

# Public Trust in the Auditors' Work and the Prevailing Macroeconomic Conditions

ISSN 1857-9973

UDC 657.6:316.644]:303.725.3(100)"2005/2022"

*Darko Dachevski, M.Sc.<sup>1</sup>, Barry Ackers, D.Com.<sup>2</sup>*

<sup>1</sup> *Ph.D. candidate, College of Accounting Sciences, University of South Africa, Pretoria, South Africa, darko\_dc@yahoo.com*

<sup>2</sup> *Professor, College of Accounting Sciences, University of South Africa, Pretoria, South Africa, ackerb@unisa.ac.za*

## Abstract

This paper aims to explore whether the audit profession is impacted by global economic growth, how, and to what extent. In that manner, the study paper explores the interrelationship between the public trust in the auditors' work and the prevailing macroeconomic conditions. For the applied research methodology, the proportion of audit company revenue, for the period from 2005 through 2022, derived from audit services and non-audit services, is used as a proxy to measure 'the public trust in the auditors' work' and 'the audit expectation gap'. These resultants are multiplied to calculate the 'public interest', which is juxtaposed against the global gross domestic product growth for the same period, to support the conceptual assertion that the public interest follows the current trends in the global economy. The study finds that public interest is directly related to the public trust in the auditors' work. In this view, enhanced demand for audit services implies an increased public trust in the auditors' work. The higher the demand for audit services, the bigger the public trust in the auditors' work. The function of the audit expectation gap implies the general public to obtain a bigger scope of data and information regarding the operational activity of the auditees. The audit profession is connected with global economic growth through the public interest. This is because public interest follows the current trends in the global economy. The higher economic growth is accompanied by bigger public interest. In this regard, bigger public interest implies a bigger demand for audit services which in turn increases the public trust in the auditors' work. This paper which uses the public interest as an indicator for global economic growth, contributes to understanding the relationship between the audit profession and prevailing macroeconomic conditions.

## Keywords

Audit Expectation Gap; Economic Growth; Public Interest; Public Interest Entities; Public Trust in the auditors' work.

## 1. Introduction

Regulatory changes worldwide introduced many challenges for the audit profession. Two new terms were introduced, such as "public trust" and "public interest" which require further attention by the audit profession. This is because the audit regulatory authorities bear the ultimate responsibility in protecting public trust by monitoring audit quality on public interest entities (PIEs). By increasing public interest, audit regulatory authorities contribute to

achieving greater financial stability, which is a precondition for sustainable economic growth. In other words, the audit regulatory authorities are responsible for preserving the public trust in the auditors' work (Centre for Financial Reporting Reform, 2016).

Users of audited financial statements do not properly differentiate between the responsibilities of auditors, and those of the management regarding the preparation of the financial statements. The result of this is the audit expectation gap, which arises from the fact that the majority of the users of audited financial statements do not properly understand the function of external audits (Gros and Worret, 2014:345-374).

This paper explores the interrelationship between the public interest, the audit expectation gap, and the public trust in the auditors' work. The objective is to understand the relationship between the audit profession and global economic growth. The study is undertaken in three phases. The first, involving a review and analysis of the literature, including, but not limited to pertinent audit regulations introduced by the European Union, is used to conceptually argue that the public trust in the auditors' work and audit expectation gap impact, the public interest. The second, uses secondary data extracted from public pronouncements by the big four audit networks in their global reports of transparency for the period between 2005 and 2022, to validate observations emerging from the first phase. To understand the relationship between public interest and global economic growth, the third phase uses publicly available information relating to global gross domestic product (GDP) growth by the International Monetary Fund (IMF) to investigate the relationship between public interest and worldwide economic activity. The study empirically uses the revenues of the big four audit companies as disclosed in their global reports of transparency from 2005 to 2022, to determine the demand for audit services as a proxy for exploring the public trust in the auditors' work for the same period. In addition, the study empirically uses the revenue from non-audit services of the big four audit companies as announced in their global reports of transparency, to determine the supply of non-audit services as a proxy for exploring the function of the audit expectation gap for the same period. As such, this paper contributes to the crucial discourse on the audit profession, by being one of the first papers to explore public interest as proxy indicator of global economic stability that combines public trust in the auditors' work and the function of the audit expectation gap. Furthermore, to understand the relationship between the public interest and global economic growth, the proportion of the global audit revenue for the big four audit companies from 2005 to 2022, is juxtaposed against global GDP growth for the same period.

This conceptual paper, which explores the relationship between the public interest and economic growth proceeds with the customary literature review to provide an overview of the prevailing scholarly discourse on the audit profession. The paper continues by briefly describing the research methodology, before describing, analysing and interpreting the key findings.

## **2. Literature Review**

International standards of auditing (hereafter: the ISAs) do not provide an exact definition of the phenomenon which auditors call "the audit expectation gap". Porter (1993) defines the "audit expectation gap" as the gap between society's expectations of auditors and the auditors' performance as perceived by society. As this author explains, the audit expectation gap consists of two components, the reasonableness gap, which describes the expectations of the society regarding auditors' performances; and the performance gap, which describes the reasonableness of auditors' performances. The author further notes that this phenomenon arises from the different understanding of the role of the auditors regarding the question of what their actual job is.

Maroun and Atkins (2014) explain that the general public does not make a proper distinction between the responsibilities of the auditors, versus the responsibilities of those charged with governance who bear the main responsibility for the preparation of audited financial statements. For example, lost trust in the audit profession worldwide was caused by the reviled

corporate scandals in Enron, WorldCom, Sunbeam, Societe Generale Bank, where auditors failed to design appropriate audit procedures that would have secured them to gather sufficient and relevant audit evidence to detect material misstatements in the presented financial statements (Leidner and Lenz, 2017; Centre for Financial Reporting Reform, 2016; Tara, 2011; Zemen and Lentner, 2018). A common characteristic of all these entities is that all of them were PIEs because they were banks, listed entities, investment funds, etc.

Kusaila (2017) found that different understandings of the audit and its aim and purpose could result in different expectations of auditors' work by the public. However, an incorrect understanding of auditors' responsibility is the key component in the audit expectation gap (Gros and Worret, 2014:345-374). According to Mansur and Tangl (2018), the audit expectation gap may be decreased by educating the users of the financial statements and auditors regarding the auditors' tasks and responsibilities, and/or by prescribing additional reporting and professional requirements for auditors by competent national authorities. Koh and Woo (1998) found that national authorities need to prescribe a legal basis for the profession to appropriately react when there is an imbalance between the expectations of the users of the financial statements regarding the auditors' duties on one side, and the real duties of the auditors on the other side.

Velte and Freidank (2015) explain that the volume of the economic transactions and events between the different types of entities is strongly affected by the issued audit opinion because the basic function of the audit is to add credibility to the presented financial statements. These authors assert that the role of the audit during the financial reporting process of any client is not to create financial data and information regarding its business operations. However, issued audit opinions on presented financial statements of listed entities do not necessarily affect the price of the securities (Karkacier and Ertas, 2017). Instead, investment decisions are affected by the presented data and information in the financial statements that are prepared by the clients (Mustikarini and Samudera, 2017). In addition, issued audit reports do not have an influence on the securities' trading prices on the stock exchange (Danescu and Spatacean, 2018). Instead, Shahzad, Rubbaniy, and El-Temtamy (2017) found that the volume of investment activity on the stock exchanges was bigger when auditors issued a modified audit opinion on the presented financial statements. As these authors explain, investors undertake risks when they make investments and the bigger the risk is, the bigger the return on the investment. Although Shahzad et al. (2017), assert that auditors play a significant role in enhancing investors' confidence in financial markets, the global financial crisis between 2008 through 2012 shocked investors' confidence. This is because Mareque, Lopez, Villanueva-Villar, and Lago-Penas (2019) found that there is less probability for the clients to receive unmodified audit opinions in stable times than in turbulent times. According to these authors, auditors increased their propensity to issue reports with a modified audit opinion at the beginning of the global crisis in 2008 because of the increased regulatory scrutiny, the increased risk of audit error, a potential increase in reputational damage, and the litigation risk. According to Cohen and Wright (2010), audits on PIEs' financial statements provide greater transparency of their business activities by increasing their credibility and secured by providing a high level of audit quality. In addition, Bedard and Johnstone (2010) explain that the credibility of PIEs' financial statements depends on the performed audit procedures based on which the auditors gather sufficient and relevant audit evidence (Jones, 2018), and under which they form their opinion in the independent auditor's report (Antipova, 2016). However, the newest changes in the European audit regulations aim to strengthen audit quality since they set requirements for (Centre for Financial Reporting Reform, 2016):

- Public oversight;
- Quality assurance;
- Ethical principles and auditor independence;
- The appointment and removal of auditors;
- Internal organization of the audit company;
- Education and training;

- Approval and registration of auditors and audit companies;
- Audit standards; and
- Audit committees for PIEs.

Sang Ho (2012) claims that the public interest represents the interest of an imaginary person who forgot his identity, and who believed that he could have equal chances of being anyone in the general society. However, as Mill (1972) explains, the public interest depends on the PIEs' business performances, i.e. the bigger the business performances of the PIEs are, the bigger the welfare of the general public. As this author asserts, lost public interest means that the general public, i.e. the users of PIEs' financial statements are not interested in their business performances. This is logical because the general public expects "to receive a reasonable return" from the business activities of the PIEs since its assets represent their main source of funds (Gibson, 2018).

The International Federation of Accountants (hereafter: the IFAC) in its Code of Ethics outlines that the key reason why the audit profession needs to apply ethical guidelines in public practices is the public interest. According to Zager, Malis, and Novak (2016), the basic characteristic of the audit profession is its acceptance of the responsibility to act in accordance with the public interest. As these authors explain, that is why auditors when conduct audit services need to satisfy the needs not only of particular individuals or organizations, but they need to reasonably respond to the expectations of the general public regarding the fair presentation of the financial performances of the PIEs.

Douglas and Wodak (2015) assert that audit regulatory authorities worldwide should focus on protecting the public interest by increasing the level of public trust in the auditors' work by achieving a high level of quality of audits on PIEs. Based on this, it is logical to assume that public trust in the auditors' work is more associated with the public availability of the audit opinion i.e. the independent auditor's report for the presented financial statements. However, PIEs are required to publicly announce the issued audit opinion i.e. the independent auditor's report for their audited financial statements (Iliev, 2018). For example, banks and insurance and reinsurance companies are obliged to publish their audited financial statements and the independent auditor's report on their websites, while listed entities are obliged to publish their audited financial statements and the independent auditor's report on the website of the stock exchange in which their securities are officially listed (Gibson, 2018). Therefore, it is logical to understand that public trust in the auditors' work is more associated with audits on PIEs, because of the requirements for public availability of their audited financial statements and independent auditor's report. In comparison, the availability of the audit opinion i.e. the independent auditor's report of the audited financial statements of other "non-public" interest entities, is significantly reduced because of the "non-existing" or "low" requirements for a public announcement of their audited financial statements and independent auditor's report (Gibson, 2018). According to Iliev (2018), other entities that are not in the public interest must submit their audited financial statements and independent auditor's report to an appropriate governmental agency, such as the national registries, which significantly reduces the public availability of the audit opinion regarding their financial statements. Even though Gibson (2018) and Iliev (2018) both agree that audited financial statements and audit opinions of other "non-public" interest entities may be obtained in a legally prescribed procedure from the national authority where the client had submitted them before, the public availability of the audited financial statements of the PIEs and the audit opinion for them has a significant influence on the public's perception regarding financial stability and economic growth in the national economy (Karkacier and Ertas, 2017). This is because the public has easier access to reliable data and information on the PIEs, to make an analysis based on competent financial statements, which were independently audited by a competent auditor, who issued an independent auditor's report, which contains a professionally prepared audit opinion - publicly announced, regarding the objectivity of the presented financial statements as under the accepted financial reporting framework, in all material respects (Mustikarini and Samudera, 2017). This explains why the collapses of the PIEs affected the audit profession worldwide, because:

- Their financial statements were materially misstated i.e. there was low financial reporting quality of the PIEs regarding their business activities (Sirucek, 2012; Mill, 1972); and
- Auditors failed to detect and report those material misstatements to the general public i.e. there was suspicious audit quality on PIEs (Gibson, 2018; Iliev, 2018).

By having in mind that the financial statements represent the financial effects of the economic events of every client, including PIEs, which are publicly available; and by noting that the function of the audit is to add credibility to the presented data and information in the financial statements, it can be postulated that the collapse of the PIEs certainly affects the audit profession. This is because auditors participate in the financial reporting process by adding credibility to the presented financial statements, which are prepared by their clients (Maroun and Atkins, 2014; Velte and Freidank, 2015). In addition, the general public does not make a proper differentiation of the responsibilities between the auditors and their clients, which causes the public interest to be lost.

On one side, public interest is more associated with the economic decisions of the uses of financial statements of PIEs. This is logical because when business performances of PIEs are low, investors are not willing to invest. There is a low level of financial stability and accordingly low returns of investments. On the other, the financial effects of the business activities of PIEs are presented in their financial statements. Auditors need to convince the general public that the business activities of PIEs are stable to satisfy their needs.

To conclude, public interest represents the level of return which the general public expects for its economic activities with the PIEs, to earn profits which are reasonably distributable to it in different or expected forms. However, the business activities of PIEs are financially reflected in their presented financial statements. This means that the function of the audit on PIEs is to add value to their economic events, by making them credible for analysis by the general public, and to bring valuable economic decisions by using competent data and information. As a result, the public interest should be differentiated by the public trust in the auditors' work. This is because the public trust is reasonably affected by the audit quality, which has an impact on the provided level of confidence by the auditors to the presented financial statements of the auditees. On one side, the public interest is affected by the expectations of the general public regarding the stability of its interest in the business activities of the PIEs, which depends on the provided level of confidence by the auditors regarding the fairness and the objectiveness of their financial statements (public trust in the auditors' work). On the other, public interest is affected by the understanding of the general public regarding the credibility of the data and information that is used by it to assess the reasonableness of the provided form and level of return for their economic decisions (the audit expectation gap).

### **3. Research Methodology**

The thesis advanced by this paper is that the core function of audit regulatory authorities is to protect public trust in the auditors' work and increase public interest, to achieve a more stable financial environment, conducive to promoting economic growth. The paper applies interpretive phenomenology as a research philosophy to collect and evaluate the data obtained from various secondary resources, which allows researchers to apply their subjective knowledge to investigate the research problem.

Extant literature, including relevant legislation and regulations, professional auditing literature, as well as pertinent scholarly literature, is used to identify and explain the nature and characteristics of the public interest. Particular focus is placed on the audit as a tool to add credibility to the presented financial statements. However, since public trust in the auditors' work is more associated with the extent to which the independent auditor's reports on PIEs are publicly available (Iliev, 2018; Gibson, 2018), the professional audit literature is used to identify factors affecting audit quality on PIEs. The study analyses the most recent addendums to the European audit regulations, with particular reference to the legal changes adopted by

the European Union aimed at narrowing the audit expectation gap. Within that context, the explanatory method is used to explore the areas relating to the external oversight function of the audit profession. Simultaneously, the explanatory method is applied to analyse audit market reforms within the European Union concerning the discussions and the conclusions referring to the impact and influence of these reforms on the audit profession in Europe and beyond.

With reference to the statutory audit regulations in the European Union, the study considers the specific legal and professional requirements applicable to auditors in the European Union. However, the study's findings are not used to assess or compare the performance of European leaders, audit companies or auditors. Instead, it identifies the specific statutory audit regulations relating to the role and function of external auditors in the European Union.

Since this study explores the relationship between the audit profession, and financial stability and economic growth, it seeks to understand how the audit profession should perceive public interest. Whereas the public trust in the auditors' work is affected by the audit quality, the public interest is affected by the scope of the business activities of the PIEs. The study examines the public interest and its alignment with the aim of the audit, within the context of adding credibility to the underlying financial statements, by focusing on the financial disclosures in the financial statements of PIEs.

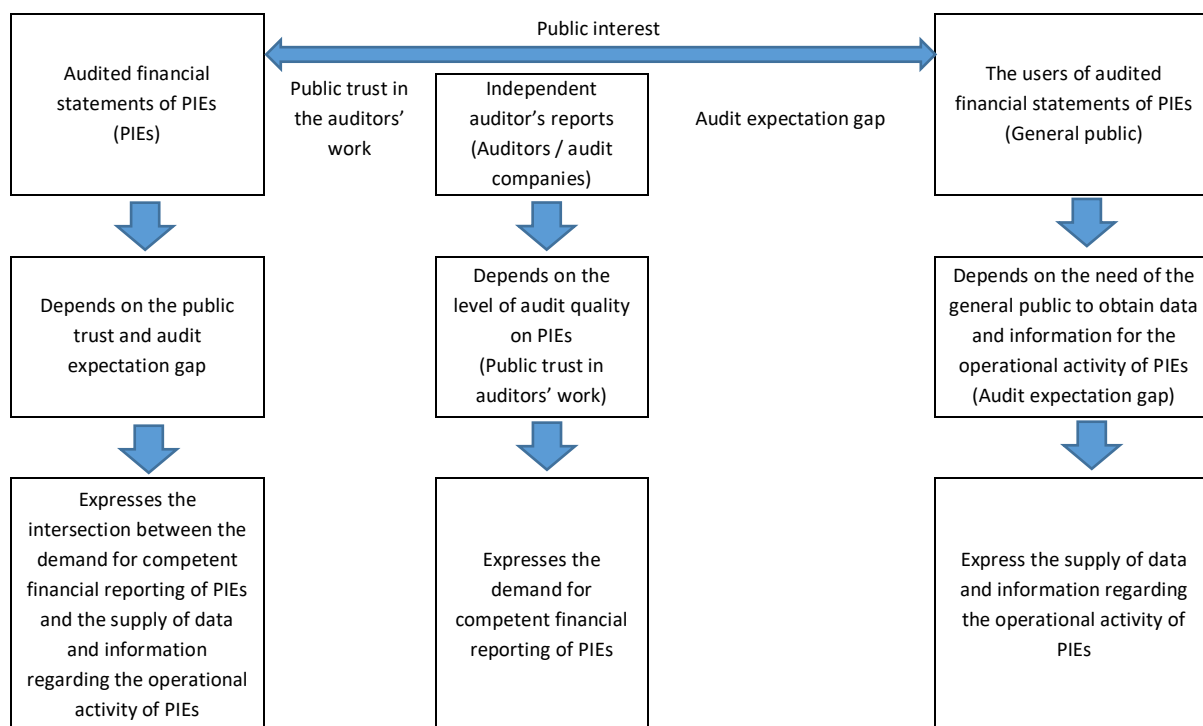
To validate the research results, the publicly available data and information provided by the big four audit networks in their global transparency reports for the period between 2005 and 2022, is juxtaposed with the IMF's data and information on worldwide economic activity, for the comparable period. To confirm the relationship between the audit and worldwide economic activity, the trends in the audit profession are linked to the global GDP growth. The study therefore investigates the public interest under both stable and volatile economic conditions.

The limitation of the research refers to used empiric data and information from the big four audit networks, to calculate the global ratios of audit versus non-audit revenues, between 2005 and 2022, as a proxy for determining the ratios of the audit expectation gap and public trust in the auditors' work. To delineate this limitation, obtained results are extrapolated on the global level by using the global GDP growth rates for the same period, as provided by the IMF, to line reached conclusions of the analysis with the global trends of the audit profession.

### **3. Research Results**

Public interest by its nature represents the relationship between the audited financial statements of PIEs and their users. In addition, public trust in the auditors' work represents the relationship between audited financial statements of PIEs and independent auditor's reports. The function of the audit expectation gap represents the relationship between the independent auditor's reports and the users of audited financial statements of PIEs.

By having in mind that public interest incorporates the audit expectation gap and public trust in the auditors' work, it is reasonable to postulate that the relationship between audited financial statements of PIEs and their users consists of 1) the relationship between audited financial statements of PIEs and their independent auditor's reports; and 2) the relationship between the independent auditor's reports and users of audited financial statements of PIEs. This composite relationship is illustrated in Figure 1 below which shows that the mutual relationship between public interest on one side, and public trust and audit expectation gap on the other, depends on the relationship between the demand for competent financial reporting of PIEs, and the supply of data and information regarding the operational activity of PIEs.



**Figure 1** Composite relationship of public interest

*Source: Authors' theorising.*

A higher audit quality on public interest entities increases public interest. This is logical, because when audit quality is higher, the general public obtains more competent financial statements of PIEs, to bring its decisions. On the other side, a lower audit quality decreases public interest, because the general public obtains financial statements of public interest entities which are less competent, for making decisions. The impact of this relationship is illustrated in Figure 2 below which illustrates that public trust in the auditors' work is directly related to public interest. This is because a higher audit quality on PIEs increases public trust, and accordingly public interest. As a result, the bigger public interest increases the change of the cost between non-audit versus audit services, which in turn results in a bigger audit expectation gap due to the decreased reporting requirements of auditors. On the other side, a lower audit quality on public interest entities decreases public trust and accordingly public interest. As a result, the smaller public interest decreases the change of the cost between non-audit versus audit services, which results in a smaller audit expectation gap due to the increased reporting requirements of auditors. The mutual relationship is presented below as:

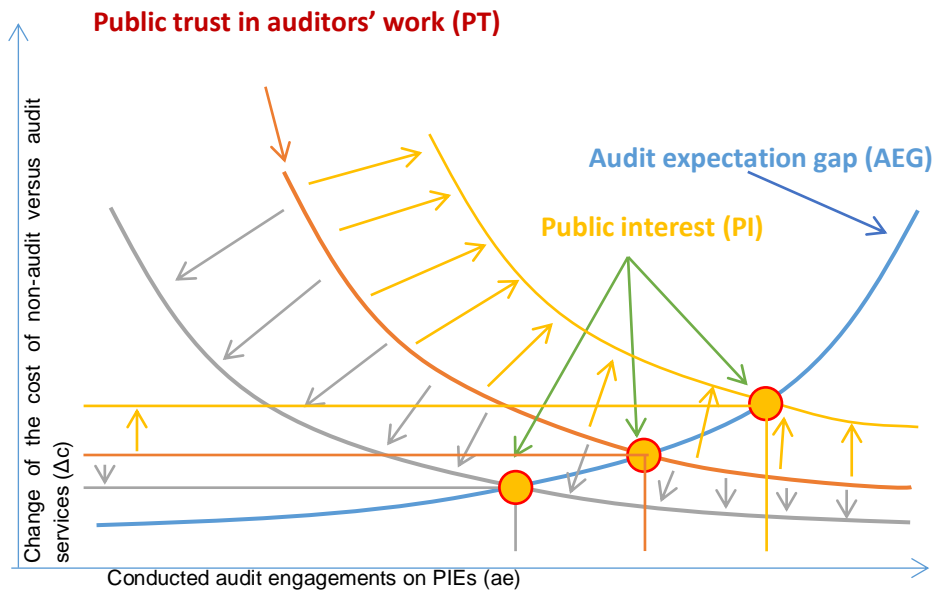
$$PT \sim PI \Rightarrow PI \sim AEG, \text{ where}$$

"PI" is the public interest;

"PT" is the public trust in the auditors' work; and

"AEG" is the audit expectation gap.

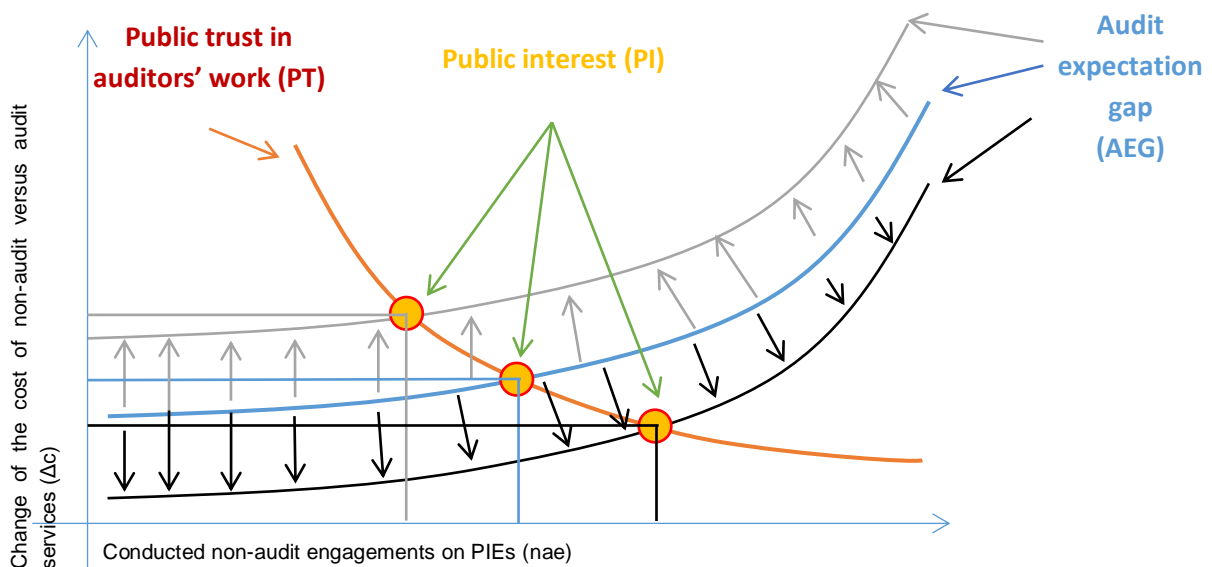
The above implies that the larger audit expectation gap increases public interest. This is also logical because when the general public has bigger need for data and information regarding the operational activity of PIEs, then they announce a bigger volume of those, to properly respond to the bigger need. As a result, this increases the reporting requirements of PIEs, and decreases the reporting requirements of auditors, in which case the cost of non-audit services increase. In addition, when the audit expectation gap is smaller, then the demand for competent financial reporting is larger, in which case the change of the cost between non-audit versus audit services is smaller, resulting in a smaller public interest.



**Figure 2** The relationship between audit quality and public interest

Source: Authors' theorising.

The impact of the relationship between the need of the general public for data and information regarding the operational activity of PIEs and public interest is illustrated in the following Figure 3. This figure illustrates that the audit expectation gap is also directly related to public interest due to the reasons explained above. However, the main source of the general public for credible and reliable data and information regarding the achieved business performances of PIEs is their audited financial statements. As a result, when public interest is increased due to the larger audit expectation gap, the general public perceives the other data and information which PIEs publicly announce as competent, for bringing various decisions. This, in turn, increases public trust, because the bigger the level of confidence in the audited financial statements of PIEs, the more competent the general public perceives the other data and information which they publicly announce regarding their operational activity.



**Figure 3** The relationship between the need of the general public for data and information regarding the operational activity of PIEs and public interest

Source: Authors' theorising.



To conclude, the above-noted relationship between the audit expectation gap and public interest may be expressed as follows:

$$AEG \sim PI \Rightarrow PI \sim PT, \text{ where}$$

“AEG” is the audit expectation gap;

“PI” is the public interest; and

“PT” is the public trust in the auditors’ work

Figure 2 and Figure 3 above illustrate that public trust and audit expectation gap are mutually inversely related. This is because when the audit expectations gap is larger, the demand for audit services is smaller, which in turn, decreases the scope of competent data and information which PIEs publicly announce regarding their operational activity. In other words, the audit expectation gap is bigger when the reporting requirements of auditors are smaller, resulting in decreased public trust in the auditors’ work. On the other way, the audit expectation gap is smaller when auditors have bigger reporting requirements. This inverse mutual relationship between the public trust and audit expectation gap may be presented as follows:

$$PT \sim \frac{1}{AEG} \Rightarrow AEG \sim \frac{1}{PT}, \text{ where}$$

“PT” is the public trust in the auditors’ work;

“AEG” is the audit expectation gap; and

“PI” is the public interest.

Above-noted study results imply that public interest is directly related to the audit expectation gap and public trust. This is because the larger audit expectation gap increases public interest and vice versa. In addition, the bigger the public trust in the auditors’ work, the bigger the public interest is. As a result, the public interest represents a multiplication of the audit expectation gap and public trust, which can be presented as:

$$PI = AEG \times PT \Rightarrow PT = \frac{PI}{AEG} \Rightarrow AEG = \frac{PI}{PT}, \text{ where}$$

“PT” is the public trust in the auditors’ work;

“AEG” is the audit expectation gap; and

“PI” is the public interest.

The derived model above is logical because as Iliev (2018) and Gibson (2018) conclude, financial instability and economic recession/depression occur when the low financial reporting quality of PIEs is accompanied by suspicious audit quality. Having in mind that public interest, on one side, is associated with economic stability, while on the other, the audit expectation gap is related to the reporting requirements of auditors and public trust in the auditors’ work is associated with the audit quality of PIEs, it appears that that the level of public interest will be properly determined by assessing the levels of the audit expectation gap and public trust.

By considering that public trust in the auditors’ work depends on the level of audit quality on PIEs, it can be postulated that the level of public trust in the auditors’ work shows how many audit engagements on PIEs were conducted with full compliance with the ISAs, i.e.:

$$PT = \frac{\text{Number of complied audit engagements on PIEs with the ISAs}}{\text{Total number of audit engagements on PIEs}}, \text{ where}$$

“PT” is the public trust in the auditors’ work.

The more the audit engagements on PIEs comply with the ISAs, the bigger the public trust in the auditors’ work.

Based on the above, it appears that in stable economic times, the cost of the audit decreases due to the increased demand for audit services. In unstable economic times, the cost of the audit increases because public interest entities struggle to regain the trust of the general public in their financial statements. PIEs publicly announce a bigger volume of data and information regarding their operational activity, to respond to the bigger need of the general public. As a result, this increases the cost of non-audit services. However, the general public perceives as credible and reliable the other data and information which PIEs publicly announce regarding

their operational activity because they believe that the quality of these data and information is secured due to the misunderstanding of the actual aim and purpose of the audit. In other words, the general public does not differentiate between auditor's reporting and auditee's reporting and perceives the auditee's reporting as auditor's reporting. Therefore, the larger audit expectation gap in stable economic times results in an increased cost of non-audit services which auditors provide versus the cost of the audit. In unstable economic times, it is the opposite – the cost of the audit increases while the cost of non-audit services decreases, due to the question of where the attention of the general public is put. In other words, in turbulent economic periods, the attention of the general public is put on the financial statements of PIEs, which in turn increases the need for audit services, and accordingly, their cost. On the other side, in stable economic times, the general public is more interested in obtaining data and information regarding the operational activity of PIEs, which in turn increases the need for non-audit services, and accordingly their cost. Therefore, the function of the audit expectation gap shows the extent of the change in the cost between non-audit versus audit services which auditors provide. Because the revenue of audit companies depends on the cost and scope of services which they provide, it is logical to postulate that the function of the audit expectation gap actually shows the revenue structure of the audit companies, i.e.:

$$AEG = \frac{(Revenue\ from\ non-audit\ services)-(Revenue\ from\ audit\ services)}{(Total\ revenue\ of\ audit\ companies)}, \text{ where}$$

“AEG” is the audit expectation gap.

The bigger the change in the cost is, the larger the audit expectation gap, due to the bigger misunderstanding of the function of the external audit by the general public. This is because in stable economic times audit quality on public interest entities is higher which, as already explained, results in increasing demand for audit services. It is the opposite in unstable economic times. However, by considering that the revenue which audit companies earn is affected by the cost and scope of the services they provide, the ratio between the revenue from audit services and the total revenue of audit companies, on the global level, shows the ratio of the global average cost of the audit, i.e.:

$$aca = \frac{Revenue\ from\ audit\ services}{Total\ revenue\ of\ audit\ companies}, \text{ where}$$

“aca” is the ratio of the global average cost of the audit.

Based on the above it appears that the level of public interest may be presented as follows:

$$PI = \frac{(Revenue\ from\ non-audit\ services)-(Revenue\ from\ audit\ services)}{(Total\ revenue\ of\ audit\ companies)} \times \frac{Number\ of\ complied\ audit\ engagements\ on\ PIEs\ with\ the\ ISAs}{Total\ number\ of\ audit\ engagements\ on\ PIEs}, \text{ where}$$

“PI” is the public interest.

The economy is stable when public interest has a ratio which is close to one. As the ratio of public interest decreases to zero, the economy becomes unstable. However, when the audit expectation gap has a negative ratio, the economy becomes more unstable and turbulent, which may end in a financial crisis, recession, and/or depression, depending on negative trends in the specific sector (financial/banking sector, capital market/corporate sector, insurance/reinsurance sector, etc.).

To validate the aforementioned assertions, the study analyses the global revenue of the big four audit companies between 2005 and 2022, juxtaposed against the prevailing economic conditions provided by the IMF, for the comparable periods.

Table 1 below presents the empirical results - the revenue of the big four audit companies (in USD billion), differentiated between revenue from audit services, and revenue from other non-audit services; the audit expectation gap (AEG) on the global level from 2005 through 2022, the ratio of the global average cost of the audit (aca) for the same period; the ratio of public interest (PI) on the global level for the same period; and the global GDP growth in % for the same period. Based on the empirical results presented in

Table 1, Figure 4 below was prepared for this research and illustrates the functions of the audit expectation gap, average cost of the audit, and public interest on the global level for the period 2005 - 2022; and the function of the global GDP growth for the comparable period.

Table 1 Empirical results.

Year	Revenue in USD billion			AEG	aca	PI	GDP growth in %
	Audit Revenue	Non-audit revenue	Total Revenue				
2005	32,01	38,78	70,79	0,10	0,45	0,04	4,9%
2006	34,46	41,67	76,13	0,09	0,45	0,04	5,5%
2007	41,43	47,31	88,74	0,07	0,47	0,03	5,6%
2008	44,27	58,53	102,80	0,14	0,43	0,06	3,0%
2009	45,13	48,66	93,79	0,04	0,48	0,02	(0,1)%
2010	44,94	50,12	95,06	0,05	0,47	0,03	5,4%
2011	45,90	57,46	103,36	0,11	0,44	0,05	4,3%
2012	48,88	61,37	110,25	0,11	0,44	0,05	3,5%
2013	47,23	62,68	109,91	0,14	0,43	0,06	3,5%
2014	48,37	68,02	116,39	0,17	0,42	0,07	3,6%
2015	48,84	72,54	121,38	0,20	0,40	0,08	3,5%
2016	49,99	77,24	127,23	0,21	0,39	0,08	3,4%
2017	51,89	82,49	134,38	0,23	0,39	0,09	3,8%
2018	56,00	91,64	147,64	0,24	0,38	0,09	3,6%
2019	56,71	98,19	154,90	0,27	0,37	0,10	3,0%
2020	57,39	99,70	157,09	0,27	0,37	0,10	(2,8)%
2021	52,60	115,03	167,63	0,37	0,31	0,12	6,3%
2022	55,65	133,89	189,54	0,41	0,29	0,12	3,4%

Source: Adjusted by the global review reports of the big four audit companies, from 2005 through 2022; and IMF's official data, 2023.

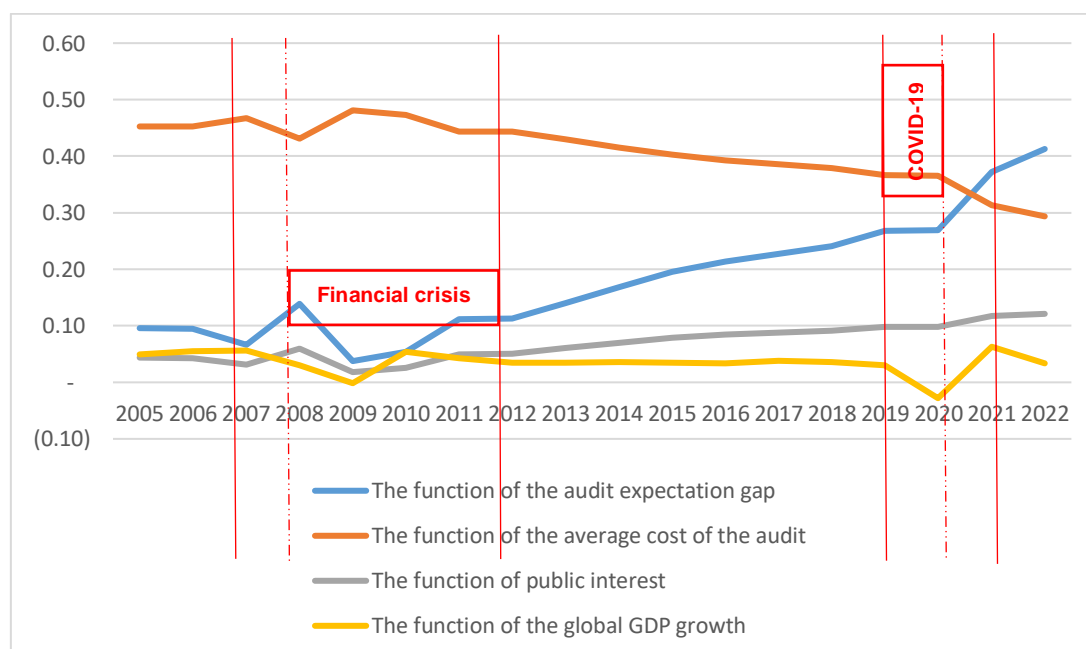


Figure 4 AEG, aca, PI and global GDP growth movements

Source: Adjusted based on the empirical results in

Table 1.

Figure 4 above illustrate that during the unstable economic time between 2007 and 2012 (during the global financial crisis), the global average cost of the audit was increased, accompanied by a smaller audit expectation gap. From 2012 until 2020 (during the period of financial stability), the global average cost of the audit was decreased, accompanied by a larger audit expectation gap. However, in 2020 which is the beginning year of the COVID-19 global pandemic, the cost of the audit remained on the same level without any change in the level of the audit expectation gap. On the other side, the level of public interest follows the level of the global GDP growth from 2005 through 2022. During the global financial crisis between 2007 and 2012 (during economic instability), the public interest on the global level was decreased resulting in a decreased public trust in the auditors' work, accompanied by an increased cost of the audit. Between 2012 and 2020 which is the period of global economic stability, the public interest was increased, resulting in an increased audit expectation gap, accompanied by decreased cost of the audit, and increased public trust in the auditors' work. In 2020, which is the beginning year of the COVID-19 global pandemic, the public interest, audit expectation gap, public trust in the auditors' work, and cost of the audit kept the same level.

### 3. Conclusion

The audit profession is directly connected with global economic growth through the public interest. This is because public interest follows the current trends in the economy.

Public interest is directly related to public trust in the auditors' work and audit expectation gap. Additionally, public trust in the auditors' work is inversely related to the audit expectation gap and vice versa. This inverse relationship is reflected in the cost of non-audit and audit services which auditors provide i.e. the revenues audit companies earn from conducting audit and non-audit services.

In stable economic times, the demand for audit services increases resulting in an increased public trust in the auditors' work. However, the bigger demand for audit services has a negative impact on the cost of the audit. It is the opposite during unstable economic times.

### References

1. Antipova, T. 2016. Auditing for Financial Reporting. *Global Encyclopedia of Public Administration, Public Policy, and Governance*. 2016; 10:1-9.
2. Bedard, J.C. and Johnstone, K.M. Audit Partner Tenure and Audit Planning and Pricing. *Auditing: A Journal of Practice and Theory*. 2010; 29 (2): 45-70.
3. Bruhn, M. *Qualitätsmanagement für Dienstleistungen. Grundlagen, Konzepte, Methoden*. Springer. 2011; 8<sup>th</sup> Edition.
4. Centre for Financial Reporting Reform. News Letter July 2016. The World Bank. 2016;
5. Cohen, J.K.G. and Wright, A. Corporate Governance in the Post-Sarbanes-Oxley Era: Auditors' Experiences. *Contemporary Accounting Research*. 2010; 27 (3): 751-786.
6. Danescu, T. and Spatacean O. Audit Opinion Impact in the Investor's Perception – Empirical Evidence on the Bucharest Stock Exchange. *Audit Financiar*, 2018; XVI (1): 111-121.
7. DeAngelo, H., et al. Reversal of Fortune: Dividend Signalling and the Disappearance of Sustained Earnings Growth. *Journal of Financial Economics*. 1996; 40: 341-371.
8. Douglas, B. and Wodak, J. Who Speaks for and Protects the Public Interest in Australia? *Essays Notable to Australians*. 2015; 21: 24-25.
9. Duréndez, A. The Usefulness of the Audit Report in Investment and Financing Decisions. *Managerial Auditing Journal*. 2003; 18 (6/7): 549-559.
10. European Parliament. Directive 2014/56/EU. 2014.
11. European Parliament. EU Audit Regulation No. 537. 2014.
12. European Parliament. Directive 2006/43/EC. 2006.
13. Feigenbaum, A.V. *Total Quality Control*. McGraw Hill, New York. 1991; 3<sup>rd</sup> Edition.

14. Fiolleau, K., Hoang, K., Jamal, K. and Sunder, S. How do Regulatory Reforms to Enhance Auditor Independence Work in Practice? *Contemporary Accounting Research*. 2013; 30 (3): 864-890.
15. Garvin, D.A. What Does "Product Quality" Really Mean? *Sloan Management Review*. 1984; 26 (1): 25-43;
16. Gibson, C.H. *Financial Reporting and Analysis – Using Financial Accounting Information*. The university of Toledo, Emeritus. 2018;
17. Gros, M. and Worret, D. The Challenge of Measuring Audit Quality: Some Evidence. *International Journal of Critical Accounting*. 2014; 6 (4): 345-374.
18. Heinhold, M. and Pasch, H. *Qualitätsmanagement in Steuerberatung und Wirtschaftsprüfung*. Oldenbourg Verlag. 1999.
19. IFAC. *International Standard on Auditing 701 – Communicating Key Audit Matters in the Independent Auditor's Report*. New York. 2016.
20. IFAC. *Code of Ethics for Professional Accountants*. New York, USA. 2018;
21. IFAC. *International Standard on Auditing 320 - Materiality in Planning and Performing an Audit*. New York. 2009.
22. IFAC. *International Standard on Auditing 240 - The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements*. New York. 2009.
23. IFAC. *International Standard on Quality Control 1 – Quality Control for Firms That Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements*. New York. 2009.
24. Iliev, K.P. Challenges to Financial Audit in Enterprises of Public Interest. *Open Journal for Research Economics*. 2018; 1 (1): 23-30.
25. International Monetary Fund. *Real GDP Growth - Annual Percent Change*. In site [https://www.imf.org/external/datamapper/NGDP\\_RPCH@WEO/OEMDC/ADVEC/WEO\\_WORLD](https://www.imf.org/external/datamapper/NGDP_RPCH@WEO/OEMDC/ADVEC/WEO_WORLD). 2023 October.
26. Jones, M. *Audit Quality: Detection of Material Misstatement*. West Virginia University, ProQuest Dissertations. 2018.
27. Köhler, A.G. Audit Committee, Board of Director Characteristics and Earnings Management. *Journal of Accounting and Economics*. 2005; 33: 375-400.
28. Karkacier, A. and Ertas, F.C. Independent Auditing Effect on Investment Decision of Institutional Investors. *Accounting and Management Information Systems*. 2017; 16 (3): 297-319.
29. Kellner, K. *Internationales Marketing, Lecture in Kufstein*. Austria. 2010.
30. Koh, H.C. and Woo, E-S. The Expectation Gap in Auditing. *Managerial Auditing Journal*. 1998; 13 (3): 147-154.
31. Kusaila, M.M. *Managing Informal Learning in the Auditing Profession: How Auditors Develop Proficiency*. Walden University, ProQuest Dissertations. 2017.
32. Leidner, J.J. and Lenz, H. *Client's Business Risk, Public-Interest Entities, and Audit Fees: The Case of German Credit Institutions*. *International Journal of Auditing*, University of Würzburg, Germany. 2017.
33. Mansur, H. and Tangl, A. How to Bridge the Audit Expectation Gap? *Centre for Excellence for Scientific and Research Journalism, COES and RJ LLC*. 2018; 7 (2);
34. Maroun, W. and Atkins, J. Whistle-Blowing by External Auditors in South Africa. *Accounting, Auditing and Accountability Journal*. 2014; 27 (5): 834-862.
35. Mareque, M., López, E.R., Villanueva-Villar, M. and Lago-Peñas, S. Determining Factors for Audit Opinion in Private Family and Non-Family Firms - Evidence from Spain. *SAGE Open*. 2019; 9 (2): 1-12.
36. Marten, K-U., Quick, R. and Ruhnke, K. *Wirtschaftsprüfung - Grundlagen des Betriebswirtschaftlichen Prüfungswesens Nach Nationalen und Internationalen Normen*. Schäffer-Poeschel, Stuttgart. 2015; 5<sup>th</sup> Ed.
37. Marx, B. An Analysis of Audit Committee Responsibilities and Disclosure Practices at Large Listed Companies in South Africa. *South African Journal of Accounting Research*. 2009a; 23 (1): 31-44.
38. Marx, B. An Analysis of the Development, Status and Functioning of the Audit Committees at Large Listed Companies in South Africa. PhD Thesis, University of Johannesburg. 2009b.
39. Marx, B. Challenges Facing the Modern Day Auditing Profession, Accountancy SA. 2009c. In site <https://www.accountancysa.org.za/challenges-facing-the-modern-day-auditing-profession/>. 2023 October.
40. Mickhail, G. The Big 4 Global Monopoly. 2012. In site <http://www.metacapitalism.org/pubs/wps/>. 2023 October.
41. Mill, J.S. *The Collected Works of John Stuart Mill. The Later Letters of John Stuart Mill 1849 – 1873, Part II and III* (eds. Mineka, F., Lindley, D.). Toronto, ON, Canada, University Press. 1972; XV & XVI.

42. Mustikarini, A. and Samudera, M.B. Does Modified Audit Opinion Matter to Investors? Evidence from Indonesia. Universitas Gadjah Mada, Indonesia. 2017. In site [www.foura.org](http://www.foura.org). 2023 October.
43. Porter, B. An Emirical Study of the Audit Expectation – Performance Gap. Accounting and Business Research. 1993; 24: 49-68.
44. Rice, S. The Meaning(s) of Public Interest in Law. University of Tasmania, Faculty of Law. 2015.
45. Sang Ho, L. Public Policy and the Public Interest. Lingnan University, Hong Kong. 2012.
46. Sirucek. M. Macroeconomic Variables and Stock Market: US Review. International Journal of Computer Science and Management Studies. 2015; MPRA paper No. 39094. In site <https://mpra.ub.uni-muenchen.de/39094/>. 2023 October.
47. Shahzad, K., Rubbaniy, G. and El-Temtamy, O. Audit Quality During the Global Financial Crisis: The Investors' Perspective. Research in International Business and Finance. 2017; 45: 94-105.
48. Tara, I. The Going Concern – Theory and Practice in the Financial Audit. University of Oradea, Economic Sciences Department. 2011.
49. Tepalagul, N. and Lin, L. Auditor Independence and Audit Quality: A Literature Review. Journal of Accounting, Auditing and Finance. 2015; 30 (1): 101-121.
50. Velte, P. and Freidank, C-C. The Link between in - and External Rotation of the Auditor and the Quality of Financial Accounting and External Audit. European Journal of Law and Economics. 2015; 40 (2): 225-246.
51. Zager, L., Sever Malis, S. and Novak, A. The Role and Responsibility of Auditors in Prevention and Detection of Fraudulent Financial Reporting. Procedia Economics and Finance. 2016; 39: 693-700. and
52. Zeman, Z. and Lentner, C. The Challenging Role of Going Concern Assumption Supporting Management Decisions after the Financial Crisis. Polish Journal of Management Studies. 2018; 18: 441-454.