

Consideration of Significant Audit Matters: An Evaluation

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To Link this Article: <http://dx.doi.org/10.6007/IJARAFMS/v12-i3/18928> DOI:10.6007/IJARAFMS/v12-i3/18928

Published Online: 19 October 2023

ABSTRACT

Key Audit Matters (KAM) are the main component in independent auditor reports. The requirement for the KAM started in 2015, whereby the auditors were required to provide the auditor to identify the significant audit risk and explain the audit procedure that undertook while conducting the audit practices. The purpose of this study is to provide a review of academic literature about Key Audit Matters (KAM) from 2019 until 2022. This study found that the discussion can be divided into three categories which are the factors that influence the disclosure of KAM, the effect of KAM and the narrative reporting of KAM. This study also provides several potential research areas at the end of the discussion.

Keywords: Key Audit Matters, Literature Review, Quantitative, Qualitative, Future Study

Introduction

The collision of information possessed by the business owner, agent, and management made the potential investor doubt the stability and creditability of their investment. This situation has a significant impact on the growth of the countries and reduces the job market. One way to eliminate this situation is by preparing an audit report. An audit report is the primary source of information for the investors that results in creating and enhancing trust and confidence among investors in Malaysia (NST Business, 2021). The audit report is one communication document that links actors, business organizations and potential investors. The outcome of the thorough and lengthy auditing processes is verified by professional and qualified personnel and auditors.

The financial crisis changed the requirements of audit reports. It is believed that one of the causes of the financial crisis is untransparent and misleading information. (Ernst & Young Global Limited, 2015). The skeleton of the auditors' report is minimal. It should include the description of the responsibilities of management and auditors, the auditors' signature and the auditors' opinion. In conjunction with that, International Auditing and Assurance Standard

Board (AASB) issued a standard that enhanced the requirement of audit reports in 2015 (Ernst & Young Global Limited, 2015; NST Business, 2018).

One of the requirements is the disclosure of critical audit matters (KAM). The purpose of disclosing this requirement is to provide more information on how the auditors highlight the significant activities that will increase the risk of internal control of organizations (International Auditing and Assurance Standards Boards, 2015). The standard had spelt out the criteria on the KAM disclosure. The requirements are activities with high risks, significant auditors' judgement such as estimates, and activities may affect critical events or transactions.

However, this disclosure requirement is more focused on qualitative information. It depends on the preparer's judgement; on the other side, users may not be able to understand the audit reports.

Malaysia reported on KAM as early as 2016 (Izma, 2018). After one year of implementation, the review indicated that the disclosure of KAM had changed from standard wording to more dynamic reporting. The auditors have the opportunity to express their explanations and protect their liability. After six years of implementation, the academic discussion is still lacking in developing the KAM discussion.

Therefore, this study aims:

to provide a systematic analysis of the development of the KAM in the academic area, which may help the academician explore the potential research area.

to help the young researcher to develop their research objectives and improve the discussion on KAM.

to help the auditors in enhancing the pattern of the disclosure of KAM in their audit reports by identifying which areas the KAM should tackle while writing the KAM inside the audit reports.

to help regulators to determine the budget that may improve the academician to research on the KAM.

Key Audit Matters (KAM)

The purpose of the KAM is to enhance the communicative value of the audit reports and provide transparency of the audit performed (International Auditing and Assurance Standards Boards, 2015). The discussion on the academic literature can be divided into three segments. It begins with a discussion on the factors that influence the disclosure of KAM (Wuttichindanon & Issarawornrawanich, 2020). Later, it will be followed by a segment of the effects of disclosure (Li, Hay, & Lau, 2019; Segal, 2019; Velte, 2020; Kitiwong & Sarapaivanich, 2020; Rautiainen, Jani, & Kati, 2021). In the last segment, this paper will discuss the KAM's reporting mechanism (Rahaman & Chand, 2021; Mihret, Kansal, Muttakin, & Rana, 2022; Wuttichindanon & Issarawornrawanich, 2020).

2.1 Factors that Influence KAM

Several studies have focused on the factors that influence the disclosure of KAM. Three common factors have been discussed which are the types of audit companies

(Wuttichindanon & Issarawornrawanich, 2020; Fera, Pizzo, Vinviguerra, & Ricciardi, 2022; Hossain, Bhuiyan, & Rahaman, 2022), the Audit Committee (Wuttichindanon & Issarawornrawanich, 2020; Velte, 2020; Fera, Pizzo, Vinviguerra, & Ricciardi, 2022) and the gender of auditors (Wuttichindanon & Issarawornrawanich, 2020). These studies unanimously agreed that higher corporate governance influences the disclosure of KAM.

The Big 4 companies tend to disclose the KAM more robust since the companies have more resources to provide the information to the clients (Fera, Pizzo, Vinviguerra, & Ricciardi, 2022; Nguyen & Kend, 2021; Suttipun, 2022; Hategan, Pitorac, & Crucean, 2022). However, the requirement for the KAM does not affect the Big 4 companies, and it is just one step extra in reporting the audit procedures (Nguyen & Kend, 2021). Another study found vast differences in the reporting style between new auditor reports and experience auditors (Rahaman & Chand, 2021). Another study further explained that the experience auditors improved the reporting style from year to year (Nguyen & Kend, 2021). The improvement of the reporting style is due to the frequent training conducted. It helps the auditors to identify the significant issues in KAM. However, the other studies refuted the earlier findings (Baatwah, 2022; Wuttichindanon & Issarawornrawanich, 2020; El-Haddad, Hegazy, & Kamareldawla, 2022). Therefore, it can be inferred that The Big 4 reported KAM differently. The audit reports are first prepared using the "boilerplate" method or template, while users can see it through audit reports. It arises due to uniform standard reporting. Mimetic and coercive pressure from the regulator makes the auditors disclose KAM in this way. Up to this study, their improvement had been made through the disclosure of KAM.

The Audit Committees also influence the disclosure of KAM (Velte, 2020; Velte, 2020). The arguments are based on the audit committee's contribution. The independent audit committee, which has financial expertise, can help the company to disclose the KAM. They are going to deliberate the message to the top management of companies. It will result in a higher understanding of the purpose of reporting the KAM. At the same time, it gives the director some insight into how the KAM may protect the auditors from litigation issues.

The other study highlighted and discussed on the engagement of female executives can influence the readability of KAM (Wuttichindanon & Issarawornrawanich, 2020; Rautiainen, Jani, & Kati, 2021). Female auditors most complied with the requirement in reporting the KAM. Other studies refuted the statement. The claim is on the basis that the disclosure of KAMs is more on the requirement by the regulation (El-Haddad, Hegazy, & Kamareldawla, 2022).

2.2 Impact of the Disclosure KAM

The desired outcome of the KAM is to minimise the risk to the company. The disclosure of KAM may facilitate the user's decision-making. The discussion on the effect of the disclosure of KAM is lingering around audit fees (Li, Hay, & Lau, 2019; Suttipun M., 2021; Hossain, Bhuiyan, & Rahaman, 2022; Kitiwong & Sarapaivanich, 2020), the liability of the auditors (Pratoomsuwan & Yolrabil, 2020) and audit quality (Li, Hay, & Lau, 2019; Fera, Pizzo, Vinviguerra, & Ricciardi, 2022).

Audit Fees

Implementing the KAM will increase audit fees (Li, Hay, & Lau, 2019; Suttipun M., 2021; Hossain, Bhuiyan, & Rahaman, 2022; Segal, 2019). The process required the auditors to spend resources to determine the significant audit findings to be included. It is also a time-consuming process. Not only that but they also are required to perform details audit procedures to ensure that significant findings can be generated from audit procedures. As a result, it increases audit fees.

Liability of Auditors

The disclosure of the KAM may increase the auditors' liability (Pratoomsuwan & Yolrabil, 2020; Wuttichindanon & Issarawornrawanich, 2020). The arguments are made on the basis that the KAM may reduce auditors' liability when the auditors can highlight the significant audit findings related to the fraud. The studies also argued that the auditors might not use KAM in the case of a disclaimer. It may lead to the auditors wanting to find the easiest way to escape the responsibility.

Other studies supported the discussion on the more critical information published to the users. The higher the chance, the higher the litigation process (Kitiwong & Sarapaivanich, 2020). The users may find ways to assess the errors and queries about the disclosure requirement; as a result, it distorts the auditors' independence (Mihret, Kansal, Muttakin, & Rana, 2022). The auditors acted as the verifier of the information. The management gives the information.

Audit Quality

There is a different opinion regarding the impact of the KAM on audit quality. The requirement for the KAM increases the audit quality (Li, Hay, & Lau, 2019; Suttipun M., 2021; Hategan, Pitorac, & Crucean, 2022). Another study refutes the earlier claims by stating that the requirement for KAM does not improve the audit quality (Rautiainen, Jani, & Kati, 2021), while another study found mixed results impact KAM on the audit quality (Nguyen & Kend, 2021).

The positive result of the requirement of KAM maximises the user's interest in decision-making (Li, Hay, & Lau, 2019). The study argued that the KAM highlighted that the KAM help the users in determining the significant audit findings. It includes the going concern, impairment and accounting estimates. Some issues cannot be expressed regarding the numbers and impact in the financial statements (Suttipun, 2021).

The Finland data indicated that the KAM does not improve audit quality (Rautiainen, Jani, & Kati, 2021). The arguments indicate that the KAM is not a good issue in the audit report because it depends on the management arguments. However, the Finnish auditors perceived that KAM manages the audit procedures smoothly.

The qualitative study indicates that the double-checking process on KAM improves audit quality (Nguyen & Kend, 2021). The reporting led the auditors to assess the key audit risk cautiously. The KAM can help the auditors to strengthen the communication between the auditee and the auditors. The KAM required the auditors to scrutinise the information included in KAM.

Another study refutes the earlier claims that the reporting of the KAM improved the audit quality (Rautiainen, Jani, & Kati, 2021; Nguyen & Kend, 2021; Kitiwong & Sarapaivanich, 2020). The KAM improves the team members' relationships and gives value to the audit reports. It does not simplify the auditors' work even if the regulations require it.

Narrative Reporting of KAM

This section focuses on the narrative reporting of the KAM. The KAM can act as an enriching tool between the clients and the auditors by giving added value to the usefulness of the information (Nguyen & Kend, 2021; Rahaman & Chand, 2021). This KAM challenges the auditors to take a cautious step in preparing the reports. The auditors argued that they must select the best words to describe KAM in the organisation's current condition (Nguyen & Kend, 2021).

Another study supports the claims that words chosen may not give an adverse disclosure on KAM (Rahaman & Chand, 2021). Later, this practice may lead to the company's financial statement being in the wrong position. Other consequences may defeat the purpose of the audit reports. Another study expands the research by examining the usage of technical words and jargon inside the KAM (Rahaman & Chand, 2021). The study highlighted that disclosure of KAM is almost the same within the industries. The reports used standard languages without technical jargon for the stakeholders to understand the contents.

Works of literature on the KAM focus more on how many words had been used to report the KAM (Wuttichindanon & Issarawornrawanich, 2020; Rahaman & Chand, 2021; Nguyen & Kend, 2021). These studies missed the word -pattern used in KAM in the annual report and what is the latest expansion of the disclosure.

This study argued that the transparency of audit reports might widen the audit expectation gap if the information available is not in the correct context (Segal, 2019; Liu, Ning, Zhang, & Zhang, 2022). The study found that the displayed accounting estimates as part of the KAM do not enhance the decision-usefulness of accounting information (Lau, 2021). The reporting KAM can be a red flag for accounting estimates.

A Way Forward

This study aims to highlight the recent academic paper on KAM. This study found that the literature discussion can be divided into three aspects. The first aspect is the factors that may look at the factor influencing the KAM. This previous discussion focuses on the Big 4 audit firm, audit committee and gender of the auditors. The future study may look at the governance issues, such as the organisation's motivation to adopt or market factors influencing the adoption.

Therefore, this study proposes the following research:

RQ 1: Does the motivation element influence the reporting of KAM?

RQ 2: Does any requirement from the industry player influence the reporting of KAM?

The disclosure of KAM is influenced by the financial reporting landscape of the country. The common reporting standards are General Accepted Accounting Policies (GAAP) and Financial Reporting Standards (FRS). The issue may be derived here whereby is the complexity of the

accounting standard influence the degree of the KAM. The research question may be formulated as follows:

RQ 3: Does the accounting standards' complexity influence the disclosure of the KAM?

After six years of implementation, the reporting KAM seems to impact the audit fees, auditors' liability, and audit quality. The most common discussion is the impact on the concept of auditors' independence. The discussion on the reporting of KAM and the auditor's independence remains unexplored. The following research questions may facilitate further studies:

RQ 4: Is the reporting KAM influence the auditor's independence?

RQ 5: How does the management assist the auditors in reporting significant matters in KAM?

There is no checklist to report KAM. It depends on the significant evaluation perceived by the auditors. Due to that, the narrative reporting varies among countries. This study argued on the following issues:

RQ 6: Are the patterns of the disclosure KAM the same?

RQ 7: Over the six years of implementation, how does the reporting KAM differ between one company or the other company or years?

It is helpful for the researchers to explore the discussion on the KAM. The academic research may help enrich the information the preparer needs in preparing the KAM. The findings may benefit the regulator in designing the suggested template to report the KAM at the exact times.

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