INVESTOR PERCEPTION OF AUDIT EXPECTATION GAP

A STUDY OF THE NAIROBI SECURITIES EXCHANGE

BY

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DECLARATION

I declare that this Research Project is my original work and has not been submitted for examination in any other university or institution of learning.

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DEDICATION

To my parents who sacrificed greatly to start me out in life with an education that did lay the foundation and desire in my heart to pursue greatness.

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ABBREVIATIONS

ANOVA	Analysis of Variance
CBK	Central Bank of Kenya
CEO	Chief Executive Officer
GDP	Gross domestic product
ICAEW	Institute of Chartered Accountants in England and Wales
NSE	Nairobi Securities Exchange
SPSS	Statistical Package for Social Sciences
UK	United Kingdom

ABSTRACT

The study sought to establish investor perception of audit expectation gap. This was informed by the well-publicised collapses of large companies and the eventual incrimination of the external auditors, during recent time. This has highlighted the audit expectation gap. There is a common viewpoint that for an individual who is interested in a company, they should easily rely on the financial statements that have been audited as an assurance of business viability. The individuals who invest in companies trust that the information given by the external auditor acts as a guarantee of a company's financial condition. There thus seems to exist a relationship between investor perception and the audit expectation gap, the narrowing or widening of this expectation gap is thus pegged on investor understanding of the role of auditors.

The study made a comprehensive analysis of audit expectations on investors and auditors' own view of the expectations gap. The study utilized both analytical and descriptive methodology to examine the gap between audit expectation and investors perception. The study used a questionnaire as the key tool for collecting data. Covariance and correlation matrices were used to identify how investors' decisions (market, usefulness, responsibility and nature of audit factors) were influenced by the audit expectation.Statistical analysis was used to capture empirical data on all variables explaining the audit expectations gap and to determine the factor with the greatest impact on audit expectations gap. A second regression analysis was applied to capture auditors' responses concerning the audit expectations gap. It was therefore a longitudinal study which sought to investigate the investor perception on audit expectation gap by studying the Nairobi Securities Exchange. The study found out that there is indeed an expectations gap in the role of external auditors in company audits. The analysis shows that there is a positive correlation between audit expectations gap and investor perception. The results from statistical analysis indicate that audit expectation gap increases by 0.2378 when investor perception increases by a unit. This basically explains the hypothesis of how investors will have a look on the audited financial statement to allocate their investment resources. The findings on the investor perception of audit expectations gap can be used to inform a number of policy decisions at improve understanding of the work that auditor's do. Future researchers may focus on how improved stakeholder participation in the audit process may reduce the investor expectations gap and how this can improve investor understanding of what auditors actually do.

CHAPTER ONE: INTRODUCTION

1.1 Background to the study

An investor is defined as one who commits capital with the expectation of financial returns that will make up to investor the duration that the funds are held, the rate of inflation and the uncertainty of the future payments. This involves a trade-off of present consumption for a higher level of future consumption. Numerous investments instruments are available in the market. This vary based on liquidity, marketability and risk. Investor choices of investments are dependent on their risk appetite, expected return and needs.

Fundamental analysis is a technique of assessing an investment by trying to gauge its intrinsic value by studying economic, financial and other qualitative and quantitative factors. The intrinsic value of an investment is the real value of an investment based on underlying assumption of its true value including all angles of the business. The main focus of our study is value investors who follow fundamental analysis and typically evaluate a security in an quest to measure its intrinsic value. The biggest part of fundamental analysis involves delving into the financial statements.

Benjamin Graham pioneered the concept of intrinsic value whereby the underlying true value of a share is based on its potential earnings power. Warren Buffett a student of Graham is another great proponent of fundamental analysis, he advocates for a value investment strategy. This involves focusing on the value of the business and its market price.

1.1.1 Investor Perception

Perception is defined as a state of awareness either conscious or unconscious in the mind that is shaped through sensory signals that are stimulated by memories, existing conditions and outlook. This could also be driven by one’s understanding of one's surroundings. The convergence of complex sensory inputs creates a perception that is unreliable and unverifiable as it may not be based in reality.

This is also described as the method by which individuals decipher and arrange sensation to produce a significant experience of the world. It is an intricate mental process and varies from one person to another based on the needs, values and notions of the individual. The numerous literatures of investors’ behaviour have been analytically passed on to behavioural scientists in current periods (Shiller. 2000; Shefrin, 2000). They depend mainly on two key propositions of traditional finance theory first that the investors make decisions that are rational and that in making forecast about the returns of securities in the future they are unbiased (Sultana, 2010). Individuals attempt to increase their utility' based on classic wealth criteria to make a choice between consumption and investment through time (Merikas et al., 2004).

Practically, awareness and perception are impossible to differentiate, because they are part of one perpetual process (Lindsay and Norman, 1977). Perception research provides actionable feedback from investors who have considered the impact of audited financial statements and the audit expectation gap. Investors will invest in companies that are perceived to have strong intrinsic value.

1.1.2 Audit expectation gap

The first individual to interpret the expectation gap was made by Liggio in the year 1974. He described this to be the gap between the level of expected performance as envisaged by the auditor and the individuals who are the users of the financial statement. This was further expounded in 1978 by the Cohen Commission, where this is exhibited by the difference between what the public expects and needs and the auditors' actual accomplishment. In 1993 Jennings et al. stated that the expectation gap is the disparity between the people deem to be the responsibilities and duties of the auditing profession and what services and outcome the profession actually provides.

Porter in 1993 elucidated this concept as the gap between the society's expectations of external auditors and the actual performance professionals in the auditing field. In the same year Monroe and Woodliff defined the expectation gap as the disparity between the beliefs of auditors on their responsibilities and duties and the public's beliefs over the same concerning the auditors.

According to Porter (1997) uncovering fraud was the primary aim of performing an audit before the 1920's phase. By the 1930's this had however changed such that the primary aim of conducting an audit was verification of accounts. The change could perhaps have been occasioned by the difficulty for auditors to examine all transactions due to the increase in size and volume of companies' transactions. As a consequence the responsibilities of detecting fraud within their organisation rests with management. Management should also put in place the appropriate internal control to prevent fraud from taking place in the companies. The existence of the audit expectation gap can be deduced to be as a result of the individuals who use accounting information not having adjusted to the changed role.

1.1.3 Nairobi Securities Exchange

The Nairobi Securities Exchange herein NSE was registered in 1954 as a voluntary association of stockbrokers registered under the Societies Act. Currently, NSE has 64 listed companies from various sectors, such as banking, agricultural, commercial and services, automobile and accessories, construction and allied, energy and petroleum, insurance, investment, manufacturing and allied, investment services, telecommunication, and growth enterprise market.

1.4.1 Role of audit

Auditing plays a key role in serving the interests of the public in as far as strengthening accountability and by developing assurance in the financial reporting“(ICAEW, 2005). The audit process is an objective review and assessment of the financial statements of a company to ensure that the accounts are a fair and reflection of the transactions they claim to represent. The Companies Act No. 17 of 2015 require that all limited liability excluding small as outlined in the Act should prepare annual financial statements that show a true and fair view of the company’s financial status and have their annual reports audited by independent Certified Public Accountants.

The main role of auditing is to express an opinion to the users on the credibility of the financial reports and whether the financial statements are free of material misstatements. This then gives an assurance to the public that what they are reading is what they think they are reading. This further gives confidence on adherence to the accounting standards, compliance with regulatory and professional codes and boosts confidence that the annual reports are a 'true and fair' representation of all angles of the company’s business (Nicholson, 2007). It is argued that both the external and internal monitoring roles which are carried out by the external auditors and management have an impact on the firm value. This roles are perceived to be substitutes or complements to each other (Saibal, 2007).

1.2 Research Problem

In recent times, the well-publicised collapses of large companies and the eventual blaming of the external auditors has shone light to the existing audit expectation gap. There is a common view that a stakeholder in a company should be able to gauge business viability based on the on the audited financial statements. Shareholders expect that the audit report provides an assurance of a company’s financial status. There thus seems to exist a relationship between investor perception and the audit expectation gap, the narrowing or widening of this expectation gap is thus pegged on investor understanding of the role of auditors.

The annual reports provided by the reporting audit professionals’ boosts confidence in the accuracy of financial reporting by ensuring compliance with GAAP. However the usefulness of the signature and the auditors opinion is largely reduced when the performance of the auditors is below public expectations. At the time of writing (September, 2016), the Kenyan financial sector has experienced a deepening crisis, given visibility by banking failures and state intervention through the central bank to restore public confidence in financial institutions.

In the past 5 years the country has also seen significant scandals in the manufacturing industries for example accounting scandals in Mumias Sugar, Haco tiger brands and Uchumi supermarket to highlight a few. This has led to significant criticism of the auditors from whose opinions have emerged over the years. This has stirred significant response from the accounting profession and policy makers. It then appears that stakeholders have a differing view of what auditing should be. This has led to the expectation gap.

Baker (2002) argues that the living heart of any profession is public confidence in a professionals. A betrayal of such confidence leads to destruction of the professional function as it becomes useless (Porter et al., 2005). This statement is reinforced by a report in the Business Daily on 12 April 2016 stated that “For years, auditors have had cosy relationships with their clients, helping them cook books, declare sham profits, evade taxes, and conceal shady dealings and under-report debt. Uchumi Supermarkets, for instance, manipulated financial accounts to the tune of Sh1 billion, hoodwinking shareholders that all was well in the retail chain. When it all blew up in the managers’ face, the auditors defended themselves stating that the misreporting happened at the very top of the company making it hard to find inconsistencies – a truly onerous position to take”.

Obiamaka (2008) did a study to highlight determinants leading to the audit expectation gap in Nigeria. In the UK, Humphrey et al (1993) reviewed the expectation gap by determining the perception of individuals of audit expectations issues. A study by Kamau (2004) sought to find out whether an expectation gap exists in the audit of quoted companies in Kenya. Epstein and Geiger (1994) conducted a survey of stock investors that showed evidence of the expectation gap between the assurances auditors give and the expectation of investors and other users of financial statements. A study by Musyoka (2010) on the Nairobi Securities exchange concluded there is existence of the audit expectation gap. Based on the literature findings, most of the studies carried out have concentrated on identifying the existence of an expectation gap and the determining the role of auditor's disclosure.

In Kenya this is a study of its kind as the researcher could not locate any published research on the extent to which investor perception has impacted the audit expectation gap. Some of the previous studies concentrated on the existence of audit expectation gap and those that concentrated on factors contributing to the expectation gap arrived at several factors. The focal point and concern in this current study attempted to fill this research gap by answering the question: What is the effect of investor perception on audit expectation gap by studying investors on the NSE.

1.3 Objective of the study

To investigate the investor perception on audit expectation gap by studying the Nairobi Securities Exchange.

1.4 Value of the study

The incentive of carrying out this study in Kenya is that auditing profession is under pressure as a result of the increasing public expectations. This empirical study is now more than ever important to first investors who form part of the audit beneficiaries they will have a better understanding of the statutory objectives of external audit in order to reduce any unreasonable expectations of the external auditor.

This study will also be beneficial to auditors who are the custodians of public confidence in financial statements. They will be able to understand what the public expects of them as far as the role and responsibilities. This is critical in as far as protecting their interests and being relevant.

The study will be useful to the accounting profession who as a result of the dynamic business environment may have to re-examine the role of external auditors. The study will also be useful to scholars as the study findings will be used as sources of literature in the library and will contribute to the development of the theory of audit expectation gap and investor perception. The gaps mentioned in the study act as a guide to any intended research to assist in topic selection and identify the areas that need further study.

CHAPTER TWO: LITERATURE REVIEW

2.1 Introduction

This chapter contains a review of the theories and empirical studies that are deemed to be relevant in explaining that the relationship between investor perception and the audit expectation gap.

2.2 Theoretical Review

2.2.1 Nature of audit expectation gap

The critical judgement of auditors by the public can be seen in the environment that is keen on engaging in legal battles this typifies the modern auditing profession. This view can be traced to the disparity that exists in the view of the expected performance of the profession (Boyd et al 2001:56). The collapse of firms and the eventual bankruptcy and losses incurred by the shareholders has led to these negative assessments. The idea of audit expectation gap was defined in the ’80s, as the profession was facing increased public critic. Eden, Ovadia and Zuckerman (2003:32) proposed that the disparity arises when the investors who presume that the financial reports are an absolute truth and thus as a result do not question it have expectations that are not in tandem with the characteristics of the tasks that are undertaken by the auditor’s task which are guided by the obligation set within the law and regulations.

Jennings et al. (1993), in looking at how audit decision tools can be used to enhance compliance of auditors to set regulation are of the conclusion that the expectations gap that exists within the audit profession is the disparity when one compares what society awaits from the profession and is actually availed to them. Lowe (1994) in reviewing the expectation gap within the legal profession system advances a similar description. Porter (1993) undertook an experimental study of the disparity in the performance gap in reference to expectation gap in audit. He went ahead and described the gap within the auditing profession to be the gap between the society's expectations of external auditors and the actual performance of the professionals in the auditing field. Pierce and Kilcommins (1995) went further and describe the expectations gap to arise as a result of the external auditors' comprehension of what their role is and the duties that they should undertake and related this to the expectancy of stakeholders and the public.

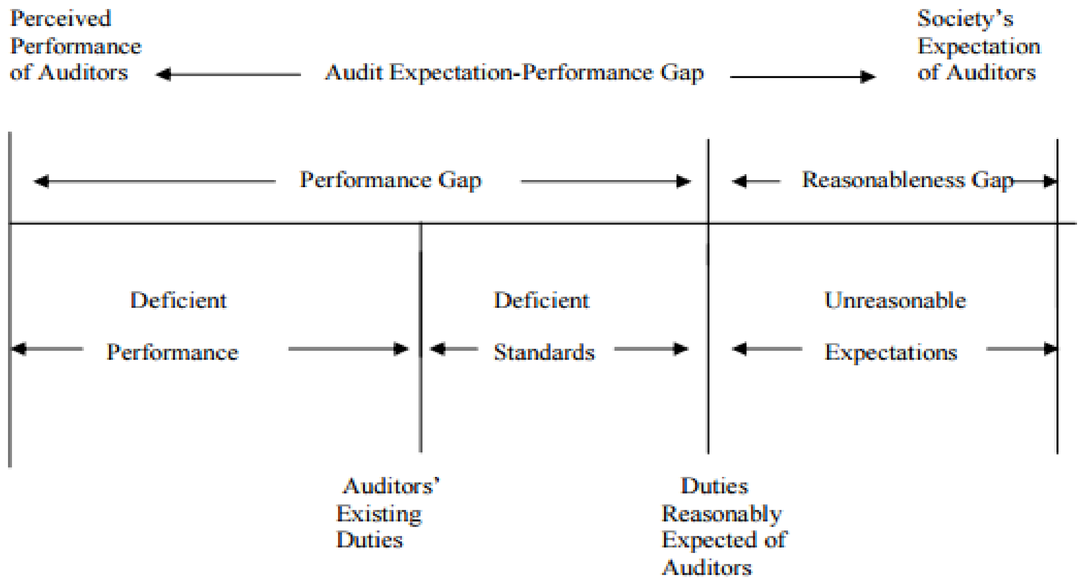
A practical introduction to the expectation gap is given by Humphrey (1997) where he gives a basic description of this concept as an account of the view that auditors are undertaking their set role and obligations in a way that is at conflict with whatever ideas and wants of the stakeholders for whose welfare the profession normally carry out the audit process for. He more narrowly describes this concept further as a "role-perception gap". This is from the view that stakeholder are capable of doing a comparison of actual with the idea held of what is within reason to expect of a professional auditor. It can thus be inferred that there could be an "ignorance gap" that by educating the public this can result in the narrowing of the expectations gap.

The expectation gap was described as the disparity between levels of anticipated performance as visualised by those within the profession and stakeholders who then go ahead and make use of the financial statements. It is seen as the difference when we take a look at what the public notion of the professionals within the auditing system and the actual performance as perceived by those in the society (Shaikh & Talha, 2003).

It can thus be deduced that the gap arises when there are differing notions between the profession and the auditors in as far as what the auditors' obligations and responsibilities are and the message that is contained in the audit report (Wolff et al., 1999; Koh & Woo, 1998; Frank et al., 2001). According to Godsell (1992), the view that audited financial reports should be an assurance of going concern, legitimacy and business viability is common among the stakeholders in a company. Therefore, if by any chance, without notice a company is in serious financial difficulty, it is widely assumed that auditors should be made accountable for these financial disasters.

2.2.2 Structure of expectation gap

FIGURE 2.1 The structure of the audit expectation gap



Porter, B. A. (1993), An empirical study of the audit expectation- performance Gap, Accounting and Business Research, Vol. 24, No. 93, pp. 49-68).

Porter (1993) undertook an experimental study of the disparity in the performance gap in reference to expectation gap in audit. Porter's research determined that the gap has two major parts; first he identified that the reasonableness gap, this shows the disparity between what society counts on auditors to meet and what they can actually within reason be expected to be able to do. Secondly the performance gap, this measure the disparity between what the societies can within reason expect the reporting auditors to meet and what they are deemed to fulfil. This can be further subdivided into deficient standards, this is described as the difference between the duties which within reason can be assumed of auditors and auditors' existing duties as defined by regulations and professional guidelines. Secondly the deficient performance is then described as the difference between the envisaged axiom of accomplishment of the current duties that the auditors' do and what is then deemed to be their accomplishment by the public.

2.2.1 Investor perception

Phillip Kotler describes perception to be a process by which people choose, organizes and decipher the information given so as to create a picture that is meaningful. There are theories that have been formulated to expound on how and why individuals make financial decisions on how to spend, invest, save and borrow funds (Belsky and Gilovich, 1999) and the factors that determine the investment decision making. Traditional finance main theory is that individuals are rational. Psychologists have however differed with this notion, by arguing that people normally act in irrational manners as a result of mental and emotional biases.

In order to model financial markets and the behaviours of the firms, modern finance theory begins from a set of standard truths about individual behaviour (DeBondt & Thaler, 1994). Individuals are thus said make rational choices this is driven by the dislike risk, the anticipated usefulness and the unbiased prognosis of the future. The advocates of behavioural finance assert that the traditional model is incomplete since it does not consider the investors behaviour and is sets to only stand within certain set boundaries Olsen (1998). Barberis & Thaler (2003) have concluded that some financial developments are better expounded using models that recognise that investors can be irrational and as such speculators cannot offset all incidences of mispricing.

Raines & Leathers (2011) determined that financial behaviour is driven by the psychological inclinations by the institutions. Conventional judgements is thus used by investor since they lack confidence in their own judgement. The lapse in confidence can be attributed to the difficulty in precisely computing the long term return from investments. As such professional investors would only be on the lookout for how the market has valued investment, under the mass inclination within a duration of three months to a year (Keynes, 1936).

2.3 Determinants of audit expectation gap

There are many and varied factors that have been identified to be the potential factors contributing to the existence audit expectation gap. One of the factors is the investor perception, this is a key determinant of audit expectation gap. This is based on the individuals understanding of the role and responsibilities of the reporting auditors are expected to fulfil and the meaning behind the information that is contained within the audit report. Bogdanoviciute, (2011) indicates that the factors to be too much expectations of users of financial statements as far as the duty of the auditor and lack of understanding about auditor’s role and responsibilities. Epstein and Geiger in 1994 argued that society's failure to acknowledge the features and the limitations that are inherent in an audit process is one of the factors that attribute to the expectation gap.

Second is the subjective nature of the auditing process. In 1997, Humphrey determined that the existence of the audit expectation gap is due to the fact that key audit terms and concepts are open to individual interpretation. This terms include concepts like reasonable assurance, true and fair view, reliability etc. These concepts and terms are not clearly described within the accounting standards that govern the audit process and are thus free for individual interpretation.

Third, self-regulation process of the auditing profession. Humphrey et al (1992) suggested the disparity in expectation can be attributed to the profession being a monopoly and in that sense servings its own self-interest. As such their socially conscious role undertaken by the profession is deemed a façade. The study also identifies other factors leading to the gap to be; time lag between when the audit is carried out and when the public reviews the performance of the auditors work as such this is a hindsight review, the unreasonable expectation resulting from ignorance of the stakeholders the probabilistic nature of auditing; changing expectation and accountability requirements that arise as a result of the corporate crisis that have rocked the global financial markets and the features of auditing that tends to be probabilistic in nature.

According to Lee and Ali (2008), the presence of audit expectation gap can be associated to features of the auditing function that is complicated in nature; the contradictory role of auditors; review of auditors' performance is based on past performance; delays in responding to changing demands; and the auditing profession being a self-regulated process. They attest that expectation gap is harmful to the reputation of the auditing profession.

2.4 Empirical Studies

In 1994, Epstein and Geiger undertook a survey of stock investors that showed evidence of the expectation gap between the assurances auditors give and the expectation of investors and other users of financial statements. Of the 246 investors surveyed, they found that over 70 per cent believed that auditor needs to be bear responsibility for their work. Further 47 percent of those surveyed expected that absolute assurance of no material misstatements due to errors should be given on the audited financial statements.

Humphrey et al (1993) through the use of a questionnaire investigated the expectation gap in the UK by determining the perception of expectation issues by people. The issues investigated included the role of the auditor to an investor, the regulations that have been put in place on audit firm, what prohibitions are placed on the professional firms and the expected decisions they should make? The respondents were bankers, accounting professional, journalists, management in finance, and investment analysts. A large difference was noted from the survey in as far as the views of the auditors and respondent on the nature of auditing. The results confirmed existence of the gap between the target groups' view in areas such as nature of audit action and perceived performance (Khaleghi, 2004).

According to Godsell (1992), the view that audited financial reports should be an assurance of going concern, legitimacy and business viability is common among the stakeholders in a company. Therefore, if by any chance, without notice a company is in serious financial difficulty, it is widely assumed that auditors should be made accountable for these financial disasters. A report in the Economist dated 13 December 2014 right after the Tesco and Barclays scandal in the UK stated that they had noted a pattern where investors have disregarded the auditors, as a result of scenarios where value investors have used financial statements assuming they were the truth, and then erupt in fury when they lose everything when the tides changes.

Jim Peterson, a former lawyer for Arthur Andersen that audited Enron stated that "An the opinion issued by auditors really means that the financials are more or less ok as far as auditors can tell at the time. He further asserts that no one has paid any attention to it for 30 years.

Obiamaka (2008) did a study to highlight elements leading to the audit expectation gap in Nigeria. She did a sample of four hundred (400) individuals made up of one hundred (100) each of bankers, investors/ stock brokers, auditors and accountants was selected in Lagos and Ogun States. It was discovered that there is a statistically large disparity between the opinion of auditors and stakeholders in Nigeria with regard to the statutory role of external auditors, how reliable audit reports are in making investment decisions, qualities and interpretation of audit report and independence. Factor analysis revealed that the audit expectation gap in Nigeria is multi-faceted but consists mainly of misunderstanding of the external auditor's responsibilities by the users of audited financial statements.

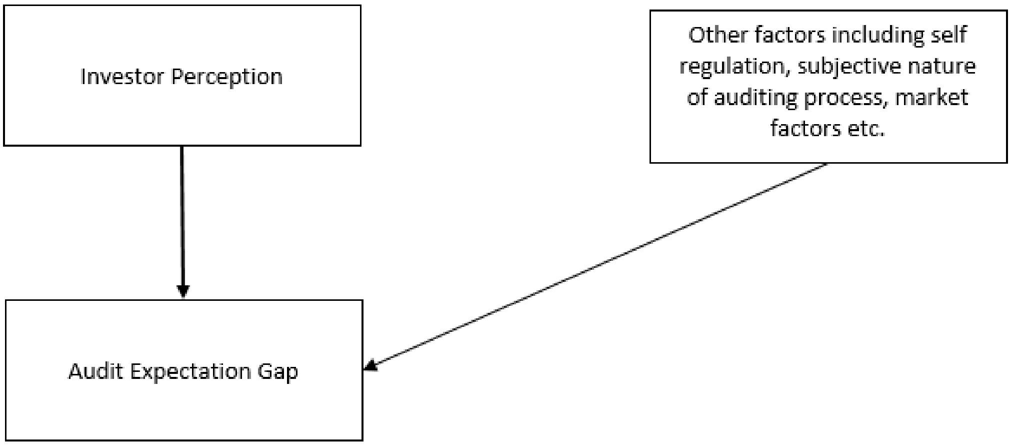
Comprehensive studies have been done in various regions into the view of stakeholders of the auditors' report and their expectations where in Egypt Dixon et al (2006); Singapore Low (1980) and Hong Kong Leung and Chau (2001) found that numerous users of financial reports are of the view that the identification of inconsistencies is the main audit aim and that the reporting external auditors have an obligation to identify all existing irregularities. This is a misinterpretation and manifests the existence of an audit expectation gap between auditors and investors with regard to the actual role of auditors.

A study by Musyoka (2010) concluded that audit expectation gap does exist within the Nairobi Securities Exchange. The respondents were 40 investors for quoted companies in Kenya. The study found out that the investors expected much more from auditors with regard to their responsibility, did not deem the audit report to be reliable, seldom used the audit report in making their decisions and finally it was established that increased level of the audit expectation gap was a key contributor to low levels of investor confidence.

A study by Kamau (2004) sought to find out whether an expectation gap exists in the audit of companies listed in Kenya. He concluded that in fact there exists an expectation gap. The expectation gap was found to be prevalent on the responsibilities that the auditors have in as far as it relates to detection of instances of fraud, the prevention and the integrity of the internal controls framework of the entity. To a lesser extent, in regards to the responsibility of maintaining of the accounting records within a firm a gap was noted an expectation gap was found. A narrow gap was also observed on the issue of the objectivity of the auditor with the majority agreeing that the auditor is unbiased and objective.

2.3 Conceptual Framework

Fig 2.2 The relationship between investor perception and audit expectation gap



2.4 Summary of Literature Review

The previous studies have revealed that the audit expectation gap exists. The study through its literature findings indicate that stakeholders have high expectation on the work of the auditors and hence expect them to provide them with credible reports that will enable them make informed investment decision. The studies have also revealed that the main factor to the expectation gap by the users of audited financial statement is the misunderstanding of auditor’s responsibilities.

CHAPTER THREE: RESEARCH METHODOLOGY

3.1 Introduction

In this chapter the research approach used by the researcher to accomplish the research objective is discussed. The chapter is sectioned into; research design, population, sample design, data collection, validity and reliability and data analysis.

3.2 Research Design

A research design is described by Dul and Hak (2008) as an arrangement of conditions for collecting and then going ahead to analyse data in a manner that intends to combine relevance with the research purpose. This study used a descriptive research design. A descriptive research design involves observing the characteristics in a given population or phenomenon being studied without manipulating it in any way. The advantage of this design is that the researcher is can incorporate individual experience as well as going ahead to use various forms data. It gives researchers the ability to look at what they are studying in various aspects and provides a bigger picture as opposed to other types of research design (Kothari, 2004).According to Cooper and Schindler (2004), by the very nature descriptive studies are more structured and formal and this can have clearly stated hypotheses.

3.3 Population

Population is defined as the total collection of elements that the researcher wishes to make inferences (Cooper and Schindler, 2006). The target population for the study comprised of all individual investors in the NSE and auditors in audit firms in Kenya.

3.4 Sample Design

Sampling provides a valid alternative to a census when it would be impracticable to survey the entire population due to the budget, time constraints and urgent need for results after collecting the data (Saunders, Lewis and Thornhill, 2007). Because the population under study is large, a sample of 40 investors and 40 auditors was selected through convenience sampling.

3.5 Data Collection

The study was based on primary data collection that was done through the use of self-completion questionnaires which were distributed to target respondents and collected later, i.e. “drop and pick later method”. This method was taken in order to allow the respondents to have enough time to respond to the question efficiently and effectively. A preliminary structured questionnaire was prepared by the researcher and presented to the supervisor for evaluation and approval.

3.6 Validity and Reliability

Mugenda & Mugenda in their study undertaken in 2003 define data reliability to be the extent to which a research instrument give rise to unchanging outcomes. They go further and define data validity to be the extent to which results gotten from the analysis of the data is representative of the phenomenon under study. The quantitative questionnaires were validated, coded and checked for any errors and omissions before the data entry is done.

3.7 Data Analysis

Mosby (2009), describes data analysis as classifying, coding and tabulating information that is required by the researcher in order to carry out both quantitative or qualitative analyses on the data as per what has been set as the research design. The research was quantitative in nature. Descriptive statistics was used to explain the primary features of the data. Descriptive statistics include measures of central tendency i.e. mean scores, percentages, measures of variability (ANOVA), and measures of relative frequencies. The research findings were first be coded and classified into categories. The Statistical Package for Social Sciences (SPSS) package was used for the data analysis. Data display included tables and graphs.

3.7.1 Gap analysis

Gap analysis refers to an analysis model used to identify, specify and execute the gap between the existing and wanted situation. The gap can be the difference between the actual situation and ideal condition. The analysis includes 3 tollgates:

a) Comparing the auditors understanding of their role with the investor perception of the role of auditors.

b) Determining the "gaps" between the existing perceived role and the identified guidelines

c) Taking decision of ways to fulfill the gaps

3.7.2 Analytical Model

The regression model used in analyzing this relationship effect is as follows:

$$Y=\alpha+\beta_1X_1+\beta_2X_2+\beta_3X_3 + \beta_4X_{4+}\varepsilon$$

Where

Y= Audit expectation gap

α = Regression constant

$X_{1=}$Investor perception

$X_{2=}$Nature of auditing

$X_{3=}$Regulation process

$X_{4=}$Market factors

$\beta_1\beta_2\ldots Bn$ = coefficients of variables X in the regression model

ε = Error term normally distributed about the mean of zero

3.7.3 Test of Significance

Y represents the dependent variable (audit expectation gap) and $\beta_1\beta_2\ldots B_n$ are the coefficients of the variables in regression model. The basis of the model is to help in determining the relationship between the investor perception and audit expectation gap on the Nairobi Securities Exchange. Correlation was used to establish the relationship between the variables in question. The test of significance was performed at 95% level of confidence using Analysis of Variance (ANOVA) and F test and coefficient of determination to determine whether the model is a good predictor.

CHAPTER FOUR: DATA PRESENTATION, ANALYSIS AND INTERPRETATION

4.1 Introduction

This chapter focuses on the return rate of the questionnaires, demographic information of the respondents, data interpretation and discussions of findings. The presentations were done based on the research questions. Further the data was analyzed by the SPSS software to examine the audit expectation gap.

4.2 Questionnaire return rate

Completion rate is the proportion of the sample that participated as intended in all the research procedures. In this study, all the respondents participated. This means that the researcher's method for data collection was accurately reliable with 100% response rate. We obtained responses from 40 auditors and 40 investors.

4.3 Demographic findings

The study was carried randomly among two major groups, auditors and investors with different heterogeneity characteristics to capture the different group audit expectations. The sample consisted of 53.8% female auditors, 46.2% male auditors, 65% female investors and 35% male investors as shown in table 4.1.

Table 4.1 Gender of Audit Respondent

	Frequency	Percent	Cumulative Percent
Male	18	46.2	46.2
Female	21	53.8	100.0
Total	39	100.0	

Source: Winnie Operu (2016)

The study has a mean score center at 2.3 which shows overall respondent have minimum of bachelor's degree for the academic qualification but with different length of experience. Most of the respondents have accounting experience as shown below in table 4.2. 100% of the auditors respondent had at least a bachelor`s degree this is so since the requirement to practice requires academic or professional education level of such.

Table 4.2 Length of Accountancy experience of Auditors

	Frequency	Percent	Cumulative Percent
	6	15.4	15.4
below 1	5	12.8	28.2
1-10yrs	28	71.8	100.0
Total	39	100.0	

Source: Winnie Operu (2016)

4.4 Frequency of respondents

The researcher sort to establish the frequency of responses for the determinants of audit expectation. This was as shown in the table below;

Table 4.3 Frequency of response for determinants of audit expectation gap

Factor	Frequency investor	Percent	Frequency Auditor	Percent	Cumulative percent
Investor perception	18	45%	19	48%	46%
Market factors	3	8%	4	10%	9%
Self-regulation process	8	20%	4	10%	15%
Subjective nature	11	28%	13	13%	30%
Total	**40**		**40**		

Source: Winnie Operu (2016)

The table gives a summary of the responses given by the respondents in terms of frequencies and cumulative percent. Among both groups the investor perception had the highest percentage at 46%, followed by subjective nature at 30%, then self-regulation at 15% and finally market factors at 9%.

Table 4.4 Frequency of response for determinants of Responsibility factor

	Frequency	Percent	Cumulative Percent
Strongly agree	1	2.5	2.5
Agree	3	7.5	10
Neutral	3	7.5	17.5
Disagree	18	45	62.5
strongly Disagree	15	37.5	100
Total	40	100	

Source: Winnie Operu (2016)

The responses from the investors show a more negatively skewed trend as majority disagree with the perceived responsibility of the auditors. 45% disagree, and 37.5 % strongly disagree.

Table 4.5 Frequency of response for determinants of usefulness factor

	Frequency	Percent	Cumulative Percent
Strongly agree	4	10	10
Agree	17	42.5	52.5
Neutral	4	10	62.5
Disagree	14	35	97.5
strongly disagree	1	2.5	100
Total	40	100	

Source: Winnie Operu (2016)

Investors agree that auditors work is useful to make investment decision. This raises the audit expectation gap. 42.5% agree, 35% disagree which shows indifference in deciding the usefulness factor.

4.5 Correlation analysis

The study analyses the audit expectation on investors and identified gap between the existing and wanted situation. The gap can be the difference between the actual situation and ideal condition. The covariance and correlation matrix below shows how investor's decisions are highly influence by the audit expectation. This was further developed by operationalization of the questionnaire which aims to capture different expectation of investors to audit perception. From the analysis below, all independent variables are weakly correlated i.e. less 65% hence no case of multicollinearity

Table 4.6 Coefficient Correlations

Model			Market Factors	Usefulness Factors	Responsibility Factors	Regulator Factors	Nature of Audit
1	Correlations	Market Factors	1.000	.271	-.166	-.301	-.503
		Usefulness Factors	.271	1.000	-.105	.055	-.459
		Responsibility Factors	-.166	-.105	1.000	-.352	.286
		Regulator Factors	-.301	.055	-.352	1.000	-.038
		Nature of Audit	-.503	-.459	.286	-.038	1.000
	Covariance	Market Factors	.072	.024	-.009	-.021	-.045
		Usefulness Factors	.024	.107	-.007	.005	-.050
		Responsibility Factors	-.009	-.007	.043	-.019	.020
		Regulator Factors	-.021	.005	-.019	.068	-.003
		Nature of Audit	-.045	-.050	.020	-.003	.112

a. Dependent Variable: Which of the following factors has the greatest impact on audit expectation gap

The investors have high expectation on the auditors they relied on their audit opinion. The independent variable usefulness factors, market factors, regulatory factors by the investor's shows a strong association with the audit expectation gap as analyzed above.

4.6 Regression model and ANOVA results

The researcher applied the data collected in the separate groups of respondents as per questionnaire in appendix 2 to do two separate regression analysis. The first regression analysis captured the empirical data on all the variables explaining the audit expectation gap as per questionnaires issued out to the auditors.

Table 4.7 Regression model

Regression Statistics	
Multiple R	0.457
R Square	0.209
Adjusted R Square	0.093
Standard Error	1.056
Observations	40

Table 4.8 Anova Results

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	10.01648	5	2.003	1.797936	0.139677[b]
	Residual	37.8835	34	1.1142		
	Total	47.9	39			

a. Dependent Variable: Which of the following factors has the greatest impact on audit expectation gap?

b. Predictors: (Constant), Market Factor, Usefulness Factor, Responsibility Factors, Regulator Factors, Nature of Audit

Table 4.9 Coefficients

Model	Coefficients		T Stat	P value
	B	Std. Error		
(Constant)	5.264	1.701	3.094	0.004
Responsibility Factors	0.256	0.359	0.714	0.480
Usefulness Factor	-0.848	0.423	-2.006	0.053
Nature of Audit	0.148	0.290	0.511	0.612
Regulator Factors	-0.393	0.457	-0.860	0.396
Market Factor	-0.446	0.419	-1.066	0.294

a. Dependent Variable: Which of the following factors has the greatest impact on audit expectation gap?

From the regression statistics of auditor responses,$R^2 = 0.2030$ this implies that responsibility factors, market factors, usefulness factor, regulatory factors and nature of audits account for 20.3% of the changes in audit expectation gap *ceteris paribus*. From the ANOVA (Analysis of Variance), $F(Fcalculated) = 1.79$F and is greater than the significance F= 0.1396. This implies that the model is significant.

We then went further and computed the second regression analysis that captured the empirical data on all the variables explaining the audit expectation gap as per questionnaires issued out to the investors.

Table 4.10: Regression Statistics and ANOVA results

Model		Sum of Squares	df	Mean Square	F	Sig.
	Regression	3.536	5	.707	.647	.0600[b]
1	Residual	36.054	33	1.093		
	Total	39.590	38			

a. Dependent Variable: Which of the following factors has the greatest impact on audit expectation gap?

b. Predictors: (Constant), Market Factor, Usefulness Factor, Responsibility Factors, Regulator Factors, Nature of Audit

Coefficients

Model	**Coefficients**		**t**	**Sig.**
	B	Std. Error		
(Constant)	2.707	1.069	2.532	.016
Responsibility Factors	-.018	.207	-.086	.932
Usefulness Factor	-.279	.326	-.855	.399
Nature of Audit	-.267	.335	-.799	.430
Regulator Factors	.060	.261	.229	.820
Market Factor	.213	.269	.794	.433

a. Dependent Variable: Which of the following factors has the greatest impact on audit expectation gap?

4.6.1 Interpretation

From the regression statistics on investors responses, $R^2 = 0.62$. This implies that responsibility factors, market factors, usefulness factors, regulatory factors and nature of audits account for 62% of the changes in audit expectation gap *ceteris paribus*. From the ANOVA (Analysis of Variance),$F(Fcalculated) = 0.647$ and is greater than the significance F= 0.06. This implies that the model is significant.

The specific model was:

$Y=\alpha+\beta_1X_1+\beta_2X_2+\beta_3X_3 + \beta_4X_{4+}\varepsilon$

Where:

Y= Audit expectation gap

α = Regression constant

$X_{1=}$Investor perception

$X_{2=}$Nature of auditing

$X_{3=}$Regulation process

$X_{4=}$Market factors

$$\boldsymbol{y} = B_0 + B_1 \boldsymbol{ivestment\ perception} + B_2\ \boldsymbol{nature\ of\ audit} + B_3\ \boldsymbol{regulation} + B_4 \boldsymbol{market\ factor} + \boldsymbol{U_i}$$

From the regression results, the model became:

From the regression results, the auditor's model became:

$\boldsymbol{y} = 5.6 - 0.2378\boldsymbol{investor\ perception} - 0.3929\boldsymbol{nature\ of\ audit} + 0.1482\ \boldsymbol{self\ regulation} + 0.44617\boldsymbol{market\ factors}$**....................................... *(i)***

From the regression results, the investor model became:

$\boldsymbol{y} = 2.70 - 0.279\boldsymbol{investor\ perception} - 0.267\ \boldsymbol{nature\ of\ audit}\ + 0.060\ \boldsymbol{self\ regulation} + 0.213\boldsymbol{market\ factors}$**.................................. (*ii*)**

4.8 Interpretation of the regression model coefficients

B0=5.6 for audit equation 1 and 2.7 for investors equation 2. This is the audit expectation gap when all other factors are held constant and assumed there are not in existence. This implies that the Audit Expectation will still grow when all the variables in this model are zero. Other than the mentioned factors the audit expectation gap can be influenced by other variables e.g. limitations of audit, retrospective review of audit, hindsight evaluation of audit performance.

B1=-0.2378 for auditors equation 1 and **-0.279** equation 2. This is the coefficient of investors' perception. This means that the audit expectation increases by 0.2378 when audit gap decreases by a unit and also investor's perception will inversely change as the audit expectation changes. This variable is significant as its p -value is less than 0.05 and the t value is less than 2. This basically explains the hypothesis of how investors will have a look on the audited financial statement to allocate their investment resources. This can be explained by the fact that very crucial variables such as the investors' perceptions and reliance on audit statements and opinion have a big impact on the audit expectation gap

B2= -0.337 for auditors equation 1 and **-0.3929** investor`s equation 2. This is the coefficient of the nature of audit. This means that the audit expectation gap decreases by 0.337 for auditors and 0.267 for Investors when the nature of audit increases by a unit. The p value is very significant and the t value is less 2 test of significance at 5% level of significance. This can be explained by the fact that very crucial variables such as the investors' perceptions and reliance on audit statements and opinion have a big impact on the audit expectation gap

B3= 0.1482 for auditors equation 1 and **0.06** investor`s equation 2. This is the coefficient of regulation. This means that when auditors are self-regulated the audit Expectation gap will increase by 0.855 as per the auditor's response but the investor has a different perception which shows direct relationship. This opens a wide gap between the profession expectation and how investors perceive. This relationship will be expected due to governing provision on profession. This variable is very significant as reflected in its p-value which is less than 0.05.

B4 = 0.4417 for auditors equation 1 and **0.213** investor`s equation 2**.** This is the coefficient of the Market factor. This means that the audit Expectation gap increases by 0.487 for equation 1 and increase by 0.213 for equation 2 when the market factor changes by a unit. Expectation gap will have a direct relationship with market factors depending on the expectation of the individual. This variable is significant as P- value is less than 5% significant level and a t value of less than 2.

CHAPTER FIVE: SUMMARY OF FINDINGS AND CONCLUSION

5.1 Introduction

This chapter provides a summary, conclusions and recommendations that were deduced from the study findings.

5.2 Summary of the study

The research study aim was to analyze investor perception of audit expectation gap by studying the Nairobi Securities Exchange. The role of external audit has been a major discussion area in the public over the last one year in Kenya due to failure by a number of industry giants. These discussions have also been at global level. Most studies done in developed countries found out that there is was a large expectation gap present when they compared the assurances that the financial report gives as prepared by auditors and what users deem to be the message from the financial report. Locally, this area has not been comprehensively explored and explained. This study has shown that investor perception of audit is varied and there is a bigger expectation gap as far as external audit goes.

This study focused on investor perception of audit expectation gap. The perception of audit is expected to be varied and the researcher aimed at establishing relationship between investor perspectives to the expectations gap. Several views have been given on expectation gap gap within the auditing profession to be the gap between the society's expectations of external auditors and the actual performance of the professionals in the auditing field.

The Nairobi Securities Exchange lists several companies opting to trade their securities on the public domain. These are what the researcher views as investors. Investors place key reliance on the performance of the companies they trade in. Key in this is financial performance of these companies, which external audit is directly linked to. Audit expectation gap was measured through structured questionnaires disseminated randomly to 40 auditors and 40 investors.

The study analyses the audit expectation on investors and identified gap between the existing and wanted situation. The gap can be the difference between the actual situation and ideal condition. Covariance and correlation matrices are used to show how investor decisions (market, usefulness, responsibility and nature of audit factors) are influenced by audit expectations. Auditor views on expectations gap are also analyzed. Empirical studies have showed that there indeed exist a big expectations gap on audit by stakeholders of financial statements.

The research has established from analysis of investor responses that responsibility factors, market factors, usefulness factors, regulatory factors and nature of audits account for 89% of the changes in audit expectation gap. Further, from analysis of auditors responses, responsibility factors, market factors, usefulness factor, regulatory factors and nature of audits account for 20.3% of the changes in audit expectation gap. From the analysis of the regression model, audit expectations gap was found to have a positive correlation with investor perception while it negatively correlated to subjective nature of the audit, audit self-regulation and market factors.

The findings from this study may explain investor perception on audit expectation gap. The study may assist investors, who form part of the audit beneficiaries, to have an in depth knowledge of the objectives of the external audit function as outlined in statutory regulation so as to reduce any expectations that may be impossible to meet. It will also be beneficial to auditors who are the custodians of public confidence in financial statements. They will be able to know what society expects of them in as far as their role is in protecting their interests and remaining relevant.

5.3 Conclusion

Using the empirical data from the analysis, we can establish that there is indeed an expectations gap in the role of external auditors in company audits. The analysis shows that there is a positive correlation between audit expectations gap and investor perception. The results from statistical analysis indicate that audit expectation increases by 0.2378 when investor audit gap increases by a unit. This basically explains the hypothesis of how investors will have a look on the audited financial statement to allocate their investment resources. Other factors such as subjective nature of audit, market factors and audit self-regulation were found to be negatively correlated to audit expectations gap. This can be explained by improved governance of the profession by Institute of Certified Public Accountants of Kenya (ICPAK), improved market response to the work of auditors and audit focus areas.

This findings of the research were in line with empirical studies by Epstein and Geiger (2004) that showed evidence of the expectation gap between the assurances auditors give and the expectation of investors and other users of financial statements. The findings are also in line with studies done by Humphrey et al (1993) that confirmed existence of the gap between the target groups' view in areas such as nature of audit action and perceived performance.

5.4 Recommendations

The findings on the investor perception of audit expectations gap can be used to inform a number of policy decisions at improve understanding of the work that auditors do. Effective understanding of the work of external auditors will enable better understanding of financial statements for decision making by all stakeholders. The basic need by investors of reliable information that can be easily understood is both challenged and underscored by the dynamic nature of the current financial markets. Financial markets have become more accessible with improved technology leading to unprecedented complexities. Continuous improvements in the audit and assurance techniques has improved better understanding of the profession. However, from policy perspective, a lot still need to be done to bridge the expectations gap of stakeholders who rely on the work of auditors. Governing institutes, locally – ICPAK, should encourage rollout of stakeholder forums to enable better understanding of audit techniques and the results of audit assurance.

Market interconnectedness has greatly improved, and so is volatility. Any shocks, however insignificant, can reverberate powerfully across the world leading to investor confidence shakeup. Credible corporate reporting is key to market confidence. Auditors provide this assurance relying on quality of information provided by the entity. Improved investor involvement in audit will enable better understanding of international standards of auditing and how these are applied in coming up with the audit opinion.

5.5 Limitations of the study

The researcher is expected to encounter certain obstacles that may have an effect on the results or outcome of the study. These obstacles may be controllable, uncontrollable or both. One of the controllable obstacles included miscomputations by the researcher from the raw data collected from the survey. This obstacle was double checked before data was analysed in SPSS.

In the study, the researcher may have carried out wrong analysis of the data hence ending up with wrong conclusions. This limitation was avoided through relying on statistical analysis tool, SPSS version 17. The role of the researcher was to interpret the data as the analysis was done through computerized statistics. The interpretation and conclusion were based on computer generated analysis which was accurate.

The other limitation, uncontrollable, encountered by the researcher was the validity and reliability of the responses. To avoid this, the researcher applied online questionnaires through google forms to disseminate the survey to random respondents. The researcher shared the research questions with 60 investors and 60 auditors and once 40 responses were received from each set, the researcher locked any further responses. Finally the other limitation is inherent to all questionnaire studies. Dilution of results is possible in the use of questionnaires as respondent strive to have socially desirable behaviour and non-response bias.

5.6 Suggestions for future research

This study established that there is indeed an expectations gap in the role of external auditors in company audits. Future researchers may focus on how improved stakeholder participation in the audit process may enhance investor perception and in extension reduce the expectations gap and how this can improve investor understanding of what auditors actually do.

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APPENDIX 1

QUESTIONNAIRE

Section A: Background Information

Please tick your response.

1. What is your Gender? Male { } Female { }
2. Highest academic qualification? Secondary certificate { } Bachelor's Degree { } Master's Degree { }
3. Do you have accounting experience?

Accounting qualifications Yes { } No { }

Accounting experience Yes { } No { }

4. If yes, below 1 year { } 1 - 10 yrs { } Above 10 years { }

Section B: Responsibility factor

Instruction: The following statement use a 5 points likert scale. The likert scale is as follows (1-Strongly Agree, 2-Agree, 3-Neutral, 4-Disagree and 5-Strongly Disagree)

	Description	**1**	**2**	**3**	**4**	**5**
5.	The auditor is responsible for preparation of the company's financial statements					
6.	The auditor is responsible for the soundness of the internal control structure of the entity.					
7.	The auditor is responsible for preventing all fraud in a company.					
8.	Business failure means audit failure					
9.	An auditor is responsible for maintaining public confidence in a company					
10.	An auditor should report to shareholders on management efficiency					
11.	The auditor is unbiased and objective					

12.	The auditor should conduct 100 percent examination in audit proceeds					
13.	Auditors should detect all illegal acts by the management					
14.	The auditor is responsible for maintaining accounting records.					
15.	The extent of audit work performed is clearly communicated.					

Section C: Usefulness factor

(1-Strongly Agree, 2-Agree, 3-Neutral, 4-Disagree and 5-Strongly Disagree)

	Factor	**1**	**2**	**3**	**4**	**5**
16.	The information contained in the audited financial report is adequate for making informed investment decision					
17.	The audit report should be expanded to be more useful and understandable to enable investors make informed decisions					
18.	The existing duties and responsibilities of the auditors should be increased to include the responsibility to investors					
19.	The audited financial statements are not useful for making investment decisions					
20.	The auditor should perform a public watchdog function for the audited firms' investing public					
21.	The audited financial statements are not useful in monitoring the performance of the entity					

Section D: Nature of auditing

Instruction: The following statement use a 5 points likert scale. The likert scale is as follows (1-Strongly Agree, 2-Agree, 3-Neutral, 4-Disagree and 5-Strongly Disagree)

	Description	**1**	**2**	**3**	**4**	**5**
22.	Conducting 100% examination in audit procedures as opposed to sampling will enhance audit quality					
23.	Standardised wording as compared to free-form reporting will enhance the usefulness of audit reports					
24.	The audit report should be accompanied by a supplementary explanation of the audit including its limitations and the meaning of the audit report					
25.	The extent of assurance given by the auditor is clearly indicated					
26.	The terms and concepts such as the true and fair view, reasonableness, materiality, adequacy, reliability and relevance are subjective in nature					

Section E: Regulation

27.	The existence of regulation, standards and guidelines for the conduct of the accounting profession is well known					
28.	Regulation of the accounting profession has led to improved quality of audit in the recent years					
29.	The regulator ICPAK is equipped to streamline the audit profession					

30.	Self-regulation of the auditing profession lead to enhanced safeguards in the performance of your duties properly					

Section F: Market factors

31.	High profile corporate scandals have had an effect on perception of auditors performance					
32.	News information content has impacted your understanding of auditors role					
33.	To what extent do you agree to the following as factors led to increase audit expectation gap? 1. Increased frauds 2. Collapse of entities 3. Poor audit reports 4. Weak accounting infrastructure?					

34. Which of the following factors has the greatest impact on audit expectation gap?

Factor	**Tick**
Investor perception	
Subjective nature of auditing	
Self-regulation process of the auditing profession	
Market factors	

APPENDIX II: LETTER OF INTRODUCTION

Dear Respondent,

I am a post graduate student undertaking a Master of Science Finance at the School of Business, University of Nairobi. In partial fulfilment for the requirement for the course I am undertaking a study entitled **"Investor Perception of Audit Expectation Gap a study of the Nairobi Securities Exchange**" using the enclosed questionnaire.

You have been selected as one of the respondents and I am therefore kindly requesting you to fill the questionnaire. The information is needed purely for academic research and will be treated with utmost confidentiality.

Your co-operation will be highly appreciated.

Yours Sincerely,

Winnie Zesiro Operu