Audit expectation gap: fraud detection and other factors

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ABSTRACT

Financial information is an essential element in our society and in our economic system, as it plays a decisive role in the relationship between the various social agents. Therefore, this financial information must have a high level of quality, transparency and credibility. The expectation gap is the difference between the responsibility that auditors believe they have in developing their professional activity, and that which the users of the financial information attribute to them. Numerous analysed studies confirm that the audit expectation gap exists.

Among the profusion of possible causes, the studies coincide in highlighting fraud detection, independence, erroneous expectations, nature of the audit process and the “going concern” analysis.

Once the main factors have been presented, the article takes an in-depth look at one of these factors: the role of the auditor when fraud is detected.

KEYWORDS

Expectation gap, audit, fraud detection, financial information.

1. Introduction

Financial information is an essential element in our society and in our economic system, as it plays a decisive role in the relationship between the various social agents. Therefore, this financial information must have a high level of quality, transparency and credibility. Account audits have the social function of attesting that the financial information is adequate, correct, sufficient, and good quality. And this is a very significant aspect for the users of this information. Account audits have a very specific purpose, according to current legislation: reviewing and checking the financial information, within a specific framework of rules.

However, several empirical studies carried out in recent decades, show that the perception of the aims of an audit, held by users of financial information, does not coincide with the idea auditors have regarding the development of their work, and this has been called the “audit expectations gap”.

The appearance of certain company irregularities after the auditor has issued a favourable audit report, has called the audit activity into question and has led to doubts about whether audit tasks are carried out adequately.

This work, firstly, introduces the audit expectations gap concept, by outlining the legal audit framework, identifying audit users and searching for proof of the existence of the expectations gap, so as to, subsequently identify its determining factors. Once the main factors have been presented, the article takes an in-depth look one of these factors: the role of the auditor when fraud is detected. Finally, the study ends with the corresponding conclusions.

2. The audit expectations gap

As indicated in the introduction, the expectations gap is the difference between the expectations of auditors and the expectations of those who use the account audit. So, the study on the expectation gap cannot advance without first analysing a) the legal framework in which audits are developed, and according to which the auditor will act; b) the interest of the audit users; and c) finally, the proof of the existence of the audit expectations gap.

2.1. The legal account audit framework

The aim of the audit, according to the provisions of the Account Audit Act, is to verify that the financial statements reflect the true image of the equity or assets, the financial situation and the profits and losses of the going concern, according to the Generally Accepted Accounting Principles (PCGA) and the rules in the country where they are applied.

Account audit regulations are a dense, lively set of rules that are updated constantly. It is important to highlight that the auditing activity is highly regulated and must obey very specific procedures and models.

While discussing the legal audit framework, it is worth indicating that, on the one hand, the rules are not very well known to audit users. In fact, it is difficult for the general public to be informed on the provisions in audit legislation. Okafor et al. (2013) analyzed the expectation gap in auditing and their conclusions were that “the public appears ignorant of what is expected of the auditors as enshrined in the statute books and other documents issued by regulatory and professional bodies. This public’s lack of knowledge no doubt is responsible for their unreasonable expectations from the auditors”. Nevertheless, the ruling framework defining the audit activity is firmly upheld, and the globalisation of the economy is leading to establishing a more uniform regulation framework on an international level. This is all manifested by the enactment of the International Audit Standards, which the various countries have been adapting to gradually.

Account audit legislation particularly indicates that the audit has public importance, since it is a professional service not only intended for the going concern, but also for third parties who have, or may have, a business relationship with it.

This social purpose of an audit is the most important part of the work, and it is the reason why it is essential to understand the expectations it creates within the company and to check to what extent these are fulfilled or not.

2.2. Audit users

Audit users, as a group, are very extensive and heterogeneous.

The main users of a company’s economic-financial information are its own shareholders, who have a legitimate interest in knowing the company’s situation, particularly in the case of shareholders who are not involved in the company administration. However, audit users also include other groups: possible investors, creditors and suppliers, banks and

financial entities, the State and its various Public Administration offices, or the staff working in the actual company.

The user of the financial information of a going concern expect that the entity's financial information is correct, true and sufficient, and therefore financial information users have a series of very specific expectations regarding the account audit task.

Our society is used to the term "account auditing" being used in many conversations, and being the focus of certain news items in the media.

Many news items regarding account audits appear every day. Therefore it is important to look into the expectations of financial information users and to try and see what it is they trust they will obtain from an account audit. Logically, the response is varied. User expectations can be very different, according to each person's particular interests.

However, several authors agree about highlighting some factors as expectation gap generators, as we can see that they are repeated in many of the works analysed.

The first aim of an audit is to offer guarantees regarding the truthfulness of the information vis-à-vis third parties, as mentioned above. This important desideratum is one of the great audit expectations: audited accounts have a certificate of guarantee indicating that they have been drawn up adequately and include the necessary information. After conducting a supervision, auditors express an opinion on the company's financial statements.

Following this global aim (where users and auditors converge), the general public trusts that the audit will provide other guarantees of the audited information.

In spite of this coincidence regarding the general aim of the audit, it is equally true that account audits have a very specific aim: to check that the company follows the accounting criteria set out in each particular country. This does not include reviewing documents one hundred percent, instead it means analysing the business and its relevant sector to determine whether or not there are any risks, as well as checking the company control systems, which is used as a basis for planning the work to be done.

However, a majority of financial information users do not know neither how the auditing process is developed (materiality, or how the audit evidence is obtained) nor the performance of audit. Humphrey et al. (1993) examined the expectation gap by ascertaining the perceptions of individuals of audit expectations issues. The results confirmed that an audit expectation gap exists, specifically in areas such as the nature of the audit function and the perceived performance of auditors.

In the same sense, other authors as Chandler et al. (1993) and Cameron (1993), suggested that a general confusion over the audit work has existed.

Consequently, we are witnessing a distancing between how the auditing process and how the performance of audit is developed and the Knowledge that users have of this work.

2.3. Proof of the expectation gap

When the aim of the account audit is to specifically review and check the financial information within the framework of the applicable standard, for the audit users the audit must provide greater guarantees, and they trust that the going concern has been reviewed in-depth.

This distance, or gap, between the expectations of public users of the financial information of an account audit and the actual auditor's vision of what the auditing task must be, is called the "audit expectation gap", and this term was coined by Liggio (1974). Since the expectation gap was analysed for the first time, the term has been widely debated in professional circles. It has also been an important topic in the field of empirical research, and numerous studies have been conducted on the subject.

In the 70's various works were undertaken on the audit expectation gap. In the United States, Baron et al. (1977) conducted a study to compare the point of view of auditors and the general public using an empirical study based on questionnaires. Their work concluded that there are significantly different beliefs regarding the extent of the auditor's responsibility in detecting and exposing material errors, and illegal acts. In particular, audit users expect greater responsibility from auditors in detecting fraud than the actual professionals believe they should have.

This aspect is probably one of the most significant factors in the audit expectation gap: fraud detection, which is understood to be intentionally including misstatements in financial statements.

The definition of "expectation gap" gradually evolved and, in 1978 in New York, the "Commission on Auditor's Responsibilities" extended it further, by considering that a gap can exist between what the public expects or needs and what the auditors should be able to fulfil from a reasonable point of view.

As you can see, there are different descriptions and, over the years, different authors have been broadening the various nuances.

Most studies carried out on the subject are quantitative, and have been developed using surveys, questionnaires and interviews. The result of these studies confirms what we have already mentioned in the section introducing the definition of the term.

Since the 90's, research has been conducted on the differences in audit expectations in different countries. Therefore, in 1993, García Benau et al. (1993) did a comparative study on the nature of audit expectations in Spain and Great Britain.

Also, studies have been done to analyse third party perception, of judges in particular. Thus Lowe (1994) concluded that judges systematically expect more from the auditors than the auditors believe that they must provide. This is a very significant aspect that must be taken into account when analysing the expectation gap: the actual auditor's consideration of the scope of their work, particularly where fraud detection is concerned. The phenomenon was also analysed in Bangladesh by Chowdhury and Innes (1998), in a study where they explored the possible differences in the audit expectations in the Public Sector between the auditors and those who use their reports.

The literature on the expectation gap has continued to grow in recent years. In USA, Frank et al. (2001) analysed the different audit expectations of auditors, juries and students. Lin and Chen (2004) researched the increase in the audit expectation gap in the context of businesses in China. Alleyne and Howard (2005) explored how auditors and users have a different perception of the auditor's responsibility to discover fraud. Okafor and Otor (2013) ran an in-depth study on how to reduce the expectation gap via the role of the auditor profession, developing a quantitative work using questionnaires targeted at university lecturers and students.

So, in the light of a multitude of publications, it looks like the audit expectation gap does exist, and that it has generated enough interest to be the subject of a whole range of scientific research around the world. This interest has not only been maintained, it has actually tended to expand in recent years, with different perceptions existing between what audit users "desire" and what auditors understand to be their role. The empirical studies conducted have revealed the distance between the various points of view of the auditors and the public regarding the main reason for account audits and the auditor's responsibility in the auditing process.

After introducing the audit expectation gap concept, the following section will be dedicated to identifying the factors determining this gap.

3. Identifying the factors determining the expectation gap

After noting that numerous studies have confirmed that the audit expectation gap does exist (in different countries and different socio-cultural environments), we think that it is important to identify which factors can be considered the causes of this expectation gap. Simply observing the above-mentioned studies, will enable us to highlight the factors determining the expectation gap, where the authors have given greater emphasis. Among the profusion of possible causes, the studies coincide in highlighting the following aspects as the main factors creating the expectation gap. We do not intend compiling an endless list of these causes, and merely want to highlight the ones that are referenced most in the studies:

Source: Elaborated by authors

Figure 1. Identification of factors that can contribute to creating the expectation gap

3.1. Fraud detection

The general public believe that one of the fundamental functions of the audit is to detect fraud, although really this is not its main aim.

Auditors and users have different convictions about the scope of the auditors' work and responsibility regarding the detection of irregularities and fraud. Users consider that an auditor's review should extend further in this area, whereas auditors think that user expectations are "unrealistic" or "excessive."

In recent years, certain cases where going concerns have "collapsed" have made headline news, have put auditors in a delicate position vis-à-vis public opinion which, probably, is more predisposed to criticising the audit task and less towards trusting of the results this task offers.

3.2. Auditor independence

Auditor independence is a basic aspect of their professional work. Their mission is to guarantee the truthfulness of the financial information, and this mission can only be duly fulfilled if the professional auditor maintains a fully independent position from the going concern.

Obviously any circumstance linking an auditor to the company it is auditing can affect their impartiality when working. Therefore, Independence is one of the essential requirements.

Auditors are in a delicate position, between their role as an independent guarantor of financial information and as the professional hired by the actual going concern. This aspect is erroneously perceived by the general public.

3.3. The existence of erroneous expectations on auditing

This factor is highlighted by auditors, who express the need for the user public to confine themselves to reasonable expectations of the auditing process. This is because they think that, on many occasions, the public's expectations can be excessive.

Erroneous expectations can occur, basically, for 2 reasons:

- Because of excessive perceptions of the auditor's scope and responsibility.
A relatively frequent example of this is the conviction that auditors supervise all the financial information. The general public do not know some of the terms used, like "materiality" or "sampling techniques".

- Because of confusion (which is relatively frequent) between the responsibilities relating to auditors and those corresponding to company administrators.

Here we can quote the example of the relatively generalised public belief that auditors are responsible for drawing up the annual accounts, whereas legally, this is the responsibility of the company administrators.

These are samples of the erroneous beliefs regarding auditing which must be clarified and explained by positioning the terms at their corresponding level.

3.4. The actual nature of the auditing process

Many users of financial information think that the nature of the auditing process is “complicated” and they find it difficult to understand what an account audit process actually involves.

There are two aspects to take into account regarding the complexity of audits: first of all, understanding the actual audit process. Empirical studies show that a high percentage of users do not know the nature or scope of auditing tasks, and this is linked to the excessive expectations mentioned in the previous point. Users do not know how an audit is carried out, and so it is difficult for them to understand how the sampling techniques are carried out to do certain tests, or how the task to be carried out in each case is determined.

Secondly, the language used in the audit report does not help the comprehension process either. It is widely proved that most people who read (not experts) an audit report find it complicated to identify the various parts, and also the language used is often confusing to them.

3.5. The auditor’s responsibility with respect to the going concern principle.

International Audit Standard 570 relates to the auditor’s responsibility with respect to applying the going concern principle. Said going concern principle considers that the company, or concern, will continue operating normally over the next 12 months. In practice, this standard refers to the auditors’ capacity to anticipate problems within the going concern.

This has been one of the major debate topics in recent years, particularly within the context of the economic recession. In an environment where some companies are closing, or where others are forced to alter their staff numbers or a particular line of business, audit

users expect that the auditor will inform them on whether or not the audited company is going to continue operating normally.

The work involved in an audit process is useful but, logically, it has its limitations. As we have already pointed out, not all the financial information is supervised, the tests are not always able to detect all the problems a company may have, or appropriately assess the deterioration that may occur, and these tests may even make it harder to anticipate future conflicts in uncertain economic situations.

Additionally, there is the risk that highlighting a problem of this kind,” in the audit opinion of a company, technically called a “going concern”, very significantly increases the danger of it really happening. Therefore it is a particularly delicate part of the auditor’s technical task, and it would be convenient to analyse it in greater depth given its importance and impact.

With respect to detecting those circumstances that can introduce doubts about an entity continuing its normal activity in the following financial year, there are two possible scenarios, as set out in the following figure:

Source: Elaborated by authors

Figure 2. Scenarios when identifying problems of continuity

It is possible that the auditor does not detect any possible problems of continuity, but there is also the possibility that the auditor does adequately detect the possible continuity problems. The issue here is how will this be reflected in the audit report?

Two possible scenarios must be distinguished:

- where the company has factors that mitigate any doubts over its continuity
- where the company does not have sufficient arguments to counteract the possible operating problems

In the first scenario, we have a company that has no doubts about the continuity of its activity over the next 12 months, because although there are factors raising doubts, the company can argue mitigating factors:

Source: ISA on applying going concern, and elaborated by article authors

Figure 3. Cases of companies with factors that cause doubts over continuity

In the cases where there are doubts over the continuity of a company, and the mitigating factors do not succeed in diminishing these doubts, or cases where the company is already in compulsory liquidation:

Source: NTA on the applying going concern and elaborated by the article authors

Figure 4. Cases of companies with doubts over continuity

This shows that it is the technical standard that determines the way in which it must be reflected in the annual accounts: via information in the company report, a reservation or an uncertain fact in the report.

The paragraph containing the emphasis of matter due to uncertainty follows the opinion paragraph and begins with the text “without affecting our opinion...”. The way the report is structured and written may lead readers to just retain what is indicated in the opinion paragraph and consider that the paragraph of emphasis merely corresponds to secondary aspects, whereas in fact we are talking about a crucial aspect such as a company’s continuity.

In some cases, audit reports can be interpreted incorrectly by third parties, because for the report to be “decoded” appropriately, it is necessary to know the content of the technical standard, and this fairly unlikely.

Here we are not just talking about whether the auditor has done his or her job properly and has adequately assessed the going concern principle (which is an essential part of the job). It is also important to consider the application of the standard, and this could be a factor of confusion or, at least, difficulty, when third parties try to understand an entity’s financial information. This widens the gap between what users expect from an audit and the final result of said audit.

Until now, we have listed some of the main factors contributing to the creation of the expectation gap. To determine them, we have based our arguments on the most frequently mentioned causes in the scientific publications we have analysed.

The factor mentioned the most in the analysed literature is: “the auditor as a fraud detector”, which is quoted in 67% of the indicated publications. Consequently, we consider that it is a very relevant factor in the expectation gap analysis. This is a leading factor because, on the one hand, it is credited as such by the empirical studies carried out in various countries and at different times and, on the other hand, because the international scientific literature has repeatedly discussed the auditor’s responsibility vis-à-vis fraud. There is a certain amount of controversy over this factor, and it is discussed not only at scientific level, but also in the general media, which just goes to show that it is a very contemporary issue, that triggers considerable interest among the general public.

As for the auditor’s independence, this is obviously a very important factor for developing the auditing activity correctly, but it does not seem to be such a major issue in debates. Probably, since it is a legally imposed requirement in the auditing sector, nobody doubts

that it is an essential aspect and it therefore does not spark as much interest as the preceding point. Therefore, we cannot go further in-depth into this factor.

The erroneous expectations that arise over account audits is a proven fact, based on an ignorance of the standards governing audits. We think that this aspect is associated with the lack of information, and this does not allow for a very extensive analysis, and so neither will we reflect upon this aspect.

The difficulty that the general public have in understanding the nature of the audit process is a clear factor. However, like the point above, it could be solved with greater information on account auditing. We believe that going further in-depth into this factor would lead us to discussing procedures and rulings more than the actual distance between the general public and auditors.

Finally, as for applying the going concern principle, which is understood to be the auditor's ability to predict the future evolution of companies, this factor is not often quoted, even though it is probably a very topical issue. In a recession environment, where some companies must close or significantly reduce their business, the public expect auditors to inform them on the viability of the company's future. Therefore we think that it is a factor to be taken into consideration, and which we will discuss in greater detail.

Based on the arguments raised, we are going to go further into analysing the most quoted factor, due to its important effect on the audit expectation gap: fraud detection, due to its proven high profile in numerous studies and analyses.

4. The auditor as a fraud detector

The factor quoted most in literature due to its influence on the audit expectation gap is "the auditor as a fraud detector".

Several scientific studies have shown that users of financial information expect auditors to be fraud detectors, even though this is not the essential aim of account audits.

In the business world an infinite number of situations can occur with numerous causes. When problems that may lead to fraudulent situations are detected, the general public expects the audit to detect these irregularities and warn about them. And this is particularly expected by company investors who are not directly involved in the company administration.

In fact, there is no account audit regulation that indicates fraud detection as the main aim. The only thing that is stated clearly is that the auditor must design his or her work plan so that, if there is any significant fraud, it can be detected.

So, there seems to be a dichotomy in the way account audits are understood. For most of the public, account audits must be a fraud detection system, whereas the standard sets out that the purpose of audits is to check that the financial statements adapt to accounting standards.

In fact, fraud detection is a field that corresponds to the so-called « forensic audit», which is not the same as an account audit. Forensic audits do specialise in obtaining proof to be submitted as evidence, generally in legal proceedings. A greater number of professionals are involved in forensic audits, apart from the account auditor - lawyers, IT technicians or writing experts, etc.

It is to prove alleged economic and financial crimes, like administrative corruption or corporate fraud. Account audit procedures, however, are more specific and the task is more defined, since it is limited to the evidence associated with the irregular fact that has been detected.

In view of this set of factors, it is important to specify what is meant by an account audit: a process for checking that a company's financial information adapts to the Generally Accepted Accounting Principles and the applicable General Accounting Plan.

If there is significant fraud, it must be detected in an audit study.

Although it is true that an account auditor must make a maximum effort to produce work that is independent and reviewed with high quality standards, given the social dimension of his or her work and the implications for third parties, it is also true that he or she must point out what an account audit involves, so that their clients and society in general are aware of its purpose and work scope.

Having reached this point, we can review two aspects concerning fraud detection in audits:

- Research work that has been carried out on fraud detection in audits and
- International Auditing Standard 240 “The auditor's responsibilities relating to fraud in an audit of financial statements”

4.1. Research work on fraud detection

International scientific literature has repeatedly discussed the auditor's responsibility relating to fraud, as indicated above. One factor that has undoubtedly led to this increased interest has been the financial scandals that have occurred in the economic world, associated with audits.

Sometimes auditors have failed to detect very significant cases of fraud. The role that audits must develop in relation to fraud is not an issue to be minimised, because they have a very important social and economic impact.

The appearance of certain business irregularities after the auditor has issued his favourable audit report, has led many users to question the validity of the account audit process.

This is a controversial point, and it is even discussed in the media and it can be summarised in this quote by Singleton-Green¹ (1990):

“The real issue behind fraud ... The fact is that if the auditors were not responsible for detecting fraud, people would not waste time and money asking for what they cannot find. Auditors must accept their responsibilities and take a positive position”.

The author indicates that there must be a coincidence between what auditors do and what is expected of them. And it is probably in the field of fraud detection where we have to make the greatest effort.

Generally speaking, users expect auditors to protect the interests of shareholders, creditors, employees and the general public so that, inter alia, they assure that there has been no fraud.

GarcíaBenau et al. (2013) summarised the most important empirical literature published between 1986 and 2008, showing that there is notable interest and lively debates on the auditor's role in detecting and informing on business fraud.

It is also significant that a larger number of studies on the subject were detected after 2001, following scandals in the auditing world, like Enron and WorldCom.

They also highlight the concern over how to improve fraud detection techniques. All because of the effect fraud detection has on the audit function, and, particularly, on the auditors' image.

¹Editor of the magazine, Accountancy.

In recent account auditing history there have been some significant financial scandals, and at these times, the question on everyone's lips has been: how come the auditors did not detect it?

The most significant occurred in 2001: the Enron case, which put an end to the audit firm, Arthur Andersen, and the WordCom case, which affected the firm KPMG.

Khurana and Raman (2004) planned a study to analyse the quality of the audit work by the Big 4 and the non-Big 4, to ascertain whether the quality of an audit is related to the auditor's reputation or to the auditor's exposure in lawsuits. The study results suggest that the possible exposure to lawsuits is the aspect that most influences the quality of audit work.

Lai (2005) studied the position of the auditors who replaced Arthur Andersen in the audit reports, following the Enron scandal, to see if they were issuing more conservative reports, and they drew the conclusion that this was in fact the case.

And more recently, during the financial crisis that began in 2008, numerous audit reports have been questioned for not having detected any possible solvency problems that certain financial entities may have been experiencing. In Spain the most significant cases were Bankia and Pescanova.

It is difficult to determine the extent of the auditor's responsibility in not detecting irregularities leading to fraud. However, certain business growth models must make people take full precaution, since an audit is an essential guarantee element for investors who have no other means of comparing the truthfulness of a company's information.

Proof of the importance that is given to this aspect is also found in the development of International Standard on Auditing 240.

4.2. International Standard on Auditing 240

International Standard on Auditing (ISA) 240 includes the "The Auditor's responsibilities relating to fraud in an audit of financial statements".

Said ISA 240, in its introductory section defines the characteristics of fraud in relation to account audits:

"Misstatements in the financial statements can arise from either fraud or error. The distinguishing factor between fraud and error is whether the underlying action that results in the misstatement of the financial statements is intentional or unintentional.

Although "fraud" is a broad legal concept, for the purposes of the ISAs the auditor is concerned with the fraud that causes a material misstatement in the financial statements.

Two types of intentional misstatements are relevant to the auditor: misstatements resulting from fraudulent financial information and misstatements arising from misappropriation of assets. Although the auditor may suspect or, in rare cases, identify the occurrence of fraud, the auditor does not make legal determinations of whether fraud has actually occurred.”

We can now see that the factor differentiating between fraud and error lies in whether it is intentional or not, highlighting that the auditor’s aim is to detect significant misstatements in the financial statements.

The standard even dedicates Appendix I to listing some examples of fraud risk factors, indicating that they are merely provided by way of illustration, and are not intended to be a detailed list. The risk factors are presented according to the type of fraud relevant to the auditor and we have illustrated them in the following figure:

Source: ISA 240, Appendix I, elaborated by the article authors

Figure 5. Types of fraud and risk factors

Based on the definition of the concept of fraud, the Standard moves on to specify the auditor’s responsibility regarding the prevention and detection of fraud. In this respect, it points out that the auditor’s aims must be:

- a) “to identify and assess the risks of material misstatements in the financial statements arising from fraud;
- b) to obtain sufficient and appropriate audit evidence regarding the assessed risks of material misstatements arising from fraud, by designing and implementing appropriate responses; and
- c) to respond appropriately to the fraud or the indications of fraud identified during the audit”

These aims introduce specific requirements in the audit study, which affect the need to maintain the necessary professional scepticism, discussions between the members of the commissioned audit team, procedures for assessing the risk, identifying and assessing the risks of material misstatements arising from fraud, a response to the assessed risks of material misstatements arising from fraud, assessment of the audit evidence, cases where it becomes impossible for auditors to continue their commission, written contributions, communication sent to the management and those responsible for running the company, communication sent to the regulating, supervising and documenting authorities.

As well as considering these conditions, it provides an application guide for each requirement mentioned.

It is important to point out that point 4 of the Standard establishes that the first ones responsible for avoiding fraud are the company administrators and managers. They must be responsible for preventing and detecting fraud. However, the auditor must be reasonably sure that the financial statements are free of material misstatements arising from fraud or error.

The risk of not detecting material misstatements arising from fraud is greater, because the fraud may involve sophisticated planning to hide or even “collude”² it, which can “lead the auditor to think that the audit evidence is sufficient when, in fact, it is false”.

It also specifies that the risk of the auditor not detecting fraud committed by the company management is greater than the cause of fraud committed by employees, since their hierarchical position allows them to avoid control procedures designed to prevent employees from committing fraud.

Therefore, by establishing the audit procedures in response to different risks, ISA 240 sets out some specific procedures for analysing the risks associated with the management avoiding the controls.

² ISA 240, section 6 on “Responsibilities of the auditor”

The Standard also refers to the content of the representation letter, and indicates that the auditor is to obtain written statements from the management and, when applicable, from those responsible for running the company, indicating that they admit their responsibility in designing, implementing and maintaining internal control to prevent and detect fraud. One of the most relevant sections of ISA 240 relates to the “impossibility of auditors continuing their”. In this section, the standard indicates that if, after detecting fraud or indications of fraud, auditors must consider whether they continue with the commission or reject it.

If the auditor rejects continuing, this must be communicated appropriately to the company management and administration body, and it must be analysed whether there is any professional or legal requirement which demands the information from the regulating authorities.

In spite of the auditor’s duty to keep the information confidential, in some circumstances, the auditor’s legal responsibility to inform the regulating authorities can prevail over the duty of confidentiality.

All this gives a view to the importance that is given to fraud detection which, as the ISA indicates, does not only include the undue misappropriation of assets, but also the submission of fraudulent financial information, which is what essentially worries the financial information users.

Fraudulent information implies intentional misstatements, including omitting amounts or information from the financial statements in order to mislead those who use them. This manipulation of the results can start with small actions or undue adjustments of the hypothesis and changes in the management’s judgement.

The actual ISA 240 indicates that elements of pressure and incentives can make these actions increase to the point that fraudulent financial information is provided. A situation like this can occur when the management, due to pressures it is under to comply with market expectations, or the desire to maximise payments based on results, adopts, intentionally, postures that lead to fraudulent financial information by introducing material misstatements in the financial statements.

Consequently, we have been able to ascertain the importance of fraud detection in audits: it has been a widely studied term over recent decades. Investigations have shown that there is a wide gap between what the general public expect regarding fraud detection and what auditors consider they must cover.

This concern has been included in the international standard, by means of its consideration in the International Auditing Standards, in ISA 240. This all proves that an effort is needed regarding fraud detection in audits and to implement more effective procedures that make it possible to offer more guarantees over financial information.

5. Conclusions

Numerous analysed studies confirm that the audit expectation gap exists.

There are differences between the responsibility that auditors believe they have in developing their professional activity, and that which the users of the financial information attribute to them.

The factors that contribute most to creating said gap are as follows: fraud detection, auditor independence, erroneous expectations by users, the nature of the audit process, and the capacity to anticipate possible operating problems in the going concern. Out of these factors, the one that is analysed the most in literature is fraud detection by auditors. Being aware of the main factors separating user and auditor expectations regarding account audits, is important for developing measures to help minimise these differences, succeeding in offering more reliable financial information, and for giving audits a leading role that contributes to financial stability. As indicated by the European Commission³ *“an audit is a key factor for recovering the market’s confidence, as it helps to protect the investor and reduces the capital cost for companies”*.

According to current legislation, auditors are not obliged to guarantee that the audited accounts are absolutely free of any misstatements. But certainly, the auditor must provide the greatest possible guarantees of truthfulness and correction for the interested parties.

These reflections on the future of auditing, in one sense or another, are made in a society that is changing at a very fast pace, and auditing must adapt to the new situations.

³ European Commission, “Green Book. Audit Policy: lessons from the crisis”, Brussels 13/10/2010

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