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## CORPORATE AUDITING EXPECTATION GAPS IN DEVELOPING MARKETS: EVIDENCE FROM SAUDI ARABIA

### Key Words

***Corporate Audit;  
Internal Auditing;  
Expectation Gap;  
External Auditing;  
Developing Markets;  
Saudi Arabia..***

### Abstract

*This study endeavors to identify the existing corporate audit expectation gaps in developing countries such as Saudi Arabia, and to suggest ways for bridging these gaps. Based on an interview comprising of 128 individuals from five different groups: academic staff, external auditors, directors of internal audit departments from the private sector, general managers or their deputies from private companies, and finally relevant prominent figures of society, the five various gaps were identified. These were: (1) gap between what corporate management believe external auditors do when performing the independent audit and what their real task is, (2) gap between how the corporate management should appreciate its internal audit and how management recognizes internal audit in reality, (3) gap between what those being audited expect corporate auditors search for when performing their duties and what internal auditors real job is, (4) gap between what the private sector requires from internal auditors (qualification and experience) and what the internal auditors actual qualifications and experiences are, (5) gap between the scope of internal audit as expected by the professional standards (SPPIA) and what internal auditors are actually doing. The existence of such gaps results in delaying the development of the corporate audit profession, and probably weakening corporate governance. Possible ways of bridging these gaps include: i) educating relevant parties of the actual role of internal and external audit and how they work together ii) enhancing collaboration between corporate internal auditors and audited parties, iii) adopting an effective mechanism to ensure corporate auditors are qualified, iv) establishing an effective internal professional body to serve the whole region.*

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## Introduction

**R**ecently, and in particular after the collapse of many corporations worldwide, most noticeably in the US, a strong debate arose regarding corporate governance and how to improve its effectiveness. Selim (2003) affirmed that, "The recent corporate scandals in the USA and Europe have forced legislators, regulators, and organizations to look deeply into current practices, the means of enhancing corporate governance, and the role(s) played by different players such as internal auditors within this context".

It is widely accepted that corporate auditing is an essential part of good management and proper corporate governance (Ridley 1994, CIPFA 1995, Melville 2003). During October 2002, a conference titled "First European Academic Conference in Corporate Governance and Internal Audit" took place in Prague. It emphasized the importance of the corporate auditing role in modern corporate governance. However, existing audit expectations gaps significantly contribute to the failure of companies, and participate in the delay of developments - not only in the audit professions - but also in the business environment as a whole. However, in recent years, the dramatic corporate collapses and subsequent implications of the corporate auditing activity have highlighted the audit expectation gap

which has existed since, as noted by Dittenhofer (1997). There is heavy utilization of interpersonal relationships in corporate auditing, and the CIPFA (1994) considers such relationships to have an essential influence on the effectiveness of corporate auditing. Suggestions to narrow the stated corporate audit gaps are based on three sources: professional standards, relevant literature, and interviewee proposals.

Although most of the debate has occurred in the western world, other parts of the world cannot be excluded from what has concerned the west, and hence, should recognize the need to ensure that corporate governance can secure the corporate future. For example, in Saudi Arabia on October 2003, a corporate governance conference titled "Corporate Disclosure and Transparency: Their Role in Strengthening Corporate Governance & Accountability in the Saudi Corporate Sector" took place, reflecting the issue of corporate governance as an international concern.

One important aspect of successful corporate governance is its capability to eliminate expectation gaps existing within the entity itself, or with other parties. The failure of many companies is partially related to the existence of an expectation gap which can be apparent

in many different forms. The expectation gap issue in respect to the role of accounting has been extensively documented and researched, primarily with reference to users of financial statements (See for example Humphrey *et al.* 1993, Gramling *et al.* 1996, Koh and Woo 1998, McEnroe and Martens 2001, Lin and Chen 2004, Schelluch and Gay 2006, Sidani 2007). However, the expectation gap issue with reference to auditing (external and internal) has received very little attention in the developing countries.

Expectation gaps are, to some extent, influenced by culture. The degree to which concepts of accountability and auditing are shaped by culture has been the subject of vast discussion. Few would argue that these concepts are universal in the sense that they are independent of social and political context. Others would suggest that they cannot be interpreted other than by reference to this context. For example, Wallace (1997) argues that in the African context, accountability has a completely different meaning to that of western economies and societies. Others are more cautious in attributing such differences to cultural factors. Hoque and Hopper (1997) suggest that western observers frequently identify differences in the accounting practice are rooted in cultural differences, when in fact institutional factors are far more powerful

although institutional diversity may just reflect cultural diversity. The cultural environment (education, family, society, media, religion, and politics) is expected to have a significant impact on people's expectations of auditing.

The purpose of this research is to identify the various existent expectation gaps with regards to corporate auditing in developing countries using Saudi Arabia as an example, and then to suggest approaches that might help bridge such gaps which will enable corporate governance to be more effective as well as enhance the development of audit as a profession. Saudi Arabia has been chosen to be the case study for this research for its unique nature in comparison to the western world, and at the same time, Saudi Arabia shares many similarities with other developing nations. As opposed to the developed nations, the whole political, religious, cultural, and economic environment of Saudi Arabia has had a significant impact on people's perceptions of both internal and external audit within the country. The strong hierarchical nature of the Saudi society and economic enterprises, together with the heavy emphasis on personal relationships and trust, as well as the importance of kinship, has distinguished Saudi Arabia from the western nations. Political, cultural, and institutional systems have acted to shape the development of

both internal and external audit in Saudi Arabia.

### **Auditing Development In Saudi Arabia**

The Kingdom of Saudi Arabia is conventionally characterized as a developing country (Al-Rumaihi 1997), albeit one with a very high GNP per capita, relative to most developing countries. It is located on the Arabian Peninsula, in south west Asia. According to Article Number One of the Saudi Arabian Basic Law of Government, the Islamic Law is the constitution of the country and theocracy is often used to describe the Kingdom of Saudi Arabia (Abir 1993, p. 10).

Before the discovery of oil in 1938, there was little demand for auditing in the Kingdom and indeed it was not until 1955 when the first international auditing firm opened its door. The Companies Act (1965) introduced specific requirements for corporate audit. However, the first law that regulated the auditing profession in Saudi Arabia was the Law of Certified Accountants, which was pronounced in 1974 by Royal Creed No. 43. Until the beginning of the 1980s, there were no professional external auditing bodies in Saudi Arabia, but now both the Saudi Accounting Association (SAA) (formed 1980), and the Saudi Organization for Certified Public

Accountants (SOCPA) (established 1992) play a significant role in the development of external auditing in the KSA. The role of the SAA is primarily an educational one whereas the SOCPA is the accounting and auditing (external) chief standard setting body. The Saudi external auditing standards are now fourteen standards, one of which is named "Auditor's responsibility to detect and report errors or irregularities". The early development of internal audit in Saudi Arabia rests almost exclusively in banks and very large companies. The first IIA chapter in Saudi Arabia was formed in ARAMCO in 1982, the second in Saudi Airlines (SA) in 1992 (closed in 1997), and the third in Arab National Bank in 1999. At the moment (October 20, 2007) as presented on the IIA homepage ([www.theiia.org](http://www.theiia.org)), Saudi Arabia is not listed with countries affiliated to (or running chapter of) the IIA. Documentation of the development of internal audit is scarce, but the study's interview outcome suggest that, in most companies, internal audit is a function in its own right and was established only within the last fifteen years.

Up until recently, there have been no specific government initiatives seeking to encourage and develop the internal audit function, nor have there been professional accounting bodies (SOCPA and SAA) significantly supporting the development of internal audit. The

interviewees of SOCPA and SAA strongly emphasised that their organizations do not deal specifically with internal audit but rather focus on accounting, public accountants, and other related issues. However, as referred to above, there have been attempts to promote internal audit via the formation of IIA Chapters which, to date, have been partially successful. A major hinder to their success is the lack of necessary authorizations from the Kingdom's authorities as explained by the representatives of the Chapters.

In 2003, SOCPA recognized the need for enhancing the development of the internal audit profession in Saudi Arabia and consequently formed a committee for this purpose. However its focus was only on the relationship between internal audit and financial statements. At a different initiative, the accounting department at Qaseem University in Saudi Arabia applied for authorization to establish an association for internal auditors (Saudi Internal Auditing Association) which is a practical implementation of one of the recommendations of the 10<sup>th</sup> Accounting Symposium in Saudi Arabia which was held during the month of October 2003. However this request for authorization was rejected by the authority responsible. Thus we conclude that the extent of development

of internal audit is still inconsequential and is in its early stage, struggling for recognition.

### **Audit Expectation Gap Phenomenon**

Professional standard setters, researchers, and practitioners have recognized the existence of the audit expectation gap and its influence on the development of the audit profession and corporate governance. Pany (1993) stated "Practitioners, accounting researchers, and study groups (e.g., The Cohen Commission, and the Treadway Commission), have acknowledged the existence of confusion regarding the responsibilities of the auditor for many years."

Professional standards have continuously been attempting to lessen the gap existing between the auditing profession and other parties that have either direct or indirect relation to the auditing function. For example, in the US, Expectation Gap standards had been an issue between 1988 and 1993 and the ASB's Fraud Task Force, which includes representatives from the IIA, carried out extensive research on fraud and the auditors' responsibilities, and have reached the conclusion that auditing professional standards should include more clarifying statements (Mancino 1996). In

The Institute of Chartered Accountants (ICA) in Ireland created an independent commission to study the audit expectations gap and stated in its 1992 final report evidence of the existence of such gaps. Similarly, in Australia in 1994, both ASCPA and ICA released a research study stressing the need to address expectation gap issues. In current action, after a series of recent corporate collapses, in September 2002, the Australian government released the CLERP 9 Paper reflecting the need for corporate governance reform. This paper reinforced the audit expectation gap between society and auditors. However, in Saudi Arabia, the auditing standards do not specifically highlight the issue of audit expectation gap and there are no attempts from the accounting and auditing bodies to study this matter. Therefore this research is expected to provide some insight on this subject to be beneficial for SOCPA.

A large majority of the audit expectation gap studies focused on the US and Europe (see for example Kelly and Mohrweis 1989, Anderson 1993, Harris and Marxen 1997, Koh and Woo 1998, McEnroe and Martens 1998 and 2001, Frank *et al.* 2001, Hooks *et al.* 2002, Shaikh and Talha 2003, Dobler 2004, Vinten 2005, Kirk 2006, Hayes 2006, Hüpkes 2006, Shoulders and Freeman 2007) and

the minority of researches concentrated on the other parts of the world (for example, Gloeck and Jager 1993 in the Republic of South Africa, El-Saqa 1997 in Saudi Arabia, Koo and Sim 1999 in Korea, Best *et al.* 2001 in Singapore, Fadzly and Ahmad 2004 in Malaysia, Lin and Chen 2004 in the Republic of China, Sidani 2007 in Lebanon, Pahuja 2007 in India). El-Saqa (1997) used a questionnaire based analysis to examine the external audit expectation gap in Saudi Arabia. He found that the expectation gap is largely existent between external auditors' perception of their duties and the perception of those who utilize the audit service.

Previous studies investigated the perception of investors, stakeholders, bankers, judges, auditors, jurors, financial analysts, bank loan officers, small business owners, and students on independent auditors' performance and responsibility. Other studies looked at expectation gap from a different angle. For example, Hornik *et al.* (2003) focused on how the expectation gap strategy can be used to test information system perceived performance and Fink (2000) suggested that the expectation gap can be between reported earnings and operating results, or between net income growth and operating cash flow, whilst Opdyke (2004) argued that the

expectation gap existed when investors expected the company to earn more than it reports - even if positive earnings - which results in stock price decline. This might mean that expectations have more impact on peoples' decisions than reality does.

## Research Method

The research data helps identify audit expectation gaps and suggests approaches for bridging such gaps. The data was collected through both telephone interviews and face-to-face interviews. A sample of 100 companies was systematically randomly selected from the largest 1000 Saudi companies according to the latest available volume size rankings which are quite consistent. Telephone calls were made to ask whether or not the company had its own audit function, and if not, to ask questions regarding the absence of such a function. 71 telephone interviews were conducted with large (in the Saudi Top 1000) companies without an internal audit function to highlight the most common reasons for the absence of such a function. In Saudi firms, auditing departments carry different names. In some firms, it is called the Check Office/ Division while in others it is known as the Inspection Unit, or Review Section, or Supervising Department. In the majority of firms it is called Internal Audit. The director of an audit

department is referred to in some banks as the General Auditor, and in some firms as the Manager of Auditing.

The face-to-face interviews with other groups (academic staff, directors of internal audit departments, external auditors, governmental, accounting and internal auditing bodies) were designed to gather information regarding the difficulties facing the corporate audit function within the country and primarily the expectation gap phenomenon. Table (1) presents detailed information as to the number and type of interviews carried out.

As Hughes (1996, p. 169) notes, since there is no one optimal way of conducting an interview, the researcher should select the techniques most appropriate to his/her study. However, in this research, since specific information was being sought, the interviews with the different groups was structured, but the interviews with directors of internal auditors was not structured so as to give them more freedom in providing information about their work, and to highlight issues and topics they saw as relevant to the overall aim and objectives of the research. These interviews were then classified and grouped.

The academic staff was chosen based on their academic experience on the underlying issues. External audi-

**Table 1**  
**Number and Nature of Interviews**

Group No.	Type of group	No. of Organizations	No. of Interviewees	Range of time period in minutes per meeting	The major topic(s) of the questions and the subject of the discussion
1	Academic staff	3	5	40-180	Internal audit courses and curriculum. Auditing in the Saudi business sector.
2	Directors of Internal Audit Dept. in the Business sector	15	15	15- 120	The problems confronting them in their work and the manner in which they seek solutions to these problems. The future development of the internal audit function in the business sector of Saudi Arabia.
3	External Auditors*	10	13	20-90	Audit function in the business sector. The problems it faces and the scope for development. The scope of work of internal and external auditors.
4	General Managers or their Deputies at business companies**	89	89	4-15	Whether or not to have an audit function within the organization. Reason(s) for not having internal audit function.
5	Others***	6	6	20-160	Their particular perspective on the nature and practice of internal and external audit in Saudi Arabia. Related issues to audit expectation gap.
Total		123	128	4-180	

\* Two of these 10 accounting firms are from the Big 4 international accounting firms and these 13 external auditors consist of 5 partners and 8 managers. These 10 accounting firms represent different sizes and locations.

\*\* All of these interviews were conducted by telephone calls.

\*\*\* Those were: 1) the general secretary of the Saudi Organization of Certified Public Accountants (SOCPA); 2) the deputy manager of the Saudi Companies Management at the Ministry of Commerce; 3) the general secretary of the IIA Chapter that used to function in Jeddah under the control of Saudi Airlines; 4) the head of the IIA Dhahran Chapter in Saudi Arabia; 5) the head of the IIA Riyadh Chapter in Saudi Arabia; and 6) the chairman of the Saudi Accounting Association (SAA). Those figures were chosen for their close link to the development of accounting and/or internal auditing and internal audit profession within the country.

tors' participation was subject to their availability during the time the interviews were conducted. The heads of the internal audit departments interviewed by the researcher were chosen to ensure

representation from a variety of industries and from various sizes of internal audit departments. The interviewees' companies are demographically classified as in Table (2).

**Table 2**  
**Demographical Classification of Organizations that Interviewees belong to**

Type of group	Eastern Province	Central Province	Western Province	Other Parts of the Country	Total
Academic staff	1	2	-	-	3
Directors of Internal Audit Dept. in the Business sector	5	7	3	-	15
External Auditors	3	5	2	-	10
General Managers or their Deputies at business companies	32	26	16	15	89
Others	1	4	1	-	6
Total	42	44	22	15	123

It is worth noting that in Saudi Arabia more than 90% of business entities, accounting firms, accounting and auditing bodies, and governmental authorities are located in the either Eastern, Central, or Western provinces. All the interviewees were males because in Saudi Arabia females do not hold such positions. The ages of the interviewees ranged between 30 to 60 years old. The Saudi nationals account for about 45% of the interviewees. The remaining interviewees were of non-Saudi nationalities including Egyptian, Pakistani, Hindi, American, Jordanian, and Sudanese. Since the majority of the interviewees were not Saudi nationals, this might have a minor negative effect on the results and conclusions since different ethnic backgrounds have different views and perspectives. On the other hand, having different nationalities represented in the study sample could

strengthen the outcomes by eliminating any possible nationality biasness.

## Results Analysis

Based on the interviewees perceptions, the expectation gap in relation to Saudi corporate audit can be classified into five categories: 1) gap between what corporate management expects external auditors to do when performing the independent audit and what their actual task is; 2) gap between how corporate management should appreciate its internal audit function and how in reality the management recognizes the internal audit function; 3) Gap between what the audited parties expect corporate auditors search for and what the internal auditors actual job is; 4) Gap between what the business sector requires in internal auditors (qualifications and experiences) and what are internal auditors' actual qualifications and experiences; 5) Gap between the scope of

internal audit as expected by the professional standards (SPPIA) and what the internal auditors are actually doing. Each of these gaps will be discussed separately.

### **I. Gap between what corporate management expects external auditors to do when performing the independent audit and what their actual task is.**

From the 89 respondents of the selected 100 companies, only 18 (20%) do operate an internal audit function. On the other hand, the external auditor interviewees were asked to give an approximate percentage of the companies that have an internal audit function which they have audited in during the previous year which came out to be 28% on average. For example, one external auditor interviewee stated that all the joint stock compa-

nies that he had audited do have an internal audit function but the remaining majority does not. Another interviewee confirmed that the percentage is low and internal audit departments are almost entirely located in the joint stock companies and large group companies.

In comparison to the UK, Liu *et al.* (1997) report a 1995 Ernst & Young survey suggesting that 61% of the FTSE 500 companies surveyed had an internal audit function. An understanding of why companies do not have such a function is likely to form an overall evaluation of the internal audit effectiveness in the Saudi corporate sector. The results of the interviews with companies that did not have an internal audit function are set out in Table (3).

**Table 3**  
**Reasons for not having an Internal Audit Function**

Rank	Reason	Frequency of Response*	%
1	External auditor (EA) is sufficient.**	52	49
2	Cost/benefit reasons.	23	21
3	Internal audit is accomplished by ordinary employees or by external parties (other than EA).	14	13
4	No need because of strong internal control system.	8	8
5	Internal audit function is not important.	5	4
6	Could not find professional people to recruit.	3	3
7	No need because of the type of the business they run.	3	3

\* Many of the companies provided more than one reason for not having an internal audit function. For instance, one common reason was that the company did not require internal audit as it had a strong internal control system and this was complemented by the activities of the external auditor.

\*\* It should be emphasized that companies suggesting that external audit in itself was sufficient, were not referring to what is known as "outsourced internal audit".

The most frequent response (49% of the surveyed companies with no internal audit function) was that reliance on the external auditor enables the company to obtain the relevant benefit that would have been obtained from the internal auditor. For example one interviewee corporate manager stated, "Why do we need to have internal auditors when we have external auditors". Another said, "The reason is that the external auditor is better and saves us money". Some management believe that in order for the audit function to be efficient, it should be from outside the organization.

In some countries, such as the United States, Britain, and Australia, it is not uncommon for an external audit firm to perform both the external and internal audit role for an organization. Such a situation is precluded by law in many countries such as India, Italy, and France (Lower 1998). Similarly, in Saudi Arabia, external auditors are prohibited from providing internal audit services to their clients.

Given the differing nature and function of internal and external audit the degree of confidence placed by these respondents in the external audit is quite surprising. The interviews with the external auditors confirmed the above findings of the expected gap's existence, and found consensus that this reliance was misconceived. One

interviewee, for example, confirmed, "We found that 70% of those we have dealt with cannot clearly distinguish between the work and roles of internal audit and external audit".

This expectations gap occurred because corporate management either does not know what the internal audit scope of work is, or believe that external auditors should discover all the problems in the company, such as irregularity and fraud. For example, one interviewee said, "There is a misperception of what the external auditor does. They think the external auditor does everything for the company and must discover any problem". External auditor interviews saw a big difference between what they do and what internal audit should be doing, as one mentioned, "We base our work on samples, whereas the internal audit should include all the transactions. The service provided by the internal auditor is completely different from the one provided by the external auditor." The interviewees explained that while internal audit is 100% responsible before the management, external audit is not. One important difference between internal and external audit as perceived by interviewees is that external audit may help discover the errors and problems after they happen, while internal audit should prevent them happening. Therefore, the interviewee-

wees suggested that companies with large activities should have their own audit unit as external audit alone is not sufficient as the work and scope is not the same to that of internal audit.

This problem was noted by Moeller and Witt (1999) who compared internal auditors to external auditors and stated that "... internal auditors sometimes suffer from an identity problem", and this is simply because members of management do not realize the actual difference between different types of auditors which has resulted in an audit expectations gap. The evidence presented above suggests that on this dimension there is a wide expectation gap in Saudi Arabia, and this is a factor which impacts the development of corporate audit in the country.

As long as this perception of corporate management about the internal and external audit profession is set, a number of consequences will occur. For example, establishing an internal audit function is unlikely and if the company experiences any problems relating to its internal control systems such as fraud or irregularities, the management will accuse the independent auditors as a result of its perception of the role of external auditors. This gap can be bridged through educating management about the actual duty and scope of work of an external auditor to that of

an internal auditor, which can be done through formal or informal education since this is an important step towards reducing the audit expectation gap (Mednick 1986, Monroe and Woodliff 1993, McEnroe and Martens 2001). The academic interviewees suggested, "Internal audit should be taught not only to accounting students but also to business and administration students". External auditors should explain to their clients their roles and responsibilities before they sign the contract. This is required by the professional standards which also address issues relating to the expectation gap phenomenon and clearly clarify the role of an independent auditor especially with regard to internal control, fraud detection, and financial irregularity discovery.

It should be noted that sometimes the expectation gap exists because the accounting and auditing professional standards themselves are not precise and different groups have their own interpretation of the standards. SOCPA should pay more attention and play a more practical and proactive part before the situation gets worse. Distributing newsletters and holding seminars with corporate governance staff to explain the exact responsibilities of external auditors could help narrow this type of audit expectations gap.

## **II. Gap between how corporate management should appreciate its internal audit function and how in reality the management recognizes the internal audit function.**

Management acceptance and support for the internal audit function has long been seen as critical to the success of the function (Sawyer *et al.* 2003). This is partly related to support in terms of staffing and resources, but there is also a deeper need for individuals to feel accepted and valued by their organization (Maslow 1987). However, the interviews showed a strong perception that management *per se* significantly under valued the internal audit profession considering it to be an unproductive overhead expense, rather than realizing its contribution towards a more efficient and effective company operation. For example, one director of an internal audit department stated, "The company's management has not yet recognised the importance of the internal audit function". Another confirmed, "The internal audit function has not gained full support and recognition from the decision makers".

Management's failure to appreciate the value of the internal audit function to fully endorse the purpose and objectives of it, has lead to the creation of a huge gap between the actual value internal auditors should receive, and the actual treatment they

receive from the corporate management. As a consequence this has restrained the development of corporate audit and weakened corporate governance. One internal audit director explained that the operational and executive management in many companies is still far from understanding the point that businesses are run by people who believe philosophy and psychology play a vital role in the day to day activities. Internal audit tool is the human being himself.

In a number of instances, corporate management directly interferes with the work of internal audit, for example by diverting staff to mainstream accounting and finance work or limiting the scope of internal audit to that of an adjunct to the accounting and finance function and failing to act on recommendations made. One internal audit director complained, "Whenever there is a shortage of employees in the other departments, they (*the management*) take from the internal audit department to fill such needs. Sometimes they return those employees back to the audit department, and sometimes they do not". Interviewees saw that in many companies in Saudi Arabia, the internal audit function is part of the financial department, and its scope is confined. In other companies, the internal audit department's recommendations are not followed as they should be. As a

result, internal audit was neither effective nor efficient.

The existence of this gap does significantly reduce the value of the internal audit function in the corporate sector, and has held back the development of the profession throughout the region. To eliminate this gap, corporate management needs to be educated about the role of internal audit within the corporation and be persuaded of its importance. This can also be done through the formal education to the potential administrators, or informal education to the commercial sector management. However, this is unlikely happen as long as no formal body, such as internal audit associations, exist and as noted earlier the proposal for establishing an internal audit association in Saudi Arabia was rejected by government authorities.

### **III. Gap between what the audited parties expect corporate auditors search for and what the internal auditor's actual job is.**

Another dimension of the expectation gap occurs in relation to what audited companies expect internal auditors to look for when performing the audit tasks and what the auditors' real objectives are. The professional and academic literature as well as auditing standards emphasize that the relationship between internal

audit and the audited departments and the individuals within those departments is important in determining the success or failure of the internal audit function (Mints 1972, CIPFA 1993, Flesher 1996, Ridley and Chambers 1998, Moeller and Witt 1999 Sawyer *et al.* 2003).

Such literature focuses on the need for cooperation and teamwork between the various parties if internal audit is to be effective. Bethea (1992) suggested that the need for good human relation skills is enhanced because internal audit, by its nature, creates negative perceptions and attitudes. These issues are particularly important in a multi-cultural business environment such as that of Saudi Arabia where there are significant differences in the cultural and educational background between the auditors and audited companies (Woodworth and Said 1996) which significantly contributes to the expectation gap. O'Regan (1999) considered that in an international context it is a prerequisite for the successful internal auditor to be sensitive to the nuances of cultural diversity, and Balheran (1995) saw that auditors should consider the organizational culture when structuring the audit approach. Dittenhofer (1997) confirmed that the varying environment, experience, and education of auditors and those being audited results in a dichotomy of attitudes and interpretations.

There is a consensus among the majority of interviewed directors of internal audit departments on the existence of a wide expectation gap. For example, one interviewee stated, "The unfriendly attitude by those being audited is sometimes due to a lack of understanding of internal audit role". The other departments' managers feel, as noted by one interviewee, *unhappy to see the internal auditor* because they view him as "the mistakes tracker", which consequently leads those people work cautiously and unwillingly.

The existence of such a gap is reflected in lack of cooperation from those being audited and has provided a major hindrance to the internal audit's performance. This lack of cooperation was seen as partly by resistance to change on behalf of those audited which in turn led to the recommendations by the internal auditors not being implemented. For example, a director of an internal audit department pointed out that, "The people being audited do not like being audited because they do not accept their faults to be detected, and hence they resist the auditing process. The nature of the internal audit makes matters complicated and is often rejected." Others complained that those audited only provide the minimum information required and they do not disclose everything. They also

delay in attaining responses. In order for the internal audit work to be performed effectively, those being audited must cooperate accordingly.

Again the education to those being audited can play a significant role in removing the misconception about internal audit. Hornik *et al.* (2003) suggested that such gaps be shortened through improving communication skills. The auditors themselves should explain their objective behind their audit as one interviewee said, "We are in need of explaining our goals to the management of various departments".

#### **IV. Gap between what the business sector requires in internal auditors (qualifications and experiences) and what are internal auditors' actual qualifications and experiences.**

Mohamed and Lashine (2003) highlighted that there is an existing gap between the skills acquired by accounting graduates and the actual skills required by the global markets and this warrants that the level of competency of accountants should be improved. In specific to internal audit, a SPPIA standard pointed out "Internal auditors should possess the knowledge, skills, and other competencies needed to perform their individual responsibilities. The internal audit activity collectively should possess or obtain the knowledge, skills,

and other competencies needed to perform its responsibilities" (Attribute Standard 1210).

A relative lack of professional qualification among both staff and directors of the internal audit department came across strongly in the interviews as a major limitation on the development of the internal audit function in Saudi Arabian companies. As noted by Ridley and Chambers (1998) the effectiveness of the internal audit function is influenced by the education, experience, and professionalism of the internal auditors. Liu *et al.* (1997) point out the potential threat to the quality of work in internal audit departments who employ a significant number of unqualified staff and Jin'e and Dunjia (1997) note that the internal auditors' lack of professional competence hinders their expected benefits to the enterprise. Al-Twajry (2000) surveyed 78 internal audit departments in Saudi Arabia and found that out of the 567 staff members in these departments, only 7% hold a CIA certification. Eliminating the gap between what the market requires in auditors and what the auditors actually acquire, is substantial for developing commercial activities (Mohamed and Lashine 2003). In developing nations, there should be more focus on this matter since there is a considerable difference between what students learn at business

schools and what the business sector demands. Difficulties in staffing internal audit departments is one of the greatest challenges facing the profession worldwide (Viles, 1998) and this is even worse in the internal audit profession in developing countries. Two thirds of the interviewed directors considered the lack of qualified employees to be a major problem encountering their departments and attributed this to a weakness in the Saudi professional labor market. As stated by one interviewee, "There is a shortage in the supply of good auditors in Saudi".

Hawkes and Adams (1995) pointed out that internal auditors have to be better trained and educated to identify, measure, and evaluate quality problems, preferably before they can adversely affect business process. The shortage of supply of qualified internal auditors does significantly affect the scope and performance of audit work. One director of an internal audit unit stated: "At the moment, the internal audit department lacks the required and qualified manpower to function as expected in meeting the diversity of the company's operations". In one of the surveyed internal audit departments, all of the internal auditors had not worked as auditors before. Consequently, they need to be trained and their personal characteristics altered which is a lengthily process.

This gap however can be bridged through three complementary procedures. One is by introducing internal audit course(s) or even complete programs as suggested by interviewed academics. They stated, "We are supposed to be bringing the spirit of internal audit to our program because an accounting background is not sufficient for performing internal audit work since internal audit is rapidly expanding". Another academic said, "I suggest that the universities in the Gulf and Arab world introduce internal audit not only as part of the accounting curriculum, but also to be a complete set of courses where a special degree can be earned". Two is by means of acquiring professional qualifications (i.e. CIA, CMA, CDP, CPA) which can be obtained internally or externally. However, this cannot be achieved as long as corporate management does not support the internal audit function. Three is through training, as one director of internal audit department said about his staff, "We always need to train them a lot before they can become competent enough to do the job".

**V. Gap between the scope of internal audit as expected by the professional standards (SPPIA) and what the internal auditors are actually doing.**

The professional standards of internal audit (SPPIA) in their latest

release stated that the purpose, authority, and responsibility of the internal audit activity should be formally defined in a charter, consistent with the Standards, and approved by the board (Attribute Standard 1000). However, in more than 80% of the interviewed internal audit departments, the internal audit activities are restricted to the financial affairs of internal control whilst the scope of the internal audit profession, as expressed in the SPPIA, is much wider than that. The definition of the internal audit profession as released in the latest SPPIA form is "Internal audit is an independent, objective assurance and consulting activity designed to add value and improve an organization's operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes." (Performance Standard 2100).

In Saudi Arabia, as is the case in most developing countries, the internal audit function was not designed to fulfill the professional standards requirements. The interview process supported that a widespread implementation gap is evident within the business corporate sector in Saudi Arabia. The focus of audit work is in most cases limited to financial issues

as interviewees said, "The concentration of the work, now, is on the outgoing money (expenses) only", "In Saudi Arabia, it is very likely to find the internal auditors within the financial department", "Our internal audit department mainly audits the financial affairs and financial statements". In some other cases, auditing in Saudi companies is primarily focused on internal controls which was frequently referred to, "The first aim of the internal audit department is to check the other departments' procedures of internal control", "The major objective of the internal audit is to provide a dependable internal control which will be relied upon by the external auditor", "Internal audit department can only recommend ways and means to improve and strengthen weak areas of internal control".

There are many different reasons for the existence of this gap and the lack of conformance with the professional standards. The weak support of corporate management, the small size of the internal audit department, the shortage of qualified personal, and the ignorance about the professional standards are the major factors contributing to widening the gap between how internal audit should be performed (as illustrated by the standards) as opposed to how it is actually practiced. One internal audit director com-

plained, "From what I have seen in Saudi Arabia, the internal audit profession gets the least importance... We are considered non-productive and of least value". This gap of implementation might not be easily reduced since diverse issues must be solved and the above discussed gaps should be at least minimized, if not entirely eliminated.

## Conclusion

Identifying the various auditing expectations gaps and suggesting ways for narrowing them are an important theme for enhancing corporate governance and cannot be ignored. Although in the developed countries a large number of researches were directed towards studying issues relating to the audit expectation gap, in the developing countries, where the case is in more need to be investigated, this field of study is under researched. This paper aimed to bridge the existing gap in this research area.

The interview method was found to be the most appropriate way in achieving this purpose since the perception of certain groups regarding corporate audit expectation issues was captured. The interview process suggested that several gaps exist with relation to Saudi corporate audit. These gaps are (1) between what corporate management believe external auditors do when per-

forming the independent audit and what their actual task is, (2) between how the corporate management is expected to value its internal audit and how the management does in reality appreciate its internal audit, (3) between how those audited within the company perceive internal auditors and what the internal auditors actual job is, (4) between what the business sector requires in internal auditors (qualifications and experiences) and what internal auditors actual qualifications and experiences are, and finally (5) between the scope internal audit as

expected by the professional standards (SPPIA) and what the internal auditors are actually doing.

These gaps have significantly reduced the value of corporate audit in Saudi Arabia and probably in most developing countries and contributed to the delay in developments of both internal and external audit. It might seem impossible to close these gaps entirely, however narrowing them can make big difference and hence corporate governance can be more effective and efficient.

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## الملخص

# الفجوات المتوقعة في مراجعة الشركات في الأسواق النامية: دليل من المملكة العربية السعودية

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هذه الدراسة محاولة لدراسة الفجوات المتوقعة والبارزة في مراجعة الشركات في الدول النامية باستخدام المملكة العربية السعودية مثالاً، ثم عرض مقترحات لسد تلك الفجوات، اعتماداً على أسلوب المقابلة مع ١٢٨ فرداً يمثلون خمس مجموعات مختلفة: أعضاء هيئة التدريس بالجامعات، مراجعين خارجيين، رؤساء أقسام المراجعة الداخلية في قطاع الأعمال، مديري الشركات أو نائبيهم، أشخاصاً يشغلون وظائف ذات أهمية خاصة للدراسة. وقد تم تحديد خمسة أنواع من الفجوات هي: (١) الفجوة بين ما يتوقع مديرو الشركات من المراجعين الخارجيين عند أداء مهمة المراجعة المستقلة، وبين مهمة المراجعة الخارجية الحقيقية، (٢) الفجوة بين الكيفية التي يجب أن تقدر بها إدارة الشركة المراجعة الداخلية لديها، وبين التقدير الواقعي للمراجعة الداخلية بواسطة الإدارة، (٣) الفجوة بين ما يتوقعه الذين تتم مراجعتهم (المراجعون) من المراجعين الداخليين عند أدائهم لمهنة المراجعة، وبين مهمتهم الحقيقية، (٤) الفجوة بين متطلبات قطاع الأعمال في المراجعين الداخليين (العلمي والعملي) وما يمتلكه المراجعون الداخليون من كفاءة في الواقع، (٥) الفجوة بين مجال المراجعة الداخلية كما حددها المعايير المهنية SPPIA، وبين ما يقوم به المراجعون الداخليون على أرض الواقع. إن بروز مثل تلك الفجوات ينتج عنه تأخر تطور مهنة مراجعة الشركات، كما يمكن أن يؤدي إلى إضعاف محكومية (إدارة) الشركات. ومن الطرق الممكنة أن تساعد على تضييق تلك الفجوات: أ) تثقيف الأطراف ذات العلاقة بدور المراجعة الداخلية والخارجية وتعليمهم وكيف يمكن التعاون فيما بينهما، ب) تقوية أو اصر التعاون فيما بين المراجعة الداخلية وبقية وحدات المنشأة (الأطراف المراجعة)، ج) تبني إستراتيجية جيدة للتأكد من تمتع مراجعي الشركة بالكفاءة المرجوة، د) تأسيس هيئة مهنية ذات فعالية لتطوير مهنة المراجعة الداخلية في المنطقة.

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