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## **The Guiding Reasons Why Public Interest Entities in Europe Elect a Particular Audit Firm and Auditors versus the Cost of the Audit**

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### **Info Articles**

### **Abstract**

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Declining audit fees represent a worldwide phenomenon which draws particular attention and concerns in the audit profession. The study explores the guiding reasons of public interest entities (PIEs) in Europe when electing a particular auditor, and investigates whether these reasons are reflected on audit fees. Further, it considers the impact of the prevailing macroeconomic conditions on these reasons, and accordingly on the cost of the audit. To this end the study intends to investigate whether these guiding reasons represent a declining factor on audit fees and under which macroeconomic conditions. To achieve the study objectives, a pragmatic mixed methods research approach is adopted, comprising surveys of respondents at audit firms and PIEs, and semi-structured interviews with participants at purposively selected PIEs, in Europe. The study finds that the guiding reasons are associated with the macroeconomic conditions, and reflect PIEs' expectations from the external audit. Ultimately, these expectations impact the cost of the audit depending on the current trends in the economy. The study proposes that the audit regulatory authorities should take actions to regulate PIEs' expectations from the external auditors and regulate the reporting requirements of auditors and audit firms, to achieve a proper balance between the scope of the audit procedures and the cost of the audit. In this view, the study recommends audit regulatory authorities adopt guidelines for determining the cost of the audit based on the assessed audit risk and scope of audit procedures.

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## **INTRODUCTION**

Worldwide corporate scandals, coupled with audit failures, have resulted in calls for strict regulation of the global audit profession, to regain public trust in the auditors' work and increase interest in the audited financial statements of PIEs. In response, The United States of America introduced the Sarbanes-Oxley Act (Verleun et al. 2011), and the European Union (EU) passed Directive 2006/43/EC (European Parliament 2006), subsequently revised by Directive 2014/56/EU (European Parliament 2014a) and Regulation 537 (European Parliament 2014b), to regulate specific statutory and reporting requirements for the auditing of PIEs. These imposed additional reporting requirements on auditors for audits of PIEs, aimed at improving audit quality and strengthening the independence of auditors. While these changes to the professional and legal requirements for the audit profession were ostensibly aimed at reducing the impact of the audit expectation gap (Leidner and Lenz 2017; Gheorghe 2011; Zemen and Lentner 2018), on a global level, the revised audit regulations have negatively impacted the cost of the audit (Institute of Certified Auditors of the Republic of North Macedonia 2015). Therefore, although increased oversight over audit firms may improve audit quality, auditors are facing constant pressure from their clients to reduce audit costs.

This study aims to understand the relationship between the cost of the audit and the guiding reasons why a particular PIE in Europe elects a particular auditor i.e. audit firm. We analyse these reasons through the prism of PIEs' expectations from the external audit function, to investigate their impact on the cost of the audit. We investigate the global economic conditions, to understand the relationship between the cost of the audit and prevailing macroeconomic trends. We link this relationship with the audit risk, and assert that the scope of the audit procedures is directly related to the level of the audit risk. To that end, we attempt to explain the impact of increased audit reporting requirements on audit costs and investigate whether the audit risk is related to the determination of the cost of the audit. We explore how the audit profession responds to the dynamic global stimuli, in order to protect the confidence of investors and other stakeholders. We provide important insights to resolve the dilemma of whether the audit regulatory authorities, on a global or national level, should intervene to influence the audit market in order to stabilise audit fees. In other words, we attempt to respond to the question about whether the audit regulatory authorities worldwide, should intervene to rein in the trend of declining audit fees, to improve the stability of the national and global audit market.

We deploy a mixed methods research approach, incorporating observations from surveys with respondents at audit firms and PIEs, and semi-structured interviews with participants at purposively selected PIEs in Europe, to achieve the study objectives. Their structure is presented in the text below. As such, this paper attempts to link the level of audit risk to the prevailing economic trends, by examining the scope of the audit procedures under the different economic conditions. In addition, we use global macroeconomic trends as a prism to further understand the guiding reasons of the PIEs under the different macroeconomic conditions. The relatively unique contribution of this study is that it uses PIEs' expectations from the external audit function, as proxies, to assess the resources available to auditors in the preparation of a cost-effective, yet sufficiently comprehensive offer to provide audit services.

The study finds that the cost of the audit is impacted by the current macroeconomic trends on the global and national level. In other words, the study finds that during vulnerable macroeconomic conditions the cost of the audit increases and vice versa. This is because of the bigger scope of the audit procedures which auditors conduct under vulnerable macroeconomic conditions, which requires more time and resources by the auditors to be arranged to conduct a particular audit. This is reflected in the different guiding reasons of the PIEs in Europe under the different macroeconomic conditions which ultimately results in the PIEs in Europe to have different expectations from the external audit function under the different macroeconomic conditions. In turbulent economic periods, PIEs in Europe expect auditors to conduct bigger scope of audit procedures, to regain public trust in audited financial statements. The bigger scope of audit procedures reduces the detection risk and accordingly the audit risk. On the other side, vulnerable economic conditions impact the inherent risk, forcing the auditors to design and conduct bigger scope of audit procedures, to reduce the audit risk on an acceptably low level (to reduce the detection risk). This again impacts the cost of the audit, by making the guiding reasons of the PIEs for electing a particular auditor a determining factor on the cost of the audit, depending on the current macroeconomic trends.

The study is structured in four headings which systematically present the flow of the study, to draw the research conclusions, based on the study results. The introduction presents the key information regarding this study article – background of the study phenomenon, contribution of the study, applied research methodology, and key study conclusions. The literature review heading presents the findings from other researchers which are related to the study phenomena. Used secondary sources are presented in the references at the end of the study article. The methodological heading presents the applied research methodology, while the empirical results are presented in the third heading. Ultimately study conclusions are presented in the last (fourth) heading.

## LITERATURE REVIEW

An independent audit adds credibility to the presented financial data and the information contained in the financial statements (Fiolleau et al. 2013; Marx 2009; Tepalagul and Lin 2015). During each audit engagement, auditors must find an appropriate balance between the quality of information and the costs incurred (Kritzinger 2016). Auditors expect the users of audited financial statements to understand that the audit opinion expressed in relations to the underlying financial statements is based on the work done over an extended period, at a reasonable cost. The independent auditor's opinion therefore cannot refer to the entire population of information, nor confirm that each transaction has been investigated in sufficient detail to ensure that the presented information is not incorrect or fraudulent, unless the evidence suggested otherwise (Velte and Freidank 2015).

Cancino et al. (2019) found that the composition of the audit team affects audit fees, improving the competitiveness of the audit firm on the professional market. In other words, the more competent the audit team, the more competitive the cost of audit.

O'Leary et al. (2006) assert that the time required to conduct the audit, significantly impacts the audit fees. However, when preparing the audit offer, the audit partner should assess the availability and cost of the resources required for the particular audit engagement, to make a reasonable estimate, failing which, the audit firm may conduct the audit at a loss (Cancino et al. 2019). Although audit firms may offer to conduct an audit engagement for lower audit fees, this may create ethical issues for auditors (International Federation of Accountant 2018). Audit firms should not accept audit engagements where the client's management requires the scope of audit procedures to be reduced to reduce the cost of the audit. Omitting audit procedures at the client's behest, reduces the scope and relevance of the audit evidence, which in turn, may impair audit quality.

The literature proffers different reasons for offers of lower audit fees. Cancino et al. (2019) explain that as a commercially oriented profession, auditing may be also affected by the prevailing economic conditions, making it reasonable for audit firms to offer audit services for reduced audit fees. Al-Nawaiseh (2015) however, suggests that auditors could rely on the work of the client's internal auditors to assist with conducting the audit engagement, which may reduce audit fees. In such cases, auditors must comply with the prescripts of International Standard on Auditing 610 (International Federation of Accountants 2013). Additionally, the dynamic progress of digital technology may facilitate a substantial reduction in audit firm costs, justifying a decrease in audit fees.

The cost of the audit should reflect the level of the client's business risk (Elliott et al. 2008). Therefore, the greater business risk associated with the client, the higher the cost of the audit engagement, since audit engagements on riskier clients require auditors to conduct more extensive audit procedures, reducing the audit risk to an acceptably low level.

Picconi and Reynolds (2013) found that audit fee elasticity in relation to the assets in financial statements, is not constant. De Lima Castro et al. (2015) postulate that audit fees are positively related to the client's size, complexity, level of corporate governance, and the size of the audit firm conducting the audit engagement. Lemonakis et al. (2018) found that the client's earnings negatively affect the cost of the audit during periods of economic instability, i.e. the larger the client's earnings, the lower the cost of the audit. Furthermore, the book value on the financial statements positively affects the cost of the audit under stable economic conditions (Lemonakis et al. 2018).

Notwithstanding the lack of a professional framework to apply when offering an audit service, the audit offer must be comparable with those submitted by other audit firms. In the absence of a standardised format, Cancino et al. (2019) explain that an offer for an audit engagement should include:

- The audit fees and basis for their determination;
- An assessment of the audit personnel required;
- A schedule for conducting the audit procedures;
- Other key assessments, performed by the audit partners, relating to the specific audit engagement;
- The audit methodology that the audit firm intends to apply;
- A short reference list of the audit firm; and
- A short summary of the proposed audit team for the specific audit engagement.

The commercial practice of professional auditing represents a labour-intensive activity (Simunic 1980). When determining the audit fee for a particular audit engagement, auditors must consider the real cost of conducting the audit, the expected loss arising from the quality of the client's financial reporting, and the auditor's potential financial liability (Simunic 1980). Beatty (1993) identified auditor's liability loss as comprising three main components, namely, delisting, bankruptcy and lawsuits. The pricing of audit services is therefore negatively affected by pending audit litigation, with the potential to decrease audit fees being less

likely when auditors are being sued in relation to an audit engagement (Eu-Jin and Houghton 2000). Bell et al. (2001) found that the level of audit risk is integrally linked to the audit fee auditors determine when offering their audit services. The level of audit fees, therefore, indicates the level of risk that auditors are prepared to accept on a particular audit engagement. In addition to audit services, audit firms usually offer and provide many other professional services to their clients, such as consultancy services, accounting, taxation, etc.

Since the cost of the audit engagement factors in risk (Beatty 1993; Bell et al. 2001; Simunic 1980), during periods of economic instability, auditors should design and conduct more extensive audit procedures, reducing the audit risk to an acceptably low level. However, the client's business activities tend to be greater during stable times, offsetting a possible reduction in audit fees. For example, clients may require consultancy services to expand their business. In this view, the cost of the audit tends to increase to compensate for the additional audit risk in turbulent times (Dachevski and Ackers 2022), with auditors incorporating an appropriate risk factor into their estimation of audit fees. Conversely, the lower audit risk associated with stable economic conditions decreases the cost of the audit due (Dachevski and Ackers 2022). Thus, in stable times, auditors require lower 'risk compensation', which reduces the cost of the audit. Since the level of audit risk is directly related to the audit procedures performed, the higher the audit risk, the more audit procedures auditors need to design and conduct, to reduce audit risk to an acceptably low level. Auditors therefore need to do more work when conducting audit engagements in turbulent times, in turn, increasing the cost of the audit. Accordingly, the relationship between the audit profession and the broader macroeconomic trends has a direct impact on the cost of the audit.

However, a lower cost audit engagement does not necessarily imply a risky audit engagement. The cost of the audit engagement reflects how the audit firm has used its resources to conduct the audit, i.e. how the audit was planned, under what conditions and circumstances it was conducted, etc. This means that audit fees should be determined based on the extent of work conducted by auditors, the hours spent, and the resources deployed. Any misalignment between the cost of an audit engagement, the audit quality factors and their determinants, may indicate a risky audit engagement, with resultant dubious audit quality.

Proper segregation of duties and responsibilities between auditors and their clients in relation to the preparation of the financial statements, contribute to achieving high audit quality (Antipova 2018). However, as in established commercial practices, auditors should agree the terms under which they will provide the audit service, including the cost, with their client.

Incorrectly understanding the auditor's role and responsibilities, is a key contributor to the audit expectation gap (Gros and Worret 2014; Velte and Freidank 2015). The International Standards on Auditing (ISAs) do not precisely define the phenomenon called the audit expectation gap. Porter (1993) suggests that the audit expectation gap represents the difference between what society expects from auditors and their actual performance. Porter (1993) explains that the audit expectation gap consists of two components, namely, the reasonableness gap, which describes society's expectation regarding audit performance; and the performance gap, which describes the audit performance. The audit expectation gap results from society's different perception of the auditors' role, when compared with their actual responsibilities (Maroun and Atkins 2014).

Failure to correctly understand the aim and purpose of the audit may result in different expectations of the audit work performed (Kusaila 2017), with different stakeholders having diverse views on the purpose of the financial statement audit, without appropriately differentiating between the responsibilities of auditors and those of their clients. Similarly, Maroun and Atkins (2014) explain that the public confusion about the aim of the audit, results from the public not properly distinguishing between the responsibilities of auditors and those charged with governance (usually the board of directors), who are actually responsible for preparing the financial statements submitted for auditing. Recognising the different roles and responsibilities of auditors and their clients, is crucial to understanding the audit process (Velte and Freidank 2015). The purpose of the audit during the financial reporting process of any client, is not to create financial data or information about the business operations (Velte and Freidank 2015), but rather to attest to the veracity of the financial disclosures. Auditors are independent of their clients (Saha and Roy 2016). The auditor's role is to provide reasonable assurance, expressed as an opinion in an independent auditor's report, about the fairness and objectivity of their client's financial statements, in all material respects, under the accepted financial reporting framework (Fiolleau et al. 2013; Marx 2009; Tepalagul and Lin 2015; International Federation of Accountants 2009).

These differences in perceptions about the role of the auditors highlight the difference in expectations of the audit services provided (Kusaila 2017). On the one hand, the public may expect auditors to guarantee the correctness of all financial transactions reflected in the financial statements. On the other hand, given the inherent limitations of an audit, auditors can only provide reasonable, but not absolute assurance, about the fairness and objectivity of the financial statements, and about whether they have been prepared in all material respects according to the appropriate financial reporting standards (Velte and Freidank 2015).

The public may be under the misconception that auditors are responsible for the preparation of the audited financial statements and expect to receive assurance that all the client's financial transactions are correct in every respect (Kusaila 2017). However, recent high-profile financial reporting scandals at PIEs have had a devastating impact on the credibility of the global audit profession, prompting fundamental changes to legislation around the world aimed at improving the way audit firm conduct is regulated (Centre for Financial Reporting Reform 2016; Gheorghe 2011; Leidner and Lenz 2017; Zemen and Lentner 2018).

Kusaila (2017) postulates that the audit expectation gap arises from the public not being a contractual party to any audit engagements. The contractual parties are the auditors and audit firms as the providers of the audit services and the clients requiring audit services to enhance the credibility of their financial statements (Fiolleau et al. 2013; Marx 2009; Tepalagul and Lin 2015), with the public merely being users of the audited information contained in the financial statements. Despite not being a contractual party, the general public use the final product of the audit, relying on the audit opinion expressed in the independent auditor's report regarding the fairness and objectivity of the underlying financial statements, to inform their investment, credit and similar decisions. However, Velte and Freidank (2015) attribute the public misconception of the purpose of an audit on the public not having insight into the contract for the provision of audit services, nor of the work actually undertaken by the auditors. Mansur and Tangl (2018), accordingly postulate that the audit expectation gap could be narrowed when the users of audited financial statements are educated about the auditor's role and responsibilities, and when competent national authorities prescribe appropriate reporting and professional requirements for auditors.

While the cost of the audit cannot be based on the audit expectation gap, the audit expectation gap nevertheless impacts the cost of the audit. The greater the audit expectations, the higher the cost of the audit. This is because of the greater impressions which the audit expectation gap creates towards the interested parties to resolve particular issues, such as the expectations that the external audit may provide the stakeholders with guarantees for a future prosperity, inspecting and reporting of fraudulent financial transactions, internal control deficiencies, management quality concerns, going concern issues, legal compliances, etc. Our study therefore argues that expectations from the audit are greater during turbulent economic periods and reduced during economic stability (Dachevski and Ackers 2022). It is accordingly expected that auditors will conduct audits at higher cost during economic instability, to compensate for the higher audit risk. Conversely, during economic stability, the auditors face lower audit risk, resulting in lower expectations of the audit, reducing the cost of the audit (Dachevski and Ackers 2022).

Referring to the objective of this study paper, the guiding reasons of the PIEs in Europe for electing particular auditors/audit firms are considered as one component of the audit expectation gap. This is because, the audit expectation gap represents the difference in expectations from the external audit function from many stakeholders, such as the individual users of audited financial statements, public officials, journalists, investors, creditors, etc. In this view, PIEs represent only one group of stakeholders which has different understanding and expectations from the external audit function. To that end, this study paper focuses on the PIEs' expectations when selecting their auditors/audit firms, to explore the guiding reasons that justify their selecting decisions. In this view, their expectations are analysed under vulnerable and stable macroeconomic conditions, to identify which guiding reasons prevail under the current economic trends. Therefore, the cost of the audit is linked to the scope of the audit procedures which auditors conduct under the different macroeconomic conditions by considering the assessed level of the audit risk. Ultimately, the relationship between the cost of the audit and the guiding reasons of the PIEs is investigated under the different macroeconomic conditions, to draw conclusions whether, to what extent, and under which conditions these guiding reasons represent an impacting factor on the cost of the audit, i.e. audit fees.

## **METHODOLOGY**

This study seeks to understand the impact of the PIEs' guiding reasons for electing a particular auditor/audit firm on the cost of the audit and accordingly, the audit fees. The aim is to investigate the relationship between the audit risk and the scope of the audit procedures required to meet the different expectations of the PIEs from the external audit function, under the prevailing economic conditions. Ultimately, we attempt to provide an answer to the dilemma about whether the audit regulatory authorities, on a national and international level, should take further actions to protect the audit profession, by controlling the cost of the audit and accordingly the resultant audit fees. We submit that the scope of audit procedures is directly related to the resources auditors deploy during the audit. The greater the scope of the audit procedures, the more resources auditors must expend during the audit (i.e. time, professional staff, etc.), consequently making the audit more expensive.

The thesis advanced in this paper is that audit firms should ensure that the cost of the audit is adequate to meet the reasonable expectations of the PIEs from an external audit, with their guiding reasons influenced by the macroeconomic conditions. Since the cost of the audit depends on the audit risk, the preparation of

the offer to provide audit services, therefore requires auditors to consider the audit risk when determining the audit fee. To appropriately respond to the associated audit risk, auditors must design and conduct specific audit procedures to decrease the detection risk to an acceptably low level. The scope of these audit procedures should consider the time and resources required – the more time and greater competencies required to conduct these procedures, the higher the cost of the audit. Therefore, to ensure high audit quality, when determining the cost of the audit, auditors must consider all the resources required to effectively and efficiently conduct the audit. The research variables applicable to this study include the guiding reasons of the PIEs for electing a particular auditor/audit firm, audit risk and cost of the audit, which are explored to investigate the mutual relationships amongst these variables.

This mixed methods study uses primary and secondary sources of data and information. The secondary sources include extant literature, whereas the primary sources include a combination of quantitative data from surveys with respondents at audit firms and PIEs, in Europe; and qualitative data from semi-structured interviews with participants at PIEs, in Europe.

We use extant literature, including scholarly resources and professional audit literature, to explain the impacting factors on the cost of the audit, nature of the audit expectation gap and its characteristics, as well as to describe the proposed audit risk model. The observations from the literature are linked to the scope of the audit procedures to explore the relationship between the level of audit risk, and the scope of audit procedures required and accordingly, its impact on the cost of the audit. We link PIEs' guiding reasons for electing a particular auditor/audit firm to the audit risk, to explain the impact of the prevailing economic conditions on the audit risk. We conceptually argue that the audit risk is higher when the PIEs have greater expectations from the external audit and postulate that these guiding reasons of the PIEs represent a reflection of their different expectations from the external audit function, under the different macroeconomic conditions. Ultimately, we consider these expectations of the PIEs as only one segment of the audit expectation gap, because this phenomenon arises from the different understanding and expectations which many stakeholders have from the external audit (not only the PIEs, but also the investors, creditors, individual users, regulatory bodies/agencies, and other users of audited financial statements).

The quantitative component of this study involved surveys with respondents at audit firms and PIEs, in Europe. To understand the cost of the audit, in relation to the different economic conditions, to establish the appropriate scope of audit procedures and the required resources, we investigate the cost of the audit under the prevailing audit risk associated with different macroeconomic conditions.

Quantitative sample representativeness was achieved by applying the statistical sampling formula provided by Taherdoost (2016), who asserted that to generalise the form of a simple random sample and avoid sampling errors or biases, the sample size needs to be adequate. Taherdoost (2016) recommends the following formula for calculating the sample size:

$$n = \frac{N \cdot p \cdot (100-p) \frac{z^2}{e^2}}{p \cdot (100-p) \frac{z^2}{e^2} + N - 1} \quad (1)$$

Where:

'n' is the required sample size;

'N' is the total population size;

'p' is the proportion of the population;

'e' is the margin of error; and

'z' is the confidence interval.

Although larger samples tend to reduce the likelihood of biased findings, diminishing returns may apply when samples get too large (Gill et al. 2010). Simply stated, larger sample sizes may reduce sampling error, but at a decreasing rate (Taherdoost 2016).

For this purpose, 264 audit firms in Europe were randomly selected (from the total population of 10.000 audit firms in Europe), 80 of which agreed to respond to the survey (30.30% response rate). Survey respondents at selected audit firms included audit partners and audit managers. Inclusion criteria were that audit firms/respondents had to be officially registered as providers of audit services based on the EU Acquis Communautaire for Statutory Audit, in publicly available registers of auditors and audit firms of national audit institutes and professional audit associations in the European countries. Regarding the PIEs in Europe, 267 of them were randomly selected (from the total population of 19.074 PIEs in Europe), 75 of which agreed to respond to the survey (28.01% response rate). Survey respondents at selected PIEs included chief finance officers, chief executive officers, and other senior officials. Inclusion criteria were that PIEs/respondents had to be registered in the official registers of the particular European country as 'entities from public interest', i.e. banks, insurance/reinsurance companies, and/or other listed entities.

The surveys were conducted between June 2021 and July 2022. Appropriate survey questions were developed for the two respondent groups, which are respectively disclosed in Appendix 1 and Appendix 2 below. The surveys were web-based and all randomly selected respondents received an email invitation to participate with a link to the survey questions. The respondents needed about five minutes to submit their responses. Obtained results from the surveys were analysed using descriptive statistics. We applied the Pearson's ratio for simple linear correlation, to identify the relationships between the research variables, their impacting factors and affecting determinants, as follows (Taraldsen 2022):

$$r = \frac{n\sum xy - \sum x \sum y}{\sqrt{n\sum x^2 - (\sum x)^2} \sqrt{n\sum y^2 - (\sum y)^2}} \quad (2)$$

Where:

- 'r' is the Pearson's ratio;
- 'n' is the number of series; and
- 'x' and 'y' are the research variables.

The model presented above, illustrates the simple linear correlation between the research variables (Taraldsen 2022), where the minimum value may be negative, and the maximum value may be positive (Taraldsen 2022). However, to test the significance of the obtained ratio, we applied the Student's T-distribution with two degrees of freedom, as presented below (Taraldsen 2022):

$$t = \frac{r}{S_r} \quad (3)$$

$$S_r = \sqrt{\frac{1-r^2}{n-2}} \quad (4)$$

Where

- 'r' is the Pearson's ratio;
- 'Sr' is the standard deviation ratio;
- 'n' is the number of series; and
- 't' is the significance test.

Whereas a Pearson's ratio of zero means that no simple linear correlation exists, a positive value reflects a simple linear correlation, while a negative value reveals a simple linear regression (Taraldsen 2022). However, since the value of the Pearson's ratio does not represent the strength of the simple linear correlation (Taraldsen 2022), we applied the significance test, and considered the Student's T-distribution with two degrees of freedom, based on the obtained significance test value. This resulted in two hypotheses being developed for the quantitative analysis (Taraldsen 2022):

- $H_0$ , which means that no simple linear correlation exists; and
- $H_1$ , which means that a simple linear correlation exists.

If  $t(S_r/2; n-2) > t$ , then  $H_0$  applies, and if  $t(S_r/2; n-2) < t$ , then  $H_1$  applies (Taraldsen 2022). Gradual scaling of the x variable is calculated as presented in Table 1 below with five series.

**Table 1.** Gradual scaling - x variable

Variable	Grade
Strongly agree	100%
Agree	75%
Uncertain	50%
Disagree	25%
Strongly disagree	0%

Source: Authors' own theorising.

The critical values of the Student's T-distribution are presented in Appendix 3.

The semi-structured interviews with participants at PIEs in Europe provide additional insights into the phenomena being studied, based on the obtained survey results. Although fifteen PIEs in Europe were purposively selected for the interviews (five banks, five insurance or reinsurance companies and five publicly listed entities), eleven agreed to participate (response rate of 73.00%). In addition, the purposively selected PIEs in Europe were multinational firms with subsidiaries and branches in more than one European country.

The interview participants included chief executive officers, chief finance officers as well as other appropriate senior representatives. All invited participants had to be registered with the official authorities of the European country in their registers of PIEs (banks, insurance/reinsurance companies, other listed entities). The semi-structured interview results were thematically analysed according to two themes – the guiding reasons of the PIEs for selecting a particular auditor/audit firm, and the cost of the audit. All semi-structured interviews were transcribed. They were conducted in September/October 2022. Participants needed between ten to fifteen minutes to participate in the semi-structured interview. Developed guiding questions are disclosed in Appendix 4 below. The semi-structured interviews were web-based by using the zoom digital platform.

To validate the research results, we triangulated the data and information gathered from the various sources. Research variables were then linked to the prevailing global economic trends, to identify any relationships. In this regard, we postulate that after 2012, but before the global COVID-19 pandemic, the global economy was relatively stable (International Monetary Fund 2023). To that end, we consider the audit regulatory authorities' mandate to increase the reporting obligations of auditors, aimed at meeting the reasonable expectations of various legitimate stakeholders, and to improve how they understand the objectives of an external audit.

The study was conducted in three phases. The first phase included a review of secondary sources including relevant regulatory and professional literature. The second phase included the surveys to inform the observations from the first phase, with the semi-structured interviews in the third phase providing important insights into the study observations. Ultimately, we concluded by triangulating the data and information from all sources.

Limitation of the study results arises by the geographical location of the samples – Europe/EU. In this view, obtained results from the quantitative and qualitative component of the study may be applicable only in Europe and in the common market of the EU. To delineate this limitation, the study extrapolated obtained results by using the data from the International Monetary Fund, to link the obtained results to the official data related to the global macroeconomic conditions. In this view, the study draws general conclusions regarding the study phenomena.

## **ANALYSIS AND DISCUSSION OF RESULTS**

The audit expectation gap provides an indication of what the public expect the independent auditor's report to address regarding the financial audit. The greater these expectations, in relation to actual audit performance, the larger the audit expectation gap. The audit expectation gap therefore represents the extent to which the public may misunderstand the purpose of an external audit. Since the public tend to conflate the audited financial statements with the independent auditor's report (Maroun and Atkins 2014), the audit expectation gap reflects the disconnect between what the independent auditor's report provides and what the users of audited financial statements expect.

While higher audit quality may decrease the audit expectation gap (Rice 2015), audit quality deficiencies tend to refer to audit firm operations, i.e. how the audit has been conducted, and not the underlying financial statements, which remains responsibility of the audit client (Gibson 2018). Since the public may not understand the responsibilities of auditors (Maroun and Atkins 2014), when audit quality deficiencies come to light, the public may incorrectly perceive the auditors, and not their clients, as being responsible for identified financial reporting deficiencies. Since the users of audited financial statements constantly require additional data and information (Cohen and Wright 2010), the audit expectation gap cannot be eliminated. As the requirement for better information about the auditee's business activities constantly increase, the public may expect the auditors to respond to those needs (Leidner and Lenz 2017; Zemen and Lentner 2018). The audit expectation gap is therefore influenced by the public's need for relevant and credible financial and non-financial data and information about the auditee's operations. The audit expectation gap is accordingly not constant, with its level increasing or decreasing according to the public need for data and information about the auditee's operational performance. Figure 1 below illustrates the nature of the audit expectation gap and its characteristics, based on the reviewed literature.



<b>Independent auditor's report</b>		<b>Users of audited financial statements</b>
<p><b>The audit expectation gap:</b>                  Identifies what the public expects auditors to report on in their independent auditor's report;                  Represents the extent to which the public misunderstands the external audit function;                  Reflects the relationship between the independent auditor's report and the public as users of audited financial statements;                  Represents the level of perceived credibility to the financial statements by the public;                  Always exists, and can never be eliminated;                  Depends on the public's need to obtain credible and reliable financial and non-financial data and information about the auditee's operations;                  Is not static, with its level increasing or decreasing according to the public's need for relevant data and information about the auditee's operational activities and the prevailing socio-economic circumstances.</p>		

Source: Authors' own theorising.

**Figure 1.** The nature of the audit expectation gap and its characteristics

The first survey question to the PIEs in Europe probes their expectations from the external audit. Table 2 below summarizes the obtained results.

**Table 2.** PIEs' expectations from the external audit

<b>PIEs in Europe expect the external audit to:</b>	<b>Frequency of received responses</b>	<b>Total received responses</b>	<b>Percentage of received responses</b>
Add additional value, and/or confidence, and/or credibility to the presented financial figures in the financial statements	75	75	100%
Improve the internal control processes	75	75	100%
Improve the quality of the financial reporting	62	75	83%
Provide competent financial reporting	62	75	83%

Source: Authors' own theorising.

Table 2 above reveals that PIEs in Europe have many expectations from the external audit. The different understanding of the actual aim and purpose of the external audit implies the users of the audit services have different expectations from the auditors' work (Kusaila 2017). Therefore, it appears that the different expectations from the external audit arise because of the audit expectation gap which usually exists when audit services are provided by the auditors to the auditees. However, the actual aim of the external audit is to ensure the veracity of the presented financial statements and in Table 2 above, 83% of the respondents (62 of the total of 75 received responses) revealed that they expect the external audit to provide the users with competent financial statements.

The results from the first semi-structured interview question with the PIEs in Europe revealed that the expectations of the PIEs from the external audit might be classified into five categories. These categories are presented in Table 3 below.

**Table 3.** Expectations from auditing financial statements of PIEs

<b>Traditional expectation</b>	This expectation arises from the traditional function of the independent audit. Auditors are expected to report on the fairness of presented financial statements, in all material respects, to the management and those charged with governance, and shareholders. This expectation is considered a public expectation from the external audit function because all findings must be publicly reported.
<b>Regulatory expectation</b>	This expectation arises from existing regulations under which PIEs operate. Auditors are expected to report on compliance with those regulations, tax obligations, etc. to the management and those charged with governance. Auditors' findings refer to confidential issues and are not publicly announced.

**Table 3.** Expectations from auditing financial statements of PIEs (continued)

<b>Operational expectation</b>	This expectation arises from the operational activity of PIEs. Auditors are expected to report on the internal controls, internal processes, working policies, business activities, risk management policies, etc. to the management and those charged with governance, and shareholders. Depending on the current circumstances, auditors need to apply their professional judgment to decide whether findings need to be publicly announced or not.
<b>Strategic expectation</b>	This expectation arises from the strategic goals of PIEs to meet a particular business aim. Auditors are expected to report on the achieved business success, conquered markets, market share, etc. to the management and those charged with governance, and shareholders. Depending on the strategic commitment of the particular PIE, auditors need to apply their professional judgment to decide whether findings need to be publicly announced or not.
<b>Specific expectation</b>	This expectation arises from the specifics of the sectors in which PIEs operate. This expectation may vary from a non-financial reporting expectation of auditors, such as sustainability, and compliance with ecological standards, to actuarial reports, and transfer costs to the management and those charged with governance, and shareholders. In this regard, auditors are expected to protect the interest of the insured parties, deponents, investors, etc. Depending on the current circumstances, auditors need to apply their professional judgment to decide whether findings need to be publicly announced or not.

Source: Authors' own theorising.

Table 3 above reveals that all participants have additional expectations from the external audit, besides the expectation to provide them with reasonable assurance regarding the fair presentation of the financial statements. In addition, participants expect the external auditors to provide improvement suggestions in various areas which are outlined above in Table 3. In this regard, a participant from the banking sector explains, "The biggest expectation of auditing is, first of all, to get assurance of the correctness and comprehensiveness of the financial statements, and then to receive information about some areas where there is space for improvement, which is very good with everything that comes with it".

The second survey question to the PIEs in Europe investigates whether the external audit improves their financial reporting quality. All 75 respondents strongly agreed that the external audit improves their financial reporting quality. Bigger insights to this result are obtained from the results from the second semi-structured interview question with the PIEs in Europe where all participants explained that auditors' improvement suggestions are always taken into consideration. As participants explained, this is because auditors have deeper insights into the current trends of the operating sectors, and access to various databases while making the cross-analysis of the received information, to reach their audit conclusions. That is the reason participants rely on auditors' improvement suggestions based on the identified weaknesses of the internal controls, working rules, procedures, policies, etc. Furthermore, all participants explained that auditors improve the operational efficiency and effectiveness of all processes, to achieve stable economic flows and better financial results; maintain and improve the current market share and position; improve PIEs' business performance; etc. In this regard, a participant from the energy sector (a listed entity) outlines "The audit improves the quality of our financial reporting because their notes intend to improve our performance".

The third survey question to the PIEs in Europe investigates their election preferences concerning the types of audit firms. Obtained responses are summarized in Table 4 below.

**Table 4.** PIEs' election preferences concerning the types of audit firms

<b>PIEs' election preferences concerning the types of audit firms</b>	<b>Frequency of received responses</b>	<b>Percentage of received responses</b>
International networks	51	68%
Local audit firms	12	16%
No preferences	12	16%
<b>Total</b>	<b>75</b>	<b>100%</b>

Source: Authors' own theorising.

Table 4 above reveals that international networks are more attractive to PIEs than local audit firms. Bigger insights into this matter provide the results from the second semi-structured interview question with

the PIEs in Europe. To this semi-structured interview question, all participants explained that they prefer international networks, mainly the big four international networks because regulatory requirements impose a legal obligation to select external auditors from an international network. However, the participants gave additional reasons for this preference, such as to obtain world-class audit quality (usually big four international networks are perceived as world-class providers of audit quality); faster obtain the audit opinion for the consolidated financial statements on the group level; to obtain more transparent financial reporting, etc. For example, a participant from the insurance and reinsurance sector gave the following explanation “Local audit firms do not have sufficient resources to audit international groups, especially in the field of actuary. On the other hand, international networks have regional actuarial experts who support auditors while testing the technical reserves, solvency ratios, capital adequacy, etc. In addition, international networks are more familiar with our culture because they conduct audits on the entire group, i.e. on all subsidiaries and branches which are under the control of the parent”.

Audit quality is associated with the proper application of the ISAs, International Standard for Quality Control 1, and International Federation of Accountants’ Code of Ethics. In this view, international networks deliver higher-quality audits than local audit firms (Salman 2023). In addition, Swan and Alsaqqa (2013) asserted that the regulations in some jurisdictions prohibit local audit firms from auditing the financial statements of PIEs, to preserve the financial reporting credibility. However, this provides the big four international networks with a monopoly on the global audit market (Mickhail 2012).

In the above-noted view, Table 5 below illustrates the results from the fourth survey question to the PIEs in Europe concerning their criteria for the election of particular auditors and audit firms.

**Table 5.** PIEs’ criteria concerning the election of particular auditors and audit firms

PIEs’ election criteria concerning particular auditors and audit firms	Frequency of received responses	Total received responses	Percentage of received responses
International networks	62	75	83%
Good public reputation	62	75	83%
Short period to conduct the audit	62	75	83%
Experience in external audit	50	75	67%
Official public registration	50	75	67%
The auditor’s independence	38	75	51%
No conflicts of interest	38	75	51%
Low cost of the audit	13	75	17%
Provided references by the auditees	13	75	17%
Small scope of audit procedures	13	75	17%

Source: Authors’ own theorising.

The above table reveals that international networks and good public reputation of the auditors and audit firms represent just two of the many criteria of the PIEs that may lead to their decision to elect particular auditors and audit firms (83% of the respondents in Table 5 above gave these responses, i.e. 62 out of the total of 75 received responses). The remaining criteria are listed in this table based on the frequency of responses provided by the respondents.

To identify the leading reason why PIEs, elect particular auditors and audit firms, the research considers the responses from the fourth semi-structured interview question with the PIEs in Europe. These responses revealed that the criteria for electing auditors and audit firms reflect the expectations of PIEs concerning the external audit. The criteria for electing auditors and audit firms may be classified into five main categories which are presented in Table 6 below.

**Table 6.** Criteria for electing external auditors and audit firms by PIEs

<b>Traditional criteria</b>	These criteria arise from the traditional external audit function. PIEs elect their external auditors and audit firms based on their auditee references. These criteria intend to improve the auditor’s independence, and accordingly audit quality.
<b>Regulatory criteria</b>	These criteria are prescribed in the audit regulations or set up by the regulatory authorities of the sectors in which PIEs operate, such as central banks, insurance supervision agencies, security and exchange commissions, etc. PIEs elect their external auditors and audit firms based on regulatory requirements. These criteria aim to create a bigger “distance” between the management and those charged with governance, and the auditors.

**Table 6.** Criteria for electing external auditors and audit firms by PIEs (continued)

<b>Operational criteria</b>	These criteria depend on the business activity of PIEs. External auditors and audit firms are elected depending on whether they have specific business arrangements with the PIEs, such as banking deposits, investments in shares, bonds, bought insurance policies, etc. These criteria represent a potential risk of conflicts of interest between auditors and auditees and may deteriorate the auditor's independence.
<b>Strategic criteria</b>	These criteria depend on the auditee's commitment to a comprehensive audit. External auditors and audit firms are elected based on the auditee's group regulations, for example, the same international network audits all of the branches and subsidiaries of the parent on the global level. Usually, the election is made by the higher governance of the parent and the lower governance in the branch or subsidiary follows its election decision of external auditors. These criteria aim to provide the higher governance of the parent with credible financial reporting of all branches and subsidiaries and intend to improve the auditor's independence in the short term. In the longer term, these criteria deteriorate the auditor's independence due to the bigger audit tenure.
<b>Specific criteria</b>	These criteria depend on the specifics of the sector in which the PIEs operate. Per these criteria, PIEs select their external auditors and audit firms based on their competence to audit specific items in their financial statements, such as capital adequacy, capital solvency, technical reserves, etc. Audit quality, per these criteria, depends on the competence of the experts who are engaged by the auditors to meet the specific requirements that are set by the auditees.

Source: Authors' own theorising.

Although participants gave different responses regarding their eligibility criteria as presented in Table 6 above, all of them explained that they desire an audit at a lower cost. In this regard, a participant from the energy sector (a listed entity) explained "The first criterion for electing external auditors and audit firms is their experience i.e. their history in providing audit services. However, the cost of the audit prevails when making the election decision".

Based on the above it appears that the leading criterion of PIEs to elect particular auditors and audit firms refers to the cost of the audit.

According to Elliot et al. (2008) the business risk of the auditee directly impacts the cost of the audit, i.e. the higher the business risk of the auditee, the higher the cost of the audit. In addition, during economic stability auditees face lower business risk than during economic instability (Elliot et al. 2008). Therefore, it is expected the cost of the audit to decrease during economic stability due to the lower business risk of the auditees. The results from the first survey question to the auditors and audit firms in Europe appear to confirm this. They are presented in Table 7 below.

**Table 7.** The relation between the cost of the audit and the prevailing macroeconomic conditions since 2012

<b>The cost of the audit has significantly decreased since the recovery from the global financial crisis in 2012</b>	<b>Frequency of received responses</b>	<b>Percentage of the received responses</b>
Strongly agree	19	24%
Agree	45	56%
Uncertain	12	15%
Disagree	4	5%
<b>Total</b>	<b>80</b>	<b>100%</b>
Pearson's ratio		0,59
Standard deviation ratio		0,47
Significance test		1,27
<b>Critical value of t-distribution</b>	<b>(0,25;3)</b>	<b>0,77</b>

Source: Authors' own theorising.

In the above table the cost of the audit represents the tested variable against the recovery from the global financial crisis in 2012. The significance test of the tested variable, in this table, appears to be higher than the critical value of the t-distribution. This implies that the cost of the audit has significantly decreased since the recovery from the global financial crisis in 2012. However, the development of digital information technology may significantly reduce the cost of the audit (Roberts and Kotb 2011) and therefore, it appears that auditors and audit firms feel constant pressure from the auditees to provide high-quality audits at reduced costs.

Bell et al. (2001) found that the level of audit risk is directly related to the cost of the audit because the higher the audit risk, the bigger scope of audit procedures are necessary, to reduce the detection risk on an acceptably low level. This implies that auditors and audit firms engage more resources resulting in higher costs for the audit. In this view, the results from the second survey question to the auditors and audit firms in Europe reveal that the providers of audit services in Europe (auditors and audit firms) intend to determine the cost of the audit based on the assessed level of the audit risk and scope of audit procedures. The results are illustrated in Figure 2 below.

**95% of the auditors and audit firms in Europe intend to determine the cost of the audit based on the assessed level of the audit risk and scope of audit procedures.**

Source: Author's own theorising.

**Figure 2.** Determining the cost of the audit

Concerning the result that is illustrated in Figure 2 above, 95% of the respondents (76 out of the total of 80 received responses) intend to determine the cost of the audit based on the assessed level of the audit risk and scope of audit procedures, to decrease the detection risk on an acceptably low level. The remaining 5% of the respondents (4 out of the total of 80 received responses) intend to determine the cost of the audit based on the scope of conducted audit procedures.

Responding to Koh and Woo's (1998) assertion that national authorities should prescribe a legal requirement for the audit profession to react appropriately when the user expectations of the duties of auditors regarding the financial statements and the real duties of auditors are not aligned, we submit that it is necessary for national and international audit regulatory authorities to intervene to regulate the level of the audit expectation gap and protect the public trust in the auditors' work. In this regard, we seek to understand the influence of the audit expectation gap on the cost of the audit, as well as its impact. To explore this influence, first of all we analyse the audit risk model.

The audit risk model (referred to below as 'AR') represents the combination of the risk from material misstatements (referred to below as 'RMM') and detection risk (referred to below as 'DR'), in terms of which the risk from material misstatements represents the combination of inherent risk (referred to below as 'IR') and control risk (referred to below as 'CR') (Dowling et al. 2018; Fontaine et al. 2016; Hakwoon et al. 2015; Knechel et al. 2013; Wilson et al. 2018).

$$\text{AR} = \text{RMM} \times \text{DR} \quad (5)$$

where

$$\text{RMM} = \text{IR} \times \text{CR} \quad (6)$$

or

$$\text{AR} = \text{IR} \times \text{CR} \times \text{DR} \quad (7)$$

The audit risk model described above illustrates the direct relationship between audit risk on the one hand, and inherent, control and detection risk on the other. The inherent risk in every audit engagement has a given level which auditors must assess, while the control risk is subject to the auditors' assessment based on the control environment of the client (Niemi et al. 2018). Detection risk is the only risk that the auditors may influence (Dowling et al. 2015; Fontaine et al. 2016; Hakwoon et al. 2015; Knechel et al. 2013; Niemi et al. 2018; Wilson et al. 2018), because auditors must assess the risk of material misstatements (Jones 2018), i.e. the inherent and control risk, when designing and conducting appropriate audit procedures to respond to the assessed risk of material misstatements. Consequently, the assessed level of risk from material misstatements is directly related to the substantive audit procedures performed (Antipova 2018). A high risk of material misstatements requires the auditors to conduct more substantive audit procedures, in terms of the scope, nature and extent, to reduce the audit risk to an acceptably low level (Antipova 2018; Niemi et al. 2018). The detection risk is inversely related to the substantive audit procedures, since fewer substantive audit procedures may increase the detection risk.

The literature notes that auditors should use the going concern assumption to assess the auditee's business risk (Zeman and Lentner 2018), identifying the security risks (the risk of cyber-attacks, web-sales risk, etc.) that may reasonably be expected (Popescu and Popescu 2018). This gives rise to a strong relationship between the risks associated with the business and the audit, which are influenced by inherent and control risks (van Buuren et al. 2014). However, Bell et al. (2008), and Houston et al. (1999) assert that audit risk is unrelated to business risk, because:

- The business risk arises from the client's business;
- The audit risk is focused on the client's financial statements; and

- The audit risk only exists in the auditor’s opinion, which is expressed in the independent auditor’s report.

Since audit risk relates to the audit of the financial statements of a specific auditee, the business risk of an auditee influences the risk of material misstatements (Robson et al. 2007). This especially applies when the identified business risks are so significant that they could materially influence the going concern assumption applied during the audit of the client’s financial statement (Zeman and Lentner 2018).

Since the audit risk is higher during periods of economic instability and lower during economic stability, the public expectations of the audit tend to be greater during periods of economic instability. Consequently, the resultant cost of the audit tends to be higher during economic instability and lower during economic stability, contributing to an increase in the cost of the audit during vulnerable economic periods.

Table 7 above confirms the assertion that lower audit costs are associated with periods of economic stability. Illustrating the inverse simple linear correlation between the cost of the audit and economic conditions, Table 7 shows the inverse relationship between the cost of the audit and the prevailing economic conditions. In addition, Figure 2 above, proffers an explanation for the relationship between the cost of the audit and the prevailing economic conditions, with the audit risk being higher under vulnerable economic conditions. This increased audit risk requires auditors to conduct more expansive audit procedures to reduce the risk to an acceptably low level, increasing the cost of the audit during unstable economic periods (Dachevski and Ackers 2022). Conversely, under stable economic conditions, the opposite applies (Dachevski and Ackers 2022), due to the lower audit risk.

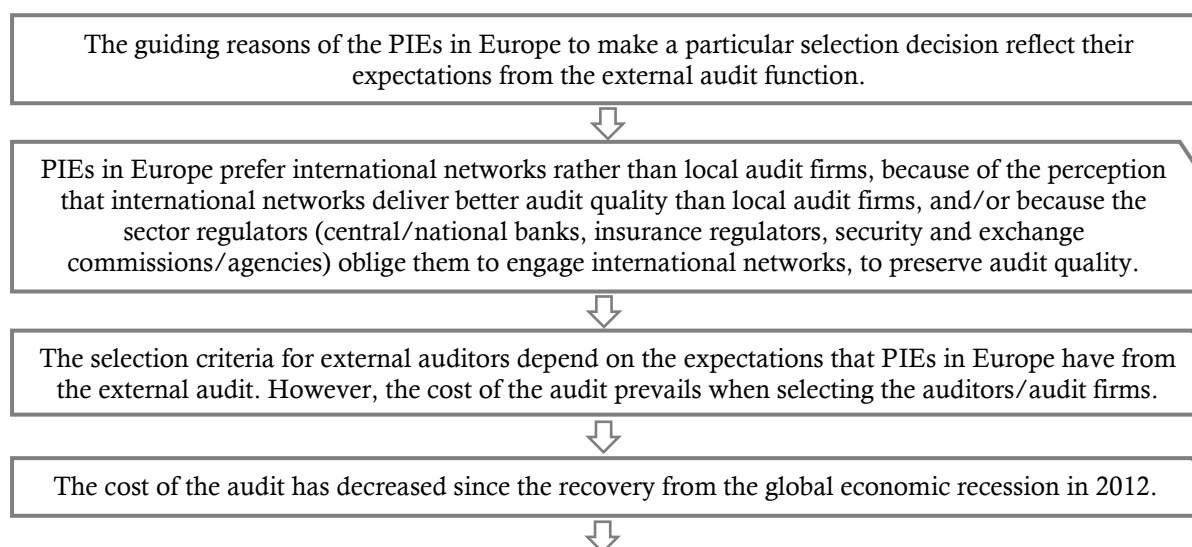
As illustrated in Table 8 below, the results from the third survey question to the auditors and audit firms in Europe confirmed the assertion that European audit firms provide both assurance and non-assurance services, which may increase the audit expectation gap under stable economic conditions (Dachevski and Ackers 2022). This is because of the perception that non-audit services of auditors provide the users with ‘additional’ value, which although not attested, may be considered as ‘trustworthy’ by various stakeholders (investors, creditors, etc.) for decision making. This creates additional confusion in the public regarding the actual aim and purpose of the external audit.

**Table 8.** Audit and non-audit services of the audit firms in Europe

<b>Audit firms in Europe provide audit and non-audit services.</b>	<b>Frequency of received responses</b>	<b>Percentage of the received responses</b>
Yes	65	81%
No	15	19%
<b>Total</b>	<b>80</b>	<b>100%</b>

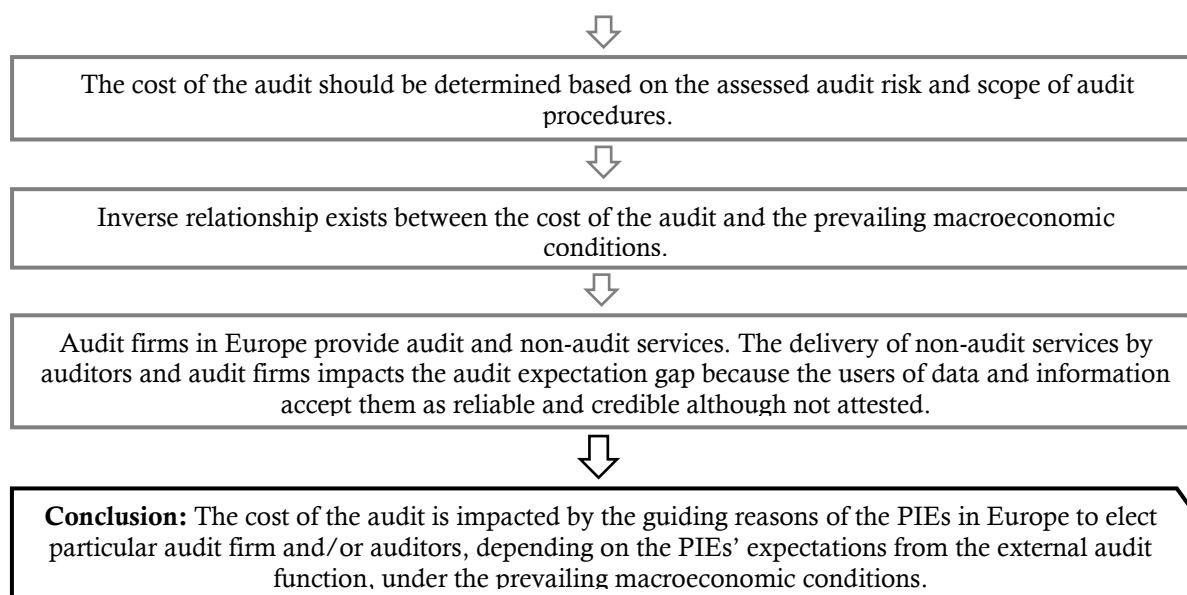
Source: Authors’ own theorising.

Triangulation of all study results are summarized in Figure 3 below.



Source: Authors’ own theorising.

**Figure 3.** Triangulation of all study results



Source: Authors' own theorising.

**Figure 3.** Triangulation of all study results (continued)

In summary, the literature reviewed, survey and semi-structured interview observations confirm the assertion that the cost of the audit appears to be directly related to the audit risk, and accordingly to the required scope of audit procedures. Thus, the higher the audit risk, the greater the scope of audit procedures that the auditors must conduct to reduce this risk to an acceptably low level. Furthermore, the expectations of the PIEs concerning the financial audit represent an integral component of the cost of the audit, which is greater under economic instability, due to the higher audit risk. Accordingly, during vulnerable economic periods, auditors need to conduct more extensive audit procedures, which, in turn, increase the cost of the audit. Conversely, during economic stability, the lower cost of the audit is attributed to fewer audit procedures being required, due to the lower audit risk. By implication, during periods of economic stability, the PIEs' expectations of the audit are reduced.

## CONCLUSION

The study observations confirm the assertion that the cost of the audit is inversely related to the prevailing macroeconomic conditions. PIEs have greater expectations from the external audit during economic instability and smaller during economic stability (Dachevski and Ackers 2022). Therefore, it appears that the audit expectation gap during economic stability, negatively affects the cost of the audit. This is caused by the lower audit risk and reduced scope of audit procedures. Conversely, during economic instability, to appropriately respond to the higher audit risk, auditors are required to design and conduct more expansive audit procedures, to adequately respond to this risk, increasing the cost of the audit. In this view, the guiding reasons of PIEs to elect particular audit firm/auditors positively affect the cost of the audit during economic instability and negatively during economic stability.

Auditors should therefore properly assess the level of the audit risk, to meet the reporting expectations, i.e. to report on material misstatements and omissions detected in the presented financial statements. When PIEs' expectations of the audit and the scope of audit procedures are aligned, the cost of the audit of the financial statements is optimised. Auditors are accordingly required to determine the cost of the audit, based on the assessed audit risk.

We accordingly propose that to stabilise audit quality and reduce the volatility of audit costs, the audit regulatory authorities in Europe should intervene to control the scope of the audit procedures and auditors' reporting requirements based on the prevailing macroeconomic conditions. This could be achieved by the regulatory audit authorities around the world, introducing mandatory regulation to control the scope of competent data and information in the public. For example, by requiring auditors to include other competent data and information that the public use to inform their decision-making, which are usually in the scope of an audit engagement on the financial statements. This could be addressed by expanding the scope of audit engagements to include providing independent assurance on selected non-financial disclosures (Ackers 2017) or by prescribing the combined assurance model for PIEs (Venter and van Eck 2021). In other words, auditees with complex transactions and/or poor financial reporting quality should expect to pay higher audit

fees.

In the above view, the study recommends the audit regulatory authorities in Europe adopt guidelines for determining the cost of the audit based on the assessed audit risk and scope of audit procedures. This approach will enable auditors and audit firms to properly plan the conduct of the audits against the available resources – money, time and staff, to stabilize the declining trend in audit fees.

The study limitation is that the semi-structured interviews and surveys were confined to entities operating in Europe, and to the EU in particular. As such, the study observations and conclusion may only apply to the European audit market. However, since auditors globally, apply the ISAs, which underpins the audit risk model presented in this study, the research findings also have implications for the global audit market. Although the study linked the cost of the audit to the availability of the requisite skills and competencies of the audit team on an audit engagement, we have not thoroughly investigated this aspect of audit quality and the audit expectation gap. We accordingly recommend that a similar study be undertaken into the influence of the skills and competencies of the audit team on audit quality and the audit expectation gap.

The audit expectation gap provides an indication of what the public expect the independent auditor's report to address regarding the financial audit. The greater these expectations, in relation to actual audit performance, the larger the audit expectation gap. The audit expectation gap therefore represents the extent to which the public may misunderstand the purpose of an external audit. Since the public tend to conflate the audited financial statements with the independent auditor's report (Maroun and Atkins 2014), the audit expectation gap reflects the disconnect between what the independent auditor's report provides and what the users of audited financial statements expect.

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**Appendix 1 Survey questions for respondents at audit firms in Europe**

1. The cost of the audit services has decreased since the recovery from the global economic recession in 2012.
  - ..... Strongly agree
  - ..... Agree
  - ..... Uncertain
  - ..... Disagree
  - ..... Strongly disagree
  
2. How should the cost of the audit be determined?
  - ..... The cost of the audit should be determined based on the assessed audit risk only
  - ..... The cost of the audit should be determined based on the scope of the performed audit procedures only
  - ..... The cost of the audit should be determined based on the assessed audit risk and the scope of the performed audit procedures
  - ..... The cost of the audit is not related to any of the above
  
3. Does your audit firm or the international/local audit network to which it belongs, offer non-audit services to the clients, such as accounting, valuations, advisory services, and/or consultancy services?
  - ..... Yes
  - ..... No

## **Appendix 2 Survey questions for respondents at PIEs in Europe**

1. What are your biggest expectations of auditing your financial statements? You may tick more than one response.
  - ..... To improve our internal processes
  - ..... To improve the quality of our financial reporting
  - ..... To add additional value, and/or confidence, and/or credibility to our presented financial figures in the financial statements
  - ..... To provide us with reliable and credible financial reporting
  
2. Does the audit improve the quality of your financial reporting?
  - ..... Strongly agree
  - ..... Agree
  - ..... Uncertain
  - ..... Disagree
  - ..... Strongly disagree
  
3. Which type of audit firm do you prefer to conduct the annual audit on your financial statements?
  - ..... Audit firm which belongs to an international audit network
  - ..... Local (small and medium) audit firm
  - ..... We don't make any preferences between international and local audit firms
  
4. What are the criteria under which you make the selection of a particular audit firm and/or auditor? You may tick more than one response.
  - ..... Auditors and/or audit firms must be registered for providing audit services by the competent governmental authorities
  - ..... Experience in external audit, basically more than three years
  - ..... High level of independence of auditors
  - ..... No conflicts of interests between the auditors/audit firms and our PIE and/or our competitors
  - ..... International audit firm is preferred
  - ..... Local audit firm is preferred
  - ..... Good national and/or international reputation of the audit firm
  - ..... References by other clients are compulsory
  - ..... High price for the audit service
  - ..... Low price for the audit service
  - ..... Big scope of audit procedures
  - ..... Small scope of audit procedures
  - ..... Long period to conduct the audit
  - ..... Short period to conduct the audit

Appendix 3 Critical value of Student's t-distribution with two degrees of freedom

<b>t Table</b>											
cum. prob	<i>t</i> <sub>.50</sub>	<i>t</i> <sub>.75</sub>	<i>t</i> <sub>.80</sub>	<i>t</i> <sub>.85</sub>	<i>t</i> <sub>.90</sub>	<i>t</i> <sub>.95</sub>	<i>t</i> <sub>.975</sub>	<i>t</i> <sub>.99</sub>	<i>t</i> <sub>.995</sub>	<i>t</i> <sub>.999</sub>	<i>t</i> <sub>.9995</sub>
one-tail	<b>0.50</b>	<b>0.25</b>	<b>0.20</b>	<b>0.15</b>	<b>0.10</b>	<b>0.05</b>	<b>0.025</b>	<b>0.01</b>	<b>0.005</b>	<b>0.001</b>	<b>0.0005</b>
two-tails	<b>1.00</b>	<b>0.50</b>	<b>0.40</b>	<b>0.30</b>	<b>0.20</b>	<b>0.10</b>	<b>0.05</b>	<b>0.02</b>	<b>0.01</b>	<b>0.002</b>	<b>0.001</b>
df											
1	0.000	1.000	1.376	1.963	3.078	6.314	12.71	31.82	63.66	318.31	636.62
2	0.000	0.816	1.061	1.386	1.886	2.920	4.303	6.965	9.925	22.327	31.599
3	0.000	0.765	0.978	1.250	1.638	2.353	3.182	4.541	5.841	10.215	12.924
4	0.000	0.741	0.941	1.190	1.533	2.132	2.776	3.747	4.604	7.173	8.610
5	0.000	0.727	0.920	1.156	1.476	2.015	2.571	3.365	4.032	5.893	6.869
6	0.000	0.718	0.906	1.134	1.440	1.943	2.447	3.143	3.707	5.208	5.959
7	0.000	0.711	0.896	1.119	1.415	1.895	2.365	2.998	3.499	4.785	5.408
8	0.000	0.706	0.889	1.108	1.397	1.860	2.306	2.896	3.355	4.501	5.041
9	0.000	0.703	0.883	1.100	1.383	1.833	2.262	2.821	3.250	4.297	4.781
10	0.000	0.700	0.879	1.093	1.372	1.812	2.228	2.764	3.169	4.144	4.587
11	0.000	0.697	0.876	1.088	1.363	1.796	2.201	2.718	3.106	4.025	4.437
12	0.000	0.695	0.873	1.083	1.356	1.782	2.179	2.681	3.055	3.930	4.318
13	0.000	0.694	0.870	1.079	1.350	1.771	2.160	2.650	3.012	3.852	4.221
14	0.000	0.692	0.868	1.076	1.345	1.761	2.145	2.624	2.977	3.787	4.140
15	0.000	0.691	0.866	1.074	1.341	1.753	2.131	2.602	2.947	3.733	4.073
16	0.000	0.690	0.865	1.071	1.337	1.746	2.120	2.583	2.921	3.686	4.015
17	0.000	0.689	0.863	1.069	1.333	1.740	2.110	2.567	2.898	3.646	3.965
18	0.000	0.688	0.862	1.067	1.330	1.734	2.101	2.552	2.878	3.610	3.922
19	0.000	0.688	0.861	1.066	1.328	1.729	2.093	2.539	2.861	3.579	3.883
20	0.000	0.687	0.860	1.064	1.325	1.725	2.086	2.528	2.845	3.552	3.850
21	0.000	0.686	0.859	1.063	1.323	1.721	2.080	2.518	2.831	3.527	3.819
22	0.000	0.686	0.858	1.061	1.321	1.717	2.074	2.508	2.819	3.505	3.792
23	0.000	0.685	0.858	1.060	1.319	1.714	2.069	2.500	2.807	3.485	3.768
24	0.000	0.685	0.857	1.059	1.318	1.711	2.064	2.492	2.797	3.467	3.745
25	0.000	0.684	0.856	1.058	1.316	1.708	2.060	2.485	2.787	3.450	3.725
26	0.000	0.684	0.856	1.058	1.315	1.706	2.056	2.479	2.779	3.435	3.707
27	0.000	0.684	0.855	1.057	1.314	1.703	2.052	2.473	2.771	3.421	3.690
28	0.000	0.683	0.855	1.056	1.313	1.701	2.048	2.467	2.763	3.408	3.674
29	0.000	0.683	0.854	1.055	1.311	1.699	2.045	2.462	2.756	3.396	3.659
30	0.000	0.683	0.854	1.055	1.310	1.697	2.042	2.457	2.750	3.385	3.646
40	0.000	0.681	0.851	1.050	1.303	1.684	2.021	2.423	2.704	3.307	3.551
60	0.000	0.679	0.848	1.045	1.296	1.671	2.000	2.390	2.660	3.232	3.460
80	0.000	0.678	0.846	1.043	1.292	1.664	1.990	2.374	2.639	3.195	3.416
100	0.000	0.677	0.845	1.042	1.290	1.660	1.984	2.364	2.626	3.174	3.390
1000	0.000	0.675	0.842	1.037	1.282	1.646	1.962	2.330	2.581	3.098	3.300
<b>Z</b>	0.000	0.674	0.842	1.036	1.282	1.645	1.960	2.326	2.576	3.090	3.291
	0%	50%	60%	70%	80%	90%	95%	98%	99%	99.8%	99.9%
	<b>Confidence Level</b>										

Source: Adjusted based on Beyer 1968.

**Appendix 4 Semi-structured interview questions for participants at PIEs in Europe**

1. What are your biggest expectations of auditing your financial statements?  
.....  
.....
2. Does the audit improve the quality of your financial reporting?  
.....  
.....
3. What are the criteria under which your PIE selects its audit firms and/or auditors?  
.....  
.....
4. Which type of audit firm do you prefer to conduct the annual audit on your financial statements, a local (small/medium) audit firm or an audit firm which belongs to an international network?  
.....  
.....