THE AUDIT EXPECTATION GAP IN ERITREA

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Thesis presented in fulfillment of the requirement for the degree of Master of Commerce in Accounting to the Department of Accounting

UNIVERSITY OF CAPE TOWN

2005

"There's a wide expectation gap between the assurance that investors believe an audit provides, and the assurance that even the best audit can reasonably provide."

Mr Copeland J.E.

CEO of Deloitte & Touche, 2002

Acknowledgements

First of all, I would like to express my thanks to my supervisor, Professor Geoff Everingham, for his unreserved effort, invaluable guidance, encouragement, and helpful comments. Special thanks also go to Assoc. Professor Tessa Minter, who provided me with useful suggestions and helped me to prepare my research proposal.

My thanks are also due to Ato Birhane Habtemariam, the auditor general of Eritrea, for providing me with the necessary information and for the great interest he has shown in this research project. I would like also to thank all the audit firms, companies, tax inspectors and individuals who participated in this research project.

I would like also to thank Megan Riley for her assistance with proofreading, and Megan Campbell, secretary of the financial accounting, for her kindness and assistance during my contact with my supervisor.

I would like also to thank all my friends for their moral support. A special thanks is also due to Tekie Teklemariam who helped me in using the statistical tools.

I am also greatly indebted to my parents for their moral and financial support.

Finally, the financial assistance of the Human Resource Development Project of Eritrea towards this research is also hereby acknowledged.

Abstract

The public's expectations of auditors are usually not met by the actual performance of auditors. This is presumed to be caused by the difference in perception between what the public expects and the auditors deliver. This is termed the "expectation gap in auditing". Due to the widespread concern raised by the public, a number of researchers have studied the problem in various countries, among others: USA, Britain, South Africa, Finland, Spain, Singapore, New Zealand and Australia. All the studies undertaken indicate the existence of an expectation gap in these countries. Although many researchers and professional bodies have suggested how to close or narrow the gap, the problem is likely to remain unresolved due to spectacular corporate collapses such as Enron.

The aim of this research study is to investigate the existence and the nature of the audit expectation gap in Eritrea, to analyze its constituent parts and to identify the factors which contribute to the gap, to compare the findings to the research findings of similar studies and, finally, to recommend possible solutions to narrow the expectation gap in Eritrea. A survey was conducted via structured interviews (through questionnaire) and unstructured interviews to examine the perceptions of auditors, directors, managers, accountants, internal auditors, shareholders, bank loan officers and tax inspectors of the Inland Revenue Department.

Overall, the findings of this research suggest that there is a wide audit expectation gap on issues concerning the auditor's responsibility for fraud detection and the reporting of fraud and other illegal acts to authorities, going concern problems, and for examining the efficiency and effectiveness of the company's management. Auditors independence was also an important point of concern. Moreover, inadequate regulations by the regulatory body with regard to audit quality was also found to be a factor which contributed to the gap.

The most dissatisfied group, of all the interest groups, were users. This can be due partly to the dissatisfaction of the tax auditors with respect to the audit of small and medium sized companies. Moreover, there seems also to exist a lack of knowledge among users and management about the nature and limitations of the audit function. With respect to auditors, lack of knowledge also exists with regard to auditors' legal responsibilities. Moreover, auditors considered many of the suggested duties as the existing duty of an auditor. Hence the "knowledge gap" also exists among auditors.

Overall, this research report indicates evidence of the existence of the audit expectation gap, and also provides a comprehensive approach to narrow the gap in Eritrea. If the recommendations are implemented, this may give the public confidence and trust in financial reporting in Eritrea. The directions that future research may take are also discussed.

Keywords:

- Audit expectation gap, Fraud, Going concern, Audit independence, Audit quality, Reporting illegal acts.

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ABBREVIATIONS

IFAC = International Federation of Accountants
ISA = International Standards on Auditing
AICPA = American Institute of certified Public Accountants
SAS = Statements on Auditing Standards
ICAEW = Institute of Chartered Accountants in England and Wales
ACCA = Association of Chartered Certified Accountants
ASB = Auditing Standards Board
CICA = Canadian Institute of Chartered Accountants
IASP = International Auditing Practices Committee
IASC = International Accounting Standards Committee
GAAP = Generally Accepted Auditing Practice
GAAS = Generally Accepted Auditing Standards
SAAS =South African Statements on Auditing Standards
SAICA = South African Institute of Certified Accountants
PAAB = Public Accountants' and Auditors' Board
SEC = Security and Exchange Commission
IRD = Inland Revenue Department
GRI = Global Reporting Initiative

Chapter one - Introduction

1.1 Introduction

Public[1] expectations of external auditors are usually not met by the actual performance of auditors. This is due to the difference in perception between what the public expects and the auditors deliver (see amongst others: Porter, 1993; Humphrey et al., 1993; Gloeck and De Jager, 1993; and Vittanen and Troberg, 1999). This is termed "the expectation gap in auditing". The audit expectation gap has a long and persistent history, but it is only since the 1970s that it has been given much attention. Due to the widespread concern raised by the public, members of the US Congress, financial writers, members of leading accounting firms, and regulatory agencies such as The Securities and Exchanges Commission in the USA, a number of researchers have studied the problem in various countries, among others: USA, Britain, South Africa, Finland, Spain, Singapore, New Zealand and Australia (see summary of previous research in chapter two). All of the studies undertaken indicated the existence of an expectation gap in those countries. Even though most researchers suggested how to close or narrow the gap, the problem still remains unresolved due to spectacular corporate collapses such as Enron.

The objective of this research project is to investigate the existence and nature of the audit expectation gap in Eritrea, to compare the findings to those studies made in countries which adopt the International Federation of Accountants (IFAC) standards and/or developing countries

[1] *Public or Society* - is defined in the same way as defined by Porter (1993) and used by Viitanen and Troberg (1999), which is the population at large inclusive of auditees and users of financial statements but exclusive of auditors.

as Eritrea is a developing country which adopts IFAC standards, and finally to recommend possible solutions to narrow the expectation gap in Eritrea. Moreover, a review of the previous literature will be made in order to present the definition and structure of the audit expectation gap, factors contributing to the gap, approaches to narrow the gap (recommendations made by researchers and professional bodies) and previous research. In the literature review, mainly IFAC standards are presented as Eritrea is a member of IFAC. However, the US expectation gap standards issued by AICPA (1988) are also considered as they are specific standards issued to narrow the expectation gap. These standards are incorporated in IFAC standards and any changes to these standards are also discussed.

This research seeks to make a constructive contribution to improve the status of the auditing profession in Eritrea and to provide information to the International Federation of Accountants (IFAC), which sets International Standards of Auditing (ISAs), as Eritrea is one of the countries which adopts ISAs.

1.2 Statement of the Problem

Eritrea, a new nation in the horn of Africa (refer to Chapter three for a history and economy of Eritrea), gained its liberation in May 1991 from Ethiopia. Ethiopia was one of the socialist countries at that time, and all public enterprises in Eritrea were owned by the government of Ethiopia. As a result, the only user of the audit report was the government itself. Therefore, the auditors were perceived as government watchdogs and fraud investigators. Since the independence of Eritrea from Ethiopia, the government of Eritrea has sold many state owned enterprises to private investors and several new investors are emerging in the country. Moreover, new private audit firms have been established and are providing services to the public. From the above facts, it would not be surprising if the publics' perception of the role and responsibility of the auditor were to differ from what the auditors deliver.

At present, the users of the audit report in Eritrea are not only the government but also include: investors, financial institutions including banks and insurance corporations, management, non-profit organizations such as the United Nations Development Program (UNDP), international lending institutions such as the World Bank and International Monetary Fund (IMF), the Inland Revenue Department (IRD), other creditors and suppliers. The financial statements are used for: investment decisions, to evaluate the credit worthiness of companies, to lend money, to extend commercial credit, to collect taxes, and to determine the current values of the companies. However, it is not known whether the perception of the public as to the role and responsibility of the auditor has changed or not.

The expectation gap is a phenomenon which is international in scope. Dissatisfaction with the work of the auditor is evidently growing world wide because of some spectacular and well-publicized corporate collapses, such as Enron (see chapter two). The problem of the audit expectation gap is likely to be even worse for developing countries such as Eritrea as most of the public are less financially knowledgeable (see chapter three). Research has shown that less financially knowledgeable users place more responsibility on auditors (see Epstein and Geiger, 1994 and Bailey et. al, 1983). This implies that a larger audit expectation gap may be evident in less educated users. Moreover, the auditing profession in Eritrea is characterized by a shortage of qualified accountants and auditors, and a lack of resources (see chapter three). This may result in inadequate regulation of the audit firms, the problem of audit independence and audit communication, poor quality of the audits and hence a deterioration of the pubic confidence in financial reporting. Thus far no empirical investigation has been undertaken in Eritrea regarding the audit expectation gap and the auditing profession in Eritrea has not as yet considered the problems which could arise from this.

1.3 Research limitations

In classifying the suggested duties of an auditor (see chapter four and five) into the three categories of an audit expectation performance gap ("deficient performance gap", "deficient standards gap" and "reasonableness gap") the Porter (1993) classification was mainly used. However, as Porter (1993) pointed out, the classification of some of the duties into one category or the other is not an exact science and there exist arguments both in favor of and against this. Another limitation of this research project is that so far no research has been conducted on the issue of the audit expectation gap in Eritrea. Therefore, the literature review focuses on the studies made in other countries.

Auditing is an essential element of the system of Corporate Governance (EU's Green Paper, 1996 – as cited in Viitanen and Troberg, 1999:117). Corporate Governance is "concerned with the auditor's traditional responsibility in terms of reporting in the financial statements and the public's perceptions as to how well this responsibility has been discharged" (Everingham, 2003). Several recommendations are contained in the South African report on Corporate Governance (see King II Report, 2002) regarding the responsibility of auditors to find and disclose financial irregularities (see chapter two – 2.7 Corporate Governance p.57). However, Eritrea has only a few large companies at present. As a result, it does not have a Code for Corporate Governance. Therefore, this study will not include the analysis of the duties of an auditor in relation to Corporate Governance.

1.4 Significance of the study

The study of the audit expectation gap is believed to be of significance for the following reasons. First, knowledge of the perceptions of the public in Eritrea as to the role and responsibility of the auditor can assist the auditing profession in Eritrea to identify and implement ways and means to close or narrow the expectation gap, if the gap is significant and needs to be closed. Closing the expectation gap in Eritrea may help to restore the public confidence and trust in financial reporting, to give assurance to the government that taxes are correctly computed, and to give creditors confidence in the sustainability of the organizations. Second, the study can be helpful to the International Federation of Accountants, which sets International Standards of Auditing (ISA's), as Eritrea is one of the countries which adopts ISA's. Third, it can serve as an input to literature for academic use. Finally, the study can be a base on which other interested researchers can build studies in the area of auditing in Eritrea and in other countries.

Chapter two – Literature review

The objective of the literature review is to examine the theoretical perspectives of the audit expectation gap within the context of the international development of the auditing profession. This review presents current views regarding (a) the definition and constituent parts of the audit expectation gap, (b) the historical development of the audit expectation gap, (c) the factors which contribute to the gap and (d) the existing duties of an auditor. It proceeds to analyse the audit expectation gap from practical based research studies of the auditing environment in order to present the evidence of the existence of an audit expectation gap in various countries. The various approaches that have been suggested by researchers and professional bodies to narrow the gap are identified and categorized. Finally, conclusions will be drawn based on the analysis of the issues, which have been a major focus of the debate of the expectation gap. Its possible implications for the auditing profession in Eritrea will be discussed later in this chapter.

2.1 Definition and structure of audit expectations gap

According to Koh and Woo (1998:147) the term "expectation gap" was seemingly first applied to auditing by Liggio (1974). Liggio defined the expectation gap as the difference between the levels of expected performance "as envisioned by the independent accountant and by the users of financial statements" (Liggio, 1974:27). Since then a variety of definitions have been provided by different authors and researchers. The definition was extended by the Cohen Commission (Commission on Auditors' Responsibilities, 1978:XI). The commission was charged to 'consider whether a gap may exist between what the public expects or needs and what auditors can and should reasonably be expected to accomplish'.

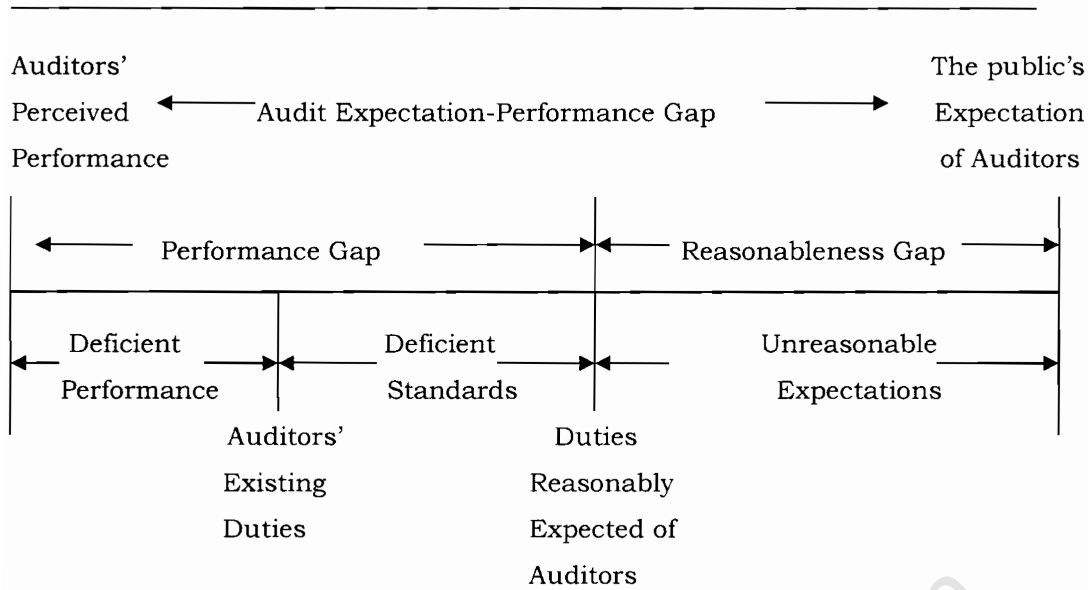
Porter (1993), in an empirical study of the audit expectation performance gap in New Zealand, claimed that the definitions given by Liggo (1974) and the Cohen commission (1978) were too narrow in failing to recognize that auditors may not accomplish 'expected performance' (see Liggo, 1974) or what they 'can and should reasonably expect to accomplish (see Commission on Auditors' Responsibilities, 1978). Porter added that the definitions do not allow for sub-standard performance. She suggested that the gap which gives rise to criticism of auditors is that between what society expects from auditors and what it perceives it receives from them. It is therefore proposed that the gap, more appropriately entitled 'the audit expectation- performance gap', be defined as the gap between society's expectations of auditors and auditors' performance, as perceived by society. Given this definition, Porter suggested that the gap has two major components. These are the R*easonableness gap* and the *Performance gap* (Porter 1993:51):

- *Reasonableness gap:* "the gap between what society expects auditors to achieve and what the auditors can reasonably be expected to accomplish".
- *Performance gap*: "the gap between what society can reasonably expect auditors to accomplish and what auditors are perceived to achieve".

The Performance gap was further sub divided in to a *deficient standards* and *deficient performance gap* (Porter 1993:51):

- *Deficient standards*: " a gap between the duties which can reasonably be expected of auditors and auditors' existing duties as defined by the law and professional promulgations".
- *Deficient performance*: "a gap between the expected standard of performance of auditors' existing duties and auditors' perceived performance, as expected and perceived by society".

Figure 2.1: Structure of the audit expectation - performance gap



The overall expectation-performance gap was analysed into three constituent parts. These are: 'Deficient Performance', 'Deficient Standards' and 'Reasonableness gap' as depicted in Figure 2.1 (reproduced from Porter, 1993:50).

2.2 The history of the audit expectations gap

As previously mentioned, Liggio (1974) was seemingly the first to apply the phrase "expectations gap" to auditing. The Cohen commission on auditors' responsibility was set up by AICPA in 1974 with the specific task of making recommendations on the appropriate responsibilities of auditors, owing to growing public concern about the criticism of the quality of auditors' performance. In doing so, the Commission's terms of reference stated that it was to consider whether a gap exists between what the public expects or needs and what auditors can and should reasonably expect to accomplish (Commission on Auditors' Responsibilities, 1978).

This was followed in 1976 by the setting up of the House Subcommittee on Oversight and Investigations of the House Commerce Committee, which was also concerned with standards of corporate accountability. In Canada, similar concerns led the Canadian Institute of Chartered Accountants (CICA), in 1977, to establish a group called the special committee to examine the role of the auditor. This became known as the Adams Committee and reported in 1978, soon after the Cohen Commission. Similar concerns about the role and accountability of auditors were concurrently being expressed in the United Kingdom (UK) (Humphrey, 1997: 9).

From the latter half of the eighties, the phenomenon gained greater publicity, especially after various influential commissions investigated the role of the auditor. In the USA owing to the concern raised by members of congress, the financial press, judges and members of leading accounting firms, the AICPA's Auditing Standards Board (ASB) responded in 1985 and tackled questions such as: should auditors accept additional responsibility for uncovering fraud and illegal acts? Have auditors taken enough responsibility for evaluating going concern? In 1987, the ASB issued nine new standards as an attempt to reduce the gap (Guy and Sullivan, 1988:36). Since then several research studies have been conducted to find out the effectiveness of these standards (see among others: Robson, 1988 and Guy and Sullivan, 1988).

In Canada, the 1988 Canadian Institute of Chartered Accountants (CICA) MacDonald Commission studied the public's expectations of audits and identified a perception that auditors were not independent of management in making their determinations. It concluded that the public is largely ignorant of the extent of the responsibilities entrusted to auditors and that some of the most knowledgeable segments of the public feel that their expectations are not being fulfilled.

"In the UK, the Auditing Research Foundation (1989) identified the expectation gap as one of the priority areas for investigation. Moreover, in 1991, the Institute of Chartered Accountants in Ireland established an independent commission to study the expectations gap. The commission presented its final report in 1992 and concluded that there was evidence of an expectation gap which should be addressed as a matter of priority" (Pierce and Kilcommins, 1995-96:3).

In the period that followed, several studies were made of the further evolution of this expectation gap. Gramling *et al* (1996) stressed that the American studies were not comprehensive. Lowe and Pany (1993) compared the view of a number of members of the jury with the views of a number of auditors. In Australia, Monroe and Woodliff (1994), found that an expectation gap exists between auditors and various user groups with regard to the messages communicated through the audit report.

A more comprehensive analysis of the differences between the views of various categories of users of financial information and the view of the auditors themselves was made by Humphrey et al (1993). This British study included a survey of several groups involved in the reporting process. This investigation identified a substantial expectations gap, with regard, among other issues, to fraud detection, the liability of the auditors vis-à-vis third parties, the independence of auditors and the extent to which auditors deal with risks and uncertainties.

Concurrent with the America and British investigation, a comparable survey was conducted in New Zealand (Porter 1993). It concerns a survey asking the respondents about their knowledge of and their views on the duties of an auditor.

In South Africa, Gloeck and De Jager's (1993), research report on the expectation gap in South Africa provides useful evidence on what is an international phenomenon. They found many areas in which an audit expectation gap exists between auditors and non auditors. These includes, among others, the independence of auditors, the role of auditors with respect particularly to fraud and going concern issues, the compulsory audit of small owner manager companies and partners contributions towards total audit time.

Furthermore, since the end of nineties, a variety of studies on the audit expectation gap have continuously indicated the existence of the gap (see 2.5 Previous Research p.29).

2.3 Factors that contribute to the audit expectations gap, and existing auditor's duties

Factors which contribute to the audit expectation gap, as identified in the academic and professional literature by all the studies reviewed in this research project (see previous research later in the chapter) are presented in this section. The existing auditor's duties according to the International Federation of Accountants (IFAC), which are related to the factors that contribute to the gap, will be discussed. IFAC standards are mainly presented as Eritrea adopts IFAC standards. Recent developments in the US expectation gap standards, which were issued by AICPA and incorporated in the IFAC standards (see US expectation gap standards later in this chapter), are also presented as they were specifically issued to narrow the audit expectation gap. Even though

South Africa is a developing African country and the presentation of SAICA standards, which are related to the factors which contribute to the gap, is justifiable, its standards are similar to IFAC standards, as South Africa adopts IFAC standards. Moreover, SEC rules, especially in relation to auditor's independence, are presented as major recent changes in the auditor independence standards came from it.

Seven factors, which contribute to the audit expectation gap, were identified by the researchers and professional bodies and are presented below. First, a review of the history in relation to these factors well be provided and thereafter the recent issues will be discussed.

1. Fraud detection responsibility
2. Warning of Company failure – going concern
3. Discovering and disclosing illegal acts
4. Audit independence - provision of other services
5. Reporting matters of concern to regulatory authorities
6. Guaranteeing the accuracy of a company's financial statements
7. Judging the efficiency and adequacy of corporate operations and management.

Although several studies indicate that the audit report and self-regulation process of the audit profession contribute materially to enlarging the audit expectation gap (see, among others: CICA 1988; Humphrey et al. 1992; Sikka et al. 1992; Minter and Bourne, 1994; Innes et al. 1997; Humphrey 1997), they are excluded for purposes of this study. The reason is that, in Eritrea, the auditing profession is regulated by the auditor general (see chapter three). Therefore, there is no self-regulation process at present. With regard to the audit report, several studies have indicated that the replacement of the short form report by the long form report has significantly reduced the expectation gap (See: Innes *et al.,* 1997; Gay and Schelluch, 1993; Nair and Rittenberg, 1987). However, for further evidence in Eritrea, future research into the expanded audit report is required.

2 .3.1 Auditor's Fraud Detection Responsibilities

According to Porter (1993), the role of auditors in detecting fraud is a controversial issue. Not only do opinions vary widely among auditors, it is also the issue which contributes to the audit expectation gap in all the countries reviewed (see summary of previous research – table 2.3 p.41). According to Troberg and Viitanen (1999) the prevention as well as the detection of fraud was regarded as the primary audit objective until about the 1930s. Between the 1930s and 1960s the importance of fraud detection as an audit objective was steadily eroded. This was reflected in several professional promulgations, which initially focused on the limitations of auditors in detecting fraud (Troberg and Viitanen, 1999: 38). The promulgations de–emphasized auditor´s responsibilities in this regard and pointed out that prevention and detection of corporate fraud is the responsibility of management and is best prevented and detected by a good system of internal control. "If an auditor were to discover defalcation and similar irregularities, he would have to extend his work to a point where its cost would be prohibitive" (AICPA, 1951:13- as cited in Troberg and Viitanen, 1999).

Other writers, however, attribute a much more proactive and self-interested motive for the audit profession down-playing the auditors' responsibility in detecting fraud. Brow (1962) suggests that the profession down-played the auditors' responsibility for detecting fraud as a defensive move, following the huge McKesson and Robbins fraud (1938) which auditors failed to uncover. This seems to lend support to Willingham's (1975:19, as cited in Humphrey, 1997:15) contention that " perhaps the discussion of the auditor's responsibility for the detection of fraud has not yet been diminished because it was a stated audit objective for over 400 years and was removed as an objective by the profession rather than by a change in the demand of clients of accounting firms. A solicitous consuming public could reinstate it."

By the 1960s, the profession's denial of responsibility for detecting fraud was subject to criticism. Morison (1970: 414) brought attention to the fact that neither the press nor the general public shared the view expressed in accounting literature that if an audit was not intended to uncover fraud, the public would consider it to be of little use. In the light of widespread criticism, professional promulgations were amended to acknowledge that auditors have a responsibility to be aware that fraud may exist and that, if it is sufficiently material, it may affect their opinion on the financial statements (Morison, 1970).

By the 1980s the profession had continued to move in the direction of recognizing increased responsibility for detecting fraud. According to Troberg and Viitanen (1999: 38), the general position of the auditing profession today is that the auditors should plan their audits so that they have a reasonable expectation of detecting material misstatements in financial information which result from fraud. The primary responsibility for preventing and detecting fraud, however, rests with management. Despite the growing criticism of auditors by politicians, the courts, financial journalists and the public, for failing to uncover even major frauds in companies, auditors remained reluctant to acknowledge responsibility to do so until the beginning of the 1990s.

Porter (1991:12) states that the then current auditing standards also fall short of what the public can reasonably expect of auditors, even though the profession was taking steps to narrow the gap. An example of this is the AICPA's release of SAS 53 *The auditor's responsibility to detect and report errors and irregularities* (See 'US expectation gap standards' later in this chapter) and SAS 82, *Consideration of fraud in a financial statement audit*, which provides expanded operational guidance on the auditor's consideration of material fraud in conducting a financial statement audit. SAS 82, which supersedes SAS 53, *The auditor's responsibility to detect and report errors and irregularities*, was issued in December 1997. SAS 82 clarified, but did not increase, the auditor's responsibility to detect fraud. That responsibility is still framed by the key concepts of materiality and reasonable assurance. (AICPA, 1997).

History has shown that the auditors' responsibility to detect and report fraud is a controversial issue and one which is not easy to resolve. It requires greater realism about what auditors should be expected to detect, and greater commitment by the profession to meeting society's realistic expectations. Despite the changes to auditors' duties, corporate fraud continues to be a major and apparently escalating social and economic problem, and it is clear that auditors' duties still fall short of society's expectations. (Porter, 1997:45).

According to ISA 240, *The auditor's responsibility to consider fraud and error in audit of financial statements*, (IFAC, 2001) "the auditor is not and cannot be held responsible for the prevention of fraud and error. The fact that an annual audit is carried out may, however, act as a deterrent. The responsibility for the prevention and detection of fraud and error rests with management through the implementation and continued operation of adequate accounting and internal control systems. Such systems reduce, but do not eliminate the possibility of fraud and error."

The AICPA's Auditing Standards Board has issued a proposed SAS, *Consideration of Fraud in a Financial Statement Audit.* The proposed SAS would supersede SAS 82, *Consideration of Fraud in a Financial Statement Audit,* AU Section 316. This proposed Statement does not change the auditor's responsibility to plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether caused by error or fraud. However, the proposed Statement does establish standards and provide guidance to auditors in fulfilling that responsibility, as it relates to fraud (AICPA, 2001).

Porter (1993) is of the opinion that given the cost-benefit constraints and the ability of perpetrators to cover their traces, the detection of fraud goes beyond what auditors can reasonably be expected to accomplish. Furthermore, Viitanen and Troberg (1999) state that the assertion that auditors should detect all corporate fraud (even petty theft by employees) suggests that at least some part of the gap could be attributed to the *reasonableness component.*

2.3.2 Warning of a company failure – Going concern

Many studies indicate that the public expect auditors to give early warning regarding the failure of a company (see among others – Porter, 1993; Humphrey et. al, 1993; Viitanen and Troberg, 1999). According to Tweedie (1987:19), in discussing the functioning of the audit report as an early warning alarm system, it is difficult for a non-financially knowledgeable person to understand how a company can suffer serious financial difficulties, or even collapse, shortly after having received an unqualified opinion. One of the problems in Eritrea is also lack of financial knowledge (see chapter one and three).

The CICA's (1988) study found that a significant proportion of the public believes that an unqualified audit opinion is issued only in circumstances where the company is not presently experiencing financial problems. Viitanen and Troberg (1999) state that, in general, auditors do not appear to meet this expectation. In practice, auditors are faced with a dilemma. If they have unresolved doubts about a company's future, they are required to state the position candidly, but simultaneously they are conscious that if they do so, this may generate a self-fulfilling prophecy. If doubts are expressed about the company's financial stability, management's plans to resolve the problems at hand may never be put into effect and the company's life may be terminated prematurely (Porter 1991:8).

IFAC, AICPA and SAICA have adopted similar views regarding the going concern assumption. In an attempt to reduce the gap, the AICPA issued SAS 59, *The auditor's consideration of an entity's ability to continue* as a *going concern* (See 2.4 US expectation gap standards p.25) and SAS 77 as an amendment to SAS 59. The amendment to SAS 59 does require the auditor to document the conditions or events that led him or her to believe that there is substantial doubt about an entity's ability to continue as a going concern, the work performed in connection with the auditor's evaluation of management's plans, the auditor's conclusion as to whether there is substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time, and the consideration and effect of that conclusion on the financial statements, disclosures, and the audit report. These amendments are responsive to the recommendations of the Panel on Audit Effectiveness (AICPA, 2001:6). According to Viitanen and Troberg (1999), this has served to narrow any portion of the gap deriving from deficient standards. Further they conclude that, while appreciating the dilemma which auditors face in practice, it appears that this issue arises primarily from *deficient performance.*

According to IFAC standard ISA 570 (2001), "If, in the auditor's judgment, sufficient appropriate audit evidence has been obtained to support the going concern assumption, the auditor would not modify the auditor's report. If, in the auditor's judgment, the going concern assumption is appropriate because of mitigating factors, in particular management's plans for future action, the auditor would consider whether such plans or other factors need to be disclosed in the financial statements. If adequate disclosure is not made, the auditor should express a qualified or adverse opinion, as appropriate." SAAS 570 of the South African Auditing Standards is also consistent in all material respects with the IFAC standard (SAICA, 2002:12).

2.3.3 Auditor independence

The Metcalf Report (1978) noted a fundamental problem in respect of independence, which is the auditor's single most valuable attribute. Independence was also one of the major concerns of the Cohen Commission (1978). In terms of the expectations gap, the concern has been that auditors have not been operating in a sufficiently independent fashion. Both the Cohen and Metcalf Commissions (1978), for example, were worried that competitive pressures were affecting audit quality. The pressure to acquire or maintain audit clients was seen to be such for Metcalf to conclude that 'accounting firms have often cut costs to the point where the integrity of the audit is impaired' (Metcalf Committee, 1978:93). Similar concerns were expressed by the Dingell investigation in the mid-1980s- as cited in Humphrey (1997:19): "The system begins with the corporate managers and directors, whose actions are to be audited, going out and choosing the auditor. They hire the independent audit firm, determine the fees to be paid and have the power to fire the auditor for any reason. The independent audit firm often provides tax and management consulting services to the same corporation it audits. Can we really expect an audit firm to remain independent when its fees, perhaps substantial consulting fees, are directly related to pleasing the corporate managers being audited?"

Over the last thirty years, a number of recommendations have been put forward (including peer review systems, the development and strengthening of audit committees, the rotation of auditors, the prohibition on auditors performing non-audit services for a company they also audit, the declaration in the company's financial statements of non-audit fees paid to the auditor, etc.) as a way of bolstering audit independence (see also later in this chapter the new IFAC independence standards, SEC rules - Sarbanes Oxley Act, and King II of South Africa with respect to audit independence). However, Humphrey (1997) stressed that doubts still remain that commercial pressure and the disproportionate power of company management *vis-à-vis* the auditor are hindering in some way the quality of audit work (see CICA 1988, Cadbury Committee, 1992 and the Accounting Standards Boards in the UK, 1990).

The auditor must be independent in both fact and appearance. Viitanen and Troberg (1999) stated that the question is about the potential interference of the consulting services with the auditor's role as an auditor. An audit and consulting role may raise doubts not only about the auditor's independence in appearance but also about the auditor's independence in fact. Many accounting firms contend, quite correctly, that it is generally not the same persons within the firm who provide both the auditing service and the accounting and financial services, but separate persons within the firm, and thus that independence in fact prevails. Many interest groups, however, may not be capable of making this distinction, the only association made is that one accounting firm has performed both the audit and the other services, and thus the problem of independence in appearance remains (see Jenkins and Krawezyk, 1999). In addition, independence in fact may also be questioned. For example, if persons from the same accounting firm have been assisting the client in planning and developing the internal control system of the client, one has to question whether the auditor can in his/her audit remain totally neutral when evaluating the system in which his/her own employer has been instrumental. (Viitanen and Troberg, 1999:141).

Jenkins and Krawezyk (1999:73) noted that in recent years public accounting firms have expanded their practices to include a wide array of non-audit services. This expansion of services has led some to question whether and to what extent the provision of these non-audit services influence the public perception of auditor independence. Thus, the profession in the US is undergoing a fundamental reconsideration of its strategy – and the independence of auditors is the key issue driving the change. For the past two decades, the accounting firms that dominate the profession in the US have been pursuing a "get big" strategy. They have moved into a wide range of consulting and advisory services, leveraging their reputation to carve a place in new markets in corporate finance, IT, human resources, and legal services. The accounting profession has finally recognized the inherent conflict of interest in performing both the consulting and audit work for an audit client. The collapse of Enron has been a major blow to the profession. The auditing firm, Arthur Andersen, was both the accountant and the consultant. Enron paid Andersen $25 million dollars for its audit in one year and $27 million for consulting work and other services (Cleary, 2002). "Enron never reported even a bad quarter before collapsing" (Will, 2002 as cited in Cleary, 2002). The SEC sees the formal separation of consulting from audit services to be a step in the right direction, but this is still a long way from a guarantee of auditor independence (Parker, 2001:50-51). (See later in this chapter for the prohibition of non–audit services by SEC 2003 and IFAC 2001).

IFAC has also turned its attention to the question of running an independent audit practice as an integral part of a 'full-service' firm. To continue to meet emerging community expectations and to take account of changing business practices and technology, in November 2001 IFAC released revised standards on assurance engagements. The IFAC ethics committee focused on the issue of auditor independence. It is a move to wards a conceptual framework requiring the identification and evaluation of threats to independence and the application of safeguards to reduce it to an acceptable level (IFAC, 2001).

2.3.4 Discovering and disclosing illegal acts

Viitanen and Troberg (1999:39-40) noted that the auditor's role in discovering and reporting illegal acts by company officials is also misunderstood by the public. Further, they stated that the public consider that auditors have a duty to discover and disclose management's failure to comply with law and regulation, and other management actions of which society disapproves for moral, public policy, or other reasons. But the auditing profession has been reluctant to undertake such responsibility.

According to IFAC standard (ISA 250, 2001) "When planning and performing audit procedures and in evaluating and reporting the results thereof, the auditor should recognize that non-compliance by the entity with laws and regulations may materially affect the financial statements. However, an audit cannot be expected to detect non-compliance with all laws and regulations. Detection of non-compliance, regardless of materiality, requires consideration of the implications for the integrity of management or employees and the possible effect on other aspects of the audit." SAAS 250 of SAICA is also similar to this IFAC standard, ISA 250.

Despite the profession's acknowledgment of such standards, the public expects auditors to accept a broader responsibility. The expectation gap appears to result primarily from the public holding unrealistic expectations of auditors and/or from their expectations being ill defined and this thus seems to represent the *reasonableness component* of the expectation gap. But it is also reasonable to expect auditors to detect illegal acts which fall within their specialist area, namely, those which are directly reflected in a company's accounts. Thus, a portion of the expectation gap relating to illegal acts is seen to arise from *deficient standards* (Porter 1991 as cited in Viitanen and Troberg, 1999:40-41).

2.3.5 Reporting matters of concern to regulatory authorities

The public have called on auditors to accept a duty to report to a regulatory authority in cases where corporate fraud or illegal acts are involved (Viitanen and Troberg, 1999:41). Porter (1991) finds the public's expectations not too unreasonable given the present socio-economic environment. Therefore, the gap in relation to this issue is derived primarily from *deficient standards*. However, it seems that the key issue is not the reluctance of the auditing profession to take responsibility, but the perceived exposure to the risk of litigation, if they fail to report as expected of them by the public.

According to IFAC standard ISA 240 (2001) the auditor's duty of confidentiality means they will not normally report possible fraud or illegal acts to anyone outside the client organization other than to the extent that it affects the audit opinion. However, in certain circumstances, the duty of confidentiality is overridden by statute, the law or by courts of law and professional obligations. For example, in South Africa, Section 20 (5) of the Public Accountants' and Auditors' Act creates a legal duty which overrides the auditor's ethical duty of confidentiality (see PAAB, 2004). The auditor may need to seek legal advice in such circumstances, giving due consideration to the auditor's responsibility to the public interest.

2.3.6 Guaranteeing the accuracy of a company's financial statements

In reviewing the studies of the audit expectation gap, the audit report has frequently been viewed by the users of the financial statements as a certification and a guarantee of accuracy of the audited financial statements (see Lee, 1970 and Humphrey, 1997). That is, many users consider that an unqualified audit report signifies that the auditor guarantees that the audited financial statements are completely accurate and/or that the company is financially secure. Viitanen and Troberg (1999) state that the auditors' views tend to be that the auditor's opinion helps to establish the credibility of financial information. This is, however far from guaranteeing its accuracy. According to Porter (1991:6), the public's expectations seem to go beyond what auditors can reasonably be expected to accomplish thus this issue appears to be associated principally with the *reasonableness gap* component in the Porter framework. Humphrey (1997:14) also suggests that the usual response to such findings among the auditing profession is to stress the general lack of understanding of the audit function and to highlight the unreasonable nature of such expectations.

2.3.7 Judging the efficiency and adequacy of corporate operations and management.

Considerable support has been found for the view that the audit is designed to give assurance on the efficiency of management and the financial soundness of the company. That is, the users of audited accounts continually perceived a broader audit function than that performed, or perceived as a legitimate function, by auditors (see Beck, 1973 and Humphrey et al, 1993). Therefore, this expectation is unreasonable and is associated with the *reasonableness gap* component of the audit expectation-performance gap.

2. 4 The US Expectation Gap Standards

In response to the concerns raised by financial writers, members of Congress, judges and members of leading accounting firms, the AICPA Auditing Standard Board approved the issuance of nine new statements on auditing standards (SASs 53-61), the so called *expectation gap standards,* in 1988 (Guy and Sullivan, 1988:36). The questions raised were whether auditors should accept additional responsibility for uncovering fraud and illegal acts and whether auditors have taken enough responsibility for evaluating the going concern assumption.

According to Guy and Sullivan (1988:36-37) the public and financial statement users believe that: a) auditors should assume more responsibility for the detection and reporting of fraud and illegal acts, b) communicate to financial statement users more useful information about the nature and results of the audit process - including early warning about the possibility of business failure and c) communicate more clearly with audit committees and others interested in, or responsible for, reliable financial reporting. They added that the public expectations vis-à-vis financial statements actually go beyond the role of auditors and their audit opinions, and it is the responsibility of management to prepare the financial statements.

These nine statements on auditing standards, the so-called *expectation gap standards,* issued by AICPA in 1988 are considered hereafter. These standards were issued by AICPA specifically to narrow the expectation gap in the US.. It is clear that many changes have been made to these standards since 1988 and are incorporated in IFAC standards. However, the aim of this section is to give the historical overview of these standards. Any changes to these standards are presented when considering each of the factors which contribute to the expectation gap (see 2.3 – Factors that contribute to the audit expectation gap and existing auditor's duties).

According to SAS 53, *The auditor's responsibility to detect and report errors and irregularities* (AICPA 1988, Para. 5), "the auditor should assess the risk that errors and irregularities may cause the financial statements to contain a material misstatement. Based on that assessment, the auditor should design the audit to provide reasonable assurance of detecting errors and irregularities that are material to the financial statements." This standard increases responsibilities by obliging the auditor to design the audit to provide reasonable assurance of detecting errors and irregularities. The standard recognizes that some irregularities like forgery and collusion may preclude even a properly designed and executed audit from detecting a material irregularity (Troberg and Viitanen, 1999: 30). It also requires the auditor to make sure that the audit committee or its equivalent is informed about all but inconsequential irregularities (Guy and Sullivan, 1988:38). SAS No. 54 establishes the same responsibility for violations of laws or governmental regulations that have a direct and material effect on line amounts in financial statements as that stated above for material errors and irregularities. However, the auditor considers how such illegal acts relate to financial statement assertions and audit objectives rather than considering their legality *per se.* (AICPA, 1988 Para. 5). The auditor is responsible to react to violations of indirect laws and regulations when information comes to the auditor's attention which could have a material effect on financial statements through a contingent liability. In such cases the auditor is obliged to apply audit procedures to ascertain specifically whether an illegal act has occurred (Guy and Sullivan, 1988:38).

SAS 55, C*onsideration of the internal control structure in a financial statement audit*, was issued to broaden the auditor's responsibility to consider internal control when planning an audit. The standard requires the auditor to obtain an understanding of each of the three control elements, namely; control environment, accounting system and control procedures, in order to plan the audit sufficiently (AICPA 1988, Para. 5). SAS 56, *Analytical procedure*, requires the use of analytical procedures in the planning and the final review stages of all audits and gives fresh guidance on designing, applying and evaluating analytical procedures as substantive tests (Guy and Sullivan, 1988:30). SAS 57, A*uditing accounting estimates*, provides guidance on obtaining and evaluating evidence to support significant accounting evidence which in turn supports significant accounting estimates such as allowances for loan losses, warranty expenses, net realizable value of inventories and losses on purchase commitments (AICPA 1988, Para. 2, 16).

SAS 58, R*eport on audited financial statements*, revises the auditor's standard report, replacing the standard jargon with clearer descriptions of the auditor's responsibility, the work the auditor does and the assurance the auditor gives. In the introductory paragraph of the report management's responsibilities for the financial statements are differentiated from the auditor's responsibility to express an opinion on the financial statements. In the second, or scope paragraph, an explicit acknowledgement should be provided that an audit provides *reasonable assurance* - within the context of materiality - that the financial statements are free of material misstatement. In addition, there should be a brief explanation of what an audit entails (Guy and Sullivan, 1988:30).

According to SAS 59, *The auditor's consideration of an entity's ability to continue as a going concern* (the most controversial of all the expectation gap standards), the auditor should consider whether the aggregate results of all audit procedures performed during planning, performance and evaluation indicate that there could be substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time, not to exceed one year beyond the date of the audited financial statements. That is, it obligates the auditor, in every audit, to evaluate whether there is substantial doubt about the client's ability to continue as a going concern. If there is such doubt, the auditor should, as a minimum, include an explanatory paragraph in the audit report. Nevertheless, SAS no. 59 states that the auditor is not responsible for predicting the future and that the absence of a reference to substantial doubt in an auditor's report can not be construed as providing assurance as to an entity's continued existence (AICPA, 1988, Para. 2-4).

SAS no. 60, *Communication of internal control structure related matters noted in an audit,* requires auditors to inform management and the board of directors or its audit committee about any material weaknesses in internal accounting control procedures uncovered by the audit (AICPA 1988, Para. 2). It broadens the responsibility of an auditor by requiring the auditor to report significant deficiencies in the control environment, accounting system and control procedures (Guy and Sullivan, 1988:44). SAS no. 61, *Communication with audit committees*, places responsibility on the auditor to make sure that certain matters are communicated to those with responsibility for oversight of the financial reporting process. It applies to entities that have an audit committee and to all SEC engagements. The auditor should ensure that those with oversight responsibility know, among others, about the auditor's responsibility in an audit and the nature of the assurance provided, the initial selection of and changes in significant accounting policies or their application, the process that management uses in formulating sensitive accounting estimates and the basis for the auditor's conclusions about the reasonableness of those estimates, any audit adjustments, whether recorded or not, that could have a significant effect on the financial statements, and any disagreement or serious difficulties encountered with management in performing the audit (AICPA, 1988, Para. 6-14).

2.5. Previous Research

The objective of this section is to present the evidence of the existence of the audit expectation gap in various countries and to show that the audit expectation gap problem is an international phenomenon. Previous research in developing countries and/or countries, which adopt IFAC standards, including Finland, Singapore and South Africa among others, will be summarized. In addition, some of the studies undertaken in developed countries will be presented to indicate that the problem is international in scope.

2.5.1. Porter study (1993)

Porter conducted an empirical study of the audit expectation-performance gap in New Zealand in 1989. The questionnaire was sent to 1698 survey participants who comprised 16 interest groups that formed four broad groups: auditors (200), auditees (400), audit beneficiaries from financial community (351) and audit beneficialry from non-financial community (747 participants, including 500 members of the general public) (Porter, 1993:52). The overall usable response rate was 69%. The results of the Porter survey show that all but five of the 30 suggested duties of auditors (see Appendix 7 p.192) listed in the questionnaire were found to contribute to the audit expectation gap. An estimate of the relative contribution of each duty to its respective component of the audit expectation performance gap (See Appendix 8 p.193) may be derived from the proportion of the societal group whose expectations are not being fulfilled with respect to the particular duty. Porter (1993) took this process a step further. If a measure of unfulfilled expectations associated with the duties contributing to a particular component of the audit expectation gap is added, a measure of society's unfulfilled expectations attaching to the component of the overall gap between society's expectations of auditors and auditors' perceived performance may be calculated (see Appendix 8 p.193). Calculated in this way, the largest part of the expectation gap, that is, 50% was attributable to deficient standards, 34% resulted from unreasonable expectations and only 16% was derived from perceived deficient performance (Porter 1993). The duties contributing most to the gap are presented in table 2.1 on page 31.

As can be seen in table 2.1 and Appendix 8, the duties are classified in either one of the three categories by Porter (1993). Troberg and Viitanen (1999: 67-68) stated that to be too categorical on the audit expectation gap issue is dangerous, as some of the duties are likely to correlate with one another. Moreover, the auditing requirements placed on the auditor may be interpreted by the respondents as similar or close to one another. Therefore, table 2.1 and Appendix 8 provide a rough picture of an actual situation. But despite their arguments, Troberg and Viitanen (1999) used the same classification as Porter (1993) in their analysis of the expectation gap (see table 2.2). One of the reasons for this could be for the purpose of comparison.

To summarize, the results of the survey show that the duties which contribute most to the expectation gap in New Zealand are:

- Disclose and report to regulatory authority deliberate distortion of financial information.
- Disclose in the audit report theft of corporate assets by non-managerial employees.
- Detecting and reporting illegal acts and going-concern reporting.

Table 2.1: Duties contributing most to the expectation gap (Porter 1993).

Duties[1]	DS[2] (50%)[3]	DP[2] (16%)[3]	UE[2] (34%)[3]
	%[4]	%[4]	%[4]
Report to regulatory authority deliberate distortion of financial information	15		
Examine and report on the company's internal control	14		
Report to regulatory authority misappropriation of company assets by company directors/senior management	14		
Report to a regulatory authority theft of corporate assets by non-managerial employees			14
Disclose in the audit report theft of corporate assets by non-managerial employees			13
Guarantee the auditee company is solvent			11
Detect illegal acts by company officials which do not directly affect the company's account			11
Express an opinion in the audit report about the company's continued existence		21	
Disclose in the audit report deliberate distortion of financial information		16	
Disclose in the audit report misappropriation of company assets by company directors/senior management		14	
Disclose in the audit report any illegal act which directly affects the company's accounts		14	

[1]The result of the Porter survey shows that out of 35 existing and suggested duties of an auditor, 30 duties were found to contribute to the audit expectation gap (see Appendix 7). Table 2.1 shows only the duties which contribute most to the audit expectation gap in New Zealand.

[2] (DP) Deficient performance, (DS) Deficient standards and (UE) Unreasonable expectation.

[3] Relative contribution of the relevant components to the overall audit expectation-performance gap.

[4] The percentage of the the non-auditor group whose expectations with respect to the duty are not being fulfilled.

2.5.2. Gloeck and De Jager survey (1993)

In the Republic of South Africa Gloeck and Jager (1993) conducted research on *the expectation gap in South Africa*. The research provides useful evidence on the existence of an audit expectation gap in South Africa. The survey's respondents were divided into two groups: 'financially knowledgeable persons' and 'members in public practice'. Out of 11792 questionnaires sent out to financially knowledgeable persons and 4303 to members in public practice, 4470 (38%) and 1374 (32%) replies were analyzed respectively (Gloeck and De Jager, 1993:33).

The results of their survey show that users of the reporting process expressed serious reservations regarding the independence and objectivity of auditors in South Africa. Moreover, large differences in perceptions were identified with regard to the auditor's responsibility to detect fraud and to look for signs of fraud, and the auditor's conduct with regard to going concern problems. Gloeck and De Jager (1993) concluded that the exact role of the auditor is no longer clear to the public in South Africa.

With regards to the difference between what users expect of auditors, and what can be reasonably expected of auditors, two factors, which contribute greatly to the expectation gap, were identified in the study. Firstly, there are cases where user and auditor require a particular situation to obtain, but statutory and professional rules forbid the auditor to act, as circumstances require. These relate to a) auditing of small owner-managed companies and b) the auditor's right to report to regulators in certain circumstances. Gloeck and De Jager (1993) recommended that the auditors' professional code of conduct should be amended with regard to confidentiality in order to allow fulfilment of the requirements of both auditor and user.

Secondly, there are cases where auditors and users agree that there has been a deviation from standards (deficient performance). Auditors and users agree that the requirements regarding independence are not met in South Africa. The following five factors which have the greatest negative influence on auditors' independence were identified by auditors: financial dependence on one client; pressure on auditing fees, established auditor-client relationships, competition between auditing firms and providing "other services" to audit clients (Gloeck and De Jager, 1993).

To summarize, Gloeck and De Jager (1993) found many areas, in which an audit expectation gap exists between auditors and non-auditors. These include, among others: the independence of auditors, the role of auditors, in particular with regard to fraud and going concern issues, the compulsory audit of small owner-manager companies and partner's contribution towards total audit time.

2.5.3. Humphrey, Moizer and Turley study (1993)

In the UK, Humphrey *et al.* (1993) examined the expectation gap by ascertaining the perceptions of individuals of audit expectations issues through the use of a questionnaire survey comprising a series of mini-cases. Out of the 2445 questionnaires mailed to respondents, the overall usable response rate was 38.2%. The issues investigated include the following:

- What is and should be the role of the auditor?
- What should be the prohibitions and regulations placed on audit firms?
- What decisions could auditors be expected to make?

The respondents included chartered accountants in public practice, corporate finance directors, investment analysts, bank lending officers and financial journalists. The survey revealed a significant difference between auditors and the respondents (representing some of the main participants in the company financial reporting process) in their views on the nature of auditing. The critical components of the expectation gap were found to include the auditors' fraud detection role, the extent of auditors' responsibilities to third parties, the strength of, and continuing threats to, auditors' independence, and aspects of the conduct of audit work (e.g. auditor's ability to cope with risk and uncertainty).

2.5.4. Best, Buckby, and Tan study (1996)

Best *et al.* (1996) conducted research in Singapore and found that an expectation gap exists, particularly in relation to the level and nature of auditor's responsibilities. The expectation gap was found to be particularly wide on the issues of the auditor's responsibilities for fraud prevention and detection, and the auditor's responsibility for maintaining accounting records and exercising judgments in the selection of audit procedures. To a lesser extent, an expectation gap was also found concerning the auditor's responsibilities for the soundness of internal controls, the degree to which financial statements give a true and fair view, auditor agreement with accounting policies used in the financial statements and the usefulness of audited financial statements in monitoring the performance of the entity.

2.5.5. Viitanen and Troberg survey (1999)

During 1997 Troberg and Viitanen conducted an empirical study of the audit expectation gap in Finland. The perceptions of auditors, financial directors, business lawyers, bank loan officers, shareholders (owners) and financial analysts regarding auditors' duties and performance of these duties were examined. Out of 782 questionnaires sent out, the overall usable response rate was 30%.

In analyzing the audit expectation-performance gap, Troberg and Viitanen used the Porter (1993) classification. That is, 35 duties were identified as the existing and suggested duties of an auditor in Finland, and these duties were classified in one of the three categories of the audit expectation-performance gap.

The results of their survey show that, calculated in the same way as Porter (1993), 39% of the expectation gap results from society holding unreasonable expectations of auditors, 31% is attributable to deficient standards and 30% derives from perceived deficient performance (Troberg and Viitanen, 1999:69). The duties contributing most to the gap are presented in table 2.2 (page 36).

Troberg and Viitanen (1999) noted that the general trend to demand more from the auditors has to be dealt with in concurrence with the auditor's legal liability and the cost-benefit issue, which includes finding parties willing to pay for any additional services. They added that, of all interest groups, the bank loan officer group was the least satisfied. Because bank loan officers are major users of auditors' work, it seems that it would be beneficial to both auditors and bank loan officers to direct educational efforts to the bank loan officer group in order to reduce the expectation gap.

Table 2.2: Duties contributing most to audit expectation gap (Troberg and Viitanen, 1999)

Duties[1]	DS[2] (30%)[3]	DP[2] (31%)[3]	UE[2] (39%)[3]
	%[4]	%[4]	%[4]
The auditor should detect and report material fraud committed in the audited company	34		
The auditor should report to an appropriate authority deliberate distortion of financial information	20		
The auditor should report to an appropriate authority fraud committed in the audited company	16		
The auditor should detect and report illegal acts by company employees which do directly affect the company's book-keeping		11	
The auditor should, when necessary, correct the financial statement		10	
The auditor should examine and report whether the company's continued existence is in doubt		10	
The auditor should detect and report theft/misappropriation of corporate assets by non-managerial employees.			19
The auditor should examine and report whether the company is managed effectively and efficiently.			14
The auditor should report on the future prospects of company			14

[1] The results of Troberg and Viitanen (1999) survey shows that 27 of the suggested duties (out of 35) were found to contribute to the audit expectation gap. Table 2.2 shows only the duties which contribute most to the audit expectation gap in Finland.
[2] (DP) Deficient performance, (DS) Deficient standards and (UE) Unreasonable expectation.
[3]Relative contribution of the relevant component to the overall audit expectation-performance gap.
[4] The percentage of the non-auditor group whose expectations with respect to the duty are not being fulfilled.

To summarize, the results of the study show that the factors which contribute extensively to the expectation gap in Finland are: the auditor's responsibility with regard to fraud detection and reporting, detecting and reporting illegal acts by employees which affect the company's accounts, going-concern reporting, and correcting the financial statements when necessary (Troberg and Viitanen, 1999:150). Finally, they concluded that their results support the view that an expectation gap does exist in Finland.

2.5.6. Other Studies

In the US, Baron *et al.* (1977) examined the extent of auditors' fraud detection responsibilities with respect to material errors, irregularities and illegal acts. They attempted to establish whether there are any differences in the perceptions regarding auditor and financially knowledgeable users of the accounting reports (financial analysts, bank loan officers and corporate financial managers). They found that auditors and financially knowledgeable users of accounting reports have significantly different beliefs and preferences regarding the extent of auditors' responsibilities for detecting and disclosing irregularities and illegal acts. In particular, users held auditors more responsible for detecting and disclosing irregularities and illegal acts than the auditors believed themselves to be (Koh and Woo, 1998:148).

In Singapore, Low *et al.* (1988) examined the extent of the expectation gap between auditors and financial analysts on the objectives of a company audit. Participants were provided with a list of 13 potential objectives. Significant differences were found in the areas of fraud prevention, guaranteeing the accuracy of financial information, effective utilization by the company of government grants, levies and subsidies, and management (Best et al., 1996:137). Financial analysts perceived an audit as setting a seal on the accuracy of the financial accounts of the company. Further, their perceptions of fraud prevention and detection responsibilities of auditors are more demanding than those that the auditors themselves believed they should possess.

Epstein and Geiger (1994) conducted a survey of investors in the US to gather information on various aspects of financial reporting issues, in particular on the level of assurance they believed auditors should provide with respect to error and fraud. The survey results suggest that investors seek a very high level of financial statement assurance and there is an expectation gap between auditors and investors as to the level of assurance an auditor provides.

In Singapore, Schelluch (1996), found that the expectation gap detected in prior research studies dealing with auditor responsibilities appeared to be reduced over time with the introduction of the long-form audit report. Differences in beliefs between auditors and users appeared to be reduced in areas specifically addressed in the wording of the expanded report. However, the expectation gap continued to exist after the introduction of long-form audit report in relation to the financial statement reliability. The study also appeared to indicate that users were generally unhappy with the role played by the auditing profession particularly with respect to auditor independence and the level of value added to the financial statements from the auditing process.

Beelde *et al.* (1997) examined the extent of the expectation gap between auditors, bankers and managers in Belgium. Significant differences were found in the areas of auditor's responsibilities in the case of fraud. In addition to fraud, the independence of the auditor was also an important point of concern. In this respect, a highly significant difference was noted between the answers given by auditors and other groups to the question which asked to what extent they agree with the proposition that an auditor's mandate can be renewed only a restricted number of times. This proposition was radically rejected by the group of auditors, while it is clear that managers are not advocates of it either, although bankers take a quite neutral standpoint.

In the UK, Dewing and Russell (2001) state that the expectation gap has several dimensions: auditor independence, auditors' responsibilities, audit quality and auditors' liability. Views about it were explored by conducting a survey with officers of trade and professional associations, individual fund managers, bankers, credit analysts, and others who had experience of both the public and private sectors. The survey revealed that those holding an accounting qualification were more likely to believe that the answer to " are auditors sufficiently independent of management to conduct audit objectively" is 'yes'. The provision of non-audit services was a key issue. Interviewees from the fund management industry expressed concern about auditors providing non-audit services, and especially about the dangers of 'low-balling'. Furthermore, the survey revealed that those with an accounting qualification believed auditors' current responsibilities for detecting and reporting fraud, for the going concern opinion, and for reporting to shareholders should not be widened. Those without an accounting qualification were in favor of widening auditors' responsibilities for fraud and for going concern, but not for reporting to a wider group of stakeholders. Bankers were content that the auditors' primary duty should be to shareholders. With regards to auditors' independence, the results show that those with an accounting qualification were less convinced than others of the need for an independent body to monitor audit quality; both groups agreed that discipline should be the responsibility of an independent body. Finally, the respondents agreed that the liability threat was not enough, in itself, to ensure the audit quality. However, moves to restrict auditors' liability were welcomed by those with an accounting qualification; others were strongly against reform.

Jenkins and Krawezyk (2001) examined how the provision of non-audit services affects financial statement users' perceptions of auditor independence in USA. Three non-audit services that were examined are under consideration by Independence Standard Board (ISB): appraisal/valuation, legal consulting, and outsourced internal auditing services. Interestingly, only one of these services, legal consulting, evoked a negative perception of auditor independence from the financial statement users, while the other two services failed to produce any significant response. Moreover, the negative perception for legal consulting services was held only by CPA firm professionals and not by members of the general public. Three commonly provided non-audit services were also examined: bookkeeping, general consulting, and tax return preparation services. Bookkeeping services evoked negative perceptions of auditor independence from the financial statement users, while the other two services favourably influenced participants' perceptions. Finally, their findings suggest that an expectation gap may exist between members of the accounting profession and the general public with respect to their perceptions of the influence of non-audit services on auditor independence. And they concluded that such findings might reflect the profession's current prohibition against many types of legal advisory services and the prohibition of auditors acting in a managerial capacity (see IFAC, 2002 and SEC, 2003).

Table 2.3: Summary of previous research

Authors, year and country (listed by countries).	Duties or factors which contribute most to the audit expectation gap							
	Fraud Detection responsibility	**Going concern**	**Independence of auditor*** **	**Report to regulatory authority**	**Disclosing irregularities and illegal acts**	**Guaranteeing the accuracy of financial information**	**Conduct of audit work***	**Others****
Porter (1993), New Zealand	E	E	NA	E	E	E	NA	NA
Gloeck and Jager's (1993), South Africa	E	E	E	E	NA	NA	NA	E (s)
Humphrey *et al.* (1993), UK	E	E	E	NA	NA	NA	E	NA
Dewing and Russell (2001), UK	E	E	E	NA	NA	NA	NA	NA
Low *et al.* (1988), Singapore	E	NA	NA	NA	NA	E	NA	NA
Best *et al.* (1996), Singapore	E	NA	NA	NA	NA	NS	E	E (I)
Beelde *et al.* (1997), Belgium	E	E	E	NA	NA	NS	NA	E (I)
Troberg and Viitanen (1999), Finland	E	E	E	E	E	E	NA	E (I)
Baron *et al* (1977),USA	E	NA	NA	NA	E	NA	NA	NA
Jenkins and Krawezyk (2001), USA	NA	NA	E	NA	NA	NA	NA	NA

E = Duties which contribute to the audit expectation gap.
* = Conduct of audit work (e.g. auditor's ability to cope with risk and uncertainty, to exercise judgment in the selection of audit procedures)
* * = Others include: - compulsory audit of small owner-managed companies (S), responsibility for the soundness of the internal control (I)
*** = Most of the independence issues are related to provision of non-audit services.
NA = Not asked NS = Asked but not statistically significant.

2.6 Approaches to narrow the audit expectation gap

2.6.1 Introduction

In an attempt to narrow the audit expectation gap, various recommendations have been suggested by researchers, authoritative commissions/committees and professional bodies for the last two decades (see, among others: Commission on Auditors' Responsibilities, 1978; Metcalf Committee, 1978; Adams Committee, 1978; Treadway Commission, 1987; Macdonald Commission, 1988). The areas of major concern common to most were: fraud detection responsibility, going concern reporting, the audit report and auditor independence. As a result many changes have been made to expand the role and the responsibilities of an auditor (See US expectation gap standards, 1988). However, there are various recommendations which have been suggested but have not yet been implemented by some countries owing to various reasons, such as the economic condition of the countries and differences in regulations. Particular approaches to narrow the gap have been identified and can be categorized into the following aspects.

2.6.2 Expansion of auditors responsibility with regards to fraud

To ensure and improve the effectiveness of the independent public accountant, the Treadway Commission (1987) in the US published its recommendations on the subject of fraudulent financial reporting. One of its recommendations concerns changing auditing standards with regard to fraud in order to provide reasonable assurance concerning the detection of fraud. The international auditing standard ISA 240 and the AICPA's SAS 82 were issued to provide guidance to auditors in fulfilling that responsibility. Further, the Commission recommended that the independent public accountant should be required to review quarterly financial data before its release to improve the likelihood of timely detection of fraudulent financial reporting (Treadway Commission, 1987:23). Various professional bodies and researchers have also supported this suggestion (see O'Malley, 1993, and Institute of Chartered Accountants in Australia, 1994). As a result, IFAC (2003) has established a committee with the objective of establishing standards and providing guidance for auditors who review interim financial information issued by their audit clients. The final ISA, *review of interim financial information performed by the auditor of the entity*, was issued in February 2004.

The recommendation made by Treadway Commission (1987) and various researchers and professional bodies regarding the audit of interim financial statements in order to improve the likelihood of timely detection of fraudulent financial reporting has only been implemented only in few countries due to the cost involved in the audit of interim financial statements. For example, in South Africa, it is not required that interim reports be audited, although King II (2002:134) recommends that, as a minimum, the audit committee should request that an independent review of the interim report is performed if the auditors have qualified or disclaimed their opinion, or produced an adverse opinion, in the last issued annual financial statements. Whereas in the US, under the SEC's rules, interim financial statements must be reviewed by independent auditors prior to filing in accordance with the procedure set forth in SAS 71 (SEC, 2000).

Humphrey et al, (1993) suggest other ways to close the expectation gap. They state that it is no good expecting the public to abandon their expectation of auditors as fraud detectives through education, or modifying the length of the audit report, or pretending that highly publicized audit failures are exceptions. Instead, they offer three suggestions: setting up an independent office for auditing to enhance auditor independence by overseeing the appointment of auditors of large companies and to regulate audit fees; extending auditors' responsibilities by statute so that they clearly include responsibility to shareholders, creditors and potential shareholders; and clarifying that auditors have a duty to detect fraud (Koh and Woo, 1998).

O'Malley (1993) agrees with the suggestion of imposing additional responsibilities on auditors, especially with regard to detecting fraud. He proposes four additional responsibilities which the profession might consider: management and auditor evaluation of internal control systems, compliance reporting, direct reporting by auditors to regulators, and auditor association with interim financial information. But, he argued that any expansion of auditors' responsibilities will not be feasible as long as the liability system operates as a risk transfer mechanism, with auditors as the prime transferees. Lochner (1993) also believes that it is not fair to expect auditors to assume more responsibilities without sufficient insurance provided to them against possible litigation (Koh and Woo, 1998).

In a research study on financial reporting and auditing undertaken jointly by the Australian Society of Certified Practising Accountants and The Institute of Chartered Accountants in Australia in 1994, the working party reviewed the recommendations of previous studies in other countries and offered possible solutions to close the expectation gap. These include: the management of reporting entities should be required to report on the effectiveness of internal control over financial reporting and auditors should report on this assertion; a review partner should be appointed for the audit of all reporting entities and he/she should countersign the audit report; and all reporting entities should be required to produce audited half-yearly and quarterly financial reports.

Ronan (1994) concludes that company stakeholders and Government authorities are growing increasingly impatient with the detrimental effects of corporate fraud. He argues that the company auditor should not be expected to detect corporate fraud, but proposes instead that public liability companies should be required to have a special audit carried out with the sole purpose of detecting and reporting on the presence or absence of fraudulent activity. The 'special auditors' would have their fees paid through a Government fund financed through the corporate taxation system. Thus the special auditors' independence would be transparent to all the stakeholders, including management. He adds that the special auditor should undergo extensive training in the detection of fraud with emphasis on computer fraud, and should report to the shareholders and government. Finally, the report to the government should be available for public inspection (Ronan, 1994:9-10).

2.6.3 Enhancement of auditor independence

Several researchers, authoritative commissions/committees and professional bodies have suggested how "other services" can be offered without impairing independence (see Metcalf Committee, 1978; Gloeck and De Jager, 1993; IFAC, 2001; SEC, 2003; draft Accountancy

Professions' Bill in South Africa, 2003). According to the Metcalf Committee (1978) the best policy in this area is to require that independent auditors of publicly owned corporations perform only services directly related to accounting as non-accounting services are incompatible with the public responsibilities of independent auditors, and should not be offered by the auditors. Gloeck and De Jager (1993) also suggest that the only solution to offer "other services" without negatively influencing the auditor's independence (as perceived by the user) is to place a ban on performing other services for the same audit client. But Gelfond (2000) argues that an unduly broad blanket prohibition on consulting might impact on the expertise audit firms can provide to clients. However, he feels that proper disclosure of all non-audit fees and services should be made, including tax services, and all fees should be addressed in relationship to the audit fees.

As a result of the above suggestions and to meet emerging community expectations and to take account of changing business practices and technology, the International Federation of Accountants released revised standards in November 2001 on assurance engagements. The IFAC revised (2001-2002) revised Independence Standard on Assurance Engagements recognizes that the provision of certain non-assurance services is incompatible with independence in mind or appearance. The Code prohibits a firm from providing:

1. Bookkeeping or other services related to the audit client's accounting records or financial statements of the audit client, except in emergency situations.
2. Appraisal or valuation services which involves matters that are material to the financial statements and involving a significant degree of subjectivity.

3. Management decision-making functions (refer IFAC code 8.156).
4. Expert services which involve making of management decisions on behalf of an audit client.
5. Broker-dealer, investment adviser or investment banking services.
6. Legal services to an audit client that is a listed entity where the results of the service will be material to the financial statements.

In the US, the independence provisions of the Sarbanes Oxley Act 2002 and the Securities and Exchange Commission (SEC 2001) rules have prohibited the provision of specified non-audit services to an audit client. Six of the prohibited non-audit services are those prohibited by IFAC code. The following non-audit services are prohibited only by SEC in US.

1. Financial Information Systems Design and Implementation
2. Internal Audit Outsourcing
3. Tax Services, unless the service has been pre-approved by the issuer's audit committee.

IFAC believes it is unnecessary to further extend the list of non-audit services that are prohibited to audit clients regardless of circumstances. The IFAC code currently permits the provision of the above three non-audit services, if any threat created may be reduced to an acceptable level, and where specified safeguards are in place. Both the IFAC code and the SEC rules permit the provision of non-audit services which are not included in the nine categories of prohibited non-audit services, such as consulting services, as long as the auditor does not (1) audit his/her own work, (2) perform management functions, or (3) act as an advocate for the client. (SEC, 2003 and IFAC, 2003).

In South Africa, as opposed to the SEC and IFAC, the ministerial panel for the review of the draft Accounting Professions' Bill (2003) stated that it is not practical to statutorily limit the non-audit services performed by the auditor to an entity. It suggests that the nature and extent of such services is a matter which specifically requires consideration and pre-approval of the audit committee. The audit committees will comprise exclusively of independent non-executive directors, and will be mandatory for all listed and other relevant entities in South Africa.

One method of ensuring that the auditor does not lose his/her independence because a large percentage of his/her income is derived from one client, is to stipulate a maximum percentage of total income which the auditor may derive from one single client or group of related clients (see ICAI, 1992: 117; IFAC, 2000; SEC, 2000; APB, 2003; AC CA, 2004). However, this may be a dangerous regulation, in that it will further reduce the number of firms which will then be able to audit large group public companies and, in so doing, further strengthen the monopolistic powers of large firms (O'Connor, 1992:17). According to IFAC (2001), the significance of the threat should be evaluated and, if the threat is other than clearly insignificant, safeguards should be considered and applied as necessary to reduce the threat to an acceptable level. Such safeguards might include: policies and procedures to monitor and implement quality control of assurance engagements and involving an additional professional accountant who is not a member of the assurance team, to review the work done or otherwise advise as necessary.

Another way in which to strengthen the auditor's independence is the mandatory rotation of audit firms (see Gaston, 1987; Gloeck and De jager, 1993). However, many researchers and professional bodies do not support audit firm rotation. The dangers arising from this are illuminated by McHugh, *et al.* (1992:11 – as cited in Gloeck and De Jager, 1993): "rotation would permit extensive monopolistic collusive behaviour between such firms". The AICPA (2004) stated that there is no empirical evidence to support the perceived benefit of mandatory audit firm rotation. Based on the international trends and the study made by the United States General Accounting Office (GOA), Sehoole (2004) stated that audit firm rotation would decrease the number of firms and the market share of public company audits would become more concentrated in a small number of accounting firms for countries with emerging economy, such as South Africa.

In response to the corporate collapses such as Enron, in US the SEC (Jan. 28, 2003) adopted rules to effectuate the statutory requirement of audit partner rotation found in Sec. 203 of the Sarbanes-Oxley Act. This should not be confused with audit firm rotation. The rules specify that certain other significant audit parterres will be subject to a seven-year rotation requirement with a two year "timeout" period. The IFAC (2003) commentary on a proposed revised rule by the SEC (2003) to rotate the whole engagement team, including those in remote subsidiaries, stated that such extension is both unnecessary and possibly impractical. The reason is that, the requirement to rotate all partners over five years may threaten audit quality as there will be little time for incoming partners to acquire sufficient in-depth knowledge of clients' businesses. Moreover, it is not practical in countries where there may be few partners with sufficient understanding of the particular industry involved, nor for small sized audit firms. This could reduce the number of audit firms and IFAC believes that it will reduce audit quality (IFAC, 2003). The IFAC Code recognizes that using the same lead engagement partner on an audit over a prolonged period may create a familiarity threat. Therefore, the Code requires the rotation of the lead engagement partner after a pre-defined period, normally no more than seven years (IFAC, 2003).

In South Africa, the ministerial panel for the review of the draft Accounting Professions' Bill (2003) stated that it is not efficient to introduce statutory term limits for auditors or statutory auditor rotation due to resource constraints in South Africa and other problems, which make it unlikely that such legislation would achieve its desired objective. It suggested that the most appropriate manner to deal with this issue is for the matter to be covered by the audit committee. It added that the consideration of the independence of auditors by an audit committee should particularly cover matters pertaining to the continued relationship with an existing audit firm and, importantly, the length of time for which a particular audit partner or audit team may conduct the audit of an entity.

2.6.4 Education

According to Koh and Woo (1998) some researchers have supported the belief that the knowledge of the users influences the size of the expectation gap. Hence, some researchers advocated education in narrowing the expectation gap. Bailey et al, (1983) found that more knowledgeable users placed less responsibility on auditors than less knowledgeable users in the US, implying that a larger gap exists between auditors and less sophisticated users. Similarly, Epstein and Geiger (1994) found that more educated investors (with respect to accounting, finance and investment analysis knowledge) are less likely to demand higher auditor assurance. Hence, they propose that one way to narrow the expectation gap is through increased public awareness of the nature and limitations of an audit. They add that, to increase users' knowledge and awareness, it is important to communicate the merits and limitations of an audit at every available opportunity chance. Further they note that the fundamental role of an audit in society must be re-examined by both the audit profession and financial users and all must agree to close the gap (Koh and Woo, 1998).

Monroe and Woodliff (1993) made a similar study in Australia and have the same view. They recommend that professional bodies should consider an active education program to increase users' knowledge about auditors' duties and responsibilities and the audit report in order to reduce the gap.

Porter (1993) points out that many expectations of users are unreasonable and therefore cannot be met by any expansion of regulations. Pierce and Kilcommins (1996), in their study of the audit expectations gap and the role of auditing education, also agree with this statement and conclude that audit education may have a wider role to play in addressing the expectations gap than that in relation to the misunderstanding gap. Further, audit education provides a basis for a more accurate and critical evaluation of those regulations, and confers on the user better understanding of the credibility of financial information. In this respect audit education can be viewed as having a positive and worthwhile contribution to make as part of a series of measures to address the audit expectations gap.

2.6.5 Communicating the auditor's role

The Treadway Commission (1987) also recommends better communication about the role of independent public accountants. The commission suggests that the standard audit report should describe the extent to which the independent public accountant has reviewed and evaluated the system of internal accounting control. According to the Commission, these steps will promote a better appreciation of an audit and its purpose and limitation and underscore management's primary responsible for financial reporting. (Treadway Commission, 1987:23).

In the USA, Nair and Rittenberg (1987) conclude that users' perceptions about the relative responsibilities of management and auditors are changed with the introduction of an expanded audit report. Miller *et al.* (1990) report that bankers found expanded audit reports to be more useful and understandable than the short form reports. In general, these studies provide evidence that an expanded audit report gives a fuller understanding of the scope, nature and significance of the audit and influences the reader's perceptions concerning the audit and the auditor's role. This implies that the expanded audit report has reduced the audit expectation gap to some degree (Koh and Woo, 1998).

Humphrey *et al.* (1992:137) examine the accounting profession's response to the expectation gap and identify two main strategies of response namely "a defensive approach focusing on education and reassurance of the public, and a constructive approach, seeking to convey a willingness to change audit activities to meet public concern". In terms of this analysis, the expanded audit report can be seen, and was seen by the APB itself, as a short-term "solution" responding to the immediate pressures on a newly formed board.

In Australia, Gay and Schelluch (1993) found that audit reports based on the revised Statement of Auditing Practice (AUP 3) have significantly increased users' understanding of the audit process, auditor's role, nature and limitations of financial reports and, to a lesser extent, the directors' responsibility for material errors and the basis of forming an audit opinion. Monroe and Woodliff (1994) also studied the impact of the wording changes in the revised AUP 3 on the expectation gap. Their findings confirm the existence of an expectation gap between auditors and various user groups related to the use of the earlier form of the report. However, the modified wording in revised AUP 3 has a significant impact on beliefs about the nature of an audit and the auditors' and management's responsibilities. The researchers suggest that wording changes in the audit report that address the specific areas of the expectation gap should be considered in closing the gap (Koh and Woo, 1998).

In the UK, Innes et al. (1997) found that the expansion of the audit report serves to improve the users' perceptions of the audit process and of the audit report in terms of its ability to communicate the purpose of the audit. This is likely to lead to enhanced reputation and status for the auditing profession. At the same time, expansion of the report also serves to increase users' perceptions of their ability to hold the auditor accountable. These arguments are consistent with those of Hooks (1992:128), who hypothesized that the profession acts to create an appearance of concern for a wider public interest without requiring much change by the largest public audit firms.

Butler et al. (2000) suggest that one approach to close the "expectation gap" between auditors and non-auditors' understanding of auditors' responsibility to detect fraud is to modify audit communications to more clearly reflect auditors' ability to provide assurance about fraud. Their results identify specific shortcomings in the communications from audit standard setters which affect both auditors and non-auditors' understanding of auditing terms. This may allow policy makers to avoid terms that are likely to mislead non-auditors. The term "irregularity" was not understood by the investor group, and SAS 82's replacement of "irregularity" with the term fraud is consistent with Butler et al's results.

2.6.6 Statutory solutions and greater external controls

Gloeck and De Jager (1993), in their review of various research studies, state that reducing the expectation gap comes about through increased regulation by an independent regulatory body. They add that such an independent body should not be governmentally or state based, but must be composed of members of the profession, investors, user groups and other users of the reporting process. An apt name for this body would be "auditing body". The essence must be improved professional responsibility through "openness" and "protection of own interests" must not be a factor (Gloeck and De Jager, 1993). Based on the recommendations made by researchers and professional bodies, various countries are establishing independent bodies to regulate the auditing profession. For example, in South Africa the Public Accountants' and Auditors' Board, an independent body, will be replaced by an independent auditors board since it has a much influence over the accounting profession and there is a need for wider public involvement in the regulatory body. This is owing to corporate collapses and scandals which have focused attention on auditors and the disciplinary process relating to errant auditors (Draft Accounting Profession's Bill, 2003).

The study undertaken by Dewing and Russel (2001) in the UK regarding the need for an independent body to monitor audit quality and the disciplining of auditors over audit failures, indicates that views varied considerably. At one extreme was the position that any profession worthy of the name should be capable of regulating its own members, whilst the other extreme was the view that the profession should be regulated by a strong, independent, public body. This result shows that there was a significant degree of support for establishing an independent regulatory body.

Pressure to introduce laws to investigate the problem of self-regulation is increasing (see Gloeck and De Jager 1993). This is due to the perception that the profession's own bodies do not have the capacity to correcty apply self-regulation. The existence of such a body is also seen as a move to gain greater acknowledgement of the commercial and practical realities of a market in which the provision of auditing services is controlled by a small group of large auditing firms (ICAEW, 1992).

2.6.7 Summary

In an attempt to narrow the gap, various approaches have been examined and suggested by researchers and professional bodies. These include, among others:
- An expanded audit report;.
- Enhancement of auditor independence;
- Education;.

- Expansion of auditor's responsibility - specially with regard to detecting fraud; and
- Statutory solutions and greater external control.

The areas of major concern common to most were: fraud detection responsibility, going concern reporting, messages communicated through the audit report and auditor independence. As a result, many changes have been made to expand the role and the responsibilities of an auditor.

The recommendations with regard to fraud and going concern reporting suggest that the auditor should play a more active role than was the case before. As a result, various standards have been issued by professional bodies regarding fraud and going concern to meet the needs of society. In addition, it was suggested that the independent public accountant should be required to review interim financial data before its release to improve the likelihood of timely detection of fraudulent financial reporting.

The recommendations put forward by various researchers and other bodies with regard to auditor independence focus on placing some restriction on the provision of non-audit services, the rotation of partners and the formation of audit committees, which is now an important part of good corporate governance. The IFAC code and SEC rules have been amended recently to deal with the prohibition of non-audit services and partner rotation, although there are some discrepancies between them. The six non-audit services which are prohibited by IFAC and SEC are the provision of: bookkeeping related services, appraisal or valuation services, management decision functions, expert services which involve management decisions, broker-dealers and investment advice, and legal services to an audit client. The three non-audit services are prohibited only by the SEC are: financial information system design and implementation, internal audit outsourcing, and tax services unless the service pre-approved by audit committee.

Finally, the suggestion made by many researchers and professional bodies with regard to the audit report was the expansion of the audit report to improve users' perceptions of the nature, scope and significance of the audit. Various researchers found that the expanded audit report has reduced the audit expectation gap in one way or another (in Eritrea an expanded audit report is used).

2.7 Corporate Governance

Corporate Governance is an issue which received increased global attention during the 1990s (see King Report I and II 1994 and 2002 in South Africa). "Corporate Governance in South Africa is concerned with holding the balance between economic and social goals and between individual and communal goals...the aim is to align as nearly as possible the interest of individuals, corporations and society." (Cadbury 1999 _ as cited in the King Report II on Corporate Governance for South Africa, 2002). Corporate Governance in South Africa has shifted the focus from profit driven reporting to integrated sustainability reporting, implying the achievement of balanced and integrated economic, social and environmental performance - the so called triple bottom line (King II, 2002). Clear guidelines are set out according to which companies should disclose their economic, social and environmental issues (see GRI, 2002 and King, II 2002).

Chambers (2002:138) states that the high quality of an audit is an essential part of effective Corporate Governance. It is an essential control in the process of disclosure to stakeholders. He adds that high priority should be given to the audit committee's review of the audit, as part of a system of continuous improvement in the audit process and in developing the auditors' relationship with the company. Where it is proposed to put the audit out to tender, a high priority should also be given to the appointment process (Chambers, 2002:161).

The Turnbull Report (1999) states that most of the complications, liabilities, exposures to ethical dilemmas, embarrassment and perceptions by the public that company directors may not be acting with the highest probity could be avoided by introducing good Corporate Governance. This approach would provide far greater protection for directors, auditors, shareholders and investors. But recent corporate collapses again raise questions about the behaviour of directors and auditors and their respective roles in company failures (see Sexton, 2001). The collapse of Enron, with $62.8 billion in assets, is a good example. It became the largest bankruptcy case in US history (AICPA, 2003). The question is "who is to be blamed?" Loubser (2002) stated that Enron is a company in which just about every rule of corporate governance had been broken. She adds that the external auditors are accused of being party to large-scale deception and fraud. As previously discussed in chapter one, corporate governance does not yet apply in terms of any code in Eritrea.

2.8 Conclusion

The concept of an audit expectation gap suggests that the public expects auditors to act in ways which are different from what auditors themselves would do. Based on the literature review, it can be concluded that evidence of the existence of an audit expectation gap in various countries is substantial. Furthermore, users generally have a higher expectation than most auditors would consider reasonable. Therefore, it is likely that the audit expectation gap will continue to be a major concern for many years to come, despite the efforts made by the profession to reduce that gap. Misconceptions and differences in expectations will persist and will grow to the detriment of the profession's standing with the public, unless effective and timely solutions are implemented.

The existence of the audit expectation gap in various countries, where the expectation gap has been studied, has important implications for Eritrea. It can be concluded that the problem of the audit expectation gap is likely to be even worse in developing countries such as Eritrea, as most of its public and users are less financially knowledgeable. Studies in various countries indicate that more knowledgeable users placed less responsibility on auditors than less knowledgeable users. The public in Eritrea has less knowledge of the auditor's role (see chapter three – Accounting and its environment in Eritrea). Therefore, the main focus of this research project is on the public perception of the auditor's duties and responsibilities. Moreover, other factors that contribute to the audit expectation gap (see 2.5 Previous Research p. 29), which are related to the specific problems in Eritrea (see chapter one – 1.2 Statement of Problem p.2) will be considered.

Perera (1980:37) states that the particular social environmental, under which accounting is done, has a direct bearing on the manner in which accounting performs its function. Therefore, the next chapter will be devoted to the discussion of accounting and its environment in Eritrea, and the Eritrean situation in relation to the Accounting and Auditing profession will be discussed thoroughly.

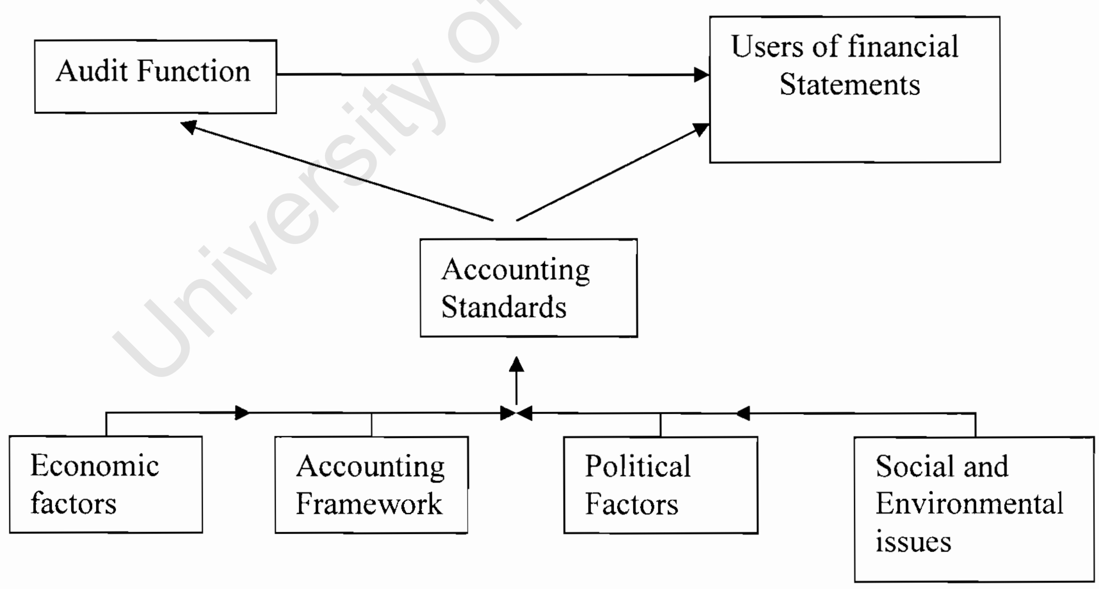
Chapter three - Accounting and its Environment in Eritrea, and auditor's duties

3.1 Introduction

According to Perera (1980:40) "accounting is a product of its environment, and a particular environment is unique to its time and locality." Accountants, in keeping their records, have to look to the environment for what property rights society protects, what organizations and institutions are used to carry on economic exchange and what legal and political procedures and instruments are involved in the economic transactions (Perera, 1980:44). Therefore, the environment that is described here is that of the total socio-political conditions and the economy of a country.

Accounting is influenced by varied factors which generally could be said to emanate from political factors, economic conditions, environmental and social issues and accounting theories (see figure 3.1).

Figure 3.1: Accounting and its environment



3.2 Socio-Political Conditions and the Economy of Eritrea

As can be seen from figure 2.1, accounting and auditing are affected by the economic, social and environmental and political situations in the country. For this reason it is important to present the socio-political conditions and the economy of Eritrea to give readers general information regarding those issues in Eritrea.

3.2.1 History and economy of Eritrea

Eritrea, a new nation in the horn of Africa, gained its liberation in May 1991 after a long and bitter struggle of 30 years of war with Ethiopia. It was a colony of Italy, Britain and later Ethiopia from 1885 to 1991. Independence was overwhelmingly approved in a 1993 referendum monitored by the United Nations and the country became an independent state in May 1993. It is strategically located in the north-eastern part of Africa, with the Red sea on its east coast, Sudan to the west and north, and Ethiopia to the south (see table 3.1 p.65 for the general information and economic overview of Eritrea).

Historically, Eritrea has been a nation of skilled people with a wealth of experience in entrepreneurship, commerce, and international trade. According to a World Bank Report (1996), at the end of the 1930s, some 730 companies producing industrial goods existed in Eritrea. In addition some 2200 trading companies were active. During this period, Eritrea also became a successful exporting nation. At the time of the Second World War, when imports from Europe to the East African markets were disrupted, Eritrean industries stepped in to supply these markets (Eritrea: option and strategy for growth, 1996). From the 1950s, the economy entered into a phase of long-term decline. In 1974, when the military regime in Ethiopia adopted a command economy, most private sector assets including land, housing and industries in Eritrea were nationalized.

Even though Eritrea was one of the most industrialized African countries in the 1950s, successive colonial rule and neglect, the thirty years protracted war of liberation and periodic droughts have resulted in a severe destruction of the infrastructure, development institutions and productive capacity. Consequently, at the time of liberation, a devastated infrastructure, weak institutions, and limited and technologically backward sectors characterized the economy (International Monetary Fund, 1998: 4).

Given all these misfortunes, Eritrea had to initiate its development efforts from scratch with meagre domestic resources and little external assistance. In spite of all the development endeavours, moving the economy towards its optimal growth path will still be a challenging task. There are still major bottlenecks that must be dealt with, which hinder the flow of domestic (private) and foreign investment and jeopardize development efforts. Among these obstructions, the most crucial ones, according to the Government of Eritrea (1998:8), are:

- Shortage of adequate and productive human capital (this problem will be solved soon with the completion of the Human Resource Development program, which has been training 600 postgraduate students in various fields since 2001, in several South African Universities);
- The financial and foreign exchange gap;
- Inadequate physical and social infrastructure;
- Lack of institutional capacity and social capital and information; and Technological constraints.

Moreover, the damage to Eritrea's economy caused by the two year large-scale border-war with Ethiopia (1998-2000) has been immense. It has drained enormous financial and human resources, which could otherwise have been used for productive purposes. Moreover, it also halted all development activities and projects and investment initiatives from all sources, especially foreign direct investment. It has almost undone all the economic achievements of the first five years since independence. Worse of all; it left the country with a heavy burden of demobilizing and reintegrating the huge army into the economy. Alleviating all of these constraints will enable the economy to grow at a faster rate towards realizing its full potential.

Eritrea is a low-income African country, with a small open economy (see table 3.1, p.65 for the economic overview). The economy of Eritrea is largely based on subsistence agriculture, with 80% of the population involved in farming. Industrialization is still in its infancy. Although there is potential to extract petroleum from the Red Sea, the economic viability of these reserves has yet to be firmly established. Fish is, so far, one of the richest known natural resources, and the country's coastal waters are believed to be among the most potentially productive fishing grounds in the Red Sea (Eritrea: option and strategy for growth, 1996).

Despite a war that has brought foreign investment to a standstill, the International Monetary Fund (2001) predicts that Eritrea's economy will grow at a far better pace than most other African countries. Economists say Eritrea has virtually no government corruption or crime. Emmanuel Ablo (2001), the World Bank's representative in Eritrea, states "unlike other countries in Africa, no one in this government is using the war for personal profit. This is a unique phenomenon". John Weakliam (2001) states that Eritreans abroad are sending their money home – about 400 million dollar a year _ making this the country's main source of foreign investment. It is an infusion of cash that experts say has made Eritrea self-reliant and kept Africa's youngest country going when much of its business has ground to a halt because of people being sent off to the warfront.

The Eritrean Government is currently engaged in creating a modern, technologically advanced and internationally competitive economy where private enterprises are the driving economic force. Besides, it has been committed to a free market economic system and has announced plans to reduce its holdings in some 40 public enterprises (African Market Research, 2001). It has established an agency with the objective of the orderly transfer of ownership and management of the public enterprises from the Government to the private sector.

In the long term, Eritrea may benefit from the development of offshore oil, offshore fishing, and tourism. Moreover, Eritrea's economic future depends on its ability to master fundamental social and economic problems, for example by reducing illiteracy, promoting job creation, expanding technical training, attracting investment, and streamlining the bureaucracy (Geography IQ, 2003).

Table 3.1: General information and Economic overview of Eritrea (CIA world fact book, 2003)

1.	Population	4,362,254 (July 2003 est.)
2	Area	121,320 sq km
3.	Currency	Nakfa
4.	GDP (ppp)	$3.3 billion (2002 est.) based on purchasing power parity
5	GDP real growth rate	7% (2001 est.) and 2% (2002 est.)
6.	GDP by sector	Agriculture 17%, Industry 29% and services 54% (2001 est.)
5.	GDP – Per capita	$740 (2002 est.) based on purchasing power parity
6.	Industries	Food processing, beverages, clothing and textiles
7.	Agriculture	Sorghum, lentils, vegetables, corn, cotton, tobacco, coffee, sisal; livestock; goats; fish
8.	Financial institutions	Banks and Insurance
8.	Resources	Gold, potash, zinc, copper, salt, possibly oil and natural gas
9.	Exports and Imports	$34.8 million and $470.5 million respectively (2000)
10.	Debt external	$311 million (2000 est.)
11.	Inflation rate	15% (2001est.)
12.	HIV/AIDS - adult prevalence rate	2.8% (2001 est.)
13.	Communications	Telephone main line and cellular, radio, TV, postal and Internet services.
14.	Languages	-National languages are Tigrinya and Arabic (there are nine languages in Eritrea). -Medium of instruction at schools and university is English

3.2.2 Environmental issues

According to the World Bank Report (Eritrea: option and strategy for growth, 1996), the sustainable utilization of the natural resource base and the protection and conservation of the environment are central to Eritrea's future development. At present, the main environmental issues of concern relate to the degradation of its land, forest and water resources. Pressures on the urban environment in the form of overcrowding, poor sanitation and inadequate water supply are already being felt in Eritrea's main cities and towns. Other environmental problems such as industrial pollution and the degradation of the coastal areas and marine resources are not significant (Eritrea: option and strategy for growth, 1996).

3.2.3 Social issues

Eritrea has inherited an egalitarian system, with most of its people owning some asset or a plot of land. A major strength of the society is its well-developed family and community solidarity which have played an important role in mitigating the consequence of war and droughts. According to the World Bank Report (Eritrea: option and strategy for growth, 1996), the following would be needed to ensure that the poor participate in the growth process:

(a) Well functioning factor markets, particularly labour markets, are crucial in helping the poor to benefit from the growth process. In the past, because of restrictive labour policies, the labour markets, both rural and urban, were characterized by reduced labour mobility, and skill shortages coexisting with high unemployment. The recent reforms by the Government have helped to provide a more enabling environment for labour. Reducing the distortions and rigidities in labour markets is the most efficient means for increasing the poor's productive assets.

(b) A broad-based pattern of public expenditure in basic education, health, and nutrition would be important in ensuring that the poor both contribute to and benefit from growth.

(c) The Government has created the framework for the removal of traditional economic and social constraints on women. This includes: re-education, provision of incentives and to widen economic opportunities for women.

(d) Finally, economic progress in Eritrea will be set against the background of a major effort to reintegrate tens of thousands of returning refugees from Sudan and other countries. This will require continued support from community services. These efforts will go hand in hand with programs to reintegrate thousands of ex-fighters into productive activities in civil society.

3.2.4 Political System

After independence from Ethiopia on 24 May 1993, the new government of Eritrea faced formidable challenges. Beginning with no constitution, no judicial system, and an education system in disarray, it has been forced to build the institutions of government from scratch. A new constitution was promulgated in 1997. The present government includes legislative, executive, and judicial bodies (Geography IQ, 2003).

For the first decade of Eritrea's existence, the government was a synthesis of the national liberation movement, the EPLF, and newly elected or appointed officials from the general population. During the transition to constitutional government, the National Assembly was composed of the elected central council of People's Front for Democracy and Justice (PFDJ) and representatives elected by the six regional assemblies and the Diaspora (Ministry of Information, 2002:57). At present the National Assembly is the highest legal power in the government. The legislature sets the internal and external policies of the government, regulates implementation of those policies, approves the budget, and elects the president of the country (Geography IQ, 2003). The president, Isayas Afwerki, was elected by this Assembly. The president selects members of the cabinet and the six Regional Governors, subject to approval by the national Assembly. The president also appoints the Auditor-General, the Governor of the National Bank, Justices of the Supreme Court, and other commissioners, judges, ambassadors and officials as needed, also with the approval of the National Assembly. The cabinet is the country's executive branch. It is composed of 17 ministries and chaired by the president. It implements policies, regulations, and laws and is accountable to the National Assembly (Ministry of Information, 2002:57-58).

The judiciary operates independently of both legislative and executive bodies, with a court system that extends from each village through district, provincial, and national levels (Geography IQ, 2003).

After widespread public consultation, a new law was passed in 2002 that defined the procedures for elections and established a commission to organize them. The first national elections were held within the framework defined by the Constitution. This marked the end of the post liberation transition (Ministry of Information, 2002:57).

3.3 Accounting education in Eritrea

According to Perera (1980), accounting practice is largely a product of the education and training given to accountants. Accounting education in Eritrea starts at the comprehensive secondary schools and vocational schools which expose students to the elementary concepts of bookkeeping. Training accountants has also been effective since the end of the 1960's under the ambit of the established Department of Accounting in the University of Asmara with an increased demand and supply from year to year due to the emergence of governmental ministries, public firms and private companies that required accountants who can process information to facilitate decision making. The Department of Accounting has offered a Bachelor's degree in accounting since 1969. Moreover, the department offers a diploma program in accounting (Haile, 1987:172-174). In addition to the University of Asmara, the Business College, which was established by the Ministry of Education in 1997, also offers a diploma program in accounting and banking.

In the University of Asmara, Department of Accounting, American textbooks are used and, according to Haile (1987:184), the syllabus is similar to some colleges of the USA. The department offers a four-year degree program. During the first year students take only common (general) courses, and the department offers accounting courses starting from the second year.

Given that many Eritrean students have been training in several South African universities for postgraduate studies, it is important to compare the accounting program of the University of Asmara (Eritrea) with South African universities in order to improve the accounting education in Eritrea. If we compare the program of the Department of Accounting of the University of Asmara with the professional syllabus of South Africa, the focus of the Asmara University seems to be on general business rather than on the profession of accountancy. It can be concluded that accounting students in Eritrea are over loaded with many common and minor courses which are not related to accounting. Although this has some advantage if students want to do their postgraduate studies in other fields, such as management and economics, it also hinders specialization leading the graduates to end up as "Jacks of all trades and masters of none "(Haile, 1987).

Another problem in accounting education in Eritrea is that there is no taxation course. With regard to the contents of the accounting courses it is almost the same as South African universities, except in some courses. For example, in South Africa Universities, in financial accounting, the focus is on different disclosure requirements, group statements and deferred tax. This is not the case at the University of Asmara. This may be due to the difference in the level of the economic development of the two countries. So far 62 Eritreans are training for postgraduate studies in accounting in different universities of South Africa and this can help in the future to improve financial reporting in Eritrea.

In South Africa, once the students finish their studies at the university, they are required to complete a further six month specialization course and take two professional examinations, while doing traineeship for three years to gain experience of practical accounting and finally becoming Chartered accountants. In Eritrea, in 1997, a Committee was established with the objective of establishing the Eritrean Institute of Certified Public Accountants (EICPA). So far the institution has not yet been established (refer to 3.4.4 Accountancy profession in Eritrea p.75). Therefore, once the students finish their B.A degree, they become accountants in different industries. Even though a limited number of students have attempted to take the ACCA examinations via correspondence, overall it has been unsuccessful. To conclude, the above mentioned problems in accounting education in Eritrea may contribute to the lack of financial knowledge of the auditors as well as the public in general (see chapter one - 1.2 Statement of Problem p.2). Moreover, the accountancy profession should consider the relevance of good financial reporting for investors, especially foreign investors, lenders as well as donors.

And this can be achieved mainly by producing professional qualified accountants.

3.4 The Eritrean Institutional framework

3.4.1 The state

In Eritrea the state plays a vital role in the economy. With no significant private sector, the State took several initiatives and invested in strategic sectors in order to accelerate economic recovery and long-term growth. The government has formulated and implemented policies and strategies that promote an outward oriented, private sector led market economy (Macro Policy 1994). Actions have been taken to rehabilitate, upgrade and expand social and economic infrastructures, improve the capacity of government and development institutions and restore the productive capacity of the economy in all sectors (Ministry of Finance, 2000:1).

The social market economy in Eritrea is both 'social' and 'market', which is similar to Germany (see Flower and Ebbers, 2002:161). As Flower and Ebbers (2002:161) state, it is 'social' because it is managed for the benefit of the society as a whole and not of any privileged group. It is 'market' because the economy is based on the principles of free enterprise and not on state direction.

In the field of accountancy, the government has already drafted several laws (see 3.4.4 Accountancy profession in Eritrea p.75).

3.4.1.1 Public sector

Accounting for the public sector in Eritrea is different for Ministries (governmental agencies which depend on governmental budget) and government owned public enterprises. The Ministries report on a standard reporting form prepared by the Ministry of Finance. Annual budget single entry recording is in use. The cash basis of accounting is the most common method used by the public sector in many countries in the world. However, the reform of the public accounting system to the accrual basis of accounting is now an international trend. Countries are now recognizing that there is a need for financially viable reporting, and independence (and globalization) of the public sector standard-setters (Adams, 2003). As a result, the IFAC has issued International Pubic Sector Accounting Standards (IPSAS). To date 20 IPSASs using the accrual basis have been issued and only one financial reporting standard on the cash basis of accounting has been released (see IFAC, 2002). It is crucial also for Eritrea to follow the accrual basis of accounting in order to assure the disclosure of information and the transparency of its affairs. Based on an interview with the auditor general of Eritrea (Ato Birhane Habtemariam, January 2004), it is evident that eventually Eritrea will also move to the accrual basis of accounting to account for Ministries (see above) depending on capacity and resources.

The objectives of accounting in the public sector (Ministries) in Eritrea are to:

-Provide a summary of revenue and expenditures;
-Enable detailed comparisons of spending to be made with the budget;
-Allow the identification of spending to ensure compliance with the law and other legal authorities (Parliamentary approvals); and
-Provide the basis for the next budget.

Eritrea follows an audit approach which focuses on legal compliance rather than fair presentation. The auditors of the public sector in Eritrea report to the Government.

Government owned enterprises, such as Telecommunications, Water, Electricity and Postal services, housing and commercial banks and other manufacturing enterprises have their own autonomy (law and guidance). Their accounting system is based on the accrual basis which is similar to the private sector. Hence, they prepare their financial statements in accordance with International Accounting Standards. Auditing is also the same as for the private sector, which is based on International Standards on auditing.

3.4.2 Companies Act in Eritrea

Eritrea, a young and small nation, is in the process of developing its Commercial Laws and Codes. The Commercial Code 1960, inherited from the Ethiopians, was adopted as the Commercial Code of Eritrea for the transitional period until it can be replaced by the Eritrean Code. This Code is still in force. It requires auditors to audit the books of a company to verify the correctness and accuracy of the balance sheets and profit and loss accounts. The Government has been preparing the various laws following the ratification of the Constitution in 1997. The Commercial Code was one of the first laws to have been completed, but has not yet been enacted by the National Assembly. There is no Code for Corporate Governance and Principles in Eritrea at present.

3.4.3 Taxation[2]

Like many other countries, the main reason for the government's interest in financial reporting in Eritrea is taxation. The government imposes different types of taxes. To facilitate the collection of income

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[2] The information is obtained from Tsehaye Ghebrezgiabher (June 2003). The method of

tax, tax payers are classified into three categories. Category 'A' includes any incorporated company based on shares with limited liability and any person having an annual gross income exceeding Nakfa[3] 350,000. Category 'B' includes any person having an annual gross income greater than Nakfa 100,000 but less than Nakfa 350,000 and any person engaged in a professional or vocational occupation whose annual gross income is greater than Nakfa 18,000. Category 'C' includes any person having a gross income up to Nakfa 100,000, and any person engaged in a professional or vocational occupation whose annual gross income is up to Nakfa 18,000. The tax law requires that all companies classified in category 'A' and 'B' must keep books of account and records in such a way as to be able to submit to the Inland Revenue Department (IRD), at the end of the year, a balance sheet and profit and loss statement with necessary disclosure and specifications within four months from the end of the annual accounting period for which the tax is due. Persons under category 'C' are not required to maintain accounting records. A presumptive tax system, where tax payers pay a specified amount of tax for a specific period of time based on assessment made by the tax inspection unit, is used to determine the amount of tax to be paid.

The following paragraphs set out the accounting methods, with respect to inventory valuation and depreciation, which are used for tax purposes by the IRD:

1. FIFO and Moving Average cost methods are allowed by IRD as inventory valuation methods.
2. The IRD allows the straight-line method of depreciation. There are four rates currently applied to calculate depreciation expenses:

Income tax collection in Eritrea.

[3] Local currency in Eritrea

Buildings 5%, Machinery- for the first year 16% and 12% thereafter, Furniture 10% and motor vehicles and computers 20%.

In Eritrea, financial statements are prepared based on IFAC standards. Most companies use the above two accounting methods, which are allowed also under IFAC standards, in financial reporting as it saves them the cost of preparing two separate sets of financial statements for tax and financial reporting purposes. Moreover, it simplifies the accounting reporting process as there is no need to provide for deferred taxation, especially in respect of depreciation. To determine the tax liability for companies, the appropriate rate should be applied to taxable income, which is Gross income less exempted income and all allowable tax deductions set out in the income tax law of Eritrea. The income tax rate for incorporated bodies is imposed at a flat rate of 30%. According to the Inland Revenue Department (2002) this rate is an internationally accepted rate. Over-all, it can be concluded that taxation influences the financial reporting system in Eritrea.

3.4.4 Accountancy Profession in Eritrea

In 1997 a committee was set up with the objective of preparing draft documents for the formation of a professional institute to manage the accounting profession and to develop accounting, auditing and financial reporting standards in Eritrea. The drafts were circulated and comments were obtained from individuals/organizations deemed to be interested and capable of presenting constructive comments. These drafts include the public accountants proclamation, bylaws of the Eritrean Institute of Certified Accountants and a list of adopted International standards of codes of ethics, accounting standards and auditing standards. But the laws have not yet been enacted by the National Assembly.

Eritrea has adopted International Accounting Standards. However, some standards are not applicable in Eritrea at present due to differences in legislation related to the standards. For example, the existing Eritrean tax law does not accommodate deferral of taxes and, as a result, accounting for taxes on income (IAS 12) is not applicable in Eritrea.

3.4.4.1 Financial reporting and financing system in Eritrea

In Eritrea there has been no tradition of financial reporting to the public as all business enterprises were owned by the government before its independence from Ethiopia. After independence, the government privatized the majority of business enterprises, and some companies are offering their shares to the public in order to raise capital. The commercial code of Eritrea requires financial statements to give a true and fair view of the financial position, performance and cash flows. Financial statements are produced once a year and consist of a Balance sheet, Income statement, Cash flow statement and Statement of changes in owner's equity. Companies are not required to prepare interim financial statements. The users of financial statements are, among others, investors, creditors (mainly bankers), government, and non-profit organizations.

In Eritrea there is no stock exchange market at present and it will take some time before the advantages of putting savings into shares and stocks will be fully realized. Most companies depend on banks, financial institutions and the state as a source of finance.

The participation of local investors in corporate business is limited to a small percentage of the total population. Most of the shares in companies are owned by the Eritrean Democracy Front (EDF), which is the ruling party in Eritrea at present and, in most cases, responsible managerial positions are held by ex-fighters, who do not have a good background in finance. Under such conditions the managers tend to believe that they need minimal accounting information. Therefore, during the past ten years there has been little incentive for the development of a system of extensive financial reporting. However, the recent failure of some companies to pay their debts to banks and their subsequent insolvency (e.g. Falcon Co., 2003) has lead to a change in the perception of the public with respect to the importance of extensive financial reporting and the need for an audit.

It can be concluded that at present the adequacy of financial information provided by existing accounting systems for any useful purpose is very much in doubt. But, with the emergence of many public companies, which are local and international companies, and the increasing public awareness of the benefit of investing in shares, it is expected that companies will publish their financial statements to the public and that financial reporting in Eritrea will improve over time.

3.4.4.2 History and development of auditing in Eritrea[4]

Before independence

Although there is no information on how the auditing profession was operating before the association of Ethiopia with Eritrea, Eritrea's

[4] The information is obtained from previous researches in auditing related topics in Eritrea and Ato Birhane Habtematriam, the Auditor General of Eritrea at present (2003).

supreme audit institution was established during the Italian colonization in 1930's. The profession developed after the British drove out the Italians and occupied Eritrea in 1941.

In the 1960's when Ethiopia forcefully annexed Eritrea, there were few audit firms (4) operating in Ethiopia. According to Birhane Habtemariam (Auditor General of Eritrea) two international firms, PriceWaterhouseCoopers and Manjudd, dominated the market and there were also only two local firms which competed with them. There was no separate law that governed the profession at that time.

An association known as the Ethiopian Professional Association of Accountants and Auditors was formed in 1972 and still exists, but it was not given any power or authority to regulate the profession and it did not play any major role in the profession. The Commercial Code of 1960 (Ethiopia) has provisions for companies to be audited. The same Code also has provisions on the appointment, nomination, term of appointment, remuneration, duties and powers ... etc of company auditors.

When the military regime of Ethiopia, the Dergue, came to power it nationalized practically the whole economy and the international audit firms had to close their Eritrean offices sometime in 1977/78. The government established the Audit Services Corporation (ASC) to audit all nationalized public enterprises. At the same time it issued a proclamation (legal document) that mandated the Office of the Auditor General of Ethiopia to issue certificates of competence to those who want to practice as auditors and provide accounting services, thus providing for some regulation of the profession. In addition to the

ASC, some local audit firms continued to audit. These firms audited small business organizations.

After Independence

After the liberation of Eritrea in 1991 from Ethiopia, the government of Eritrea decided to sell and privatize so called "Public enterprises", which had been nationalized and weakened by Ethiopia, in order to salvage whatever value remained and make them viable.

Legal Notice No. 15/1993 *Regulations to Issue Certificates of Professional Competence to Private Auditors and Accountants* was issued in November 1993. With this legal document, the Office of the Auditor General was mandated to issue such Certificates of Professional Competence, thus regulating the practise of accountants. A committee accountable to the office of Auditor General was established to make recommendations, after having made due verification, on the issuance of certificates of competence to those who apply to practise as private auditors and accountants, as well as on the renewal, suspension and cancellation of such certificates. Since then, five local audit firms have been established and are providing services to the public. There is also the Audit Services Corporation (Eritrea) which is government owned and which audits government owned enterprises. It was inherited from the Ethiopians.

In Eritrea, practising auditors are advised by the auditor general, which is the regulatory authority at present, to follow International Standards in Auditing (IAS) issued by the International Federation of Accountants (IFAC), as applicable to the situation. The researcher supports the adoption of IFAC standards as they are high quality global standards and recognize the need for a global harmonized framework to meet the increasing international demands that are placed on the accountancy profession.

3.5 Auditor's duties

As previously discussed in chapter one, the main objective of this research project is to investigate the audit expectation gap in Eritrea, with the main focus on the auditor's duties and responsibilities (see chapter one _ 1.2 Statement of Problem p.2, and chapter two _ Literature review). Therefore, it is important to identify the existing duties of an auditor in Eritrea and the other duties of an auditor, suggested by researchers and professional bodies, which will be included in this study. The selection was made based on the factors related to the problem of the audit expectation gap in Eritrea (see chapter one – 1.2 Statement of Problem), and on the factors which contributed to the expectation gap in other studies (see chapter two – 2.3 Summary of Previous Researches p.41). With respect to the existing duties of an auditor in Eritrea, the source and the studies in which the duties were included are presented in table 3.3 for purposes of comparison. With regard to the suggested duties of an auditor, the sources of the duties are presented below (see also table 3.4 p.83). These duties are discussed in detail in the next two chapters.

3.5.1 Existing duties

Eleven existing duties of an auditor in Eritrea were identified from the provisional commercial code of Eritrea (legal requirements) and IFAC standards. These are presented in table 3.3 (including the studies in which they are included).

3.5.1.1 Legal requirements

The auditor's duties as stipulated in the Commercial Code of Eritrea[5] (1960) and other Eritrean auditing acts were used to identify the legal requirements of auditors in Eritrea. Table 3.3 shows (under the Eritrean code column) the primary duties of an auditor, according to the Commercial Code of Eritrea (English version), which are relevant for the purpose of this study.

3.5.1.2 Generally Accepted Auditing Practice – IFAC standards

Eritrea adopts International auditing standards issued by the International Federation of Accountants (IFAC). Therefore, IFAC standards were used to identify the existing duties of an auditor in Eritrea. Certain of the existing duties were investigated in the Viitanen and Troberg study (1999), as Finland adopts IFAC standards, and also by Porter (1993) and Humphrey *et al.* (1993). Table 3.3 shows the existing duties of an auditor according to IFAC standards (under the IFAC standard column), which are related to the factors which contribute to the audit expectation gap that will be examined in this research project.

[5] The Commercial Code of Ethiopia (1960), which is adopted by Eritrea as the provisional code of Eritrea.

Table 3.3 Existing duties of an auditor in Eritrea (the source of the duty and/or the study in which it is included

Duty No.[1]	Duties (questions)	IFAC standards	Eritrean Code/ auditing Act	Humphery *et al.* (1993)	Porter (1993)	Viita ar Trot (19
	<u>*Existing duties of an auditor –legal requirements*</u>					
5.	*Report all material departures from Generally Accepted Accounting practice in preparing and presenting financial statements to give a true and fair view (Commercial Act 1984-1985).*		√[2]			√
9.	*Audit the accounts of the company to verify the correctness and accuracy of the balance sheets and profit and loss accounts (Commercial Code: Art. 373).*		√			
10.	*Submit to the annual general meeting a written report on the manner in which they have carried out their duties and their comments on the report to the board of directors (Commercial Code: Art. 375 a).*		√			
16.	*Recommend approval of the accounts and make such comments thereon as they think fit or refuse to recommend approval giving reasons for referring the matter back to the directors (Commercial Code: Art. 375:b).*		√			
23.	*Where the auditors find breaches of legal or statutory requirements, they shall inform the directors and, where grave irregularities or breaches have occurred, they shall inform the general meeting (Commercial Code: Art. 376).*		√			
	<u>*Existing duties of an auditor –IFAC standards*</u>					
2.	*Examine and report whether the company's continued existence is in doubt (ISA 570).*	√		√	√	√
18.	*Examine and report whether the non-financial information presented in the financial statements is correct (reliable) (ISA 1010).*	√			√	√
19.	*Acquaint himself/herself with other information included in the annual report, such as management discussion and analysis, in order to determine whether material errors (inconsistencies) exist which need to be amended or reported on in the auditor's report (ISA 720).*	√				√
14.	*Examine whether the audited company has a satisfactory system of internal control (ISA 401).*	√		√	√	√
4.	*Examine and report whether the audited financial statements contain any material errors or distortions (ISA 240).*	√		√	√	√
20a.	*The auditor should examine and report on the conduct of the company with regard to environmental matters (IAS 1010).*	√				

[1] The number assigned to the duties is based on the order in whichthey are set out.in the questionnaire.
[2] √ = the source of the duty and/or the studies in which it is also included.

3.5.2 Suggested duties

In this section, different issues that always have been heavily debated in auditing are included. Most of the enquiries set by various researchers, including: Porter (1993), Humphrey *et. al (*1993), and Viitanen and Troberg (1999), were used. Table 3.4 shows the suggested auditors' duties which are examined in this study, including the source of the suggested duties.

Table 3.4 Suggested duties of an auditor (the studies in which it is included)

Duty No.[1]	Duties (questions)	Humphrey *et al.* (1993)	Porter (1993)	Viitanen and Troberg (1999)
	Suggested duties of an auditor			
1.	*Detect material fraud committed in the audited company.*	√		√
3.	*Report breaches of tax laws to the Inland Revenue Department.*		√	√
6.	*Report to an appropriate authority fraud committed in the audited company.*	√	√	√
7.	*Report to regulatory authority deliberate distortion of financial information.*	√	√	√
8.	*Report to an appropriate authority theft or misappropriation of corporate assets by company:*		√	√
	a) Directors/ senior management		√	√
	b) Non-managerial employees		√	√
11.	*Examine and report on the efficiency and effectiveness of the company's management.*	√	√	√
12.	*Prepare the auditee company's financial statements.*		√	√
13.	*Verify every transaction of the audited company.*		√	√
15.	*Guarantee the audited financial statements are accurate.*		√	
17.	*Report on the future prospects of the company.*	√	√	√
20b.	*The auditors should examine and report on the conduct of the company with regard to societal matters.*		√	√
21.	*Take responsibility for planning the internal control system of the company.*			√
22.	*Detect illegal acts by the company officials which don't directly affect the company's accounts.*		√	

[1] The number assigned to the duties is based on the order in which they are set out in the questionnaire.
[2] √ = the studies in which it is included.

The reason for using similar enquiries in this research is that most of the empirical investigations undertaken by researchers in developing countries and/or countries which adopt ISA, such as South Africa, Finland and Singapore, used the questions developed by Porter (1993), Humphrey et. al (1993) and Viitanen and Troberg (1999). This helps, as previously stated, to guarantee the comparison of the results of the empirical investigation in Eritrea with the results of other developing and/or countries which adopt ISA's standards.

3.6 Summary

Accounting and auditing are influenced by varied factors which generally could be said to emanate from political and economic conditions, environmental and social issues, and accounting theories. Eritrea, a new nation in the horn of Africa, is a low-income country, with a small open economy. The government is currently engaged in creating a modern, technologically advanced and internationally competitive economy in which the private enterprises are the driving economic force. The main environmental concern is related to the degradation of its land, forest and water resources. Moreover, social problems such as high unemployment and lack of educational facilities exist in Eritrea.

Within any social/political environment, accounting has a unique role to play. This depends largely on the ability of an accountant to cope with changing circumstances. According to Perera (1980), in the absence of extensive financial reporting, such as countries like Eritrea, the ability to adapt to a changing environment depends largely on the education and training given to accountants. However, the existing accounting education and training in Eritrea is not adequate. Moreover, financial reporting is highly influenced by the socialist economic system (see 3.4.4.1 financial reporting in Eritrea p.76), which is characterized by less disclosure. But now, due to a move to an open market economy, it is expected that the financial reporting system will improve over time. Most companies in Eritrea depend on banks and/or the state to raise capital. At present there is no stock exchange.

After the liberation of Eritrea from Ethiopia in 1991, new private audit firms have been established and are providing services to the public. Eritrea adopts International Accounting and Auditing Standards. The Commercial Code of Eritrea requires auditors to audit the books of the company to verify the correctness and accuracy of the balance sheets and profit and loss accounts.

The auditing function is the ultimate manifestation of accounting and provides an extremely important service to society. That is, it is considered that management can not report on itself without being biased intentionally or unintentionally. Credibility of the financial information will therefore be enhanced and use of the financial information will be amenable when the information is attested by an independent party, one who is not only independent as a matter of fact, but also one who should appear to be independent (Draft of the accounting profession 1997) . Therefore, there is a need to study whether there is an expectation gap in Eritrea and, if so, to determine the factors contributing to the gap (see 1.2 Statement of Problem in chapter one) in order to minimize the difference between what the public and the auditor perceive to be the role of the auditing function. The minimization of the expectation gap between these two views increases the credibility and the confidence which the public will have in the auditing and accounting profession – an assured way to assist proper functioning of a market economy which depends heavily on financial reporting prepared or authenticated by the professional accountant. In the following three chapters the audit expectation gap in Eritrea will be examined. The next chapter will focus on the methodology of the research, which will be used to analyse the audit expectation gap in Eritrea.

Chapter four – Research project

4.1 Research objective

As already discussed in chapter one, the objective of this research project is to investigate the existence of the audit expectation gap in Eritrea, to analyze its constituent parts and identify the factors which contribute to the gap, to compare the findings to the research findings of various countries and finally to recommend possible solutions to narrow the gap in Eritrea (see research objective and methods – Figure 4.1 p.94).

4.2 Research methodology, data collection and analysis

4.2.1 Survey questions

The enquiry (questionnaire) set up by Porter (1993) and Humphrey *et. al* (1993) served as a model for similar enquires in other countries. The researchers who opted for a similar approach, among others, include: Garcia-Benua *et. al* (1993) in Spain, Gloeck and De Jager (1993) in South Africa, Beelde *et al* (1997) in Belgium, Best *et. al* (1996) in Singapore and Troberg and Viitanen (1999) in Finland. The Porter (1993) and Humphrey et al (1993) studies also served as the basis of a U.S. study by Gramling *et. al* (1996). Therefore, this research project follows similar procedures, although some of these had to be adapted to the Eritrean situation due to differences in business practices and company law, to assist in providing a reliable assessment of the audit expectation gap in Eritrea and to permit comparison with the results of other countries (see chapter three – 3.5 Auditor's duties). Moreover, recent developments in International Auditing Standards were considered.

The questions were developed based on the IFAC (International Federation of Accountants) standards, existing legal requirements for auditors in Eritrea, and previous research by Porter (1993), Humphrey *et. al* (1993) and Viitanen and Troberg (1999). A total of 34 questions were developed. Of these, 25 relate to auditors' duties (see chapter three – 3.5), and 9 relate to the provision of non-audit services (audit independence), auditors-client relationship, audit quality, audit regulations, audit communication and decision usefulness of an audit report (see part two of the questionnaire – Appendix 6 p.191). As discussed in chapter three, the questions were selected based on the factors which are related to the problem of the audit expectation gap in Eritrea (see chapter one – 1.2 Statement of problem), and on the factors which contributed to the expectation gap in other studies (see chapter two – 2.6.7 Summary of previous researches). The survey of the audit expectation gap in Eritrea, as shown in the questionnaire (Appendix 6) has two parts. These are discussed below.

Part I

Part I of the questionnaire is related to the auditor's duties. It consists of 11 existing and 14 suggested auditors' duties (see tables 3.3 and 3.5 in chapter three). This method is consistent with prior researches (see Porter (1993) and Vittanen and Troberg (1999)). These duties are discussed in detail in the next chapter. Each question (duty) has three sections:

Section 1- Is the duty an existing duty of auditors? For the purposes of this test the options 'yes' (+1), 'no' (-1) and 'unaware' (0) were provided.

Section 2 - If the duty is an existing duty of auditors, how well is it performed? This tends to involve a range rather than a point measurement, hence, the categorical rating was from 'poorly' (1) to excellently (5).

Section 3- Should the duty be performed by auditors? For the purpose of this test the options 'yes' (+1), 'no' (-1) and 'not certain (0) were provided.

Part II

In part two of the questionnaire (see Appendix 6), 9 statements regarding the provision of non-audit services (audit independence), auditors–client relationship, audit quality, audit regulations, audit communication and decision usefulness of an audit report are presented. The questions were identified based on the new IFAC independence standard, the professional code of ethics in Eritrea, and the enquires set by other researchers for the reasons stated earlier (The questions are related to the problems identified in chapter one - 1:2). Respondents were asked to indicate their agreement or disagreement with each statement on a seven-point scale.

In preparing for an interview, a preliminary questionnaire was first pilot tested with 3 auditors (2 audit partners and 1 senior auditor), an auditor general, 2 finance and administration heads familiar with audit work, 1 tax auditor, 1 credit officer and 1 shareholder before a final version was developed. On the basis of the comment received, the questionnaire was revised.

4.2.2 Interviews and sampling

Eritrea has a small economy (refer to chapter three) and the size of the population is small as compared with other countries in which the audit expectation gap was studied. As a result, the size of the sample is also small. Researchers acknowledge that interviewing is time consuming and costly but produces rich data when the size of the sample is small and homogeneous (Breakwel, 1990). According to Breakwell (1990), generalizations based upon a small sample in such cases are likely to be well-founded. Therefore, an interview was the most appropriate instrument for this research project. Qualitative and quantitative methodologies were considered as the topic is more debatable from an analytical point of view. Structured interviews were used as these provide information which is easily quantified and ensures comparability of questions across respondents and among different countries. In addition, unstructured interviews were also used as these allowed the interviewer and interviewee the flexibility to probe for details and discuss issues.

A convenience sampling method (non–probability sampling), which involves choosing the nearest individuals (the most readily available subject) to serve as respondents and continuing the process until the required sample has been obtained (see Fower 1984), was used to select the sample from the population .

4.2.3 Respondents

This research paper has been prepared for financially knowledgeable persons. Therefore, non-financially knowledgeable persons were excluded for the purpose of this study. The population was categorised in three groups due to the limited number of users of financial statements and the nature of companies in Eritrea, as discussed in chapter 3. These were:

1. Auditors. This includes:
    - -Audit Partners
    - -Non–Partner Audit staff

Auditors are included in the survey because the aim is to find out whether there are differences between the views of the public group and the auditors themselves.

2. Management (Auditee). This includes:

-Directors

-Managers

-Financial and administration heads

-Accountants (mainly chief accountants)

-Internal auditors

The financial statements can be regarded as a form of account given by management to shareholders or owners of the company with regard to its financial position and performance. The role of the auditor can be regarded as an additional guarantee regarding the reliability of the data provided. Consequently, it is important to know the auditees' perceptions regarding the role of an auditor.

3. Users of financial statements. This includes:

-Bank loan officers

-Tax inspectors of the Inland Revenue Department

-Shareholders

As the financial statements are an important source of information to users, it is necessary to establish their perceptions regarding auditing.

4. Others

- Auditor general of Eritrea.

The office of the auditor general of Eritrea is a regulatory body at present. Hence, it is important to interview the auditor general to obtain information about the regulation system in Eritrea and the existing auditor's duties in Eritrea.

Table 4.1: response rate

Interest group	Total respondents	Structured Interviews	Unstructured Interview
Auditors	40	32	8
Management (auditee)	31	23	8
Users			
- Bank loan officers	15	13	2
- Tax auditors	10	8	2
- Shareholders	5	-	5
Others			
- Auditor general	1	-	1
Total	102	76	26

All the audit firms in Eritrea, except one, were included in the survey. Of these surveyed, the audit partners and the majority of the senior auditors in the audit firms were included. The second target group was the management (auditee), which includes the directors, managers, finance and administration heads, chief accountants and internal auditors. The survey focused on the large companies which are required to be audited annually by the Commercial Code of Eritrea. The third target group were: commercial bank of Eritrea, the Inland Revenue Department and shareholders. The majority of the credit officers and tax auditors in Asmara (the commercial capital city of Eritrea), were included in the survey. With respect to shareholders, as shown in table 4.1, the response rate was very low. One of the main reasons is that most of the financially knowledgeable shareholders reside in diaspora (outside Eritrea). Therefore, to get more information from less financially knowledgeable shareholders, only unstructured interviews were conducted, with the focus on specific core questions. The auditor general of Eritrea was also interviewed.

As discussed earlier, the sample size was small because of the small size of the population in Eritrea. Overall, generalization of the questionnaire responses to the total population can be made as the majority of the population were included in the survey with the exception of shareholders due to the low response rate as discussed above.

4.2.4 Framework

This research is concerned with the full extent of the audit expectation gap in order to analyse the problem in Eritrea. Thus far no comprehensive research has been conducted in Eritrea. Porter (1993) argued that considering the full extent of the audit expectations gap could only be done by comparing society's expectations of auditors against the perceived performance of auditors. Therefore, the objective of this research project is consistent with the Porter (1993) view of the audit expectation-performance gap and, in analyzing the gap into its constituent parts, the Porter framework was used. That is, the three constituent parts of the audit expectation-performance gap that were analyzed are, the "reasonableness gap" (unreasonable expectation) and "performance gap", which is sub-divided into "deficient performance" and "deficient standards". Hence, *part I* of the questionnaire, which is related to auditor's duties, was analyzed using the Porter framework. The Porter framework is discussed in detail in chapter 2 (2.1 Definition and structure of audit expectations gap).

There are many factors, which contribute to the audit expectation gap, as already mentioned in chapter two (Literature review). Although Porter's framework (1993) has provided new insights into the structure, composition and extent of the audit expectation-performance gap, recent issues such as the provision of non–audit services to client companies were not considered. Moreover, factors which are related to specific problems in Eritrea (see chapter one) will be considered in this section. Therefore, in *part II* of the questionnaire, a series of questions, designed to elicit opinions, similar to those used in opinion surveys in other environments, such as South Africa, the UK, Singapore, US, Belgium and Singapore (which are related to specific problems in Eritrea) will be used to enable analysis of the issues which fall outside the Porter framework. Figure 4.1 illustrates the research objective and the tools used to achieve each of them.

Figure 4.1: Research objectives and methods

Chapter four, five and six

- ***Research Methods***
  - Mainly structured interviews (quantitative analysis)
  - Unstructured Interview (qualitative analysis)
  - Statistical tools and their justifications, data analysis criteria and interpretations.

- ***Porter Framework***
  - a) All duties identified by 25% or more of the public group (or mean response positive) as a duty an auditor should perform are worthy of further consideration to see if they are cost beneficial for auditors to perform and, if so, whether they are existing duties of auditors and, if so, whether the duties are performed to a satisfactory standard (in the opinion of the public group);
  - b) All duties identified in (a) that meet the cost-benefit criteria (cost beneficial for auditors or paid for by a third party such as government) qualify as duties reasonably expected of an auditor. Those that fail to meet the criteria contribute to the **reasonableness gap;**
  - c) Duties that are not existing duties of auditors but are reasonably ex pected by the public group contribute to the **deficient standards gap.**
  - d) All duties that are exisiting duties of audiors that 25% or more of the public group (mean response less than 2.9) signify that the duty performed poorly contribute to the **deficient performance gap.**

- Other factors related to the specific problems in Eritrea, which can not fit into the Porter framework (1993), will be analysed using perception differences among the intrest groups.

Research objectives

a) To investigate the existence of the audit expectation gap in Eritrea

b) To identify the factors which contribute to the audit expectation gap in Eritrea; and to analyse the components of the audit expectation–performance gap.

c) To compare the results with other similar studies.

d). To recommend possible solutions to narrow the audit expectation gap in Eritrea.

Literature review

Chapter two

- Present the definition and structure of the Audit Expectation Gap.
- Identify the factors contributing to the Audit Expectation Gap.
- Review previous research.
- Identify approaches (recommendations) to narrow the gap.

Chapter three

- Review of the Eritrean situation with respect to Accounting, Auditing and their environment.

4.2.5 Data Analysis, criteria and interpretation

The research instruments (methods) used to analyse the data for *part I* and *Part II* of the questionnaire together with their interpretation are presented below:

4.2.5.1 Data analysis, criteria and interpretation (Part I) – Porter framework

As discussed earlier, part one of the questionnaire is related to the auditor's duties (see Appendix 6 p.188). Each question (duty) consists of three sections (see 4.2.1 Survey questions p.87). With respect to *sections one* (is a duty) and *three* (should be a duty), the options 'yes' (+1), 'no' (-1) and 'unaware' (0) were provided. Where the mean of the responses is positive, the group signifies that the particular duty is or should be a duty of an auditor. The opposite applies where the mean of the response is negative. This is supported by an additional test, namely 25 % or more, used to identify duties which are considered by the interest group to be the duties of an auditor. That is, an expectation gap was considered to exist, if at least 25% of an interest group considered a duty that, according to existing regulation, is not a duty of the auditor, to be a duty or that it should be a duty of the auditor. This is discussed in the next page.

With respect to *section two*, auditor's performance of a duty, respondents were asked to select the appropriate response from 'poorly' (below 3), 'adequate' (3), 'excellently' (above 3), and 'can't judge' (0) in an ordinal scale of 1-5. If the mean is less than 3 it was considered as inadequate performance. Therefore, a mean of 2.9 was adopted as a point of differentiation. This is also supported by an additional test that if 25% of an interest group rated the performance of an auditor as poor (below 3), this signifies that a particular duty is performed poorly.

According to Porter (1993), the mean responses of the interest group provide a useful indicator of the assessment of the auditor's performance of duties. However, for purposes of deciding what action is required to remedy perceived deficient performance, an important measure is the proportion of respondents signifying that auditors perform their duties poorly. Porter in her 1993 study selected a cut-off of 20%; whereas Troberg and Viitanen (1999) selected a cut-off of 25%. Troberg and Viitanen (1999:67) argued that if the cut-off point is low it could lead to some duties being unnecessarily classified as contributing to the expectation gap. They added that whilst acknowledging the arbitrary nature of defining what constitutes a "significant portion" of a group, 25% was regarded as constituting a qualified minority, as dissatisfaction on the behalf of a sufficiently large minority may cause the auditor harm. For the same reasons, this researcher regarded 25% as a significant portion.

In analysing the data, statistical tools were used. These are: Binomial test, Kruskal Wallis one-way analysis of variance by ranks (KWA) and the Mann-Whitney test. These statistical tests are discussed below.

A Binomial test was used to determine whether the *majority* of an interest group consider a particular duty to be a duty of an auditor while it is not currently an existing duty; and whether the *majority* of the interest group signify that the duty is performed poorly by an auditor. That is, in order for a question (duty) to be considered to contribute to the expectation gap, a statistically significant ($p \leq .05$)

majority of an interest group, based on the binomial test, has to regard the duty in question to be a duty of the auditor, or, that the duty under consideration should be a duty of the auditor when, in fact, it currently is not one according to the existing regulations. For the purpose of this test, affirmative answers (yes) were considered as +1 and negative (no) as -1. The category "unaware" is considered as 0 and is not included in the test. With respect to auditors' performance, if a duty is an existing duty of an auditor according to prevailing regulation, and respondents considered it to be a duty of an auditor, based on a binomial test, a statistically significant ($p \leq .05$) majority of the group had to rate the performance of the auditor as poor (that is 1 or 2 on ordinal scale 1-5) in order to contribute to the audit expectation gap.

In order to establish whether differences of opinion evident in the responses of the different interest groups were statistically significant, Kruskal Wallis one-way analysis of variance by ranks (KWA) test was used, with a significance level of .05. Where significant differences were found among the three groups, the Mann-Whitney test was run to determine the source of the differences. The Mann-Whitney test was chosen because it tests the differences in the means of two samples (These tests are discussed in detail hereafter).

4.2.5.2 Data analysis and interpretation (Part II)

With respect to *part II* of the questionnaire, interest groups were asked to indicate their agreement or disagreement, on a seven-point scale, with each of the nine statements regarding the provision of non-audit services (audit independence), auditor-client relationship, audit quality, audit regulations, and the audit report (judging from the questions) (see Appendix 6 – part II of the questionnaire p.191).

To test for normality of the distribution, the Kolmogorov-Smirnov test (using Lilliefors probabilities) and Shapiro-Wilks W test were used. These tests indicated that, in the majority of cases, the data were significantly non-normal. In addition, the data were ordinal as opposed to continuous. Therefore, a non-parametric test was used, namely the Kruskal Wallis one-way analysis of variance by ranks (KWA) with significance level of 5%, to determine the mean differences across respondents. According to Siegel and Castellan (1988:206), this test is regarded as particularly powerful for analyzing non-parametric data, which are ordinal as opposed to continuous. Where significant differences were found among the three groups, it may be claimed that an audit expectation gap exists with respect to the statement in question (the reason for including the opinion of an auditor is discussed in chapter six, 6.1). For those statements, which were significant using Kruskal Wallis analysis, the Mann-Whitney test was run to determine the source of the differences. The Mann-Whitney test was chosen because it tests the differences in the means of two samples. Therefore, the differences between auditors and management, and auditors and users were tested. Where significant differences were found between auditors and management and/or auditors and users, it may be claimed that an expectation gap exists.

In the next two chapters the results will be presented. The next chapter deals with the results of part I of the questionnaire, which is related to auditor's duties and was analyzed using the Porter framework. That is, the above duties were classified into three categories, namely 'deficient performance', 'deficient standards' and 'reasonableness gap'. This is discussed in detail in the next chapter. The results of part II of the questionnaire are presented in chapter six.

Chapter five - Results

5.1 Expectations with regard to auditor's duties

5.1.1 Structure of analysis (Part I) – Porter framework

The research results with respect to auditor's duties are presented in terms of audit expectation-performance gap analysis using the Porter framework. That is, in analyzing the expectation gap, mainly the Porter (1993) classification was used. According to Troberg and Viitanen (1999), the classification used by Porter (1993) is not an exact science as there are arguments in favour of and against the classification of some duties into one category or the other. The reasons for classifying a particular duty into one of the three categories are presented and discussed under each category later in this chapter. As discussed in chapter three, 11 existing duties and 14 suggested duties of an auditor were identified. The audit expectation-performance gap was broken down into three categories. These are "deficient performance" "deficient standards" (reasonable expectations), and "reasonableness gap" (unreasonable expectations)..

5.1.2 Analysis of results

As discussed in detail in chapter four, mainly two measures were used to identify the duties which contributed to the audit expectation–performance gap. These were: the mean of the interest group response; and "25% or more criterion" (see chapter four, 4.2.5.1). In Appendix 1 the means of the interest group responses are presented. In Appendix 2 the proportion of the interest group responses signifying the auditor should perform the duty are presented. In Appendix 3 the mean of the interest groups' responses and the proportion of the interest groups, signifying that the duty was performed poorly, are presented.

In analyzing the results, statistical tools were used, namely the binomial test, the Kruskal Wallis one-way analysis of variance by ranks and the Mann-Whitney test (see 4.2.5 _ Chapter four for their interpretations).

From the analysis of Appendices 1, 2 and 3, 19 duties out of 25 existing and suggested duties of an auditor were found to contribute to the audit expectation-performance gap (this is discussed below). These duties (19 duties) were classified into one of the three components of the audit expectations gap. 6 duties were classified as contributing to "deficient performance gap", 5 duties as contributing to "deficient standards gap", and 8 duties as contributing to "reasonableness gap". The reasons for the classification of each duty into one of the three categories are discussed under each category of the audit expectation gap. The duties (6 duties) which did not contribute to the gap were classified as "no expectation gap" and are discussed later in this chapter.

Detailed analyses of the duties which contributed to the expectation gap and those which did not, are presented and discussed under each category of the audit expectation–performance gap below.

5.1.3 Deficient performance gap

"Deficient performance gap" as defined by Porter (1993) is the gap between the expected and perceived standards of performance of auditors' existing duties, as expected and perceived by society (see chapter two _ 2.1 Definition and structure of the audit expectation-performance gap). 11 duties were identified as existing duties of an auditor in Eritrea from the Commercial Code of Eritrea and IFAC standards (IAS) (refer to chapter three). Two measures were used to identify the duties which contribute to "deficient performance gap". These were: the mean of the interest group responses regarding the performance of an auditor's existing duties (if it is less than 2.9); and 25% or more of an interest group signifying that the duty is poorly performed. Based on these measures, from the analysis of Appendix 3, out of 11 existing duties, six duties (duties 4, 2, 18, 10, 14, 16) were identified as contributing to "deficient performance gap". With the exception of duty 18, all duties identified by mean of the interest group responses (whose mean less than 2.9), and by 25% or more of an interest group signifying that the duty was poorly performed by an auditor, are the same. With respect to duty 18, even though the mean of the responses is greater than 2.9, 25% of the users signify that the duty is performed poorly. Hence this duty is also recognized as an element of the "deficient performance gap". The six duties which contribute to the "deficient performance gap" are presented in table 5.1. Table 5.1 shows the assessment of auditor's performance.

The results of the KWA and Mann-Whitney tests, as shown in table 5.1, indicated that there is an opinion difference between auditors and the public group with respect to the auditor's performance. As expected, auditors rated their performance more highly than do the other groups, as their mean responses are higher than the other groups. Appendix 3 and table 5.1 show that the management group is more satisfied with the performance of an auditor's duties than the users group. The mean of their responses to the 11 existing duties of an auditor is more than 2.9, except for duty 2. By way of contrast, the means of users' responses for duties 4, 2, 10, 14, 16 are less than 2.9. Therefore, it can be concluded overall that the most dissatisfied group were users. In table 5.2, the proportion of the users group (bank loan officers and tax auditors) signifying that the duty was performed poorly by an auditor are presented.

The six duties which contribute to "deficient performance gap", as shown in table 5.1 , are discussed below in order of their contribution (duty with the highest contribution first):

The auditor should examine and report whether the audited financial statements contain any material errors or distortions (duty 4). Table 5.1 shows that auditors and management are satisfied (p=.000-.02), but 43% of the users (credit officers 63% and tax auditors 17% - see table 5.2 below) were dissatisfied. Table 5.1 also reveals that the mean response for users is less than 2.9. Therefore, an expectation gap exists with respect to users, especially with bank loan officers as indicated in table 5.2. The dissatisfaction among the bank loan officers can be due to the recent failure of some companies to pay their debt and which later proved to be insolvent (e.g. Falcon Company). This duty (duty 4) is the largest (≈23%) contributor to the "deficient performance gap" as shown in table 5.3. This is an estimate of the relative contribution of each duty to the "deficient performance gap". This has been estimated by reference to the level of unfulfilled expectations attaching to the duty. That is, as shown in the right of table 5.1, it is reflected in the proportion of the public group which signified that an auditor performed the duty poorly and whose expectations with respect to the duty are, therefore, not being fulfilled. According to Porter (1993), even though the mean of responses provides a useful indicator of their overall assessment, for purpose of deciding whether and what action is required to remedy perceived "deficient performance gap", a pertinent measure is the proportion of respondents signifying that, in their opinion, auditors perform their duty poorly.

Table 5.1 Duties contributing to deficient performance gap - Assessment of auditors' performance based on the mean of the interest group responses and the proportion of interest groups signifying auditor's duties are poorly performed.

		Mean			Frequency (%)			
		Section 2 (auditor's performance)[1]			Section 2 Poorly (1-2)			
No.	The auditor should	A[2]	M[2]	U[2]	A[3]	M[3]	U[3]	MU[4]
4.	Examine and report whether the audited financial statements contain any material errors or distortions.	*4.50	*4.20**	*2.80**	3.1	13.3	42.9	**32.0**
2.	Examine and report whether the company's continued existence is in doubt.	*4.70	*2.70**	*2.80**	0.0	28.6	25.0	**30.0**
18.	Examine and report whether the non-financial information presented in the financial statements (annual accounts) is correct (reliable).	*3.90	*4.10	*3.00**	8.0	12.5	25.0	**26.6**
14.	Examine whether the audited company has a satisfactory system of internal control.	*4.50	*3.80**	*2.60**	3.3	5.9	27.3	**19.0**
10.	Submit to the annual general meeting a written report on the manner in which they have carried out their duties and their comments on the report to the board of directors.	*4.60	*4.70	*2.80**	0.0	0.0	36.4	**16.7**
16.	Recommend approval of the accounts and make such comments thereon as they think fit or refuse to recommend approval giving reasons for referring the matter back to the directors.	*4.30	*4.40	*2.40**	5.3	0.0	30.0	**14.3**

[1] mean of auditor's performance on 1-5 ordinal scale (2.9 has been adopted as point of differentiation between satisfactory and unsatisfactory performance).
[2] = A = Auditors, M = Management, U= users (refer chapter 4 for number of responses)
[3] Proportion of the interest group signifying that the duty is performed poorly by an auditor.
[4] Proportions of the identified Public group (excluding auditors) signifying that auditors perform the duty poorly. Quantitative analysis is only made for structured interviews. The responses 'can't judge' was not considered in calculating the proportions.
* Kruskal Wallis one way analysis of variance by ranks significant at $p < .05$
** Mann-Whitney significantly differ from auditors at $p < .05$

Table 5.2: The Proportion of the users group – Bank loan officers and Tax Auditors signifying that the duty is performed poorly by an auditor (section 2).

		Section 2 Poorly (1-2) [1]	
Duty	The auditor should[2]	**BLO**[3]	**TA**[3]
2	Examine and report – going concern.	20.0	33.3
4	Examine and report - material errors or distortions	62.5	16.7
5	Report material departures from Generally Accepted Accounting Practice	22.2	16.7
9	Audit the accounts to verify the correctness and accuracy of the balance sheets and profit and loss accounts.	22.2	16.7
10	Report to the general meeting the manner in which they have carried out their duties and their comments on the report to the board of directors.	40.0	33.3
14	Examine the internal control system.	14.3	50.0
16	Recommend approval of the accounts	42.9	0.0
18	Examine and report non-financial information	14.3	40.0
19	Acquaint himself/herself with other information included in the annual report.	0.0	50.0
20a	Examine and report on Environmental matters	0.0	0.0
23	Inform the directors and the general meeting breach of legal or statutory requirement.	0.0	0.0

[1] Proportion of the interest group signifying that auditors perform the duty poorly. The results are presented only for existing duties of an auditor.

[2] The duties are abbreviated from their expression in the questionnaires.

[3] BLO – Bank loan officers, TA – Tax auditors (refer chapter four for number of respondents). (Shareholders were not included in quantitative analysis as the response rate was very law, and only unstructured interviews were used).

Table 5.3 Deficient performance gap

Duty No.	Response (%)[1]	Contribution (%)[2]
4	32.0	23.09
2	30.0	21.64
18	26.6	19.19
14	19.0	13.71
10	16.7	12.05
16	14.3	10.32
Total	138.6	100.00

[1] Proportion of the public groups whose expectations with respect to the duty are not being fulfilled (refer to table 5. 1).
[2] Relative contributions of duties to "deficient performance gap".
- N.B. It is important to note that the sample size is small, and the ranking of the duties is based on the proportion of respondents signifying that the duty performed poorly by an auditor.

The auditor should examine and report whether the company's continued existence is in doubt (duty 2). As shown in table 5.1, only auditors were clearly satisfied (p=.000) as a group, at a .05 significance level, whereas 28% of management and 25% of users (33% tax auditors – see table 5.2) were dissatisfied. The two groups clearly exceed the 25% threshold criterion of dissatisfaction. Moreover, as shown in table 5.1, the mean of the public group responses is less than 2.9. Thus there exists a "deficient performance gap" with regard to management and users. Calculated in the same way as the above duty (duty 4), table 5.3 shows that this duty is the second largest contributor (≈21.64%) to the "deficient performance gap". The reason for the high dissatisfaction among users is likely to be similar to that in the previous duty (duty 4).

Examine and report whether the non-financial information presented in the financial statements (annual accounts) is correct (reliable) (duty 18). In asking this question neither specifications nor guidelines were provided to the respondents as to the nature and extent of non-financial information. With respect to auditor's performance, table 5.1 shows that auditors and management were satisfied. Among users 25% were dissatisfied, but the mean of the interest group responses is greater than 2.9. Therefore, on the basis of the 25% or more criterion, there is some expectation gap with respect to users and auditor's performance.

The auditor should examine whether the audited company has a satisfactory system of internal control (duty 14). With respect to the auditor's performance, table 5.1 reveals that based on the mean responses, auditors and management were clearly satisfied as their mean is greater than 2.9. On the basis of the 25% threshold test, users (27%) were dissatisfied (their mean responses is also less than 2.9). Among users, as it may be seen from table 5.2, the tax auditors were the most dissatisfied group (50%). Thus an expectation gap exists between the expectations of tax auditors and auditor's performance regarding this duty. This dissatisfaction can be related to the audit of small companies. Research undertaken on the problems of small companies in Eritrea indicates that small companies in Eritrea have very poor internal control systems, which are characterized by an absence of source documents and lack of proper accounting records. For some of the small companies their financial statements, only for tax purposes, are prepared by the authorized accountants and/or auditors (Zeweldi, 2001). Based on the interviews conducted, the majority of the tax auditors have a view that some auditors in Eritrea prepare audited financial statements without proper source documents and accept audit engagements for companies (small and medium) for an audit in an unreasonably short time. Therefore, the dissatisfaction of the tax auditors with regard to this duty can be related to that. However, according to Kibrom (2001), the lack of satisfactory internal control in small companies in Eritrea presents difficulties to auditors and it is one of the major audit problems in small and medium enterprises in Eritrea.

The auditors should submit to the annual general meeting a written report on the manner in which they have carried out their duties and their comments on the report to the board of directors (duty 10). With respect to auditor's performance, as shown in table 5.1, auditors and management (p=.000) were satisfied at a .05 significant level. However, users (37%) were dissatisfied (33% of tax auditors and 40% of bank loan officers - see table 5.2). On the basis of the 25% threshold test, an expectation gap exists with respect to users and auditor's performance regarding this duty (their mean responses are also less than 2.9). On the other hand, an interview conducted with shareholders indicated that they were satisfied with regards to the performance of this duty by auditors. This may be partly because shareholders depend mainly on auditors for an explanation of the audit report at the annual general meeting, and are well aware of this duty as an existing duty of an auditor.

The auditors should recommend approval of the accounts and make such comments thereon as they think fit or refuse to recommend approval, giving reasons for referring the matter back to the directors (duty 16). As shown in table 5.1, auditors and management (p=.000) were satisfied at a .05 significant level. However, users (30%) were dissatisfied (their mean response is also less than 2.9). As shown in table 5.2, the most dissatisfied group among users was bank loan officers (42%). On the basis of the 25% threshold test and the mean of the interest group response, an expectation gap exists with respect to users and auditor's performance regarding this duty.

5.1.3.1 Summary

As shown in table 5.3, the duties which contribute most to the "deficient performance gap" are duties 4, 2, 18 and 14. These are: *"the auditor should examine and report whether the audited financial statements contain any material errors or distortions", "the auditor should examine and report whether the company's continued existence is in doubt", "the auditor should examine and report whether the non-financial information presented in the financial statements (annual accounts) is correct (reliable)", "examine whether the audited company has a satisfactory system of internal control".* Their total contribution to the "deficient performance gap" is ≈78% (sum of duties 4, 2, 18, and 14).

Opinion differences also exist among the interest groups and, as expected, the auditors rated their performance higher than management and users' groups. Users were the most dissatisfied group with respect to the performance of the above duties.

With regard to the first duty concerning the report of material error or distortion, there is some dissatisfaction with respect to users. This may reflect that many users (mainly owners, shareholders and bank loan officers) expect auditors to do better than what they are doing currently, in detecting material errors or distortions in the financial statements. The second duty concerns going concern reporting. It is the second largest contributor to the "deficient performance gap". The dissatisfaction of the interest groups with regard to this, indicate that auditors are not doing enough in giving early warning signals regarding failure of a company when substantial doubt about the company's continued existence exists. This can be due to the recent failure of some companies in Eritrea. The response to the third duty concerning the review of non-financial information shows that the interest groups perhaps are of the opinion that some of the non-financial information may not be consistent with the reported figures in the financial statements. Only a few companies in Eritrea report non-financial information in their annual report and accounts.

With respect to the last duty, “to examine the internal control system of a company”, the dissatisfaction of the users is related mainly to the audit of small and medium companies. This dissatisfaction reflects that many of the users expect an auditor to examine properly the internal control system of the company and, if the auditor has difficulty in relaying on the internal control of the company, he/she should perform more extensive substantive test. Moreover, the user group (especially the tax inspectors) is of the opinion that the auditors accept audit engagements for small and medium sized companies for an audit in an unreasonably short time. Therefore, the auditor should disregard the demand for an audit if there is not sufficient time to do the work.

5.1.4 Deficient standards gap

The "Deficient standards gap" as defined by Porter (1993) is the gap between the duties which can reasonably be expected of auditors and auditors existing duties as defined by the law and professional promulgation. Out of 14 suggested duties (refer to chapter three 3.5.2), five duties (duties 1, 6, 8a, 7, and 3) were identified as duties which could reasonably be expected of auditors. The reason for this is discussed below. But generally, for duties to be reasonably expected of an auditor, these must be cost-beneficial for auditors or paid for by a third party (for example the Government). In the absence of cost benefit analysis, if a duty is identified by the interest groups as a duty the auditor should perform, it will be considered as a duty reasonably expected of auditors.

According to Porter (1993), if even one group of non-auditor interest groups expects auditors to perform a duty and they fail to do so, it leaves unfulfilled expectations which contribute to the audit expectations gap. Based on the mean responses as shown in Appendix 1 and table 5.4 and 25% or more criterion as shown in Appendix 2 and table 5.5, all the duties, which were identified as duties reasonably expected of auditors, contribute to the "deficient standards gap". That is, the mean response of at least one of the interest groups is positive for the five duties shown in table 5.4. Moreover, from table 5.5 it may be seen that all (5 duties) the duties were identified by 25% or more of at least one interest group as duties an auditor should perform. It is interesting to note that the duties identified as contributing to a "deficient standards gap" from the mean of the interest groups, and those identified by 25% or more, are generally the same. The five duties which contribute to a "deficient earlier. This is also supported by the interest group responses signifying that the duty should be performed by an auditor in Eritrea. This is reflected in tables 5.4 and 5.5.

Table 5.4: Duties contributing to deficient standards gap - Duties interest groups consider auditors should perform (indicated by Mean of Interest group responses)

		Mean		
		Section 3 (should be a duty)[1]		
No.	The auditor should	**A**	**M**	**U**
1.	Detect material fraud committed in the audited company.	0.56	0.76	0.75
6.	Report to an appropriate authority fraud committed in the audited company.	0.86	0.88	0.63
8a.	Report to an appropriate authority theft or misappropriation of corporate assets by company directors.	0.79	1.00	0.29**
7.	Report to regulatory authority deliberate distortion of financial information.	0.43	0.20	0.86
3.	Report breaches of tax laws to the Inland Revenue Department.	0.07	0.53	0.23

[1]Mean of interest group responses signifying that the duty should be a duty of an auditor.
[2] A = Auditors, M = Management, U= users (for number of respondents refer chapter 4).
* Kruskal Wallis one way analysis of variance by ranks significant at $p < .05$
** Mann-Whitney significantly differ from auditors at $p < .05$

standards gap" are discussed hereafter in order of their contribution (duty with the highest contribution first):

The auditor should detect material fraud committed in the audited company (duty 1). Based on the proportion of the public group (non-auditor groups) signifying that the auditor should perform the duty, as shown on the right of table 5.5, this duty is the largest contributor to the "deficient standards gap". The contribution of this duty to the "deficient standards gap", as shown in table 5.6, is ≈22.5. This is an estimate of the relative contribution of each duty to the "deficient standards gap". It is derived from the proportion of the public group who signified that the duty in question should be performed by the auditor. This duty is not an existing duty of an auditor according to the International Standards on Auditing (see ISA 240). Moreover, there is no legal requirement in Eritrea which requires the auditor to detect fraud. The question is whether to classify this duty as a "deficient standards gap" or a "reasonableness gap". The major argument may relate to the cost-benefit issue as, by including fraud detection as the auditor's responsibility, the costs of the audit are likely to increase. As Viitanen and Troberg (1999:81) point out, the question related to that is: who is actually paying for the costs and who is/are the beneficiaries? The EU's Green Paper states that "as far as the needs and expectations of users are concerned, they can be considered reasonable if there are stakeholders who are willing to pay for the service." (EU Green Paper, 1996:9 – as cited by Viitanen and Troberg 1999). Porter (1993) and Viitanen and Troberg (1999) include this duty in their study as a "reasonable expectation" based on the preceding arguments. The duty is classified in this research as a "reasonable expectation" on the basis of the argument presented

Table 5.5 : Duties contributing to deficient standards gap - Proportion of interest group signifying that an auditor should perform the duty (% responding yes).

		Frequencies (percentages)			
		Section 3 (should be a duty)[1]			
No.	The auditor should	A	M	U	MU[4]
1.	Detect material fraud committed in the audited company.	78.1*	88.2*	87.5*	**87.9**
6.	Report to an appropriate authority fraud committed in the audited company.	93.1*	93.8*	81.3*	**87.5**
8a.	Report to an appropriate authority theft or misappropriation of corporate assets by company directors.	89.7*	100*	64.3	**82.8**
7.	Report to regulatory authority deliberate distortion of financial information.	71.4*	60.0	92.9*	**72.4**
3.	Report breaches of tax laws to the Inland Revenue Department.	53.3	76.5*	38.5	**60**

[1] Proportion of interest group signifying that auditors should perform the duty.

[2] A= Auditors, M = Management, U= users (for number of respondents refer chapter 4).

[3] Proportions of the identified public group (excluding auditors) signifying that an auditor should perform the duty

* Binomial test significant at $p< .05$

Table 5.6: Deficient standards gap

Duty No.	Response (%)[1]	Contribution (%)[2]
1	87.9	22.50
6	87.5	22.40
8A	82.8	21.20
7	72.4	18.54
3	60	15.36
Total	390,6	100.00

[1] Proportion of the public groups whose expectations with respect to the duty are not being fulfilled (refer to table 5.6)
[2] Relative contributions of duties to "deficient standards gap"

Table 5.5 shows that the duty "to detect fraud committed in the audited company" was identified by more than 25% of all the interest groups as a duty an auditor should perform (as shown in table 5.4 the mean responses are also positive for all groups). If section three (should be the duty) is analyzed, all interest groups (p=.001-.002) think that fraud detection should be the duty of an auditor. Overall it can be concluded that, as can be seen from the analysis, the majorities of all interest groups in Eritrea think that fraud detection should be the duty of the auditor. Hence, an expectation gap exists with respect to this duty.

The auditor should report to an appropriate authority fraud committed in the audited company (duty 6). This duty is not an existing duty of an auditor according to the International Auditing Standards. Moreover, there is no legal requirement in Eritrea which requires auditors to report to the regulatory authority fraud committed in the audited company. As shown in chapter three (table 3.3), this duty is included in the Porter (1993) and Viitanen and Troberg (1999) studies. In both studies it is classified as a reasonable expectation. According to Porter (1993:64) this duty can be extended fairly easily at little cost. She adds that an appropriate authority needs to be identified and legal protection should be provided for the auditors against possible claims of breach of confidentiality. There are some arguments in favor of classifying this duty as a 'reasonableness gap'. Viitanen and Troberg (1999:85) point out that the contracting party is the client and not the governmental authority. Moreover, the questions which need to be answered are which authority is the appropriate one to report to and what legal protection can be provided to auditors? In this research, the duty is classified in the same way as Porter (1993) and Viitanen and Troberg (1999).

Table 5.5 shows that the responsibility "to report to an appropriate authority fraud committed in the audited company" was identified by 25% or more of the non-auditor groups as a duty the auditor should perform (the mean of responses is also positive for the pubic group – see table 5.4). At a .05 significance level all interest groups identified this duty as a duty the auditor should perform (p=.000-.01). Moreover, based on the mean of the responses, the difference in opinion of the interest groups is statistically significant. with respect to this duty. The source of opinion difference is between the perception of the users and auditors as indicated by the Mann-Whitney test in table 5.4. Thus a major "deficient standard gap" exists with respect to this duty in Eritrea. As shown in table 5.6, based on the proportion of the public group (non-auditor groups) signifying that the auditor should perform the duty, this duty is the second largest contributor to the total "deficient standards gap" (≈22.4%).

The auditor should report to an appropriate authority theft or misappropriation of corporate assets by company directors (duty 8a). Table 5.5 shows that this duty (duty 8a) was identified by more than 25% of the non-auditor groups as a duty the auditor should perform (although the mean of responses is negative for the users' group – see table 5.4). Based on the binomial test, at a .05 significance level, the result of the study shows that both auditors and management (p=.000 for both groups) identified the duty as one the auditor should perform. The Mann-Whitney test, as shown in table 5.4, also indicates that there is a significant difference between the opinion of users and auditors with respect to this duty. Thus an expectation gap exists in respect of this duty and it contributes to "deficient standards gap". Porter (1993), and Troberg and Viitanen (1999) classified the duty "to report to an appropriate authority theft or misappropriation of corporate assets by company director" as being part of deficient standards on the argument that, if the company directors are dishonest, the risk for possible distortion of financial statements increases and, thus, this constitutes a reasonable demand. This researcher also classified the duty as reasonable expectation for the same reason.

The auditor should report to the regulatory authority deliberate distortion of financial information (duty 7). According to Viitanen and Troberg (1999:83) "the major difference from the duty to report "fraud" to the authorities is the emphasis laid on the intent ("deliberate") of misrepresentation of financial information". Table 5.5 shows that this duty was identified by more than 25% of all the interest groups as a duty the auditor should perform (mean responses are also positive for all groups - see table 5.4). Based on the binomial test, at a .05 significance level, table 5.5 also shows that both auditors and users (p= .000 and .017 respectively) identified the duty as a duty the auditor should perform. Compared with the duty "to report fraud to authorities" the strong emphasis on intent with the wording "deliberate" seems to have some effect. As it may be seen from table 5.4, based on the mean of the responses, the opinion of interest groups differ in both cases, but the difference was only statistically significant, as indicated by KWT, with respect to their opinion on reporting fraud committed to regulatory authority. Generally, it can be concluded that the interest group signifies the duties (duties 6 and 7) as duties the auditor should perform and the affect of the strong emphasis on intent with the wording "deliberate" is not very significant.

The auditor should report breaches of tax laws to the Inland Revenue Department (duty 3). In Eritrea there is no statutory requirement for an auditor to do so. The tax computation for companies in Eritrea (see chapter three – 3.4.3) is not complex and it falls within the expertise of a financial accountant and an auditor. It can be said that its performance involves almost no additional audit cost. Table 5.5 also shows that this duty (duty 3) was identified by more than 25% of the non-auditor groups as a duty the auditor should perform. Therefore, this duty is reasonably expected by the public and is classified as contributing to the 'deficient standards gap'. The costs of performing this duty lie, according Porter (1993:63), in the negative attitudes towards auditors which would be likely to result and this may affect the other auditing tasks as it affect the client-auditor relations. Porter (1993) classified this duty as contributing to the "reasonableness gap", whereas Viitanen and Troberg (1999:89) classified the duty as partly contributing to the "deficient standards gap", and partly to the "reasonableness gap".

As Shown in table 5.5, all responses of the interest groups exceed the 25% threshold. Therefore, it can be concluded that an expectation gap exists with respect to duty 3.

5.1.4.1 Summary

It can be concluded that the duties which contribute extensively to the "deficient standards gap" in Eritrea are detecting and reporting to regulatory authorities' fraud and fraud related issues (including breach of tax laws) (see table 5.6 - duties 1, 6, 8a, 7 and 3).

As discussed in chapter one, Eritrea was a socialist country before its independence and auditors were perceived as government watchdogs during that time. The results of this research show that the perception of the public in Eritrea as to the role and responsibility of an auditor has not changed, despite the fact that, since liberation (1991), Eritrea has shifted from a command economy to a market economy.

5.1.5 Reasonableness gap

The "Reasonableness gap" as defined by Porter (1993) is a gap between what the public expects auditors to achieve and what they can reasonably be expected to accomplish. Out of 14 suggested auditor's duties (refer to chapter three 3.5.2 – table 3.4), 9 duties (duties 8b, 11, 12, 13, 15, 17, 20b, 21, 22) were identified as duties which are not reasonably expected of auditors. Generally, these duties are not cost-beneficial for auditors to perform (these duties are discussed under each duty). The same measures were used as in the previous section to identity duties contributing to the "reasonableness gap". These were: mean of interest group responses (if positive); and if 25% or more of the interest group signify that the auditor should perform the duty.

According to Porter (1993:62) "the mean of responses from an interest group reflects the overall opinion on the group as to whether a dury should or should not be performed by auditor. However, it does not provide a useful indicator of the group's expectations of auditors in the context of the audit expectation-performance gap". Therefore, the best indicator is the proportion of the interest group signifying that the auditor should perform the duty. That is, if a significant portion of an interest group expects auditors to perform the duty, according to Porter (1993), their failure to do so may result in widespread criticism which could be very damaging to the profession's reputation. As discussed earlier, a significant portion is considered as 25% or more for purposes of this research. Based on mean responses and the 25% or more criterions, 8 duties (duties 8b, 11, 12, 13, 15, 17, 20b, 21,) were identified as duties contributing to the "reasonableness gap" (unreasonable expectation). This are presented in tables 5.7 and 5.8. The duties identified as contributing to the "reasonableness gap" from the mean of interest group responses (see table 5.7) and those identified by 25% or more of the interest group as duties the auditor should perform (see table 5.8) are the same. These duties are discussed below in order of their contribution (duty with the highest contribution first):

The auditor should examine and report on the efficiency and effectiveness of the company's management (duty 11). Porter (1993) regarded performance of this duty by the auditors as non cost-effective and classified it as contributing to the "reasonableness gap" (unreasonable expectation). The same classification is used in the Viitanen and Troberg (1999) study. Viitanen and Troberg (1999:93) state that introducing a duty that raises the auditor to a position where he/she would be a supreme judge regarding how well a company is run may be extremely questionable and there is no foundation for such a duty in economic theory. This duty is also classified the same way in this study. King II (2002:133) states that auditors have an important impact on the quality of the internal control system and may recommend improving the internal controls. This may include the financial and other general controls. However, this study does not include analysis of the duties of an auditor in relation to Corporate Governance (see chapter one - 1.3 research limitations)

Table 5.8 shows that considerable support for the duty to be a duty of an auditor, is found among the auditors (63%),management (87%) and users (64%). Moreover, based on the interview conducted with shareholders, the majority of them consider the duty to be a duty of an auditor, even though there is no corresponding regulation in Eritrea. From table 5.7 it may be seen that, even though there is difference in opinion, based on the mean of the interest group responses, as to whether the duty should or should not be performed by auditors, the KWA test indicates that none of this difference is statistically significant. Overall, it can be concluded that, an expectation gap exists with respect to duty 11 since the proportion in each interest group exceeds the 25% threshold. The mean of interest group responses as to the duty the auditor should perform is also positive. As shown in table 5.9, this duty (duty 11) is the largest (≈17.8%) contributor to the total "reasonableness gap" based on the proportion of the public group signifying that the auditor should perform the duty.

The auditor should prepare the auditee Company's financial statements (duty 12). Porter (1993), and Viitanen and Troberg (1999) included this duty in their study as a test of awareness of the interest groups in relation to this issue. For the same reason it was included in this study. As it may be seen from table 5.8, surprisingly, the majority of the management (59%) and users (69%) identified this duty as duty the auditor should perform. But only 38% of the auditors identified the duty as the duty the auditor should perform. However, all the interest groups exceed the 25% threshold level. Table 5.7 also shows that the mean responses of the public group to this duty are positive. Moreover, the Mann-Whitney test indicates that there is opinion difference between auditors and users which is statistically significant. Thus, an expectation gap exists with respect to this duty.

Table 5.7: Duties contributing to the "reasonableness gap" - Duties interest groups consider auditors should perform (indicated by Mean of Interest group responses)

		Mean		
		Section 3 (should be a duty)[1]		
No.	The auditor should	**A[2]**	**M[2]**	**U[2]**
11	Examine and report on the efficiency and effectiveness of the company's management.	0.25	0.73	0.29
12	Prepare the auditee Company's financial statements.	-0.25	0.18	0.38**
8b	Report to an appropriate authority theft or misappropriation of corporate assets by non-managerial employees	*0.13	*0.43	*-0.39
17	Report on the future prospects of the company.	0.48	0.83	0.57
13	Verify every transaction of the audited company.	0.44	0.18**	-0.07
15	Guarantee the audited financial statements are accurate.	-0.29	0.06	0.13
20b	Examine and report on the conduct of the company with regard to societal matters.	*0.16	*-0.60**	*0.076
21	Take responsibility for planning the internal control system of the company.	*-0.87	*-0.38**	*0.14**

[1]Mean of interest group responses signifying the duty should be a duty of an auditor.
[2]A = Auditors, M = Management, U= users (for number of respondents refer chapter 4).
* Kruskal Wallis one way-analysis of variance by ranks significant at $p < .05$
** Mann-Whitney significantly differ from auditors at $p < .05$

Table 5.8: Duties contributing to the "reasonableness gap" - Proportion of interest group signifying that auditor should perform the duty (% responding yes).

		Frequencies (percentages)			
		Section 3 (should be a duty)[1]			
No.	The auditor should	A[2]	M[2]	U[2]	MU[3]
11	Examine and report on the efficiency and effectiveness of the company's management.	62.5	86.7	64.3	75.9
12	Prepare the auditee Company's financial statements.	37.5	58.8	68.8	63.6
8b	Report to an appropriate authority theft or misappropriation of corporate assets by non-managerial employees	56.5	78.6	30.8	55.6
17	Report on the future prospects of the company.	53.1	46.7	60.0	53.3
13	Verify every transaction of the audited company.	28.1	58.8	46.7	**53.1**
15	Guarantee the audited financial statements are accurate.	35.5	52.9	43.8	48.5
20b	Examine and report on the conduct of the company with regard to societal matters.	58.1	20.0	53.8	35.7
21	Take responsibility for planning the internal control system of the company.	6.7	31.3	57.1	43.3

1 Proportion of interest group signifying that auditors should perform the duty.

2 A= Auditors, M = Management, U= users (for number of respondents refer chapter 4).
3 Proportions of the identified public group (excluding auditors) signifying that auditor should perform the duty

* Binomial test significant at $p < .05$

Table 5.9: Reasonableness gap

Duty No.	Response (%)[1]	Contribution (%)[2]
11	75.9	17.77
12	63.6	14.89
8b	55.6	13.01
17	53.3	12.48
13	51.3	12.01
15	48.5	11.35
21	43.3	10.14
20b	35.7	8.35
Total	427.2	100.00

[1] Proportion of the public groups whose expectations with respect to the duty are not being fulfilled (refer to table 5.9)
[2] Relative contributions of duties to the "reasonableness gap"

Auditors in Eritrea are not allowed to perform accounting and auditing services for the same client. That is, the existing regulation in Eritrea does not allow auditors to perform both services to one audit client. However in practice, some audit firms do provide those services to the same client (mainly for small companies), although they contend that both services are performed by different persons within the firm. However, this assumption may lead to the perception that the duty "auditors should prepare companies financial statements" is a duty of an auditor. Moreover, this indicates that there is lack of adequate regulation over auditors in Eritrea (see later in this chapter). This duty, referring to table 5.9, is the second largest (≈15%) contributor to the total "reasonableness gap" based on the proportion of the public group signifying that the auditor should perform the duty.

The auditor should report to an appropriate authority theft or misappropriation of corporate assets by non-managerial employees (duty 8b). Table 5.8 shows that considerable support for this duty to be performed by an auditor is found among auditors (57%) and management (79%). 31% of the users identified the duty as the duty an auditor should perform, thus exceeding the 25% threshold (the mean of interest group responses is positive). From an analysis of table 5.7, the KWA test shows that there is a significant difference in opinion among the interest groups. Therefore, one can conclude that there is clear expectation gap with respect to auditors and management, and some expectation gap exists with respect to users.

The auditor should report on the future prospects of the company (duty 17). Viitanen and Troberg (1999) consider such an expectation as unreasonable. According to them, considering the duty as a duty of an auditor can be regarded as leading to speculation on behalf of the auditor to have him/her to report on the future prospects of the company. Therefore, it is the duty of the company directors to provide this information and not that of the auditor. The researcher supports the argument and classified the duty as a "reasonableness gap".

Table 5.8 indicates that majority of the auditors (53%) and users (60%) identified this duty as duty the auditor should perform. But only 47% of the management identified the duty as the duty the auditor should perform. However, all the interest groups exceed the 25% threshold level (the mean of interest group responses to this duty is also positive – see table 5.7), it can be concluded that an expectation gap exists.

The auditor should verify every transaction of the audited company (duty 13). It is not cost-efficient or possible for an auditor to verify every transaction of the auditee company. Therefore, the duty is classified as contributing to the 'reasonableness gap' in this study. Porter (1993) and Viitanen and Troberg (1999) also classified the duty as contributing to the "reasonableness gap" for the same reason. The majority of the interest groups do not consider the duty to "verify every transaction of the audited company" to be a duty of an auditor. As shown in table 5.8, among auditors only 28% consider this duty should be a duty of an auditor. But considerable support is found from management (59%) and users (47%). On the basis of the 25% threshold, all the interest groups exceed the cut off point (mean of the management and auditors groups responses is also positive – see table 5.7). Therefore, an expectation gap exists. One of the most likely reasons for the existence of this expectation gap is the lack of knowledge of the actual work carried out by auditors in Eritrea.

The auditor should guarantee the audited financial statements are accurate (duty 15). As discussed in chapter two, the auditor's opinion helps to establish the credibility of financial information but not to guarantee its accuracy (Viitanen and Troberg, 1999). Porter (1993) considered this duty to be beyond what auditors can reasonably be expected to accomplish. Consequently, it is classified as contributing to the "reasonableness gap". The duty is classified the same way in this study. As shown in table 5.8, the majority of the auditors and users did not consider the described duty as a duty the auditor should perform. However, 53% of the management identified the duty as a duty the auditor should perform. %). On the basis of the 25% threshold, all the interest groups exceed the cut off point. Moreover, the mean of the interest group responses, as shown in table 5.7, is also positive for this duty. Overall, it can be concluded that an expectation gap exists with respect to this duty (duty 15). This gap exists most likely due to the lack of understanding of the audit function and it can be argued that such an expectation is unreasonable.

The auditor should examine and report on the conduct of the company with regard to societal matters (20b). There has been a demand by the public for companies to be subject to an audit of their social behaviour. Further, it is argued that an auditor's responsibility will tend to increase with increasing public expectation (EU Green paper 1996 - as cited in Viitanen and Troberg, 1999:87). However the question is whether the statutory auditor has the appropriate qualifications and expertise to carry out this work. Therefore, this duty is classified as contributing to the "reasonableness gap".

In Eritrea, employee health, safety and education (training), and economic opportunities for women can be seen as important components of social reporting (see chapter three - 3.2.3). At present, there is no statutory requirement for an auditor in Eritrea to report on the conduct of the company with regard to societal matters, hence companies do not report on social issues. Table 5.7 shows that management does not consider this duty to be the duty of an auditor as their mean response is negative. However, table 5.8 shows that auditors and users (more than 25%) identified this duty as a duty an auditor should perform (their mean response is also positive for this group – see table 5.7). But the smaller absolute value of the mean responses of users indicates that they were less agreed in their opinion than were the auditors. Therefore, it contributes to 'reasonableness gap'.

Based on the mean of the responses, table 5.7 reveals that, the difference in opinion of the interest groups is statistically significant with respect to this duty. The source of opinion difference is between the perception of the auditors and management (auditee) groups as indicated by the Mann-Whitney test.

The auditor should take responsibility for planning the internal control system of the company (duty 21). Viitanen and Troberg (1999) state that in a free market economy, it is the directors of the company who decide upon what system of internal control is needed, not the auditors. Therefore, they classified the duty as contributing to the "reasonableness gap". The same classification is used in this study. Table 5.8 reveals that all interest groups, except users (57%), do not consider the duty "to take responsibility for planning the internal control system of a company" should be a duty of an auditor. There is a minority of 31% among management who think that it should be a duty of the auditor. The auditors clearly (p=.000) do not identify the duty as a duty the auditor should perform, at a .05 significance level. Therefore, one can conclude that the 25% threshold is exceeded and thus an expectation gap exists with respect to management and users (mean of the users group responses is also positive – see table 5.7). Moreover, the result of the KWA test indicates that there is significant difference in opinion of the interest groups with regard to this duty as shown in table 5.7. The most likely reason for an expectation gap to exist in this regard is the perception of the public that an auditor has the expertise and qualification to plan a good system of internal control for companies.

5.1.5.1 Summary

The duties contributing most to the "reasonableness gap" are (referring to tables 5.8 and 5.9): "*the auditor should examine and report on the efficiency and effectiveness of the company's management", "the auditor should prepare the auditee Company's financial statements", "the auditor should report to an appropriate authority theft or misappropriation of corporate assets by non-managerial employees", "the auditor should report on the future* *prospects of the company".* Their total contribution to the "reasonableness gap" was ≈58% (the sum of duties 11, 12, 8b and 17 – see table 5.9).

The response to the duties concerning *evaluation of how efficient and effective a company has been run, who prepare company's financial statements and reporting on the future prospects of a company* indicate that users in Eritrea are not well aware of the duties and responsibilities of auditors and management. It may not be reasonable to expect auditors to evaluate the efficiency and effectiveness of a company as management are involved in the day to day activities of the company and possess more knowledge about the company than auditors. With respect to the duty to "prepare financial statements of a company", the independence of an auditor may be impaired if an auditor performs accounting services for an audit client (see chapter two). Several rules and standards have been issued to prohibit auditors from performing accounting services for the audit client (see also SEC, 2003 and IFAC, 2001). However some audit firms provide accounting and audit services for their audit clients in Eritrea. Therefore the regulatory authority in Eritrea should consider the impact of this on the auditor's independence (see chapter 6). To conclude, it is clearly the responsibility of management to prepare the financial statements of a company and to report on its future prospects.

The gap regarding the reporting of the misappropriation by non-managerial employees of assets to regulatory authorities, indicate that the public expect auditors to report illegal acts, including those committed by non-managerial employees, to regulatory authorities regardless of their effects on the financial statements. The duty "to examine and report societal matters" also contributes to the "reasonableness gap", although its contribution is low (≈8%) as shown in table 5.9. However it should be noted that there is an expectation towards the auditing of social behavior.

5.1.6 No expectation gap

According to Porter (1993), and Viitanen and Troberg (1999) duties are classified as "no expectation gap" if: a) there were no unfulfilled expectations regarding how well the auditors perform the existing duties of an auditor or, b) the duties were are not the duties of an auditor (suggested duties) and were not considered to be the duties of the auditor by the interest groups. From the analysis of Appendices 1, 2, and 3, six duties (duties 5, 9, 19, 20a, 22, 23) were identified as duties which did not contribute to the audit expectation-performance gap. These duties are presented in tables 5.10, and 5.11. As table 5.11 shows, the mean of the interest groups response for duties 5, 9, 19, and 23 (existing duties of an auditor) are greater than 2.9. Moreover, less than 25% of the interest groups signify that the duty is performed poorly by an auditor. With respect to duty 22 (suggested duty of an auditor), table 5.10 shows that less than 25% of the interest groups signify that the auditor should perform the duty (the mean of the interest groups response is also negative as shown in table 5.10). Moreover, with respect to duty 20a the response rate was very low and statistically unreliable and is recognized as not contributing to the expectation gap. The six duties are discussed in detail below:

The auditor should examine and report all material departures from Generally Accepted Accounting Practice in preparing and presenting financial statements (duty 5). For the large part, as shown in table 5.11, all interest groups considered that the duty is performed well, as less than 25% signify that the duty is poorly performed (mean responses is also greater than 2.9). Therefore, no expectation gap exists with respect to this duty (duty 5).

The auditor should audit the accounts of the company to verify the correctness and accuracy of the balance sheets and profit and loss accounts (duty 9). This is the primary duty of an auditor according to the Commercial Code of Eritrea (Art. 373). Table 5.11 shows that 20% of the users have some dissatisfaction with the auditor's performance, but the threshold level of 25% was not exceeded. From table 5.11 it may also seen that, based on mean responses, all the interest groups are satisfied with the performance of an auditor with respect to this duty, as the mean of the responses to this duty is greater than 2.9.

The auditor should acquaint himself/herself with other information included in the annual report, such as management discussion and analysis, in order to determine whether material errors (inconsistencies) exist which need to be amended or reported on in the auditor's report (duty 19). With regard to auditor's performance, as shown in table 5.11, all interest groups were satisfied (p=.001-.035) as less than 25% of the interest groups signify that the duty is performed poorly by auditors. The mean of the interest group responses is also greater than 2.9.

Table 5.10: No Expectation gap – The Proportion of the interest group signifying that auditor should perform the duty (% responding yes) and mean of interest group responses signifying the duty should be performed by and auditor.

		Mean[1]			Frequency[3]		
		Section 3 (Should be a duty)			Section 3 (Should be a duty)		
No	The auditor should	A[2]	M[2]	U[2]	A	M	U
22	Detect illegal acts by the company officials which do not directly affect the company's accounts.	-0.48	-1.00**	-0.29	23.8	0.0	24.7

[1] Mean of interest group responses signifying that the duty should be performed by an auditor

[2] a = Auditors, M = Management, U= users (refer chapter four for number of respondents).

[3] Proportion of interest group signifying that auditors should perform the duty

* Binomial test significant at p<.05
** Mann-Whitney significantly differ from auditors at $p < .05$

Table 5.11: - No expectation gap - Assessment of auditors' performance of the existing duties based on the mean of the interest group responses and the proportion of interest groups signifying auditor's duties are poorly performed.

		Mean			**Frequencies (%)**		
		Section 2 (auditor's performance)[1]			**Section 2** Poorly (1-2)[2]		
No	The auditor should	**A[3]**	**M[3]**	**U[3]**	**A**	**M**	**U**
5	Report all material departures from Generally Accepted Accounting practice in preparing and presenting financial statements to give a true and fair view.	*4.8	*4.1 **	*3.8 **	0.0	0.0	20.0
9	Audit the accounts of the company to verify the correctness and accuracy of the balance sheets and profit and loss accounts.	*4.9	*4.6	*3.6 **	0.0	0.0	20.0
19	Acquaint himself/herself with other information included in the annual report, such as management discussion and analysis, in order to determine whether material errors (inconsistencies) exist which need to be amended or reported on in the auditor's report (ISA 720).	4.1	4.3	3.1	8.7	11.1	12.5
20a	The auditor should examine and report on the conduct of the company with regard to environmental matters.	3.9	3.5	3.5	9.1	66.7	0.0
23	Where the auditors find breaches of legal or statutory requirements, they shall inform the directors and, where grave irregularities or breaches have occurred, they shall inform the general meeting.	*4.4	*4.0	*3.5 **	3.7	11.1	0.0

[1] Mean of auditor's performance on 1-5 ordinal scale (2.9 has been adopted as point of differentiation between satisfactory and unsatisfactory performance).
[2] Proportion of the interest group signifying that the duty performed poorly by an auditor.
[3] = A = Auditors, M = Management, U= users (refer chapter 4 for number of responses)
* Kruskal Wallis one way analysis of variance by ranks significant at $p < .05$
** Mann-Whitney significantly differ from auditors at $p < .05$

The auditor should examine and report on the conduct of the company with regard to environmental matters (duty 20a). Even though this duty was classified by Porter (1993), and Viitanen and Troberg (1999) as a suggested duty, it was classified in this study as an existing duty of an auditor due to the new International Auditing Standard on environmental matters (ISA 1010). In Eritrea there is no statutory requirement for auditors to audit environmental matters. Moreover, based on the review of the annual reports of the companies surveyed, almost all companies do not disclose environmental issues.

With regard to the auditor's performance, as shown in table 5.11, there seems to be some dissatisfaction among management. However, the response rate was very low and statistically unreliable. And the other groups do not seem to be dissatisfied with regard to this duty. Therefore, the result is inconclusive and the duty is classified as not contributing to the expectation gap.

The auditor should detect illegal acts by the company officials which do not directly affect the company's accounts (duty 22). According to Porter (1993:63), performing this duty is not cost effective. Moreover, she is of the opinion that the duty is rather remote from the auditor's traditional accounting expertise. Viitanen and Troberg (1999) concur with this view. The researcher also tends to agree with their view and classified the duty in the same way, as possibly contributing to the "reasonableness gap". Table 5.10 shows that, at a .05 significance level, all interest groups (p=.000-.006) did not identify the described duty as a duty the auditor should perform. That is, all interest groups did not exceed the 25% threshold level of considering the duty in question should be a duty of the auditor. Moreover, as shown in table

5.10 the mean of the interest group responses is negative. Thus, this duty did not contribute to the expectation gap.

Where the auditors find breaches of legal or statutory requirements, they shall inform the directors and, where grave irregularities or breaches have occurred, they shall inform the general meeting (duty 23). With regard to the auditor's performance, table 5.11 shows that, for the large part, the interest groups consider that this duty is well performed (p=.000-.019) at a .05 significance level. The mean of the interest group responses is more than 2.9 for all the groups. Thus, all groups are clearly satisfied with the performance of an auditor with respect to this duty (duty 23) and it does not contribute to the expectation gap.

5.1.6.1 Summary

Five of the existing duties of an auditor (duties 5, 9, 19, 20a, and 23), and one suggested duty (duty 22) did not contribute to the expectation gap (see tables 5.11, 5.12, and 5.13). The interest groups seem to be satisfied with the performance of the four existing duties (duties 5, 9, 19, 23). However with regards to the duty (duty 20a) to "*examine and report the conduct of the company on environmental matters*", the interest groups are not sufficiently aware of the duty, and the response rate with regard to the auditor's performance was low. Therefore, it was classified as not contributing to the expectation gap. With respect to the suggested duty (duty 22), "*duty to detect illegal acts by the company officials which do not directly affect the company's accounts*", all interest groups did not consider the described duty to be the duty of the auditor. The researcher also agrees with the view that it is not cost effective for this duty to be performed by an auditor.

5.1.7 Knowledge of auditors' existing and suggested duties

The knowledge of the interest groups about auditors existing duties can be analyzed from *section 1 (is a duty)* as shown in Appendix 1 and 2. From the analysis of eleven existing duties of an auditor (duties 2, 4, 5, 9, 10, 14, 16, 18, 19, 20a, 23), auditors recognized all their existing duties (their mean responses for all existing duties were positive) (see Appendix 1). However, management and users failed to recognize one duty (duty 20a, relating to examining and reporting on environmental matters) as the mean of their responses is negative. With respect to suggested duties, auditors incorrectly identified 7 duties as the duties of an auditor (duties 1, 6, 7, 8a, 8b, 11, 17). Five of these duties are related to fruad detection and reporting and the rest two are: reporting on the future prospects of the company, and examining and reporting the effectiveness and efficiency of the company´s management. This shows that auditors do not know exactly what their duties are. The regulatory body, the auditor general, should take in to account the effect of the lack of knowledge of the auditors on the audit quality and should encourage auditors to implement the recomendations set out in chapter eight. The management incorrectly identified 9 duties as duties of an auditor (duties 1, 3, 6, 7, 8a, 8b, 11, 12, 17), and users also incorrectly identified 6 duties as duties of an auditor (duties 1, 6, 7, 12, 15, 17). The means of the interest group's responses for these duties were positive (see Appendix 1 and 2). In general, many of the duties, which are incorrectly identified as the duties of an auditors, are related to fraud detection and reporting. This shows that the perception of the public and the auditors as to the role and the responsibilties of an auditors has not changed, despite the fact that Eritrea has shifted from a command economy to a market economy since its liberation, 1991(see statement of the problem, 2.1).

According to Porter (1993) the average knowledge gap per duty, as shown in appendix 5, is measured by dividing the total 'knowledge gap' (the total of the proportion of respondents selecting either 'unaware' or 'yes' for duties which are not duty of an auditor , and 'no' for those which are) to the total number of duties under study (25 duties). As can be seen from Appendix 5, auditors seem to be more knowledgeable about their existing duties than the public group, although 40% of them are 'unaware' or identified an incorrect option. The management group appears to have similar knowledge about the auditor's duties. However, almost half of the users group (49%) appear to have limited knowledge about auditor's duties. Similar to Porter (1993) study, the "knowledge gap" has a serious implication for the 'reasonableness gap' component of the audit expectation gap in Eritrea.

5.1.8 Analysis of the overall audit expectation–performance gap (using Porter framework)

Figure 5.1 shows an estimate of the relative contribution of each duty to its respective component of the audit expectation-performance gap (see also tables 5.3, 5.6 and 5.9). If this is added, a measure of the public's unfulfilled expectations attaching to the component is obtained. From this, the relative contribution of each component to the overall gap between the public's expectations of auditors and auditor's perceived performance may be calculated. Figure 5.1 shows the rough picture of the actual situation since all factors which contribute to the expectation gap were not included in this study, and as already discussed in chapter one (1.3 research limitation), there exists an argument, both in favor of and against, classification of some duties in to one or other components of the audit expectation-performance gap.

As can be seen from figure 5.1, the "Deficient performance gap" contributes only ≈14% to the overall gap between public expectation of auditors and auditors' perceived performance, which is the lowest of the three components. The "deficient standards gap" contribution (≈41%) to the total gap is higher than "deficient performance" (≈14%) but lower than the "reasonableness gap" (≈45%).

Figure 5.1 also shows that the "reasonableness gap" contributes ≈46 to the total expectation–performance gap, which is the largest of all the three categories of the audit expectation gap. The main reason for the high "reasonableness gap" (unreasonable expectations) is lack of awareness of the nature and limitations of the audit function (see 5.1.7 – knowledge of auditor's existing and suggested duties).

Figure 5.1: The Audit Expectation – Performance Gap in Eritrea

Auditors' Perceived Performance[2] ← Audit expectation performance gap → publics' expectation of Auditors[1]

← Performance Gap → ← Reasonableness Gap →

Auditors Existing Duties | Duties reasonably expected of Auditors

← Deficient performance → ← Deficient Standards → ← Unreasonable Expectations → No Gap

← 14%[5] → ← 41%[5] → ← 45%[5] →

Deficient performance

Duty No.	Response %[3]	Contribution %[4]
4	32	23.09
2	30	21.64
18	26.6	19.19
14	19	13.71
10	16.7	12.05
16	14.3	10.32
	138.6	100.00%

Deficient Standards

Duty No.	Response %[3]	Contribution %[4]
1	87.9	22.50
6	87.5	22.40
8a	82.8	21.20
7	72.4	18.54
3	60	15.36
	390.60	100 %

Unreasonable Expectations

Duty No.	Response %[3]	Contribution %[4]
11	75.9	17.77
12	63.6	14.89
8b	55.6	13.01
17	53.3	12.48
13	51.3	12.01
15	48.5	11.35
21	43.3	10.14
20b	35.7	8.35
	427.2	100%

No Gap

Duty No.
5
9
19
20a
22
23

[1] Duties expected of auditors by 25% or more of the public (interest groups excluding auditors).
[2] Duties perceived by the public to be performed poorly by auditors.
[3] Proportion of the public groups whose expectations with respect to the duty are not being fulfilled (refer to tables 5.1, 5.7 and 5.10)
[4] Relative contributions of duties to component (see tables 5.5, 5.8, 5.11).
[5] Relative contributions of each component to the overall gap.

Chapter six - Results

6.1 Analysis of results (Part II)

As discussed in chapter four and shown in Appendix 6 , *part II* of the questionnaire incorporates 9 statements regarding the provision of non-audit services (audit independence), auditor-client relationships, audit quality, audit regulations, audit communication and decision usefulness of the audited financial statements. As discussed in chapter four, these factors are related to the specific problems in Eritrea. The aim was to establish whether there is an expectation gap with regard to these factors. The definition of the audit expectation – gap provided in this research (see chapter two, 2.1) deals with the existing and suggeted duties of an auditor and does not include the opinion of the auditor group. However, the factors mentioned above are not related to the duties of an auditor and can not fit into Porter (1993) framework. Hence, a separte analysis was made regarding those factors. That is, to determine the extent of the audit expectation gap, perception difference between the public group and auditors was examined.

The interest groups were asked to indicate their agreement or disagreement, on a seven-point scale, with each of the nine statements. The statistical tests used were the Kruskal-Wallis one-way variance analysis by ranks (KWA) to test for perception difference among auditors, management and users; and the Mann-Whitney test to test for perception difference between auditors and management, and auditors and users (this is discussed in detail in chapter four 4.2.5.2). The nine statements are categorized and discussed under one of the following three headings for presentation purposes. These are:

6.1.1 Expectations with respect to provision of non-audit services

The interest groups were asked to give their view on four statements with respect to provision of non-audit services in order to examine how the provision of non-audit services influences public perceptions of auditor independence. Table 6.1 shows the details of the results of the means of the interest group's responses with respect to the provision of non–audit services and the results are discussed hereafter:

Table 6.1: Statements regarding the provision of non-audit services

No.	Statements	Mean responses			Chi²
		Auditor	Management	Users	
1.	The auditor can provide tax related services to his client without impairing audit independence.	2.34	2.88	2.44	1.08
2.	The auditor can provide bookkeeping services related to audit client's accounting records or financial statement of the audit client without impairing audit independence.	4.66	4.29	5.00	0.43
3.	The auditor can provide management-consulting services to his client without impairing audit independence.	4.22	1.82 **	3.63	10.45*
4.	The auditor can provide management decision-making functions to an audit client without impairing audit independence.	5.09	4.24	3.94 **	10.52 *

Note: - The mean figures are based on a seven points scale: 1=strongly agree, 4=neutral, and 7=strongly disagree (refer to chapter four for number of respondents)
*: Kruskal-Wallis one-way analysis of variance by ranks significant at $p < .05$
**: Mann-Whitney significantly different from auditors at $p < .05$

The auditor can provide tax related services to his client without impairing audit independence. Table 6.1 shows that the majority of the interest groups agreed with this statement (mean response is less than 4). That is, the majority of the auditors (72%), management

(65%) and users (69%) agreed with this statement (see Appendix 6). Their difference is not statistically significant as indicated by KWA test in table 6.1. Therefore, it seems that the provision of tax related services is accepted by the interest groups as appropriate services that do not impair audit independence.

The auditor can provide bookkeeping services related to audit client's accounting records or financial statements of the audit client without impairing audit independence. The majority of the interest groups disagreed with this statement (mean response is greater than 4), but their difference is not statistically significant as indicated in table 6.1 by KWA test. However, it should be noted that there is a negative reaction towards provision of accounting related services to audit clients by all interest groups indicating that the provision of accounting services to audit clients may impair auditor independence. This response is not surprising given the IFAC prohibition of the provision of bookkeeping or other services related to the audit client's accounting records or financial statements (see chapter two). Moreover, the provision of this service to an audit client is prohibited under the Code of Professional Ethics of Eritrea (2.1.1.4). As previously discussed, some audit firms in Eritrea provide accounting related services to small and medium sized companies. This can either be due to the small companies lacking a capacity to hire full time accountants or due to their not possessing the necessary knowledge to prepare reliable financial statements. However, this highlights a perception of a major independence problem.

The auditor can provide management-consulting services to his client without impairing audit independence. The provision of these services is permissible under the Eritrean and IFAC Code. Table 6.1 indicates that (based on KWA) the largest difference among the interest groups, with regard to provision of non-audit services, exists with respect to "provision of management consulting services to audit clients". The difference among the interest group's responses is statistically significant (p=.0054), at 5% significance level. Based on the Mann Whitney test, the source of difference is between auditors and management (p=.012), at .05 significance level. The majority of management (88%) agree that the provision of management consulting services to audit clients by the auditors did not impair independence, but 50% of auditors and 44% of users do not agree with this statement (see Appendix 6). Referring to table 6.1, auditors and users appear indecisive about this issue as their response was close to the mid-point of the scale. The results also show that the mean responses of management and users are significantly different, in that management regarded the provision of management consulting services as appropriate services, which do not impair audit independence. Therefore, auditors and users have some concern with regard to the provision of management consulting services and it is an issue contributing to the expectation gap.

The auditor can provide management decision-making functions to an audit client without impairing audit independence. The IFAC revised independence standard (see IFAC, 2001) and the Code of Professional Ethics of Eritrea (2.1.1.5) prohibit auditors from performing management decision-making functions to audit clients. From table 6.1 it may be seen that there is a significant difference in perception among the interest groups; hence an expectation gap exists with respect to this statement. As shown in Appendix 6, 65% of the auditors disagreed with this statement, whereas, management and users are indecisive about this issue as the proportion of agreement and disagreement is almost equal.

6.1.1.1 Summary

It may be noted that in two out of the four statements, with regard to the provision of non-audit services, there is a significant difference in perception among the interest groups (see table 6.1). Hence, an expectation gap exists with respect to the two statements. These are: "*the auditor can provide management-consulting services to his client without impairing audit independence*" and *"The auditor can provide management decision-making functions to an audit client without impairing audit independence"*. With regard to the level of agreement, the user group seems to be indecisive regarding both non-audit services. A materially significant difference was found with respect to provision of management consulting services among auditors and management groups, and among users and management groups, in that the management group clearly expect auditors to perform management consulting services. Therefore, some interest groups have stronger concerns regarding auditor independence than other groups.

The results of the study also show that there is a negative reaction towards "*the provision of accounting related services to audit clients*" by the majority of the interest groups. This may indicate that the provision of accounting related services to audit clients may impair audit independence. This result is not surprising given the prohibition on the provision of these services by both IFAC and the Eritrean Code. With respect to the provision of tax related services, auditors, management and users have rather positive views regarding the offering of these services. The provision of tax related services is permissible under IFAC revised independence standards.

6.1.2 Expectations with regard to the auditor-client relationship, audit quality and audit regulations

Interest groups were asked to give their opinion with respect to three statements regarding the auditor-client relationship, audit quality and audit regulation in Eritrea. Table 6.2 provides details of the mean responses of the interest groups regarding these statements and the results are discussed below.

The quality of audit work is adequately regulated by the auditing profession. Table 6.2 shows that (based on KWA) there were significant differences in perceptions among the interest groups with respect to this statement (p=.005), hence an expectation gap exists with regard to this statement. Even though there is a difference in the level of response among the interest groups, overall, the majority of the interest groups disagree with this statement (mean responses more than 3.5). That is, as shown in Appendix 6, 76% of the auditors, 67% of management and 55% of users disagreed with the statement that the quality of audit work is adequately regulated by the auditing profession in Eritrea.

Table 6.2: statements regarding the auditors, audit quality and audit regulations

No.	Statements	Mean responses: Auditor	Management	Users	Chi²
5.	The quality of audit work is adequately regulated by the auditing profession.	5.92	4.10	3.56 **	10.2(
6.	In the last few years the quality of the external audit has improved.	1.84	5.00 **	4.13 **	12.30
9.	To what extent would you agree with the statement that "auditors are heavily influenced by management of the company they are auditing because they are paid by the company".	6.75	4.00 **	3.06 **	23.84

Note: - The mean figures are based on a seven points scale: 1=strongly agree, 4=neutral, and 7=strongly disagree
*: Kruskal-Wallis one-way analysis of variance by ranks significant at $p < .05$
**: Mann-Whitney significantly different from auditors at $p < .05$

The office of the auditor general is responsible for regulating the audit firms in Eritrea, but currently its task is limited to issuance of regulations to issue certificates of professional competence to private auditors and accountants, issuance of codes of professional ethics and standards to be followed in conducting an audit, as well as, in preparing financial statements (ISA standards to be adopted), and the distribution of pro forma financial statements to audit firms as guidance to prepare audited financial statements in accordance with the International Standards. According to the interviews conducted with members of the interest groups and the auditor general of Eritrea, the majority are of the opinion that no steps have been taken to date (since liberation – 1991) to follow up on whether or not the regulations issued by the regulatory body have been followed by the audit firms. Moreover, interviews with all the audit firms and the auditor general indicate that a review of the quality control systems of the audit firms has not been undertaken (since liberation - 1991). The main reason for this problem, according to the auditor general, is a shortage of qualified staff in the office of the auditor general. The researcher is of the opinion that the auditor general needs to solve this problem as soon as possible to assure the public that audit firms provide clients with quality services in accordance with professional standards.

In the last few years the quality of external audit has improved. As may be seen from table 6.2, there was a significant difference in perceptions among the interest groups with respect to this statement (p=.002). The majority of the auditors (88%) agreed with this statement, but only 41% of management and 44% of users agreed with this statement (see Appendix 6). Table 6.2 also reveals that the mean responses for the public group are greater than four indicating that management and users consider that the quality of audits in Eritrea has not improved during the last few years. Some of the possible reasons, obtained through unstructured interviews with the interest groups and the auditor general of Eritrea, are discussed below:

Fee low-balling[6]*:* All shareholders interviewed have expressed their concern about the cost driven appointment of auditors in Eritrea. According to the Code of Professional Ethics in Eritrea, fees should be charged based on the value of the services to the client, and should reflect the time necessarily spent on the work. Some companies in Eritrea at present appoint auditors based on the lowest fee. This has resulted in increased competition among audit firms. Therefore, the audit quality and independence may be compromised if auditors are appointed where 'low-balling' is applied.

Shortage of staff: The number of auditors in Eritrea has been decreasing since the border war broke out between Eritrea and

[6] "Lowballing means 'quoting' fee which is significantly lower than other members would charge for

Ethiopia in 1998. All audit firms interviewed (5 audit firms) stated that their firms are suffering from a shortage of auditors as many of audit staff are now in national service serving, the defence force in Eritrea. Further, they expressed their concerns about the affect of the shortage of audit staff on audit quality.

Non-compliance with regulations: refer to the statement "the *quality of audit work is adequately regulated"* for discussion (see above).

Inadequate training: Attempts have been made in recent years to encourage all audit staff to take ACCA examinations, but these were not fruitful. Audit staff receive training only while on the job and no additional training is given to them. As a result, most are not familiar with recent issues in auditing and accounting. Many students are now studying accounting, majoring in different fields, such as auditing, financial accounting, financial management and taxation in South Africa and it is expected that the quality of audits will improve over time.

To what extent would you agree with the statement that "auditors are heavily influenced by management of the company they are auditing because they are paid by the company". Table 6.2 shows that there are significant differences in opinion among the interest groups (based on KWA) with regard to this statement (p=.000). This statement relates to the audit independence issue. Auditors clearly disagreed (as indicated by their mean response) with the statement that auditors are influenced by the management of the company because they are paid by the company. Management were indifferent, as their response was in the mid-point of the scale. However, as shown in Appendix 6, 62% of the users agreed with the statement that auditors are

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the same services in an attempt to obtain or retain work" (Jackson and Stent, 2001).

influenced by company management since they are paid by the company. Hence, this indicates an independence perception problem and is an issue contributing to the expectation gap.

6.1.2.1 Summary

The results of the study show that, with respect to the three statements, regarding the auditors' client relationship, audit quality and audit regulations, there were significant differences in perceptions among the answers given by the interest groups. These statements were: "*the quality of audit work is adequately regulated by the auditing profession", "in the last few years the quality of external audit has improved", and "to what extent would you agree with the statement that "auditors are heavily influenced by management of the company they are auditing because they are paid by the company"*. Hence, an expectation gap exists with respect to all three statements.

The majority of the interest groups disagreed with the statement that the quality of audit work is adequately regulated by the auditing profession. The main reason was a shortage of qualified staff in the office of the auditor general. With respect to the quality of an audit, management and users were of the opinion that the quality of audit has been deteriorating over the last few years. The reasons for this, among others, were: shortage of audit staff, low-balling, non-compliance with regulations and inadequate training. Finally, with regards to the statement that auditors are heavily influenced by management since they are paid by the company, users have the strongest concern regarding auditor independence in comparison with the other groups.

6.1.3 Statements regarding the decision usefulness and audit communication

Interest groups were asked to give their opinion with respect to two statements regarding the audit report, focusing on two dimensions - the communication of the purpose of the audit, and the decision usefulness of the audited financial statements with regard to financial viablility. Table 6.3 provides details of the mean responses of the interest groups regarding these statements, which are discussed below:

The audit report is useful in the process of assessing whether or not the company is financially viable. Table 6.3 shows that (based on KWA) there are significant differences among the interest groups with regard to this statement (p=.001). Moreover, there are significant differences between auditors and management, and between auditors and users as shown by the Mann-Whitney test in table 6.3. This indicates that there is an expectation gap with respect to this statement. Even though there is difference in the level of responses among the interest groups, the majority agreed with the statement that the audit report is useful in the process of assessing whether or not the company is financially viable.

Table 6.3: Statements regarding audit communication and decision usefulness of audited financial statements

		Mean responses			
No.	Statements	Auditor	Manage ment	Users	Chi^2
8.	The purpose of audit is clearly communicated in the audit report	1.42	1.88	2.20 **	9.27*
7.	The audit report is useful in the process of assessing whether or not the company is financially viable.	1.22	2.81 **	1.94 **	9.38 *

Note: - The mean figures are based on a seven points scale: 1=strongly agree, 4=neutral, and 7=strongly disagree
* Kruskal-Wallis one-way analysis of variance by ranks significant at $p < .05$
**Mann-Whitney significantly different from auditors at $p < .05$

The purpose of audit is clearly communicated in the audit report. As indicated in table 6.3, there are significant differences of opinion among the interest groups with regard to this statement (p=.035). Although there was a difference in the level of their responses, the majority of the interest groups agreed with this statement. The result of the Mann-Whitney test shows that the source of difference is between auditors and users (p=.024), which is significant at .05 significance level. Hence, an expectation gap exists with respect to this statement. This reflects that there is some problem with understanding of the audit report in Eritrea. English is the business language in Eritrea and all financial statements are prepared in English. The problem probably lies with users, mainly shareholders, who are financial, as well as English language, illiterates. They depend on explanation during the auditor's presentation of the audited financial statements at the annual general meeting. Three out of the eight audit partners and audit managers interviewed suggested that the translation of the audit report to "Tigrinya", the national language of Eritrea, would assist towards better understanding of the audit report by the majority of shareholders. To meet the demands of the public, one audit firm has already translated the audit report from English to Tigrinya (see Appendix 10 - audit report in Tigrinya).

6.1.3.1 Summary

The results of this study show that, in regard to both statements regarding decision usefulness and audit communication, there were significant differences in perceptions among the answers given by the interest groups. These statements were: *"the audit report is useful in the process of assessing whether or not the company is financially viable" and "the purpose of audit is clearly communicated in the audit report".* The majority of interest groups agreed that the audit report is useful in assessing whether a company is financially viable. However, the research shows that financial and/or English language illiterate users have some problems in understanding the audit report. Some interest groups have suggested that the translation of the audit report from English (business language in Eritrea) to "Tigrinya", the national language of Eritrea, would assist better understanding of the audit report by shareholders.

Chapter seven – Comparison of results to other studies

7.1 Comparison of results to Porter (1993), Viitanen and Troberg (1999), and Gloeck and De Jager (1993)

The comparison of this study with those of Porter (1993) and Viitanen and Troberg (1999) with respect to the three component parts of the audit expectation–performance gap is presented in table 7.1. The results may not be directly comparable since (a) the groups surveyed are different (b) due to differences in sample size, and (c) this research is based on interviews rather than the use of mail survey. However, as this study relied heavily on those studies in defining the research, an attempt has been made to compare the results. As can be seen from table 7.1, there is difference in the relative contribution of each component to the overall gap between the three studies.

Table 7.1: The relative contribution of each component to the audit expectation performance gap in different studies.

Authors, year and country	Deficient performance gap (%)	Deficient Standards gap (%)	Reasonableness gap (%)
Porter (1993)- Newzealand	16%	50%	34%
Viitanen and Troberg (1999) - Finland	30%	31%	40%
This study - Eritrea	14%	41%	45%

N.B. Gloeck and De Jager (1993) study is not included in table 7.1 as the method of analysis used was different from the studies shown in the above table. Therefore, the comparison is presented later in the chapter.

With respect to the performance of an auditor, as can be seen from table 7.1, the public in Eritrea rated the performance of an auditor higher than the other two studies since the "deficient performance gap" is the lowest (14%) as compared to the Porter study (16%) and the Viitanen and Troberg study (30%). However, with regards to the "deficient standards gap", the results fall between the two studies.

Table 7.1 also shows that, in this study the “reasonableness gap” (unreasonable expectation gap) was the largest contributor to the expectation gap (45%). It is also the largest when compared to the Porter study (34%) and the Viitanen and Troberg study (40%). This indicates the lack of awareness of the audit function among interest groups in Eritrea. It may also indicate that the public group in Eritrea expect auditors to assume more responsibility than they currently accept. However, given the fact that these expectations are unreasonable, it indicates the existence of the highest “knowledge gap” from the three studies. As shown in Appendix 5, In Eritrea, 40% of auditors, 41% of the management and 49% if the users appeared to have limited knowledge of the auditor’s duties, as opposed to 22%, 31% and 30% respectively in New Zealand (Porter, 1993). This finding indicates that interest groups in countries with a developed economy and/or established capital markets (such as Finland and New Zealand) are more aware of the auditor’s responsibility than countries with a developing economy and without capital markets (such as Eritrea).

There are many reasons for the differences in the three studies. Part of the differences can be explained by differences in the legal requirements regarding auditors in these countries, differences in opinion between interest groups’ responses, and the elapse of time (this may include, among other factors: changes in socio-political economy during the last 5-10 years, globalisation and the collapse of giant companies such as Enron). In addition, the number of duties included in this study (25) was less than in the other two studies, in that the Porter study included 30 duties and, in the Viitanen and Troberg study, 33 duties were included. This may affect slightly (increase) the proportional contributions of the duties to the overall gap. 5 duties in Porter study, 8 duties in the Viitanen and Troberg study, and 6 duties in this study did not contribute to the gap. Moreover, some duties were classified in this research, differently to the other two studies, due to recent developments in auditing standards and differences in legal requirements regarding auditors. These aspects are discussed below.

With regard to the duties the auditor should "*report a breach of tax laws to Inland Revenue Department" and "examine and report on the conduct of a company with regard to societal matters"*, Porter (1993) included the duties as contributing to the "reasonableness gap" because of the argument that the social and economic cost may well outweigh the benefits. But in the Viitanen and Troberg (1999) study, these duties were classified as contributing partly to the "reasonableness gap" and partly to the "deficient standards gap" because of the arguments, both in favor and against, classifying the duties in either of the two categories. In this study, 'to report a breach of tax laws to Inland revenue Department' was classified as contributing to the "deficient standard gap" and 'to examine and report on the conduct of a company with regard to societal matters' was classified as contributing to the "reasonableness gap". In the Porter (1993) study, the duty to examine and report on societal matters did not contribute to the gap. But, in this study and the Viitanen and Troberg (1999) study this duty was found to have contributed to the gap. The duty to *"report on the conduct of the company with regard to environmental matters*" was classified in the Porter study under the "reasonableness gap" whilst in the Viitanen and Troberg study it was equally split between the "reasonableness gap" and the "deficient standards gap". In this study it was categorized as an existing duty of an auditor because of the new IFAC standard "consideration of environmental matters in audit of financial statements (IAS 1010). This duty only contributed to the gap in the Viitanen and Troberg study. The duty to "*detect and report theft or misappropriation of corporate assets by non–managerial employee"* was categorized under the "reasonableness gap" (unreasonable expectation) in this study and in the Viitanen and Troberg study since there is no legal requirement for auditors in Eritrea and in Finland to carry out such a duty. However Porter classified the duty as an existing duty because of legal requirements affecting auditors in New Zealand.

Table 7.2 shows the duties which contributed most to the components of the audit expectation–performance gap (including their percentage of contribution). With regard to the "deficient performance gap", there was considerable dissatisfaction in the three studies with respect to going concern issues, and reporting errors or material distortions of the financial statements in the audit report . Regarding the "deficient standards gap", in all the studies fraud detection and reporting to regulatory authorities contributed extensively to the gap. With respect to the "reasonableness gap", the duties which contributed most and which are common to the three studies, as shown in table 7.2, were: reporting and detecting theft/misappropriation of corporate assets by non-managerial employees, and examining and reporting on the efficiency and effectiveness of the company's management.

The comparison of this study with those of Viitanen and Troberg (1999) also shows that many of the interest groups indicated an independence problem with respect to consulting services in both studies. However, the provision of tax related services, especially in small and medium sized firms, was found to be common and expected by the interest groups in both studies. The results of the two studies support the IFAC allowance of tax related services.

Finally, a comparison of the results of this study with those of the Gloeck and De jager (1993) study in South Africa shows that fraud detection responsibility, the going concern problem, and reporting to regulatory authority in certain circumstances are major contributors to the audit expectation gap in these studies. Moreover, the auditor's independence was an issue which contributed to the gap in the two studies, in that the interest groups see an independence problem with respect to the provision of non-audit services, influence by management and the means by which auditor's fees are determined.

Table 7.2: Duties which contributed most to the components of audit expectation – performance in the three studies

Authors, year and country	Deficient performance gap	Deficient standards gap	Reasonableness gap
Porter (1993) New Zealand	Express doubt in the audit report about the company's continued existence (21%).	Report to regulatory authority deliberate distortion of financial information (15%).	Report to a regulatory authority theft of corporate assets by non-managerial employees (14%).
	Disclose in the audit report deliberate distortion of financial information (16%).	Examine and report on the company's internal control (14%).	Disclose in the audit report theft or corporate assets by non-managerial employees (13%).
	Disclose in the audit report misappropriation of company assets by company directors/senior management (14%).	Report to regulatory authority misappropriation of company assets by company directors/senior management (14%)	Guarantee the auditee company is solvent (11%).
Viitanen and Troberg (1999) Finland	The auditor should detect and report illegal acts by company employees which do directly affect the company's bookkeeping (11%).	The auditor should detect and report material fraud committed in the audited company (34%).	The auditor should detect and report theft/misappropriation of corporate assets by non-managerial employees (19%).
	The auditor should when necessary correct the financial statements (10%).	The auditor should report to an appropriate authority deliberate distortion of financial information (20%).	The auditor should examine and report whether the company is managed effectively and efficiently (14%).
	The auditor should examine and report whether the company's continued existence is in doubt (10%).	The auditor should report to an appropriate authority fraud committed in the audited company (16%).	The auditor should report on the future prospects of company (14%).
This study Eritrea	Examine and report whether the audited financial statements contain any material errors or distortions (23%).	Detect material fraud committed in the audited company (21%).	Examine and report on the efficiency and effectiveness of the company's management (16%).
	Examine and report whether the company's continued existence is in doubt (22%).	Report to an appropriate authority fraud committed in the audited company (21%).	Prepare the auditee Company's financial statements (13%).
	Examine and report whether the non-financial information presented in the financial statements (annual accounts) is correct (reliable) (22%).	Report to an appropriate authority theft or misappropriation of corporate assets by company directors (19%).	Report to an appropriate authority theft or misappropriation of corporate assets by non-managerial employees (11%).
	Examine whether the audited company has a satisfactory system of internal control (14%).	Report to regulatory authority deliberate distortion of financial information (17%).	

N.B. The shaded areas show the similarity among the three studies.

Chapter eight – Summaries of results, conclusions and Recommendations

The main aims of this study were to investigate the existence of the audit expectation gap in Eritrea with respect to external auditors, to compare the findings to the research findings of related studies in various countries and, finally, to recommend possible solutions to narrow the gap in Eritrea.

8.1. Summaries of the results

First the expectations regarding the auditor's duties, which were analyzed using the Porter (1993) framework, are presented (part I). This section analyses the duties which contributed most to the audit expectation–performance gap and its three constituent parts ("deficient performance gap", "deficient standards gap" and "reasonableness gap"). Then, an overview of the perceptions of the interest groups (part II), concerning are specific issues related to Eritrea (see chapter one – 1.2 statement of problem) with respect to audit independence, audit regulation, audit quality, and the audit report, are presented and discussed.

8.1.1 Auditors' duties (Porter framework)

With respect to auditors' duties, 25 existing and suggested auditor's duties were analyzed using the Porter framework. Out of the 25 duties, 19 duties were found to contribute to the audit expectation–performance gap, whereas 6 duties did not contribute to the gap (see figure 5.1). Out of the six duties, which did not contribute to the gap, one duty (duty 22), namely "*to detect illegal acts by company officials which do not directly affect the company's accounts*" was a suggested duty of an auditor and was found not to be a duty expected by the interest groups. The remaining five duties (duties 5, 9, 19, 20a, 23) were existing duties of an auditor which were found to be well performed by auditors (see table 5.11). Out of the 19 duties which contributed to the gap, six were found to contribute to the "deficient performance gap", five to the "deficient standards gap" and eight to "reasonableness gap" (unreasonable expectations)(see figure 5.1). The relative contribution of each component to the overall audit expectations–performance gap between the public's expectations of auditors and auditors perceived performance is shown in figure 5.1. Almost half (45%) of the gap results from the "reasonableness gap" (unreasonable expectations), 41% from the "deficient standards gap" and 14% from "deficient performance gap".

The duties which contribute most to the three constituent parts are presented and discussed below.

8.1.1.1 Deficient performance gap

The Duties contributing most to the "deficient performance gap" concerned the auditor's responsibility to examine and report whether:

- the audited financial statements contain any material errors or distortions;
- the company's continued existence is in doubt;
- the non-financial information presented in the financial statements (annual accounts) is correct (reliable); and
- to examine whether the audited company has a satisfactory system of internal control.

With regard to the first duty, concerning the reporting of material error or distortion, there is some dissatisfaction on the part of users. This may reflect that many users expect auditors to do better than what they are currently doing to inform the public about unfavorable conditions which may occur in the auditee company. The second duty concerns going concern reporting. The dissatisfaction of the interest groups with regard to this indicates that auditors are not doing enough in giving early warning signals regarding failure of a company when substantial doubt about the company's continued existence exists. This can be due to the recent failure of some companies in Eritrea (see chapter three – 3.4.4.1 Financial reporting in Eritrea p.76). The answer to the third duty concerning the review of non-financial information shows that the interest groups may be of the opinion that some of the non-financial information may not be consistent with the reported figures in the financial statements. The dissatisfaction of the users with respect to the examining of the internal control system of a company reflects that many users expect the auditor to examine the internal control system of the company properly, especially for small and medium sized companies with poor internal control systems. The users group (especially tax auditors) is of the opinion that auditors accept audit engagements for small and medium companies for audits in an unreasonably short time.

As expected, auditors rated their performance more highly than did the other groups. The management group is more satisfied with the performance of an auditor's duties than the users group. Therefore, overall, it can be concluded that the most dissatisfied group was the users. This can be partly due to the dissatisfaction of tax auditors with respect to the audit of small and medium sized companies with poor internal control systems (especially those which do not keep receipts and have no proper accounting recording system), and due to recent failures of some companies in Eritrea (e.g. Falcon Co.). Moreover, as the analysis of the "knowledge gap" indicated, there seems to also exist a lack of knowledge among users and management about the nature and limitations of the audit function.

8.1.1.2 Deficient standards gap

The duties which contributed extensively to the "deficient standards gap" in Eritrea were detecting and reporting fraud and fraud related issues to regulatory authorities. As discussed in chapter one, Eritrea was a socialist country before its independence and auditors were perceived as government watchdogs during that time. The results of this research show that the perception of the public in Eritrea as to the role and responsibility of an auditor has not changed, despite the fact that Eritrea has shifted from a command economy to a market economy since independence (1991).

Corporate Governance (King II, 2002) has shifted focus from solely profit driven reporting to integrated sustainability reporting, and to the achievement of balanced and integrated economic, social and environmental performance. In Eritrea there is no statutory requirement for auditors to audit social and environmental issues. Moreover, most companies do not disclose environmental and social issues. The majority of the interest groups do not consider these duties to be duties of an auditor, but substantial minorities do so. Due to the growing trend internationally towards environmental auditing, IFAC has issued a standard, "consideration of environmental matters in audit of financial statements" (ISA, 1010). Environmental matters may have an impact on the financial statements. For example: pollution prevention systems, the costs which may have to be accrued for remediation costs; liabilities relating to transportation of, or contamination by, hazardous waste. Therefore, auditors in Eritrea should become familiar with this standard and other guidelines on environmental matters. Moreover, the regulatory body in Eritrea need to be conscious of the consequence of pollution etc. to the environment and should set regulations for environmental issues.

8.1.1.3 Reasonableness gap

The duties contributing most to the "reasonableness gap" concerned the auditors' responsibility to:

-examine and report on the efficiency and effectiveness of the company's management;

-prepare the auditee company's financial statements;

-report to an appropriate authority theft or misappropriation of corporate assets by non-managerial employees.

The responses regarding duties concerning the evaluation of how efficiently and effectively a company has been run, and who prepares the company's financial statements, indicate that users in Eritrea may not be well aware of the duties and responsibilities of auditors and management. It may not be reasonable to expect auditors to evaluate the efficiency and effectiveness of a company as management are involved in the day to day activities of the company and possess more knowledge about the company than auditors. It is also clearly management's responsibility to prepare the financial statements of a company. Therefore, it is unreasonable to expect the auditor to perform those duties. The gap regarding the reporting of misappropriation of assets by non-managerial employees to regulatory authorities, indicate that the public expect auditors to report illegal acts to the regulatory authorities regardless of their affects on the financial statements. This includes misappropriations committed by non-managerial employees, which can be reported to management, who in the absence of collusion, are in a position to address the issue. Overall, it can be concluded that the main reason for the high "reasonableness gap" (unreasonable expectations) is due to the lack of awareness of the nature and limitations of the audit function. This is supported by the analysis of the "knowledge gap", as shown in Appendix 5, that many of the suggested duties of auditors were incorrectly identified as duties of an auditor by the interest groups.

8.1.2 Other factors related to specific problems in Eritrea

8.1.2.1 Provision of non- audit services (audit independence)

With respect to interest groups' perceptions of the influence of non-audit services on auditors' independence, significant differences were found among the interest groups regarding the provision of management consulting services and management decision making functions to audit clients among the interest groups. With regard to the level of agreement, users seem to be indecisive, but auditors and management have shown some disagreement. Therefore, some interest groups have stronger concerns regarding auditor independence than other groups in regard to the two non-audit services. A negative reaction towards the provision of accounting related services to audit clients was held by the majority of the interest groups. This may indicate that the provision of accounting related services to audit clients may impair audit independence. This result is not surprising given the prohibition on the provision of these services by both IFAC and the SEC. With respect to the provision of tax related services, auditors, management and users have rather a positive view regarding the offering of these services. This result supports the IFAC allowance of tax related services.

8.1.2.2 Expectations with regard to audit quality, audit regulations, and auditor-client relationship

The results of the study also show that, for all three statements regarding audit quality, audit regulation and auditor client relationships, there were significant differences in perceptions among the answers given by the interest groups. The majority of the interest groups disagreed with the statement that the quality of audit work is adequately regulated by the auditing profession. The main reason was due to a shortage of qualified staff in the office of the auditor general. With respect to the quality of an audit, management and users were of the opinion that the quality of the audit has not been improved over the last few years. The reasons for this, among others, were: shortage of audit staff, lowballing, non-compliance with regulations and inadequate training. Finally, with regard to the statement that auditors are heavily influenced by management since they are paid by the company, users have the strongest concern regarding the affect on auditor independence in relation to the other groups. Hence an expectation gap exists with respect to these three statements.

8.1.2.3 Expectations with regard to decision usefulness and audit communication

With regard to the decision usefulness of the audit report and audit communication, there were significant differences in perception among the answers given by the interest groups. The majority of the interest groups agreed that the audit report is useful in assessing whether a company is financially viable. However, the research shows that financial and/or English language illiterate users (especially shareholders) have some problems in understanding the audit report as the business language in Eritrea is English and the audit report is prepared in English.

8.2 Conclusion

Overall, the findings of this research suggest that a wide audit expectation gap was found on issues concerning auditors' responsibility for fraud detection, reporting of fraud and other illegal acts to authorities, going concern problems, and for examining the efficiency and effectiveness of the company's management. To a lesser extent, an audit expectation gap was found concerning auditors responsibility for examining the soundness of internal control systems and for preparing the auditee company's financial statements. Auditors' independence was also an important point of concern. Three factors which have the greatest negative influence on auditors' independence were identified by the interest groups. These were: the provision of non-audit services, the danger of lowballing (which leads to competition among audit firms) and an established auditor client relationship. Moreover, inadequate regulation by the regulatory body with regard to audit quality was also found to be a factor which contributed to the gap.

The comparison of this study with those of Porter (1993) and Viitanen and Troberg (1999), in regard to the three component parts of the audit expectation–performance gap, reveals a number of differences. Part of the differences may be explained by differences in legal requirements regarding auditors in these countries, differences in opinion between the interest groups' responses, and the elapse of time. In this study, the "reasonableness gap" (unreasonable expectation gap) was the largest contributor to the expectation gap. This indicates a lack of awareness of the audit function by the interest groups in Eritrea. This finding indicates that interest groups in countries with a developed economy and/or established capital markets (such as Finland and New Zealand) are more aware of the auditor's responsibility than countries with a developing economy and without capital markets (such as Eritrea). Moreover, the comparison of this study with those of Porter (1993), Gloeck and De Jager (1993) and Viitanen and Troberg (1999), shows that fraud detection, going concern, audit independence and reporting to regulatory authorities, including fraud committed by non-managerial employees, are major contributors to the audit expectation gap in these studies.

This research report has indicated evidence of the existence of the audit expectation gap in Eritrea. It has also provided a comprehensive approach towards narrowing the gap (see hereafter). Therefore, it is crucial that the regulatory body in Eritrea becomes conscious about the existence of an audit expectation gap in Eritrea and takes appropriate precautionary measures in order to restore public confidence in financial reporting. Moreover, as Eritrea adopts IFAC standards, the findings of this research can provide additional evidence of the existence of an audit expectation gap in Eritrea to the International Federation of Accountants.

8.3 Recommendations to narrow the expectation gap in Eritrea

The recommendations presented below aim to narrow the audit expectations gap in Eritrea. The focus of the recommendations is on the factors contributing to the audit expectation gap. Therefore, these recommendations should be read together with all the explanations presented in the entire research report.

1. Audit independence

Audit independence is the auditor's most valuable attribute. Negative public perception of auditors' independence may harm the auditing profession's standing with the public. Therefore, to ensure auditor's independence in Eritrea, the following should be done:

a) The regulatory body in Eritrea (auditor general at present) should monitor whether audit firms are adhering strictly to the audit regulations (such as Code of Professional Ethics). The prescribed disciplinary action should be taken if any audit firm violates the regulations set by the regulatory body.

b) The regulatory body should make sure that none of the audit firms are providing non–audit services which is not permissible under the Professional Code of Ethics. This includes, among others, the provision of accounting and bookkeeping related services to audit clients.

c) The appointment of auditors should not be made based on a quoted fee (lowballing). Research has shown that pressure on pricing influences the auditor's financial independence and audit quality (see Wooten 2003). It also results in competition between audit firms. Therefore, as is clearly indicated in the Code of Professional Ethics of Eritrea, fees should be a reflection of the value of the professional services to the client. According to the IFAC Code, the value of the services includes: the skill and knowledge required, the level of training and experience of the person, the time necessarily occupied by each person performing the service, and the degree of responsibility that performing those services entails.

2. Auditor's responsibility:

a. The largest components of the audit expectations–performance gap in Eritrea are derived from unreasonable expectations. Hence, the best way to narrow the unreasonable expectations gap is to educate the public about the role and responsibility of an auditor. In order to increase pubic awareness of the nature and limitations of auditing in Eritrea, audit firms, in collaboration with the regulatory body, should organize and give seminars to appropriate bodies such as the Chamber of Commerce, Ministry of Trade and Industry, Inland Revenue Department and other users of financial statements. With respect to shareholders, auditors can address these issues during shareholders' meetings. Regarding auditors, the "knowledge gap" can be narrowed through training and organizing workshops. One of the reasons for the "knowledge gap" among auditors is a lack of the knowledge of auditors' legal responsibilities. This can be narrowed by teaching accounting students the legal requirements affecting an auditor according to the Commercial Code of Eritrea, as part of the auditing course in higher educational institutions (such as Asmara University). Moreover, auditors should be encouraged to take professional examinations to enable them to develop their professional competence. Finally, the financial knowledge of the pubic and auditors can be enhanced by encouraging companies to publish their annual accounts in different forms of communications media such as newspapers and the internet.

b. With respect to auditors' responsibilities to detect and report fraud and illegal acts, several recommendations have been provided by different researchers in different countries. These include, among others, to clarify and determine exactly the auditor's duties in relation to fraud detection and reporting to authorities (including to which authorities fraud is to be reported). Attention, however, has to be paid to the extent of responsibility that the auditor can assume in reality in this respect, and to the legal protection that can be offered to the auditor (see Porter, 1993 and Viitanen and Troberg, 1999). However, given the difference in the business practices and legal systems of those countries with those of Eritrea, the regulatory body in Eritrea needs first to investigate the application of these recommendations before adapting them to the Eritrean situation. Moreover, the role of an auditor with respect to these factors needs to be communicated to the public.

c. The issue which requires attention with respect to the auditor's responsibility is also the going concern problem. Eritrea has recently adopted IFAC standards and auditors need to follow, as guidance, ISA 570 "the auditor's consideration of an entity's ability to continue as going concern" on their responsibility with regard to identifying and responding, when conducting an audit of financial statements, to events and conditions that may be indicative of significant doubt regarding an entity's ability to continue as a going concern.

3. *Quality of an audit*: to improve the quality of an audit the following needs to be done:

   a. All audit firms should apply adequate quality control in compliance with applicable quality control standards (IFAC quality control standards).

b. The quality of an audit should be adequately regulated by the regulatory body. This can be achieved by establishing a quality review committee comprised of, among others, auditors, users and preparers of financial statements, the auditor general, academics, representatives from the Chamber of Commerce, Inland Revenue Department and other financial institutions. This committee will perform quality reviews of auditor activities and enforce compliance with applicable professional standards. The period in which the quality review is conducted may be decided by the quality review committee.

c. Auditors should reject the demand for an audit in an unreasonably short time, especially for small and medium sized companies.

4. Audit communication

To improve audit communication through the audit report and to meet the demands of the public, one audit firm has already translated the audit report from English to Tigrinya. However, the researcher is of the opinion that, if all audit firms develop their own translation of the audit report into Tigrinya, this may result in different interpretations by different audit firms. Therefore, the translation of the audit report to "Tigrinya" should first be approved by the regulatory body, and then a standard audit report in "Tigrinya" should be developed by the regulatory body in collaboration with all audit firms. Moreover, in wording the standard audit report in "Tigrinya", careful assessment should be made in order to maintain consistency with the English version.

5) S elf- regulation Vs independent regulatory body

The present independent regulatory body in Eritrea is the auditor general, but a shortage of staff and a lack of resources prevent it from regulating the audit firms. If the regulatory body lacks the resources and capacity to effect the above recommendations, self-regulation of the profession would be a partial and short-term solution. However, in the light of international developments in the wake of the collapse of major companies such as Enron, Tyco, Worldcom and Parmalat, independent regulatory bodies exist, or are in the process of being established (including in South Africa), in most countries to oversee the accounting profession. Therefore, in the long run, a move to an independent regulatory body will be unavoidable to ensure that there is confidence at national and international level in the regulation of the accounting profession.

Chapter nine – Suggestions for future research

This research has provided evidence of the existence of an audit expectation gap in Eritrea. Future research will need to focus on how the expectation gap can be narrowed or reduced. Education has been suggested as one means of reducing the gap. Therefore, an appropriate form of education for both the public and auditors needs to be investigated. Moreover, to narrow the "knowledge gap" among auditors, the source of their attitudes needs first to be determined. This could be done by studying the perception differences between students and auditors. This would help to establish when auditors develop such perceptions; at university or through years of practice in auditing?

Research should also address how to improve the quality of an audit and enhance auditors' independence in Eritrea so as to reduce the expectations gap. This can be partly done by investigating whether self-regulation, an independent regulatory body or both is needed to monitor audit quality and discipline auditors over audit failures. Future research should also consider examining whether audit communication can be improved by translating the audit report from the English language (the business language) to the Tigrinya language (the national language of Eritrea). Another potential area of interest centers around fraud detection and reporting to authorities. For further discussion, refer to recommendations on fraud detection and reporting to authorities.

The results of this study were compared to studies made in Finland and New Zealand as similar survey instruments were employed in all three studies. The levels of the expectation gap are different in the three countries as discussed in chapter seven. This differences could be partially explained due to differences in culture, legal system, institutional background, level of knowledge of the interest groups, differences in opinion and the elapse of time. Therefore, similar research in other African countries, such as South Africa, might improve understanding of what determines the image of the auditor and his role in society, as pointed out by Beelde et al. (1997:16) . Even though, Gloeck and De Jager (1993), and Minter and Bourne (1995) (concerning the messages communicated by the standard audit report) have studied the audit expectation gap in South Africa, the deficient performance gap and the reasonableness gap (unreasonable expectations) were not considered in those studies. Therefore, future research will need to study the "deficient performance gap" to determine the perceptions of the public concerning the performance of auditors with respect to their existing duties. This would help to identify the "deficient performance gap". Moreover, the "reasonableness gap" (unreasonable expectations) also needs to be studied to determine the level of "knowledge gap" among auditors and public groups regarding the suggested duties of an auditor.

With respect to provision of non-audit services, the Gloeck and De Jager (1993) study indicates that the provision of non-audit services had a negative effect on an auditor's independence, and they suggest a ban on the provision of other services to auditors' clients in South Africa. However, the ministerial panel for the review of the Draft Accounting Profession's bill (2003) in South Africa stated that it is not practical to statutorily limit non–audit services performed by the auditor to an entity. The researcher is of the opinion that various studies (including this study) and professional bodies have indicated that, even though the provision of the majority of non-audit services has a detrimental effect on auditor's independence, some non-audit services were found to be widespread and expected by the public, for example the provision of tax related services to an audit client (see Viitanen and Troberg, 1999; Jenkins and Drawezyk, 1999; and IFAC, 2001). Therefore, to continue the examination of auditor independence in South Africa, future research is needed to assess the influence of particular non-audit services on auditor independence. The result may help the auditing profession in South Africa in their deliberations.

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Appendix 1

The mean of interest group responses with respect to Auditors' existing and suggested duties (section 1 and section 3).

		Section 1 (Is a duty)[1]			**Section 3** (should be a duty)[2]		
Duty	**The auditor should**[2]	**A**[3]	**M**[3]	**U**[3]	**A**	**M**	**U**
1	Detect material fraud	0.36	0.65	0.75	0.56	0.76	0.75
2	Examine and report – going concern.	0.81	0.65	0.00	0.88	0.65	0.50
3	Report breaches of tax laws	-0.13	0.53	-0.38	0.07	0.53	0.23
4	Examine and report - material errors or distortions	1.00	0.76	0.88	1.00	0.88	0.88
5	Report material departure from Generally Accepted Accounting Practice	1.00	0.63	0.88	1.00	0.88	0.88
6	Report fraud to an appropriate authority.	0.86	0.75	0.13	0.86	0.88	0.63
7	Report to regulatory authority deliberate distortion of financial information.	0.29	0.20	0.14	0.43	0.20	0.86
8a	Report to an appropriate authority theft or misappropriation of corporate assets by company directors/senior management	0.79	0.60	-0.08	0.79	1.00	0.29
8b	Report to an appropriate authority theft or misappropriation of corporate assets by non-managerial employee.	0.13	0.50	-0.69	0.13	0.43	-0.39
9	Audit the accounts to verify the correctness and accuracy of the balance sheets and profit and loss accounts.	0.73	1.00	0.88	0.73	1.00	0.88
10	Report to the general meeting the manner in which they carried out their duty and their comments on the report to the board of directors.	0.10	0.63	0.33	0.10	0.63	0.73
11	Examine and report on the efficiency and effectiveness of the company's management.	0.19	0.33	-0.14	0.25	0.73	0.29
12	Prepare the auditee Company's financial statements	-0.25	0.18	0.38	-0.25	0.18	0.38
13	Verify every transaction of the audited company.	-0.56	-0.06	-0.07	0.44	0.18	-0.07
14	Examine the internal control system.	1.00	1.00	0.57	1.00	1.00	1.00
15	Guarantee the audited financial statements are accurate.	-0.29	-0.18	0.38	-0.29	0.06	0.13
16	Recommend approval of the accounts	0.41	0.83	0.43	0.48	0.83	0.57
17	Report on the future prospects of the company.	0.41	0.83	0.43	0.48	0.83	0.57
18	Examine and report non-financial information	0.56	0.07	0.60	0.56	0.33	0.73
19	Acquaint himself/herself with other information included in the annual report.	0.44	0.2	0.39	0.69	0.33	0.85
20a	Examine and report on Environmental matters	0.29	-0.6	-0.85	0.10	-0.6	-0.08
20b	Examine and report on societal matters	-0.17	-0.6	-0.83	0.16	-0.6	0.076
21	Plan the internal control system of the company.	-0.87	-0.5	0.00	-0.87	-0.38	0.14
22	Detect illegal acts by the company officials which don't directly affect the company's accounts.	-0.53	-1.00	-0.71	-0.48	-1.00	-0.29
23	Inform the directors and the general meeting breach of legal or statutory requirement.	0.81	0.54	0.17	0.81	0.85	0.66

[i] Mean of interest group responses signifying that the duty is an existing duty of an auditor.
[1] Mean of interest group responses signifying that the duty should be a duty of an auditor
[2] The duties are abbreviated from their expression in the questionnaires.
[3] a = Auditors, M = Management, U= users (refer chapter four for number of respondents

Appendix 2:

The Proportion of the interest group signifying the auditor should perform the duty (section 1 and section 3)

		Frequencies (percentages)					
		Section 1 (Is a duty)[1]			Section 3 (should be a duty)[2]		
Duty	**The auditor should[3]**	**A[4]**	**M[4]**	**U[4]**	**A**	**M**	**U**
1	Detect material fraud	68.8	82.4	87.5	78.1	88.2	87.5
2	Examine and report – going concern.	90.6	82.4	50.0	93.8	82.4	75.0
3	Report breaches of tax laws	43.3	76.5	30.8	53.3	76.5	38.5
4	Examine and report - material errors or distortions	100	88.2	93.8	100	94.1	93.8
5	Report material departure from Generally Accepted Accounting Practice	100	81.3	93.8	100	93.8	93.8
6	Report fraud to an appropriate authority.	93.1	87.5	56.3	93.1	93.8	81.3
7	Report to regulatory authority deliberate distortion of financial information.	64.3	60.0	57.1	71.4	60.0	92.9
8a	Report to an appropriate authority theft or misappropriation of corporate assets by company directors/senior management	89.7	80.0	46.2	89.7	100	64.3
8b	Report to an appropriate authority theft or misappropriation of corporate assets by non-managerial employee.	56.5	75.0	15.4	56.5	78.6	30.8
9	Audit the accounts to verify the correctness and accuracy of the balance sheets and profit and loss accounts.	86.7	100	93.8	86.7	100	93.8
10	Report to the general meeting the manner in which they carried out their duty and their comments on the report to the board of directors.	54.8	81.3	73.3	54.8	81.3	86.7
11	Examine and report on the efficiency and effectiveness of the company's management.	59.4	66.7	42.9	62.5	86.7	64.3
12	Prepare the auditee Company's financial statements	37.5	58.8	68.8	37.5	58.8	68.8
13	Verify every transaction of the audited company.	21.9	47.1	46.7	28.1	58.8	46.7
14	Examine the internal control system.	100	100	78.6	100	100	100
15	Guarantee the audited financial statements are accurate.	35.5	41.2	31.3	35.5	52.9	43.8
16	Recommend approval of the accounts	70.4	91.7	71.4	74.4	91.7	78.6
17	Report on the future prospects of the company.	46.9	46.7	26.7	53.1	46.7	60.0
18	Examine and report non-financial information	78.1	56.3	80	78.1	66.7	86.7
19	Acquaint himself/herself with other information included in the annual report.	71.9	60.0	69.2	84.4	66.7	92.3
20a	Examine and report on Environmental matters	35.5	20.0	7.7	54.8	20.0	46.2
20b	Examine and report on societal matters	41.4	20.0	8.3	58.1	20.0	53.8
21	Plan the internal control system of the company.	6.7	25.0	50.0	6.7	31.3	57.1
22	Detect illegal acts by the company officials which don't directly affect the company's accounts.	22.6	0.0	14.3	25.8	0.0	35.7
23	Inform the directors and the general meeting breach of legal or statutory requirement.	90.6	*76.9	58.3	90.6	92.3	83.3

[1] Proportion of interest group signifying that it is an existing duty of an auditor

[2] Proportion of interest group signifying that auditors should perform the duty

[3] The duties are abbreviated from their expression in the questionnaires.

[4] a = Auditors, M = Management, U= users (refer chapter four for number of respondents)

Appendix 3 : Assessment of auditors' performance based on the mean of the interest group responses and the proportion of interest groups signifying auditor's duties are poorly performed.

		Mean			Frequency (%)		
		Section 2 (auditor's performance)[1]			Section 2 Poorly (1-2)[2]		
Duty	The auditor should[3]	A[4]	M[4]	U[4]	A	M	U
2	Examine and report – going concern.	4.7	2.7	2.8	0.0	28.6	25.0
4	Examine and report - material errors or distortions	4.5	4.2	2.8	3.1	13.3	42.9
5	Report material departure from Generally Accepted Accounting Practice	4.8	4.1	3.8	0.0	0.0	20.0
9	Audit the accounts to verify the correctness and accuracy of the balance sheets and profit and loss accounts.	4.9	4.6	3.6	0.0	0.0	20.0
10	Report to the general meeting the manner in which they have carried out their duties and their comments on the report to the board of directors.	4.6	4.7	2.8	0.0	0.0	36.4
14	Examine the internal control system.	4.5	3.8	2.6	3.3	5.9	27.3
16	Recommend approval of the accounts	4.3	4.4	2.4	5.3	0.0	30.0
18	Examine and report non-financial information	3.9	4.1	3.0	8.0	12.5	25.0
19	Acquaint himself/herself with other information included in the annual report.	4.1	4.3	3.1	8.7	11.1	12.5
20a	Examine and report on Environmental matters	3.9	3.5	3.5	9.1	66.7	0.0
23	Inform the directors and the general meeting breach of legal or statutory requirement.	4.4	4.0	3.5	3.7	11.1	0.0

[1] Mean of auditor's performance on 1-5 ordinal scale where 1 denotes 'poorly', and 5 'excellently (2.9 has been adopted as point of differentiation between satisfactory and unsatisfactory performance). The results are presented only for existing duties of an auditors.

[2] Proportion of the interest group signifying that auditors perform the duty poorly. The results are presented only for existing duties of an auditors.

[3] The duties are abbreviated from their expression in the questionnaires.

[4] a = Auditors, M = Management, U= users (refer chapter four for number of respondents

Appendix 4: The Proportion of the users group – Bank loan officers and Tax Auditors signifying the auditor should perform the duty.

		Frequencies (percentages)			
		Section 1 (Is a duty)[1]		**Section 3** (should be a duty)[2]	
Duty	**The auditor should[3]**	**BLO[4]**	**TA[4]**	**BLO**	**TA**
1	Detect material fraud	80.0	100.0	90.0	100.0
2	Examine and report – going concern.	50.0	50.0	60.0	100.0
3	Report breaches of tax laws	40.0	0.0	40.0	33.3
4	Examine and report - material errors or distortions	90.0	100.0	90.0	100.0
5	Report material departure from Generally Accepted Accounting Practice	90.0	100.0	90.0	100.0
6	Report fraud to an appropriate authority.	70.0	33.3	80.0	83.3
7	Report to regulatory authority deliberate distortion of financial information.	75.0	33.3	87.5	83.3
8a	Report to an appropriate authority theft or misappropriation of corporate assets by company directors/senior management	62.5	20.0	55.6	80.0
8b	Report to an appropriate authority theft or misappropriation of corporate assets by non-managerial employee.	28.6	0.0	28.6	33.3
9	Audit the accounts to verify the correctness and accuracy of the balance sheets and profit and loss accounts.	90.0	100.0	90.0	100.0
10	Report to the general meeting the manner in which they carried out their duty and their comments on the report to the board of directors.	55.6	100.0	77.8	100.0
11	Examine and report on the efficiency and effectiveness of the company's management.	50.0	33.3	75.0	83.3
12	Prepare the auditee Company's financial statements	60.0	83.3	60.0	83.3
13	Verify every transaction of the audited company.	33.3	66.7	33.3	66.7
14	Examine the internal control system.	87.5	66.7	100.0	100.0
15	Guarantee the audited financial statements are accurate.	30.0	33.3	40.0	50.0
16	Recommend approval of the accounts	77.8	60.0	88.9	80.0
17	Report on the future prospects of the company.	22.2	33.3	33.3	100.0
18	Examine and report non-financial information	77.8	83.3	88.9	83.3
19	Acquaint himself/herself with other information included in the annual report.	85.7	50.0	85.7	100.0
20a	Examine and report on Environmental matters	14.3	0.0	14.3	83.3
20b	Examine and report on societal matters	14.3	0.0	28.6	83.3
21	Plan the internal control system of the company.	50.0	33.3	50.0	66.7
22	Detect illegal acts by the company officials which don't directly affect the company's accounts.	12.5	16.7	12.5	66.7
23	Inform the directors and the general meeting breach of legal or statutory requirement.	66.7	50.0	83.3	83.3

[1] Proportion of interest group signifying that it is an existing duty of an auditor
[2] Proportion of interest group signifying that auditors should perform the duty
[3] The duties are abbreviated from their expression in the questionnaires.
[4] BLO – Bank loan officers, TA – Tax auditors (refer chapter four for number of respondents)

Appendix 5: The 'knowledge gap' of the Interest Groups

Duty	**The auditor should**[3]	**A**[3]	**M**[3]	**U**[3]
1	Detect material fraud	31.2	17.6	12.5
2	Examine and report – going concern.	9.4	17.6	50.0
3	Report breaches of tax laws	59.4	23.5	75.0
4	Examine and report - material errors or distortions	0.0	11.8	6.2
5	Report material departure from Generally Accepted Accounting Practice	0.0	23.5	6.2
6	Report fraud to an appropriate authority.	15.6	17.6	43.7
7	Report to regulatory authority deliberate distortion of financial information.	43.7	47.1	50.0
8a	Report to an appropriate authority theft or misappropriation of corporate assets by company directors/senior management	18.7	29.4	32.3
8b	Report to an appropriate authority theft or misappropriation of corporate assets by non-managerial employee.	59.3	47.1	87.5
9	Audit the accounts to verify the correctness and accuracy of the balance sheets and profit and loss accounts.	18.7	0.0	6.2
10	Report to the general meeting the manner in which they carried out their duty and their comments on the report to the board of directors.	46.9	23.5	31.3
11	Examine and report on the efficiency and effectiveness of the company's management.	40.6	41.2	62.5
12	Prepare the auditee Company's financial statements	62.5	41.2	31.3
13	Verify every transaction of the audited company.	78.1	52.9	56.3
14	Examine the internal control system.	0.0	0.0	31.3
15	Guarantee the audited financial statements are accurate.	65.6	58.8	68.7
16	Recommend approval of the accounts	40.6	35.3	37.5
17	Report on the future prospects of the company.	53.1	58.8	75.0
18	Examine and report non-financial information	21.9	53.0	25.0
19	Acquaint himself/herself with other information included in the annual report.	28.1	47.0	43.7
20a	Examine and report on Environmental matters	65.6	82.4	93.7
20b	Examine and report on societal matters	62.5	82.4	93.7
21	Plan the internal control system of the company.	93.7	76.5	62.5
22	Detect illegal acts by the company officials which don't directly affect the company's accounts.	78.1	100.0	87.5
23	Inform the directors and the general meeting breach of legal or statutory requirement.	9.4	41.1	56.3
	Measure of total knowledge gap	**1002.7**	**1029.3**	**1225.9**
	Measure of average 'knowledge gap' per duty	**40.108**	**41.172**	**49.036**

[1] Proportion of interest groups responses selecting either 'yes' for duties which are not duties of auditors, and 'no' for those which are (incorrect option) or 'not aware'.

[2] The duties are abbreviated from their expression in the questionnaires

[3] a = Auditors, M = Management, U= users (refer chapter four for number of respondents

Appendix 6: Perception of the interest groups with respect to audit Independence, auditors-client relationship, audit quality and audit communication (see part II of the questionnaire).

		Auditors			Management			Users		
No	Statements[1]	A[2]	N[2]	D[2]	A	N	D	A	N	D
1	Provision of tax related services to audit client	71.8	15.6	12.5	64.7	23.5	11.8	68.8	6.3	25.0
2	Provision of bookkeeping or accounting related services to audit client	28.1	18.8	53.1	47.1	5.9	47.1	25.0	12.5	62.5
3	Provision of management-consulting services to audit client	40.6	9.4	50.0	88.2	11.8	0.0	50.0	6.3	43.8
4	Provision of management decision-making functions to an audit client	31.3	3.1	65.6	47.1	11.8	41.2	37.5	25.0	37.5
5	The quality of audit work is adequately regulated by the auditing profession.	17.0	6.7	76.3	23.0	10.0	67.0	30.1	15.0	54.9
6	In the last few years the quality of external audit has improved.	87.5	9.4	3.13	41.2	11.8	47.1	43.8	18.8	37.5
7	The audit report is useful in the process of assessing whether or not the company is financially viable.	100.0	0.0	0.0	76.5	5.9	17.7	87.5	12.5	0.0
8	The purpose of audit is clearly communicated in the audit report	93.8	3.1	3.1	88.2	5.9	5.9	87.5	6.3	6.3
9	Auditors are heavily influenced by management of the company they are auditing because they are paid by the company.	0.0	0.0	100.0	58.8	5.88	35.3	62.5	18.8	18.8

[1] The duties are abbreviated from their expression in the questionnaires.
[2] A = Agree, N = Neutral, D = Disagree (refer chapter four for the number of respondents)

Appendix 7: Questionnaire

1. Your Position ______________________________
2. Educational level ______________________________

Part I - Views related to existing and suggested auditor's duties

Please indicate the extent of your agreement in the appropriate box.

		Is it an Existing Duty of an auditor?			If an existing duty, how well is it performed by the auditor?							Should the duty be performed by the auditor?		
		Yes	No	Unaware	Not a duty	Poorly				Very well	Can't judge	Yes	No	Unaware
No.	The auditor should	+1	-1	0	N/A	1	2	3	4	5	0	+1	-1	0
1.	Detect material fraud committed in the audited company.													
2.	Examine and report whether the company's continued existence is in doubt.													
3.	Report breaches of tax laws to the Inland Revenue Department.													
4.	Examine and report whether the audited financial statements contain any material errors or distortions													
5.	Report all material departure from Generally Accepted Accounting Practice in preparing and presenting financial statements to give a true and fair view.													

		Is it an Existing Duty of an auditor?			If an existing duty, how well is it performed by the auditor?							Should the duty be performed by the auditor?		
		Yes	No	Unaware	Not a duty	Poorly				Very well	Can't judge	Yes	No	Unaware
No.	The auditor should	+1	-1	0	N/A	1	2	3	4	5	0	+1	-1	0
6.	Report to an appropriate authority fraud committed in the audited company.													
7.	Report to regulatory authority deliberate distortion of financial information.													
8.	Report to an appropriate authority theft or misappropriation of corporate assets by company: a) Directors/senior management													
	b) Non-managerial employees													
9.	Audit the accounts of the company to verify the correctness and accuracy of the balance sheets and profit and loss accounts.													
10.	Submit to the annual general meeting a written report on the manner in which they have carried out their duties and their comments on the report to the board of directors.													
11.	Examine and report on the efficiency and effectiveness of the company's management.													
12.	Prepare the auditee Company's financial statements													
13.	Verify every transaction of the audited company.													
14.	Examine whether the audited company has a satisfactory system of internal control.													
15.	Guarantee the audited financial statements are accurate.													

		Is it an Existing Duty of an auditor?			If an existing duty, how well is it performed by the auditor?							Should the duty be performed by the auditor?		
		Yes	No	Unaware	Not a duty	Poorly				Very well	Can't judge	Yes	No	Unaware
No.	The auditor should	+1	-1	0	N/A	1	2	3	4	5	0	+1	-1	0
16.	Recommend approval of the accounts and make such comments thereon as they think fit or refuse to recommend approval giving reasons for referring the matter back to the directors.													
17.	Report on the future prospects of the company.													
18.	Examine and report whether the non-financial information presented in the financial statements is correct (reliable).													
19.	Acquaint himself/herself with other information included in the annual report, such as management discussion and analysis, in order to determine whether material errors (inconsistencies) exist which need to be amended or reported on in the auditor's report.													
20	The auditor should examine and report on the conduct of the company with regard to a) Environmental matters													
	b) Societal matters													
21.	Take responsibility for planning the internal control system of the company.													
22.	Detect illegal acts by the company officials which don't directly affect the company's accounts.													
23.	Where the auditors find breaches of legal or statutory requirements, they shall inform the directors and, where grave irregularity or breaches have occurred, they shall inform the general meeting.													

Part II - Views about audit Independence, auditors, audit quality and audit communication

Please indicate the extent of your agreement by ticking the relevant box.

		Strongly agree 1	2	3	Neutral 4	5	6	Strongly Disagree 7
1.	The auditor can provide tax related services to his client without impairing audit independence.							
2.	The auditor can provide bookkeeping services related to audit client's accounting records or financial statement of the audit client without impairing audit independence.							
3.	The auditor can provide management-consulting services to his client without impairing audit independence.							
4.	The auditor can provide management decision-making functions to an audit client without impairing audit independence.							
5.	The quality of audit work is adequately regulated by the audit profession.							
6.	In the last few years the quality of external audit has improved.							
7.	The audit report is useful in the process of assessing whether or not the company is financially viable.							
8.	The purpose of audit is clearly communicated in the audit report							
9.	To what extent would you agree with the statement that ''auditors are heavily influenced by management of the company they are auditing because they are paid by the company''.							

Appendix 8 : Existing and Suggested duties of an auditor in Porter (1993) study

Duty No.	Existing and suggested duties of an auditors
2.1	Prepare the auditeee company's financial statement
2.2	Guarantee audited financial statements are accurate
2.3	State whether financial statements fairly reflect the company's affair.
2.4	Guarantee the audited company is solvent
2.5a	Report to a regulatory authority doubts about the company's continued existence
2.5b	Express doubts in the audited report about the company's continued existence
2.6	Ensure compliance with companies' legislation
2.7	Report breaches of tax laws to IRD
2.8a	Detect theft of corporate assets by non-managerial employees
2.8b	Detect theft of corporate assets by company directors/senior management
2.9	Detect deliberate distortion of financial information
2.10a	Report to regulatory authority theft of corporate assets by non – managerial employees.
2.10b	Report to regulatory authority misappropriation of company assets by company directors/senior management
2.10c	Report to regulatory authority deliberate distortion of financial information
2.11a	Disclose in the audit report theft of corporate assets by non–managerial employee.
2.11b	Disclose in the audit report misappropriation of company assets by company directors/senior management.
2.11c	Disclose in the audit report deliberate distortion of financial information
2.12	Report to regulatory authority suspicions of fraud.
2.13a	Detect illegal acts by a company officials which directly affect the company's accounts
2.13b	Detect illegal acts by company officials which don't affect directly the company's account.
2.14a	Disclose in the audit report illegal acts which directly affect the company's accounts.
2.14b	Disclose in the audit report illegal acts which don't directly affect the company's accounts.
2.15	Report to a regulatory authority illegal acts uncovered in the company
2.16	Examine and report on the fairness of non–financial information
2.17	Examine and report on the company's internal control
2.18	Examine and report on the efficiency and effectiveness of the company's management.
2.19	Audit published half-yearly company reports
2.20	Examine and report on the fairness of financial forecasts
2.21	Consider and report on the company's impact on its local community
2.22	Verify every transaction of the auditee company

Appendix 9: The Audit Expectation – Performance Gap in New Zealand (Porter 1993)

Auditors' Perceived Performance[2] ← Audit expectation performance gap → publics' expectation of Auditors[1]

← Performance Gap → | ← Reasonableness Gap →

Auditors Existing Duties | Duties reasonably expected of Auditors

← Deficient performance → | ← Deficient Standards → | ← Unreasonable Expectations →

← 13%[5] → | ← 50%[5] → | ← 34%[5] →

Duty No.	Response %[3]	Contribution %[4]
2.5b	37	21
2.11c	27	16
2.11b	25	14
2.14a	25	14
2.8b	21	12
2.13a	21	12
2.8a	19	11
	175	100

Duty No.	Response %[3]	Contribution %[4]
2.10c	76	15
2.17	75	14
2.10b	74	14
2.15	64	12
2.20	63	12
2.19	62	12
2.12	60	11
2.5a	55	10
	529	100

Duty No.	Response %[3]	Contribution %[4]
2.10a	51	14
2.11a	47	13
2.4	41	11
2.13b	40	11
2.14b	40	11
2.2	39	11
2.7	33	9
2.16	32	9
2.18	25	7
2.22	16	4
	364	100

[1] Duties expected of auditors by 20% or more of the public (interest groups excluding auditors).
[2] Duties perceived by the public to be performed poorly by auditors.
[3] Proportion of the the non-auditor group whose expectations with respect to the duty are not being fulfilled
[4] Relative contributions of duties to component.
[5] Relative contributions of each component to the overall gap.

Appendix 10: Audit report and its translation in Tigriyna language (continuation on p. 198).

ABRAHAM ISAAC & COMPANY
AUTHORISED AUDITORS & ACCOUNTANTS

P. O. Box 3446 — Asmara
Tel. 121132/35 — Eritrea

AUDITORS' REPORT

TO THE MEMBERS OF
NACFA CORPORATION
SHARE COMPANY

We have audited the financial statements set out on pages 6 to 12 which have been prepared on the basis of the accounting policies set out on page 9.

RESPECTIVE RESPONSIBILITIES OF MANAGEMENT AND AUDITORS

The management is responsible for the preparation of the financial statements. It is our responsibility to form an independent opinion, based on our audit, on those statements and to report our opinion to you.

BASIS OF OPINION

We conducted our audit in accordance with International Standard on Auditing. Our audit includes examination, on a test basis of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgements made by the management in preparation of the financial statements, and of whether the accounting policies are appropriate to the company's circumstances and are consistently and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements. We believe that our audit provides a reasonable basis for our opinion.

4

OPINION

The number of the board of directors of the company was reduced from 9 to 7 with the unanimous consent of the shareholders who attended the annual general meeting without calling an extra-ordinary general meeting as required by article 423 of the Commercial Code of the State of Eritrea.

The auditors for the year of 2002, were appointed by the board of directors in accordance with the mandate given to them by the shareholders who attended the annual general meeting. According to article 368 of the Commercial Code of the State of Eritrea, shareholders themselves were supposed to appoint auditors.

Except for the foregoing paragraphs, in our opinion, proper books of account have been kept and the accounts when read in conjunction with the notes thereto, give a true and fair view of the state of the company's affairs at 31 December, 2002 and of its profit and cash flow for the year then ended and comply with International Accounting Standards.

In our opinion, the information given in the Directors' Report is consistent with the accounts, in so far as the information relates therewith.

Authorised Auditors and Accountants

ABRAHAM ISAAC & Co. P. O. Box 3446 Asmara-Eritrea Authorised Auditors & Accountants

Date. 14th May 2003

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ጸብጻብ ኦዲተራት

ንሰብ ብርኪ
ናቕፋ ኮርፖሬሽን

ካብ ገጽ 6 ክሳብ ገጽ 12 ተዘርዚሩ ዘሎ ናይ ናቕፋ ኮርፖሬሽን ሚዛን-ሕሳብ፣ ምጣነ መኽሰብን ክሳራን ከምኡውን ሓጸርቲ ናይ ሕሳብ መግለጺታትን (Financial Statements) በቲ ካብ ገጽ 9 ተገሊጹ ዘሎ ናይ ሕሳብ ሜላ (Policy) ምርኩስ ብምግባር መርሚርናዮ።

ምድላው ናይ ሚዛን ሕሳብን ምጣነ መኽሰብን ክሳራን (Financial Statements) ናይ ምምሕዳር (Management) ሓላፍነት ክኸውን ከሎ ናህና ከም ኦዲተራት ሓላፍነትና ነቲ ዝቐረበ ሕሳብ መርሚርና ኣብ ርትዓውነቱ ሞያዊ ርእይቶ ምሃብዩ።

ሰረት ሞያዊ ርእይቶ

ፋይናንሳዊ መግለጺታት ናይ ናቕፋ ኮርፖሬሽን ሞያና ብዝጠልቦ ቅቡል ብዝኾነ ኣገባብን ሜላን ኣዲት ብምኽታል መርሚርናዮ። መርመራና ኣብ ርትዓውነት ኣሃዛት ጥራይ ዘተኮረ ዘይኮነስ፣ ከማኡውን ነዚ ሕሳብ ንምድላው ብምምሕዳር (Management) ዝተተግበሩ ጥንቃቐን ናይ ምምዛን ክእለት ዝተኸተልዎ ናይ ሕሳብ ሜላን ዘጠቓለለ እዩ።

ኣብ ምምርማር ፋይናንሳዊ መግለጺታት ናይ ናቕፋ ኮርፖሬሽን መደብ መርመራና ንሰራሕና ዝሕግዙ ኣድላዪ ሓበሬታታትን መርትዖታትን ተኣኪቡ ርትዓውነት ናይቲ ሕሳብ ከነራጋግጸሉ ብዘኽእለና ኣገባብን ሜላን እዩ ተቐይሱ። ስለዝኾነ ድማ ዘካየድናዮ መርመራ ሞያዊ ርእይቶና ንምሃብ እኹል እዩ ኢልና ንኣምን።

ሞያዊ ርእይቶ

ብዝሒ ኣባላት ቦርድ ካብ 9 ናብ 7 ኣብ ዓመታዊ ኣኼባ ብዝተረኽበ ሰብ ብርኪ ተወሲኑ ኣብ ግብሪ ዊዒሉ። ይኹን እምበር ዓንቀጽ 423 ናይ ንግዲ ሕጊ ኤርትራ ከምዝጠልቦ ፍሉይ ኣኼባ ተጸዊዑ ክውሰን ምተገብአ።

ን2002 ዘገልግሉ ኦዲተራት ኣባላት ቦርድ ብሰብ ብርኪ ብዝተነብረሎም ሓላፍነት መሰረት ተመዚዞም። ይኹን እምበር ዓንቀጽ 368 ንግድ ሕጊ ኤርትራ ከምዝጠልቦ በቲ ኣብቲ ጉባኤ ዝተረኽቡ ክምዘዙ ምተገብአ።

ብርእይቶና ብጀካ እዘን ኣብ ላዕሊ ተጠቒሰን ዘለዋ ናይ ዕቃቤታት ሑጥበ-ጽሑፋት ቅቡል ናይ ሕሳብ መዛግብቲ ተታሒዞም፣ እቲ ቀሪቡ ዘሎ ናይ 2002 ሕሳብውን ርትዓውን ናይቲ ትካል ግቡእ ሕሳብ የንጸባርቕ እዩ ኢልና ንኣምን።

ዓወት ንሓፋሽ

ኣብርሃም ኢሳቕ ብጾቱን

14th May 2003

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