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The Commission to Study the Public's Expectations of Audits, popularly known as the Macdonald Commission, under sponsorship of the Canadian Institute of Chartered Accountants, set out to study the Canadian public's opinions and expectations of auditors. Its charge was to determine whether there were differences between actual audit practice and the public's expectations and to recommend ways to bridge the gaps in instances when it seemed appropriate to do so. The investigative approach taken included an extensive public opinion survey conducted by Decima Research, a public opinion company located in Toronto.

Chairman William Macdonald and his commission were greeted by a veritable tidal wave of publicity in the Canadian financial press following the release of the report. Further, since its release the report has been taken seriously by those responsible for instituting changes. But, the Macdonald Report did not include all of the Commission's findings – particularly regarding the information which can be drawn from its study of how the public really perceives accountants and auditors. The analysis presented here, which supports that conclusion, is based on the report of Decima Research. [1]

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A major thrust of the Macdonald Commission's report is that the public accounting profession and auditors are highly regarded by the Canadian public. The Commission stopped short, however, of emphasizing another provocative conclusion: the supposedly knowledgeable sector of the general public understands very little regarding financial statements and audits. Taking this a step further, given the public's lack of knowledge, it is probable that individuals can be easily influenced by media events concerning occurrences that affect them personally.

Canada and the United States have experienced many parallel events in the realm of business, accounting and auditing. For example, both countries have experienced failures of financial institutions and government-backed investigations into those failures and the related accounting environment. Other examples are the activities of the Treadway Commission and the Macdonald Commission which occurred in very similar time frames (October, 1985 through September, 1987 and December, 1985 through June, 1988, respectively), and this survey by Decima Research and the United States survey commissioned by the AICPA and conducted by Lou Harris and Associates. In both countries considerable quantities of human and monetary resources were expended on investigating audit related issues. This use of resources makes it appropriate to assess the validity of public opinions and the propriety of using public perceptions in the process of evaluating the accounting profession's standards and processes. The fact that Canada and the United States are now often being viewed from a global perspective as North America, makes it even more appropriate for Americans to consider information garnered in the Canadian arena.

The Survey

Decima Research conducted a telephone survey of 1,150 Canadians. Respondents had to be residents and at least eighteen years of age. Further screening was done to extract a "knowledgeable" group which was comprised of individuals who had read financial statements or invested in publicly traded shares of stock. The researchers identified a pool of 540 individuals who were assumed

TABLE 1
Responses Indicating Positive Reputation

- Canadians have a favorable opinion of CAs
- CAs have maintained or improved their image in recent years
- Canadians have a great deal of confidence in the audit report
- Canadians have confidence in audited financial statements
- CAs' current performance is at least as good as past performance
- The investing public relies on audited financial statements
- Auditors will "stand up" to management if necessary
- Audit quality is not damaged by competition

TABLE 2
Issues of Concern

Expansion of services for audit clients: No objectivity problems	50
Audit report: More flexibility would be better	66
Reporting to regulators: Auditors should have obligation	91

to be knowledgeable. Some questions were asked of the general public as well, but the responses were basically intended to be considered only for public relations purposes.

A major overall conclusion can be drawn from the survey responses. "Some" knowledge is not necessarily sufficient to be able to answer questions in a well-informed manner regarding the public accounting profession. It was quite obvious that, based on answers given to some of the survey questions, many of those respondents classified as "knowledgeable" were in reality quite deficient in their knowledge concerning audits and auditors.

Overall Positive Opinion of the Auditing Profession

Chartered accountants (CAs) in Canada enjoy a positive reputation, but this positive image is based largely on casual opinion – general perceptions rather than personal experience. This survey conclusion was extensively discussed by the Macdonald Commission and Decima Research and is summarized in Table 1.

Concerns of the Canadian Public

Three topics shown in Table 2 can be grouped as areas for which the Canadian public has concern.

The first area relates to auditors performing other types of services for audit clients. Concerning auditor objectivity, 50 percent of the respondents indicated that they do not believe auditors can retain their objectivity when they perform other types of services for an audit client. These other types of services are typically tax or consulting services. Given that the propriety of expansion of services has been debated by many forums, particularly in the United States, the Canadian public is not alone in its opinion.

The public also expressed concern regarding the format of the audit report and its flexibility. Sixty six percent of the knowledgeable public indicated that they believe more flexibility would make the message of the audit report more meaningful, while 31 percent indicated just the opposite, that it would make the message more difficult to understand or that its impact would be lessened. However, the terminology used in the question could have produced a stronger result about the public's feeling than is appropriate. For example, the term "flexibility" was not defined in the question. If the respondents do not know what an audit report is, then they might not know in what aspects it can be made more flexible. Further, the phrases "more difficult to interpret" and "the message would be watered down", as used in the question, probably do not convey much to someone who does not really know what an audit report communicates. Finally, it was not specified whether the question meant that individual auditors could create their own wordings or that there would be more standard phraseology available.

Another area of public concern relates to institutions which are subject to government regulation such as banks, trust companies and insurance companies. The knowledgeable public was asked whether auditors should have a legal right and obligation to report serious matters to the regulator if companies' managements do not do so. The results are highly consistent. Ninety-one percent of the knowledgeable respondents indicated agreement with that statement. The responsibilities of auditors and regulators to each other and the communications that those responsibilities may or should produce is not a clear (or comfortable) subject within the accounting profession. Therefore, the public's concern may be an echo of the concern in the financial community. However, it is also likely that the high response in agreement with the survey statement reflects the amount of public awareness of Canadian bank failures which occurred shortly before the survey

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TABLE 3
The Public's Knowledge Level

Who is responsible for financial statements: Management	37
Quantity of transactions examined: At least 75%	37
Application of GAAS: Requires very little judgment	45
Audit Report: Presents an opinion on financial statements	30
Purpose of an audit: To report on fairness	41
Auditor responsibility: To shareholders and Board of Directors	54
Financial Statements: Show a current value assessment	69
Financial Statements: Indicate financial health	78

was administered. Problems that have occurred with government regulated entities have received significant media coverage both in the United States and Canada and this can easily influence public feeling.

Of responses in these three areas the ones which provide the most information for the profession address auditors performing other types of service engagements for audit clients. Since some 50 percent of the responses indicate moderate or strong agreement with the statement that there can be some concern about auditor objectivity when other services are also provided, the perception should be taken seriously by the profession.

Issues Understood by the Public

The Canadian public agrees with the accounting profession and professional pronouncements in three statements of fact which are as follows:

(1) The financial statements are not exact, they are an approximation.

Problems that have occurred with government regulated entities have received significant media coverage both in the United States and Canada and this can easily influence public feeling.

(2) A clean audit opinion is not a guarantee that fraud does not exist at the current time.

(3) A clean audit opinion is not a guarantee that a company will not have financial difficulties in the future.

The responses to these three statements show agreement of 84, 86 and 93 percent respectively.

Issues Misunderstood by the Public

The following discussion on the public's knowledge, or lack thereof, on various topics, is summarized in Table 3.

Who Prepares Financial Statements?

The public appears to misunderstand the division of responsibilities of auditors and management. Financial statements are the representations of management and management has the final responsibility for the preparation and contents. Just 37 percent of the respondents demonstrated that they were aware of this responsibility by indicating that management prepares the financial statements. Fourteen percent of the public responded by saying that accountants prepare financial statements. This group can be either correct or incorrect depending upon the group of accountants to which it is referring. If it is referring to internal accountants, then this is a correct response; if it is referring to the external auditors, it clearly is in error. Therefore, at least 37 percent of the public has a correct view on this subject. The maximum or most optimistic estimate of the size of the group that understands the responsibilities is 51 percent of the public.

Those segments of the public which indicated an obviously incorrect answer were the 29 percent who indicated auditors, the 12 percent who said Boards of Directors and the four percent who said shareholders prepare financial statements. [2, p. 17] Although it can be argued that the 12 percent responding Boards of Directors were specifying ultimate responsibility rather than indicating that directors actually put the numbers together, it does not seem likely because of the way the question was phrased. Further, because auditors do have significant influence over the final presentation of financial statements, and may even draft the statements during the course of the audit, one might say the public response reflects a casual observation of activities. Few members of the public, however, possess such a working knowledge of an audit to make this explanation reasonable.

The possible range of the public giving an *incorrect* answer was a minimum of 45 percent (29 percent, auditors plus 12 percent, Boards of Directors plus 4 percent, shareholders) to a maximum of 59 percent which includes the 14 percent who indicated accountants and could have been referring to auditors. Even the most optimistic estimate of the percentage of public understanding (51 percent) indicates a problem.

Percent of Transactions Examined

The public believes that auditors examine far more transactions than they actually do. The Decima report indicates that 37 percent of the knowledgeable public gave an answer that auditors examine at least 75 percent of the transactions of a company under audit. The average estimate given was 60 percent of transactions. [2, p. 17] This vastly overestimates the percentage of a company's transactions which the auditor examines. Auditors usually extrapolate audit results to the population based on a sample. It can be safely concluded that no audit can be conducted on a cost beneficial basis if 60 percent or 75 percent of transactions are actually examined. It should be reinforced here that the question referred to a percentage of a company's transactions, not a percentage of dollars.

Judgments

The "knowledgeable" public does not understand the role of judgment in an audit. This lack of understanding extends both to the application of generally accepted auditing standards and generally accepted accounting principles. Regarding generally accepted auditing standards, 45 percent of the respondents indicated agreement with a statement that very little judgment is required when generally accepted auditing standards are used; 31 percent disagreed with that statement and 24 percent were neutral. This indicates that only 31 percent of the public is aware of the amount of judgment associated with an audit, because a knowledgeable person would not likely be neutral about the necessity for judgment in applying generally accepted auditing standards.

If readers of financial statements do not understand the amount of judgment that goes into decisions regarding the application of accounting principals in financial statements, then they cannot possibly understand financial statements well enough to grasp their appropriate meanings.

Regarding the application of generally accepted accounting principles, a total of 71 percent either were in agreement or were neutral about the statement that judgment is not required because generally accepted accounting principles are followed. Only 29 percent understood that judgment is required, leading to the conclusion that only 29 percent have a full understanding of the meaning of financial statements. If readers of financial statements do not understand the amount of judgment that goes into decisions regarding the application of accounting principals in financial statements, then they cannot possibly understand financial statements well enough to grasp their appropriate meanings.

Audit Reports

The public does not understand what is contained within an audit report. Only approximately 30 percent of the knowledgeable public was able to provide descriptions indicating that an audit report relates to financial statements that have been examined and reports an opinion on those financial statements. Forty eight percent of the knowledgeable public gave a description which addressed the financial status of a company, and while this could be correct for the financial statements, it is obviously incorrect for the audit report. An additional 18 percent described the audit report as a factual presentation of assets or liabilities, but this description comes far closer to being appropriate for financial statements than for the audit report. Based on the responses to this question, it seems that the public confuses the audit report with the financial statements.

Purpose of an Audit.

Lack of knowledge on the part of the public has been displayed by responses to the previous questions. This limited knowledge is further highlighted by answers to a question on the purpose of audits. The question was posed to all of those surveyed; thus the responses reflect the views of the general public. When asked about the purpose of an audit, 41 percent indicated that an auditor reports on the fairness of financial statements. The other 59 percent of the public gave incorrect responses or indicated that they did not know: 24 percent reported that they believe the auditor's report concerns the efficiency, economy and effectiveness of management; 25 percent said that they believe auditors guarantee the financial soundness of a company; and 10 percent did not know. One concludes from this that almost 60 percent of the general public does not understand the purpose of an audit. This may contribute to the problem of unfounded lawsuits as well as being a cause of an "expectation gap."

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To Whom the Auditor Reports

The public is not sure to whom the auditor reports. At best, 54 percent of the public understands that the auditor is responsible to the shareholders for audit work performed: 20 percent identified shareholders as the group to whom the auditor reports and an additional 34 percent identified the board of directors. If this last group meant the board of directors as a representative of the shareholders, then it is correct in its understanding of the auditor's reporting process. The other 46 percent clearly do not have a good understanding: 27 percent named management; 13 percent said government; and 6 percent indicated the auditors.

Thus, the response here most likely indicates that the public does not understand that financial statements are prepared using the historical cost model.

Current Dollars

The public does not seem to understand that financial statements are not in current dollars, as it displayed a distinct lack of knowledge regarding the historical cost model. The knowledgeable public was asked whether financial statements show what a company would be worth after paying all of its debts.Sixty nine percent indicated that that was, in fact, what financial statements do show. It is possible that financial statements can show what a company is worth after paying its debts but this would only be the case in the hands of skilled individuals interpreting the information. It is quite unlikely that such a statement can be made based on the face value of the numbers on the financial statements. Thus, the response here most likely indicates that the public does not understand that financial statements are prepared using the historical cost model. Given that conclusion, it follows that the public may not take into consideration the limitations of historical cost numbers in using financial statements.

Financial Health

A related area is the notion of financial health. Financial health is a difficult term to use because it has not been defined by any authoritative source, and is used in different ways within the financial community. Despite this lack of definition the knowledgeable subset of the public gave a 78 percent response that financial statements are a good indication of financial health. Again, it may be that financial statements indicate the financial health of a company in the hands of a skilled user. Because this term is poorly defined and understood, the results of the public opinion must be inconclusive in this area.

In three areas the public gave responses indicating a clear unanimity of public opinion. The first is that someone should pay if a company goes bankrupt; however, that someone should not be the auditor. Only 2 percent responded that the auditor should be required to pay for losses resulting from a bankruptcy. [2, p. 27]

The other two areas of strong unanimity are in the area of disclosure. First, the knowledgeable group indicated that disclosure is adequate. Regarding disclosure in general, 72 percent said that additional disclosure in financial statements is not needed. Second, regarding disclosure of risks, 65 percent indicated that disclosure of risks is adequate. As explained in the previous analysis, even the knowledgeable members of the public do not have a clear understanding of the various issues. Therefore, the public's opinion that disclosure is sufficient should probably not influence the profession in setting standards.

Split in Public Opinion

A final way to group the Decima survey questions is by responses which indicate a clear split in public feeling. Most of the items placed in this category reflect questions about which any opinion is legitimate. Answers may indicate expectations of the public and in that regard should be considered by the accounting profession. If members of the pubic are the final beneficiaries of financial reporting,t hen, when there are issues about which various positions may be defensible the accounting profession should take a serious look at public opinion.

When asked whether people should be able to sue auditors, 52 percent of the knowledgeable public said yes and 44 percent said no. Of those who believe that it is appropriate to sue auditors, 68 percent said there should be a limit placed on the amount recovered. This response is very important to the public accounting profession given the current availability of insurance, insurance costs and the generally litigious environment which auditors face. The profession must recognize that the clear split in public opinion indicates that these problems will not be resolved easily or quickly.

Fifty four percent of the knowledgeable public indicated a belief that a company should be able to select the generally accepted accounting principle it wishes to use when alternatives exist. Forty five percent said that one accounting principle should be required in all cases. This split indicates that even though the public is not highly knowledgeable, it possesses the same types of differences of opinion on the subject as the accounting profession.

Auditor responsibility for fraud is another topic over which public opinion is divided. Fifty two percent of the knowledgeable public indicated that auditors should react to fraud only if they happen to come across it, while 47 percent said that auditors should actively search for fraud. When the cost issue was introduced by suggesting that conducting a fraud search would double the cost of an audit, some 29 percent of the 47 percent revised their opinions and stated that auditor behavior should be limited to reaction. The final outcome, with significantly increased cost as a factor, is that the majority of the public believes auditors should be responsible for any fraud that they identify but that actively searching for it is not an appropriate part of an audit. The public is split regarding to whom auditors should report management fraud. The greatest response of the knowledgeable group was 44 percent that stated that auditors should report management fraud to the board of directors.

Conclusion

The data collected by the Macdonald Commission provides information that, perhaps, should have an impact on any potential challenges to accounting and auditing standards or the standard setting process. Specifically, in evaluating public concerns the financial community should address whether the public has the necessary understanding to contribute useful opinions to the accounting and auditing environment. Further, it may be concluded that even the knowledgeable public is not well enough informed for the accounting profession to seriously consider most of its opinions in setting standards. To do so could lead to poor decisions. Alternatively, some topics do not require much background knowledge to permit a person to express an opinion. In these areas it may be reasonable to listen to the public. Although based on the opinions of the Canadian public, the implications of the Decima survey may be meaningful to the profession in the United States as well.

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[1] Report of the Commission to Study the Public's Expectations of Audits (Toronto, Ontario: CICA, 1988).

[2] Report to the Commission to Study the Public's Expectations of Audits, Volume I Analysis (Toronto, Ontario: Decima Research, 1988).