Mind the insolvency gap: Lessons to be learned from audit expectations gap theory

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There is a general perception that public confidence in the insolvency profession is low as the result of the recent unethical practices of a few high profile liquidators. As a result, the effectiveness of the current regulatory mechanisms has been questioned, leading to a review of the performance of insolvency practitioners and subsequent regulation proposals. The challenge for the insolvency profession is balancing the expectations of the general public whilst ensuring that the obligations and duties imposed upon them are performed to acceptable and realistic standards. It is difficult (if not impossible) for the profession to meet this challenge in the absence of a cohesive framework which identifies those issues that require further regulation as opposed to those that relate to general education on the insolvency process. This article will examine the audit expectations gap theory in the context of insolvency practitioners and suggests that a model based on this theory provides an effective framework for evaluating the regulation of the insolvency industry.

BACKGROUND

Every profession will at times have to defend itself when a member or members misbehave. The opportunity of intense media scrutiny means that those unhappy with an outcome in almost any sphere have venues in which they can display their feelings. Historically, this scrutiny has invariably resulted in some form of government inquiry about the regulation of insolvency practitioners. The more significant reviews have included the 1988 General Insolvency Inquiry carried out by the Australian Law Reform Commission (the Harmer Report), the 1997 Review of the Regulation of Corporate Insolvency Practitioners and the 2004 review by the Parliamentary Joint Committee on Corporations and Financial Services titled Corporate Insolvency Laws: A Stocktake. A number of deficiencies in the regulation of insolvency practitioners were identified in the Harmer Report and subsequent reviews, including the lack of harmonisation of corporate and personal insolvency regimes, registration requirements, concerns about which body should be the principal regulator of insolvency practitioners (and related to that the monitoring and disciplinary functions), and the remuneration fees of insolvency practitioners. However, many these recommendations are yet to be addressed and, as Dickfos argues, “[t]he multiple reviews conducted by the Australian Government since the Harmer

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Report has meant the outlay of public funds with few changes to existing laws and the perpetuation of existing criticisms of the [corporate insolvency] regulatory framework".4

More recently, the spotlight was again placed on the insolvency profession following the inquiry launched by the Senate Economics References Committee Senate Economics References Committee (Senate Inquiry)3 who reported on the regulation of insolvency practitioners in September 2010. After several years and much debate, this report ultimately resulted in several Treasury consultation papers and exposure drafts which, at the time of writing, are yet to be tabled in Parliament.6 This reform agenda, and the general public’s reaction to it, has focussed on the narrow issue of increasing regulation of the profession and under what administrative structures this regulation may be achieved.

Whilst these are no doubt important to some extent, we argue there are broader issues that are revealed from this public scrutiny.

The Senate Inquiry was originally instigated by Senator John Williams who in the words of the inquiry was concerned and frustrated at “the conduct of some insolvency practitioners, the harm caused to businesses and creditors by this conduct and the perceived lack of action by ASIC”.7 It is clear that the community reaction to the actions of Stuart Ariff was perhaps a catalyst in terms of instigating the inquiry.8 However, as the inquiry showed, there were many submissions that evidenced that concerns went beyond that particular individual. The final report was keen to dispel a notion that the inquiry was only concerned with Ariff and that this was the limit of issues surrounding insolvency practitioners.9 There was an increase in insolvencies prior to the commencement of the inquiry but it is not clear that this was, of itself, significant. Rather it appears that there was some genuine concern regarding the behaviour of insolvency practitioners. Whilst insolvency laws seek to place a fence around the assets of the company so as to limit the inequity arising from those first to take legal action, it does not relieve the ferocity of the fight over the remains of the business and the resentment that arises against the insolvency professionals. Although the aim may successfully rescue the insolvent entity, the reality is that most cases will involve significant losses and it is, therefore, not surprising that the stakeholders are dissatisfied. Indeed, it is unlikely there will be a positive response if stakeholders are asked whether they are happy with their share of losses, regardless of the magnitude of those losses or the circumstances in which they have occurred.

History suggests that most persons suffering the loss will consider the remuneration fees and other insolvency expenses to be an unnecessary costs, and in some instances, the cause of the ultimate failure of the business. Another important aspect of the dissatisfaction with the insolvency profession is that parties do not understand the legal obligations of the liquidator and blame them for performing tasks that they are required to perform by law. Whilst the insolvency profession itself, and the

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4 For a general discussion of the history of regulatory reform of insolvency practitioners, see Dickfos J, “The Regulation of Corporate Insolvency Practitioners: 25 Years on from The Harmer Report (or Everything Old is New Again!)” (2014) 2 Nottingham Insolvency and Business Law e-Journal 23 at 44.


7 Senate Economics References Committee, n 5 at 1.10.

8 Senate Economics References Committee, n 5 at 1.10.

9 Senate Economics References Committee, n 5 at 1.31 where it is stated that “certainly, the committee is concerned about this misconduct and the effect it has had on the reputation of the industry. However, it rejects the characterisation that this inquiry is in some way a knee-jerk reaction to the case of Mr Ariff and a few others. While these cases are significant and deserve attention, their real interest is in the questions they raise about the extent of practitioner misconduct in the profession and the adequacy of efforts to oversee and regulate the insolvency regime in Australia”.

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regulators of the profession, have some obligation with respect to explaining what the insolvency process involves, there are often individuals who do not listen to these explanations. For example, in providing a forum for disgruntled creditors and other stakeholders to comment on corporate insolvency, it is not surprising that there were a number of submissions to the Senate Inquiry that were critical of the profession based on their experience. Insolvency invariably represents a very public failure on the part of at least some of the parties involved in the insolvent entity’s business. There is also a continuum of public interest in the failure depending usually on the status of the company concerned (in the case of corporate insolvency) and the level of investor dissatisfaction, the latter often related closely to perceived political costs. Unfortunately, the reality of insolvency is that some parties are going to lose out in the process. This realisation of failure and loss leads to behavioural activity such as blame-shifting between the parties, as well as the seeming inevitable scrambling for available assets by the various stakeholders. It is this “blame-shifting” that provides the focus of this article.

This article contends that the regulation of insolvency practitioners should take into consideration the possible gaps in community expectations and that the application of a model based on audit expectations gap theory is an effective way of achieving this. First, we consider some of the ways in which the insolvency profession is currently regulated. Secondly, we examine the general public’s perception of insolvency practitioners by reviewing some of the statistical information on complaints made about the insolvency industry. Thirdly, we examine the components of the audit expectations gap and develop a framework that may be applied to future regulation. We conclude by arguing that many of the reforms currently proposed by the government are aimed at reducing various components of the expectations gap without full consideration of the information needed to resolve that gap.

**CURRENT REGULATION OF INSOLVENCY PRACTITIONERS**

It is not intended here to deal extensively with all of the matters relevant to the regulation of the insolvency profession in Australia. The history of the registration of practitioners in corporate insolvency was traced out in the *Review of the Regulation of Corporate Insolvency Practitioners*. However this part will consider some of the existing legislative requirements. The first matter to consider is the requirement to be registered in order to conduct certain types of activities relating to both corporations and individuals. Under the *Corporations Act 2001* (Cth), in order to be appointed to deal with receivership of a company, the administration of a company under Pt 5.3A and most types of liquidation of a company, the person who conducts the administration in the particular role is required to be a registered liquidator with the Australian Securities and Investments Commission (ASIC). This broad requirement for registration is designed with protection of the general body of creditors and other stakeholders in mind both in terms of establishing confidence in the insolvency system and to ensure the best possible returns.

In order to become registered an application must be made to the appropriate authority. In the case of personal insolvency this is the Inspector-General (IG) in Bankruptcy. Following the receipt of an application to be registered as a trustee in bankruptcy, the IG convenes a committee of three persons to...
consider the application and interview the applicant. The committee then decides whether the applicant should be registered or not within 60 days of the interview. The committee must register if certain conditions are met and must not register if other matters are present (eg has been bankrupt within the previous 10 years). Apart from the specific disqualifying factors, the key requirements are that the candidate has the qualifications, experience, knowledge and abilities prescribed by the Bankruptcy Regulations. The Bankruptcy Regulations (Pt 8) provide detail about the application for registration as a trustee. In particular, in respect of the qualifications experience and knowledge, reg 8.02 sets out the requirement for a course in accountancy of not less than three years and commercial law of not less than two years’ duration. Relevant employment must be on a full-time basis for not less than two out of the preceding five years. In addition, there is a requirement to satisfy the committee that there is ability to perform the duties of a registered trustee immediately upon registration. When registered, the registration has effect for three years.

In the case of corporate insolvency there is the requirement to be registered with ASIC as the registering authority under Pt 9.2 of the Corporations Act. The application needs to indicate if the applicant is to be registered as an official liquidator. The requirement in terms of qualifications is similar to that in respect of bankruptcy trustees so an applicant must have completed a course in accountancy of not less than three years and at least two years of commercial law. Somewhat oddly, the course must be from a “prescribed” university or other institution; although the following subparagraph allows ASIC to recognise other qualifications and experience if it considers them to be equivalent.

Once registered, the second matter to consider is the obligations that are imposed on insolvency practitioners during the insolvency process. A detailed discussion of the current requirements is beyond the scope of this article. However, to emphasise the issues that are relevant to this article, some of the more salient options for reform identified by the Senate Inquiry included harmonisation of the personal and corporate insolvency regimes, creation of a single regulator and proactive surveillance of compliance through the introduction of an investigation “flying squad”, the introduction of an ongoing licensing system for corporate insolvency practitioners that would operate in a manner similar to bankruptcy, the establishment of an insolvency ombudsman, the need for improved data collection, and improvements to reporting and capping of insolvency practitioner remuneration fees.

One final point to note is that the other way in which the conduct of insolvency practitioner’s is regulated is through the various codes of professional practice, such as the Australian Restructuring Insolvency & Turnaround Association (ARITA) Code of Professional Practice (COPP). The first edition of the COPP was established in 2007 by ARITA under its former name (Insolvency Practitioners Association of Australia) and has been amended several times following the Senate

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17 Bankruptcy Act 1966 (Cth), s 155. A separate registration process exists for Debt Agreement Administrators (see Div 8 of Pt IX) and see also the requirements of a controlling trustee (s 188(2A) and Bankruptcy Act 1966 (Cth), reg 8.35).
18 Bankruptcy Act 1966 (Cth), s 155A. The committee may require the applicant to sit for an exam to assess if he or she should be registered.
19 Bankruptcy Act 1966 (Cth), s 155A.
20 Bankruptcy Act 1966 (Cth), s 155A(2).
21 Bankruptcy Act 1966 (Cth), s 155C.
22 Corporations Act 2001 (Cth), s 1283.
24 See reg 9.2.02 which lists what appears to be all of the relevant universities in Australia. It is not clear what verification is undertaken by the Australian Securities and Investments Commission (ASIC) to verify that the courses undertaken in the listed universities do in fact comply with the requirements of two years study of commercial law. The approach of ASIC might be contrasted with that undertaken by the Tax Practitioners Board which sets out detailed requirements in this regard: see Australian Government, Commercial Law Qualifications List, http://www.tpb.gov.au/TPB/Qualifications_and_experience/TPB/Qualifications_and_experience/0572_Commercial_law_qualifications_list.aspx.
25 See generally, Senate Economics References Committee, n 5, pp 147-159.
Inquiry with a view to improving ethical conduct. As discussed later in this article, the codes of professional practice play a vital role in addressing community expectations of insolvency practitioners.

PUBLIC PERCEPTION OF INSOLVENCY PRACTITIONERS: IS FURTHER REGULATION NECESSARY?

One of the key issues that placed the performance of insolvency practitioners under the scrutiny of the Economic References Committee was the spike in complaints about the insolvency profession. At the time of the inquiry, ASIC insolvency statistics showed that complaints and enquiries made against insolvency practitioners had almost doubled between 2007-2008 and 2008-2009, albeit a significant number of those appear to be related to duplicate complaints. Certainly, it was clear from the media scrutiny that there existed a negative perception of insolvency practitioner’s ethical behaviour, with one newspaper commentator stating:

community resentment has been brewing for years over excessive fees, abuses of power and gross misconduct, protracted settlements, lack of transparency, conflicts of interest and, in some quarters, even the promotion of phoenix schemes that allow companies to be reborn soon after they fail.

However, the question arises as how much of the insolvency practitioner “failure” relates to actual misconduct vis-à-vis public perception of misconduct, and related to this is a more fundamental question of whether there is a genuine need to increase regulation.

In relation to insolvency complaints, it is useful to review the ASIC statistics to determine the context in which insolvency complaints are made. At the time of the Senate Inquiry, ASIC provided a detailed set of statistics on the extent of the complaints that were received about insolvency practitioners. This showed that whilst ASIC had at that stage received in the period 2006-2009 approximately 45,000 complaints or enquiries about corporate matters, only 1,647 of those are related to insolvency practitioners. Thus in 2006-2007 complaints about insolvency practitioners represented 3.5% of the complaints received that year. This was slightly higher in 2008-2009 in that it was 4.4% of the complaints received in that period. In the ASIC submission to the Senate Inquiry, the comments made were

[17] ASIC receives some 650,000 calls and 13,500 written complaints and enquiries each year across ASIC’s jurisdiction …

[18] Complaints and enquiries in respect of insolvency practitioners over 3.5 years to December 2009 (1,647) account for 3.6% of total complaints and enquiries. In 48% of the complaints regarding insolvency practitioners either no breach was identified or there was insufficient evidence to support the allegation, and in 9% action by ASIC was precluded. A further 33% were resolved by providing assistance in regard to the enquiry or complaint. 86 or 6.5% of complaints involving insolvency

26 See Australian Restructuring Insolvency & Turnaround Association, ARITA Code of Professional Practice for Insolvency Practitioners (3rd ed, 1 January 2014) p viii, available at http://www.arita.com.au/docs/default-source/code-third-edition-2014/code-3rd-edition--as-at-18-aug-2014-for-web.pdf?sfvrsn=2 (hereinafter COPP). However, note that the COPP was not fully operational till 2008. While codes of professional practice are limited to membership of a given organisation, presumably the courts and disciplinary tribunals would refer to them when reviewing an insolvency practitioner’s conduct, as noted in para 1.4 of the COPP.


practitioners were considered by ASIC to be sufficiently serious to refer to specialist ASIC teams – the Insolvency Practitioners and Liquidators (IPL) team or Deterrence team. (emphasis added).

These figures suggest that whilst there are a significant number of complaints to ASIC, those involving insolvency practitioners are a relatively small percentage of overall complaints. Furthermore, of that small percentage only a few complaints made against insolvency practitioners were regarded as “sufficiently serious” so as to warrant reference to a specialist investigation team. Figures since this time suggest that the position has not changed significantly. ASIC released Report 389 in April 2014, which summarises the ASIC activities in relation to the supervision of registered liquidators for the calendar year 2013. It also provides some data for the previous year by way of comparison. The figures for provided show that in 2013, there were 446 complaints received about liquidators whereas in 2012 there were 477. These figures are in line with the numbers reported in 2009-2010 when there were 467 complaints. There was an increase in the number of complaints post 2007-2008, however it seems that they have, to a certain extent, levelled out. At the same time, the number of insolvency administrations increased significantly although they are now again on a downward trend, suggesting that the increase in complaints was related more to the increase in insolvency administrations.

What is instructive for the purposes of the argument made in this article is that of the total complaints made about insolvency practitioners in 2013, only 14% represented information that suggested deliberate serious breach of standards and a further 25% suggested that the misconduct was inadvertent. In fact, the vast majority of complaints made (61%) resulted in an outcome or resolution where the complainant was educated “about the applicable law or practice or by providing information about the normal practice of the insolvency process”. The authors argue that it is only the first two figures that are matters that ought to be of concern when regulating the insolvency profession. The latter category suggests that the bulk of the complaints relate to an unawareness or “gap” in the expectations of some stakeholders about the obligations that are imposed on the insolvency profession. Hence, a way forward might be to direct more resources at education rather than changing regulations.

Report 389 also provides some insight into ASIC’s approach towards reviewing insolvency practitioner behaviour. These are undertaken by targeting specific types of transactions or selected registered liquidator’s practice. In respect of the latter, the numbers of reviews are relatively small, which no doubt reflects how resource intensive these might be. They are selected on a risk analysis basis rather than in any random way. From these reviews the identification of matters worthy of formal investigation has varied with 2011 showing 42% requiring formal investigation whilst in 2012 that reduced to 19% and in 2013 it was 36%. The transaction reviews were undertaken in a larger

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30 The total complaints and enquiries against insolvency practitioners as a percentage of overall complaints ranged from 2.8% to 4.4% from the period 2006 to 2010. See Australian Securities and Investments Commission, n 27.
33 The figures for 2012 show around 69% of the complaints were resolved on the basis of education of the complainant whilst in 2011 the figure was lower at only 51%: Australian Securities and Investments Commission, Report 389, n 31, p 29.

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number of cases; there being 79 in 2013. Of these, 10% were referred for formal investigation. There were also activities undertaken by ASIC on an industry-wide basis.

What this review of the data around complaints suggests is in the authors’ view consistent with the fundamental argument in this article. That is, that the complaints, or community resentment as it is sometimes described, need to be analysed beyond the plain numbers. In making this analysis, it is consistent with the figures to suggest that a significant proportion of the complaints relate to a misunderstanding of the law or the insolvency process more generally. If that is accepted, it follows that the way to overcome such lack of knowledge does not lie in more regulation of the insolvency practitioner. Increased regulation may assist where the issues raised by complainants are specifically caused by a lack of regulatory standards, but for the majority of complaints made against insolvency practitioners there will be no improvement.

The above analysis indicates that there is some need for reform. However, what is not clear is whether the problems relate to comply with the current regulation, or whether the regulation itself needs to be more rigid. Furthermore, it is not clear as to whether the complaints made against insolvency practitioners relate to matters which are sufficiently regulated, but for which the public’s expectation of what insolvency practitioners is far greater than what is required, or indeed achievable in an insolvency process. This “gap” in the public’s expectation of insolvency practitioners has been evident in the language used by the general community during the consultation on the recent insolvency reform proposals. For example, in response to the Treasury proposals paper “A Modernisation and Harmonisation of the Regulatory Framework Applying to Insolvency Practitioners in Australia” (Proposals Paper), one submission indicated that the insolvency profession “need[s] a real cleanout in order to protect families, businesses and community organisations from criminals in these industries” and that “[f]uture reviewers of this government’s performance and the broader community will judge it badly if it does nothing to address this cancer which is eating away at the fabric of Australian society”.

While emotive responses like this do little to progress the debate on reform, it does highlight that there are high expectations of the insolvency profession by the general community with regard to their duties and obligations that may not reflect the reality of the professions’ role. This point was emphasised by ARITA, as the peak body for the insolvency profession, in its submission to Treasury’s options paper, “A Modernisation and Harmonisation of the Regulatory Framework Applying to Insolvency Practitioners in Australia” (Options Paper), stating that:

Any insolvency commences with money having been lost, and many stakeholders hold expectations that their lost money in particular should be able to be recovered and the better part of it returned to them. These are not realistic expectations, nor do they form the basis of criteria by which the appropriate cost of providing insolvency services should be judged.

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39 The numbers were 85 in 2011 and 95 in 2012: Australian Securities and Investments Commission Report 389, n 31, pp 18-19.  
40 The percentage in 2011 was 5% and in 2012, 8%: Australian Securities and Investments Commission, Report 389, n 31, p 14.  
Any gap between the public’s expectations and the requirements of the insolvency profession should be specifically addressed in any reform agenda. This was specifically identified during the Senate Inquiry and then subsequently during the consultation on both the Options and Proposals Papers. As one practitioner commented in his submission to the Options Paper:

This expectation gap has been highlighted as a result of the actions of a rogue insolvency practitioner. The actions of the rogue insolvency practitioner have been used by some to taint the reputation and standing of all insolvency practitioners and the regulators of insolvency practitioners … In many cases, complaints made against insolvency practitioners are the result of a lack of understanding of the insolvency process by the complainant … The existing regulatory regime works. Care should be exercised in considering imposing additional duties and obligations on insolvency practitioners. The additional duties and obligations must be balanced against the cost of compliance with these additional duties and obligations. The costs of monitoring compliance by the regulators should also be considered.

Having identified that there is an expectations gap in terms of the obligations and duties of insolvency practitioners, the next issue is to determine how the regulation may best bridge that gap. Certainly there is a need to address the negative perceptions held by the public in relation to the regulation of insolvency practitioners. Indeed, one of the objectives of the draft Insolvency Law Reform Bill 2014 (Cth) is to “improve overall confidence in the professionalism and competence of insolvency practitioners”. It is this objective that implicitly focuses on bridging the gap between the public’s expectation of what insolvency practitioners can realistically achieve in performing their role and the obligations and duties that should reasonably be imposed upon them. However, we argue that the focus of any review of the regulation should take into consideration the expectation gaps that may exist between insolvency practitioners and the general public, and more specifically, whether those expectations are realistic.

In the recent review of ASIC’s performance, the Senate Standing Committees on Economics recommended, yet again, that the government commission a review of Australia’s corporate insolvency laws; making reference to the results of a 2013 ASIC stakeholder survey in which insolvency practitioners had received the lowest rating for perceived integrity. In response, the validity of this negative perception was categorically refuted by ARITA, who stated that “[e]ven cursory examination of the premise of the question and demography of those surveyed highlights gross inadequacy and bias”. However, the original ASIC survey is instructive for several reasons. First, it is clear that while auditors and insolvency practitioners are both considered to be important gatekeepers of the financial market, respondents generally viewed auditors as having much more integrity; Secondly, when respondents were separated into segments, there was a significant difference in responses from those who were in the “regulated population” (such as public-listed

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44 See Parliament of Australia, Senate Economics References Committee, n 5 at 1.30.
46 Insolvency Law Reform Bill 2014 (Cth), Explanatory Memorandum, para 1.1.
49 Thirty percent of respondents either strongly agreed or agreed that insolvency practitioners operated with integrity, compared to 48% in relation to auditors, who had the highest positive response of all “gatekeepers”. See Susan Bell Research, ASIC Stakeholder Survey 2013, p 47, available at http://www.asic.gov.au/about-asic/what-we-do/how-we-operate/stakeholder-liaison/stakeholder-surveys.
companies, providers of financial products and services and other gatekeepers of financial markets such as insolvency practitioners themselves) and those who were investors, consumers and other respondents.\textsuperscript{50}

The comparison between insolvency practitioners and auditors provides a useful insight into the way in which the insolvency profession should be regulated, as the audit profession has grappled for many years with the most effective ways to bridging the gap between the public’s expectations the profession and the overall function of audit. It is for this reason that we argue that the general community resentment towards insolvency practitioners needs to be analysed in a much more rigorous way, with a proposed model based on the audit expectations gap theory providing a useful analytical tool. Once the usefulness of this approach is established, it may then be possible to re-visit the data to establish its relevance and possibly some more effective solutions.

**EXPECTATION GAP THEORY**

The “audit expectations gap” was identified as early as the mid-1960s\textsuperscript{51} and became even more prevalent in the late 1980s.\textsuperscript{52} Over the decades, the audit expectations gap theory has been applied to the function of audit in a number of ways. Most studies involve some form of empirical research aimed at identifying the specific causes of the expectation gap so as to determine the appropriate regulatory response.\textsuperscript{53} However, it has also been used as a framework for evaluating the increase in audit responsibility as imposed by case law,\textsuperscript{54} and in conjunction with other theoretical frameworks as a way of understanding beliefs about auditing.\textsuperscript{55}

The key focus of the research into the audit expectations gap has generally been around the responsibility for the accuracy of financial statements, as well as the audit profession’s obligation to detect fraud and report on the overall efficiency and effectiveness of management.\textsuperscript{56} In Australia, research into the audit expectations gap theory gained momentum following the 1994 working party report commissioned by the then titled Society of Certified Practising Accountants and the Institute of Chartered Accountants in Australia.\textsuperscript{57} This report focussed on various aspects of reporting requirements, compliance mechanisms and perfecting the scope of the auditor’s role.\textsuperscript{58} Research on the application of the audit expectations gap is not a concept that is unique to common law

\textsuperscript{50}For example, in relation to the question on whether various gatekeepers operated with integrity, 37% of the “regulated population” respondents either strongly agreed or agreed compared with 23% of the “investors and consumers” respondents: Susan Bell Research, n 49, p 95.


\textsuperscript{54}Mills M, “The Expectation Gap and Auditor’s Responsibilities” (1990) 20 Western Australia Law 538.


\textsuperscript{57}Australian Society of Certified Practising Accountants and the Institute of Chartered Accountants in Australia, A Research Study on Financial Reporting and Auditing: Bridging the Expectation Gap (1994).

\textsuperscript{58}Though it is worth noting that the 1994 working party report was criticised for not specifically addressing components of the expectations gap theory. See Porter B, “Review” (1996) 10(1) Accounting Horizons 130.
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jurisdictions, nor is it relevant only to the study of the audit profession. For example, the expectations gap has been applied more broadly to corporate governance and to other areas of study, such as accounting education.

At a rudimentary level, the audit expectations gap can be seen as the difference between the expectations that users of financial statements have in relation to the audit function and what may reasonably be expected of the audit profession. Porter argued that this view was too narrow, and did not take into account the shortfalls in measures of audit performance. Thus, Porter described the gap as an “expectation-performance” gap, the components of which are two-fold:

- differences between what the public expects of the audit profession and what auditors can reasonably be expected to achieve (reasonableness gap); and
- differences between what the public reasonably expects of the profession and what the profession is perceived to actually achieve (performance gap).

The performance gap can be further categorised as comprising:

- differences between duties and obligations which can be reasonably expected and the professional regulatory requirements, such as statute law, case law and professional standards (deficient standards); and
- differences between the expected standard of performance by the audit profession, as required by existing standards, and the public’s perception of that standard of performance (deficient performance).

As a result, bridging the audit expectation-performance gap requires analysis of the factors underpinning the expectations and perceptions of the public as compared to the audit profession about the relevant standards that exist and the profession’s overall performance against those standards.

For the purpose of this article, we argue that the expectation-performance gap theory provides a useful framework to analyse the need for increased regulation of insolvency practitioners and bridging the expectations of creditors and other stakeholders in the insolvency process. While it is difficult to determine the causes of insolvency regulation failure in the absence of empirical research, it is possible to categorise various suggestions about the regulation of insolvency practitioners that have emerged during the Senate Inquiry and reform proposals by reference to the expectations gap theory. The advantage of this approach is that it becomes clear as to which issues require increased regulation, and which require further compliance or general community education.

**BRIDGING THE GAP – A MODEL FOR FUTURE INSOLVENCY REGULATION**

In the context of the insolvency profession, the expectations gap model consists of the performance gap and the feasibility gap. The performance gap further consists of a compliance gap and a standards gap. This is represented by Figure 1 as follows:

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63 Porter, n 53 at 49.


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FIGURE 1 The insolvency practitioner’s expectations-performance gap

The performance gap is comprised of an expectations gap in relation to both standards imposed on insolvency practitioners and compliance with those standards. Reducing the performance gap, therefore, requires specific identification of inadequacies in relation to standards that could reasonably be expected in the regulation of the insolvency profession and deficiencies in performance of the insolvency profession against those standards.

The “deficient performance gap” identified by Porter can be equated to differences between the duties and obligations that are currently imposed on insolvency practitioners and the public’s reasonable perception of compliance with those requirements. Put another way, it is the gap that exists between measures for which adequate standards of performance exist, such as those set out in the relevant legislation and codes of professional practice, but of which greater compliance and performance is reasonably expected of the insolvency profession. Therefore, we refer to this gap as the compliance gap. To reduce this gap, regulatory reform should be focussed on measures which increase the quality of professional performance and compliance with the regulation. Some examples would include increasing penalties attached to breaches of standards and ensuring that an appropriate monitoring body has been established and adequately resourced.

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66 Porter, n 53 at 50. Godsell, n 66.
insolvency profession by law and other promulgated standards. The authors refer to this as the standards gap. The standards gap reflects the fact that the standards which are currently imposed on insolvency practitioners are simply inadequate. By way of example, the current reform proposal includes measures which are aimed at reducing the standards gap include recommendations about licensing and registration requirements.67

The authors argue that measures aimed at increasing the duties and obligations imposed on insolvency practitioners should be focussed solely on reducing the standards gap, and that other measures are needed to reduce the compliance gap or, as discussed below, the feasibility gap. Furthermore, any proposed regulation needs to be clear as to which component of the expectations gap is being addressed for it to be effective. To identify the standards gap, it must first be determined which deficiencies exist in the current regulation, as measured by the standards of conduct that are expected of the insolvency profession, and then whether those expected standards are reasonable. Reducing the standards gap, therefore, requires to careful examination of the duties and obligations which are reasonably expected of the insolvency profession that have not, as yet, been incorporated in the current legislation and codes of professional practice. This also requires a measure of what is reasonable which may be, for example, assessed by reference to international regulatory norms. It is only then that a deficiency in standards can be identified and amended.

The feasibility gap

The feasibility gap refers to the differences between the expectations of creditors and other stakeholders in an insolvency process and the insolvency profession. The “reasonableness gap” referred to by Porter68 equates to what is feasible in terms of insolvency performance. The authors refer to this as the feasibility gap. Specifically, this gap is a measure of unreasonable expectations on behalf of relevant stakeholders, such as creditors, directors and shareholders, and other stakeholders, when an entity becomes insolvent and what an insolvency practitioner can reasonably be expected to achieve in relation to insolvency outcomes. Again, the issue becomes what is considered unreasonable in terms of expectations. One way of achieving this may be through the application of attribution theory, which has been used to explain the underlying causes of the expectations gap in audit on the basis that the processes by which individuals make causal connections about certain behaviours or events is inextricably linked to their evaluation of the auditor’s role.69 Reducing the feasibility gap, therefore, requires that the scope of the insolvency profession’s role in the event of insolvency, and more broadly as a “gatekeeper” of the financial markets, be clearly defined so that misconceptions about this role, as held by creditors and other stakeholders in the insolvency process, can be identified and resolved.

The resolution of that gap may involve a reconsideration of the insolvency practitioners’ fundamental role. However, if (as the authors suspect is the case) the issues are related more closely to unrealistic or unreasonable expectations of creditors and other stakeholders, then the resolution is more likely to lie in education of the general community rather than further regulation. This can be carried out in a number of ways. By way of example, one of key focuses of the research into the audit expectations gap was consideration and introduction of the “long form” audit report, which was aimed at educating users about the function of audit, rather than a specific increase in the obligations and duties imposed on auditors.70 Similar measures have been recommended in relation to insolvency remuneration reports.71 However, if the feasibility gap is not clearly identified and articulated, any measures that simply increase the volume of information contained in the remuneration reports without consideration of causes of the feasibility gap will fall short of achieving the desired outcome.


68 Porter, n 53 at 50.

69 Psaros and Monsef, n 51; Arrington, Hillison and Williams, n 55.


71 See Insolvency Law Reform Bill 2014, Schs 1 and 2 (establishing Div 60 of the Insolvency Practice Schedules).
A further example of the importance of analysing reform measures within the expectations gap framework can be seen when considering the Senate Inquiry’s recommendation on establishing an Insolvency Ombudsman.72 As stated in the Senate Inquiry, the advantages of doing so include factors that relate to the feasibility gap, such as “providing a voice for complainants”, “performing an educative role on what is acceptable conduct and reasonable fees” and “maintaining community confidence in the insolvency regime”. Other advantages are more relevant to the compliance gap, such as being “a body that is independent from the regulator and is not subject to directions from the regulator” and “a body with statutory power to dismiss a liquidator from an appointment”.73 It is important to determine which particular gap the establishment of an ombudsman is aimed at reducing; so that it can be determined whether the role is viable, and if so, able to address the relevant gap in expectations.

CONCLUSION

It is argued in this article that perceptions about the failure of the insolvency profession to uphold a reasonable level of performance should not result in a knee-jerk response by government without careful consideration of the causes of these perceptions. As Cameron stated in relation to regulation of the audit profession:

adopting an expectation of change does not require the conclusion that change means “more” regulation. What it does indicate, however, is the need for greater information regarding those changes.74

The same considerations apply to the regulation of insolvency practitioners. In the absence of information about the proposed reform to the regulation of insolvency practitioners, there is a danger of regulation overkill and a likelihood that any regulation that is proposed does not actually address the performance and feasibility gaps that exist. The lack of data that is available to assess performance, and arguably community expectations, has been an ongoing issue in relation to insolvency regulation.75 Information is critical to both the identification of current expectations, perceptions and beliefs about the regulation of insolvency practitioners.76 As Anderson and Morrison stated:

It is possible to argue that the level of wrongdoing by insolvency practitioners is small relative to the matters that they deal with. This is no doubt the basis of some submissions to the enquiry. On the other hand it could be widespread, necessitating changes to the law and practice. The bottom line is that we simply do not know.77

The authors consider that the application of the audit expectation gap theory will assist the process of gathering meaningful information, particularly if specific empirical studies are carried out. If the issues experienced by creditors and other stakeholders do not relate to the standards gap, then merely increasing the duties and obligations will not result in a more positive perception of insolvency practitioners. For example, if restrictions on the levels of remuneration fees are required to reduce a standards gap, then increasing regulation will succeed. However, if the issue relates more to expectations that creditors and other stakeholders have with regard to remuneration fees that are unreasonable given the nature of insolvency, then any measures that impose tighter restrictions on the levels of fees that can be set will ultimately fail.

On review of the current reform proposals, it is argued that the majority of proposals are aimed at either reducing the compliance gap or the feasibility gap and, in some cases, both. For example, recommendations about the establishment of a single regulator and proactive compliance groups, like

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72 Parliament of Australia, Senate Economics References Committee, n 5 at [11.21].
73 Parliament of Australia, Senate Economics References Committee, n 5 at [11.21].
75 Parliament of Australia, Senate Economics References Committee, n 5, pp 117-124.
76 It is noteworthy that in the 2013 ASIC stakeholder survey 25% of investors and consumers, and 32% of other stakeholders did not really know enough to comment on the integrity of practitioners. See Susan Bell Research, n 49, p 47.
77 Dr Colin Anderson, Submission 79, cited in the Senate Economics References Committee, n 5, p 143.
the Insolvency Ombudsman and improvements to reporting requirements can have the overall purpose of increasing compliance with current standards as well as creating more positive perceptions of the integrity of insolvency practitioners. However, they are currently being developed in an ad hoc manner and are not specifically focussed on addressing the causes of those gaps.

It is vital that any reform of the insolvency profession progresses in a manner that considers the causes of gaps in expectations. Furthermore, it is simply impossible to determine what legislative measures should be put in place without information on which particular components of the expectations gap exist and the causes of those gaps. It is only when armed with this information that the government will be in a position to make more effective progress in regard to regulation of the insolvency industry.