studies conducted by Porter (1993), and Jennings et al. (1993) conculded that lack of audit procedural knowledge on the part of auditor causes difference of the expectations during audit. The depends on the technical features of auditing that means inability to know the audit scope.Auditor independence is much important factor that may increase or decrease the audit expectations gap. There are some dimensions of frauds and audit expectations gap that discussed as (Okaye & Chukwunedu, 2011); material misstatement that may also occur in two ways, (1) misappropriation of assets and (2) fraudulent financial reporting. It represents the misappropriation of assets that they are not recorded according to the accounting rules and regulations as well as there are some restrictions found in accounts while making transactions relative to assets. The main reason is that the accounting policies are not fully applied at business.

Detection of Illegal Acts:In previous researches, such as Liggio (1974), Guy and Sullivan (1988), Jennings et al.(1993), Lowe (1994), Harris and Marxen (1997), Wolf et al. (1999), stated that audit expectation gap is occurred because of the deliberated ignorance on the part of auditor, also called illegal acts of the auditor.

The questionnaire was designed at five point likert scale. In order to ensure validity and reliability, this questionnaire is adapted from Almeida, (2012) that asked close ended questions from the respondents. The questionnaire was divided in 4 sections. First section explained the title and purpose of data collection. Second section was about personal information of the respondent. Third section consists of 18 questions those were further divided into four segments. First segment refer to the measurement of audit expectation gap, which headed as communication between the auditors and users of financial information. Second segment headed as applying the principles of continuity is about the continue process of auditing and accounting techniques (Loasby, 1990). Third segment was labeled as detection of error and frauds. The forth segment headed as detection of illegal acts.

Following econometric model is used to interpret the results

$\mathrm{AEG} = \beta_{o1} + \beta_1 \mathrm{DEF} + \beta_2 \mathrm{DIA} + \mathrm{e}$ …………… eq. 01

Whereas: -

AEG = Audit Expectations Gap

β = constant β = intercept

e = Error term

DEF = Detection of error and frauds

DIA = Detection of illegal acts

Total 1000 questionnaires were distributed to the selected samples out of which 738 responses were received. According to this the response rate for the research is 73.8% that is acceptable for the research. Out of these 1000 questionnaires, 200 questionnaires were served to the board of directors of the companies and remaining

800 questionnaires were served to the shareholders of those companies managed by the directors who were given questionnaires. Questionnaire were sent through emails, Couriers and direct interaction and their response were though obtained. Only 19 directors responded against 200 questionnaires this was 9.5 % response rate and this ratio is not an acceptable response rate for the analysis, It is therefore, this research paper describe the perspective of shareholders rather than of the directors. Although the shareholders respond rate was 89.875 % that was an acceptable range for the analysis. Following tables justify the responses collected from the respondents and the distribution of respondents according to their employment nature.

Table 1. Descriptive Statistics of Employment, Age and Qualification of the Respondents

		Frequency	Percent	Valid Percent	Cumulative Percent
Employment of the respondent	Director	19	2.6	2.6	2.6
	Shareholder	719	97.4	97.4	100.0
	Total	738	100.0	100.0	
Age of the Respondent	Below 25	48	6.5	6.5	6.5
	26-40	128	17.3	17.3	23.8
	41-60	360	48.8	48.8	72.6
	Above 61	202	27.4	27.4	100.0
	Total	738	100.0	100.0	
Qualification of the Respondent	Matriculation	6	.8	.8	.8
	Intermediate	121	16.4	16.4	17.2
	Graduation	309	41.9	41.9	59.1
	Post-Graduation	198	26.8	26.8	85.9
	Certification	104	14.1	14.1	100.0
	Total	738	100.0	100.0	

Before applying the regression statistics on the data, Cronbach's Alpha Statistics was used to interpret the reliability of the scales, following table indicate the statistics for the variables in different sections of the questionnaire. Its value for dependent variable is .621 that is according to some statistician is acceptable, however for detection of error and frauds it is .721 that is falls in the acceptable range.

Table 2. Reliability Statistics

Sr. No.	Category	Cronbach's Alpha	N of Items
1	Communication between the auditors and users of financial information	.621	4
2	Detection of errors and frauds	.721	8
3	Detection of illegal acts	.646	6

Following statistics indicate the validity of the questionnaire; we used Principal Component Analysis for analyzing about the validity. The results are summarized in the following tables.

Table 3: Validity Table; Extraction Method: Principal Component Analysis (1 Component Extraction)

	Component
	1
Audit report can expresses all working of the auditor	.586
language of audit report is easy and understandable	.695
Should the auditor analyze the historical and prospective information of the enterprise	.635
An effective corporate governance mechanism can reduce the differences of expectations.	.586
Because of social criticism, adequate reforms have been taken in auditing to meet the demands of society	.517
Self-regulation in auditing profession can bring more favorable results than a completely supervisory regulation.	.641
The oligopoly of the audit companies can hinder the free and fair competition.	.532
A service to public interest is generally inherent to auditing.	.586
The investor gives importance to the audit information while taking the investment decision.	.561
The auditors are not respecting the "Public Contract" in respect of protecting public interest.	.586
A business concern can influence the auditor when he issues a qualified report?	.578
An auditor should have an active role for detecting the illegal acts of the enterprise.	.652
An audit report that doesn't make any reference to the continuity actually guarantees that the business will work as going concern.	.561
When an auditor expresses his doubt about the continuity of the business could be favoring its discontinuity.	.632
In your opinion, the size of the audit companies affects the impartiality that an auditor should have.	.553
The small audit firms are more possibly be influenced by the weight of their client.	.575
An auditor analyses all transactions while carrying the audit.	.610
When an auditor performs an audit he should actively look for signs of the frauds.	.669

Table 4: Extraction Method: Principal Component Analysis

	Initial	Extraction
Audit report can expresses all working of the auditor	1.000	.343
language of audit report is easy and understandable	1.000	.483
Should the auditor analyze the historical and prospective information of the enterprise	1.000	.403
An effective corporate governance mechanism can reduce the differences of expectations.	1.000	.343
Because of social criticism, adequate reforms have been taken in auditing to meet the demands of society	1.000	.267
Self-regulation in auditing profession can bring more favorable results than a completely supervisory regulation.	1.000	.411
The oligopoly of the audit companies can hinder the free and fair competition.	1.000	.283
A service to public interest is generally inherent to auditing.	1.000	.344
The investor gives importance to the audit information while taking the investment decision.	1.000	.315
The auditors are not respecting the "Public Contract" in respect of protecting public interest.	1.000	.343
A business concern can influence the auditor when he issues a qualified report?	1.000	.334
An auditor should have an active role for detecting the illegal acts of the enterprise.	1.000	.425
An audit report that doesn't make any reference to the continuity actually guarantees that the business will work as going concern.	1.000	.315
When an auditor expresses his doubt about the continuity of the business could be favoring its discontinuity.	1.000	.399
In your opinion, the size of the audit companies affects the impartiality that an auditor should have.	1.000	.305
The small audit firms are more possibly be influenced by the weight of their client.	1.000	.330
An auditor analyses all transactions while carrying the audit.	1.000	.372
When an auditor performs an audit he should actively look for signs of the frauds.	1.000	.447

IV. RESULTS AND DISCUSSION

The results of all diagnostic tests suggest that the data is normal and valid. There is no significant correlation found between the variables as well that causes multicollearity. So, we applied simple linear regression technique on the data(Kingsley, et. al., 2015; Shafie, et. al., 2004). The reason of selection of this model is that all the assumptions relevant to this model are fulfilled.

Table 5: Pearson Correlation Matrix

		AEG	DEF	DIA
Pearson Correlation	AEG	1.000	.629	.600
	DEF	.629	1.000	.703
	DIA	.600	.703	1.000
Sig. (1-tailed)	AEG	.	.000	.000
	DEF	.000	.	.000
	DIA	.000	.000	.
N	AEG	736	731	731
	DEF	731	733	728
	DIA	731	728	733

The assumptions of simple linear regression model, no significant multicollinearity, homoskadisticity and no autocorrelation is found between the variables. The data is normal and the collected data is valid.

Table 6: Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
1	.672[a]	.452	.451	.43065	1.529

The model summary indicates value of R as 67.2% which is a satisfactory prediction power of the model. Value of Durbin-Watson test is within the normal range of 1.50 to 2.00 which indicates the absence of auto-correlation.

Table 7: Coefficients of the Regression

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.	Collinearity Statistics	
		B	Std. Error	Beta			Tolerance	VIF
1	(Constant)	.563	.067		8.349	.000		
	DEF	.319	.041	.303	7.844	.000	1.000	1.000
	DIA	.430	.039	.424	10.948	.000	1.000	1.000
a. Dependent Variable: AEG								

Above table indicate that Detection of Error & Fraud, and Detection of Illegal Acts positively and significantly influence the Audit Expectation Gap. This is in accordance with the research conducted byAlmeida, (2012), reasons for this accordance is due to reflection that shareholders expect that auditor will highlight all possible errors, frauds and illegal acts during the conduct of audit. Our results indicate that the auditors should pay significant amount of attention on the detection of Illegal Acts, and Errors and Frauds, and that the auditor should keep these factors in the risk assessment of audit. A decrease in the audit expectation gap may resolve problems on the part of audit undertaking in future.

V. CONCLUSION

Audit Expectation Gap is positively influenced by the factors, when an auditors fails to i. detect errors and frauds and ii. Illegal acts during the conduct of audit. Our research indicated that these factors positively and significantly affect the audit expectation gap. An auditor, if take these factors, in due consideration during the process of undertaking an audit engagement and the conduct of audit, can decrease the Audit Expectation Gap from the view point of Shareholders. In this research more work could be done if the researcher could take a significant follow-up from the directors also, and a comparative analysis can also lead us to the future implication of this study.

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