

Understanding audit reporting changes: introduction of Key Audit Matters

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Abstract: The audit profession has gone through a series of polemics in the last decade, which led to the need of change and revision of audit reporting and audit quality. This study aims to investigate if users of audit reports agree with IAASB's proposal to include a new section, Key Audit Matters (KAMs), in the audit report in order to include more information regarding the audit mission, with the aim of improving audit communication. This proposal comes after users perception of audit reporting quality has decreased over time. The authors achieve this objective by examining comment letters received by the IAASB at the 2013 Exposure Draft and invitation to comment, send by respondents from the European Union. The authors have found that most of the replies are in agreement with the regulating body's proposals. However, there are several respondents who raise legitimate concerns regarding the implementation process of KAMs, and the effect KAMs will have on audit reporting. The authors conclude that KAMs are an important concept and that their introduction and applicability will have a positive effect in the audit reporting process.

Key words: key audit matters, comment letter, audit reporting, audit quality, IAASB.

JEL codes: M42

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1. Introduction and background

For decades, the audit profession has been troubled by changes and vast controversies on issues such as liability assumed by the auditors and their role in detecting fraud and error. This issue has reached unprecedented levels with the bankruptcies of well-known companies, such as Enron (Porter & Gowthorpe, 2004). This company filed for bankruptcy after adjusting their accounts while having an unmodified opinion from their auditor, Arthur Andersen. WorldCom, Global Crossing and Rank Xerox are other companies in the USA with similar outcomes. In Italy, Parmalat entered bankruptcy in 2003 when they were involved in an accounting scandal with a prejudice worth 8 billion Euros (Demaki, 2011; Norwani *et al.*, 2011). In New Zealand, Allied Nationwide Finance failed in September 2010, while NZF Money went bankrupt in January, 2011 (Lianne, 2011). After all the corporate failures from the beginning of the 21st century, as well as the effects of the recent financial crisis, regulating bodies have begun a reform process of regulation in this field (FRC, 2006; EC, 2010; PCAOB, 2011; IAASB, 2013).

Research in the topic of audit quality and audit reporting have a long history (Francis, 2011). This aspect is not surprising, because audit quality is the core of the audit market. The audit mission has no value if the public has no confidence in it (Maijor & Vanstraelen, 2012). Similarly, audit quality is a real concern for regulating bodies because trustworthy financial reporting is essential for a reliable operation of the stock market (Bolkestein, 2003).

Regulating bodies in audit, but also accounting professionals have argued that more transparency coming from audit firms can help restore the public perception of audit quality (Wyman, 2004). The audit process is a complex one, and 3rd parties can have difficulties in understanding what it accomplishes, especially because the audit report is standardised in form and content (Wooten, 2003). In general, a quality audit is the result of reducing the effect of existent anomalies and failures. Consequently, many studies focus on “audit quality” or “auditor quality” (De Angelo, 1971; Citron & Taffler, 1992; Carcello *et al.*, 1992).

The idea of extended audit reporting, or having the auditor communicate more information relevant to users, through the audit report, is not new. Academics and professional bodies alike have expressed interest in this subject. Kranacher (2011) sketches the developments that financial and auditor reporting are undergoing, endorsed by the IASB, IAASB and PCAOB. Many researchers investigate or have investigated the effect that an extended audit report would bring to users need, of receiving further

information from the audit mission. In Poland, for instance, an additional report is issued by auditors, containing information relevant to shareholders (Dobija & Cieslak, 2013). Bédard *et al.* (2014) bring into discussion the similarity between the proposed Key Audit Matter and the audit commentaries „Justification of Assessments”, or JOA, which French auditors provide since 2003.

In some studies (Chong & Pflugrath, 2008; De Muylder *et al.*, 2012; Gold *et al.*, 2012), researchers argue that such a measure would not increase the quality of users investment decisions, nor would it decrease the audit expectation gap, so the extended audit report is without use. Other researchers, like Vanstrelen *et al.* (2012) find that such a report would bring benefits only if it were to include information that is actually relevant to users; therefore, it should not be an pointless expansion. Vanstraelen *et al.* (2012) consider that for future advances, a consensus between interested parties is needed (users, on one side, and auditors, on the other side). Still, some academics go as far as considering that a more detailed audit report has more of a figurative value, than actually bringing value to users; nor does it increase audit costs or quality, for that matter (Church *et al.* 2008; Mock *et al.* 2013, Bédard *et al.*, 2014).

Our opinion is that the new proposed *Key Audit Matters* section of the Audit Report strengthens the Theory of Inspired Confidence (Limperg Institute, 1985; Hayes *et al.*, 1999), because it will provide users with information relevant for them to decide whether the disclosures provided by the management are biased or not. This aspect is relevant from a social point of view, as Carmichael (2004) points out: when the confidence of the public in the audit mission is lost, the social usefulness of the audit is damaged. As some researchers highlight, it has become extremely difficult for users (investors and other categories) to process all the information that is being offered to them (Lee, 2012; Miller, 2010). So, the Theory of Inspired Confidence associates what the users need from an audit (the reliable assessment over financial information) to the audit techniques and deliverables to meet these needs. The Limperg Institute (1985) stresses that over time, when users need change, the audit function has to change as well. Thus, we consider that the new KAM section is a result of audit reporting changes meant to assist users, even if only by merely emphasising certain aspects or deficiencies of the financial information provided by the company.

The purpose of this study is to determine if the users of audited financial statements consider that the introduction of key audit matters is beneficial. This new concept has been proposed in order to improve user's perceptions of the auditor mission. We plan to accomplish this by examining the comment letters (user responses) that the IAASB has received for its 2013 *Proposed New and Revised International Standards on Auditing. An invitation to comment*. We have only selected responses

coming from organisations, bodies or individuals from within the EU. This work method can be described as a quantitative study because we will mainly analyse responses through a grading system. Then, we will interpret the results, make connections and draw conclusions.

2. Auditor reporting developments: the proposed ISA 701 – Key Audit Matters

The **International Audit and Assurance Standards Board** (IAASB), the regulating body of International Standards for Audit (ISAs) has pushed, in the last years, the clarification of auditing standards, with a focus on audit reporting and audit quality. Starting with 2009's "Clarity Project", the IAASB has revised all current audit standards to improve clarity and quality (IAASB, 2009). In 2011, the IAASB issued the consultation paper "Enhancing the Value of Auditor Reporting: Exploring Options for Change" and in 2012 an invitation to comment "Improving the Auditor's Report". The most recent work of the regulating body has been the 2013 invitation to comment with the title "*Proposed New and Revised International Standards on Auditing. An invitation to comment*". The new draft features a new standard: the ISA 701: *Communicating Key Audit Matters in the Independent Auditor's Report* (IAASB, 2013). Paragraph 8 of the standard reveals the objective of communication **Key Audit Matters** (KAMs): "those matters that, in the auditor's professional judgement, were of most significance in the audit of the financial statements".

In July 2013, the IAASB released a new exposure draft called *Proposed New and Revised International Standards on Auditing. An invitation to comment*. This exposure draft sought views from stakeholders (investors, analysts and other users of audited financial statements) with regards to the IAASB's plans to enhance auditor reporting. These proposals come as a response to the users need for more relevant information, which was communicated through comment letters for the previous invitation to comment, launched by the IAASB in 2012.

Changes in the 2013 exposure draft include the attachment of revised standards and the addition of a new standards: the ISA 701 - *Communicating Key Audit Matters in the Independent Auditor's Report* (IAASB, 2013). As previously stated, the concept of providing matters of importance from the audit mission is not necessarily new in the auditor reporting field, because users and professional bodies have been pushing for more relevant information provided by the auditor report for some time now.

For instance, in 2007, the Financial Reporting Council (FRC) and the Audit Quality Forum (UK) have discussed how the auditor report can develop its current form in order to include more elements. One method could be a division of the

report: one part could discuss the audit of financial statements while the other can discuss other matters useful to users. The analysis is based on UK legislation (thus, has a strong tie to Companies Act 2006), but in our opinion it's also linked to EU legislation as well. ACCA also discusses this topic in 2010 – the possibility for the audit mission to bring further value, if it were to offer more specifics that are regarded as essential by users of financial and auditor reports. These facts include the auditor's opinion on risk management, corporate governance compliance and others. ACCA also discusses the concept of “real-time reporting”, which can be translated in more frequent audit missions, not only annual. Last but not least, the ACCA considers that communication between auditors and users is crucial, and that not only the management should have access to the “audit black box” – audit information before it's synthesised into the auditor report – but the shareholders as well.

What is new, though, is the expression “Key Audit Matters”, because it was only introduced in an official manner through the proposed ISA 701. The standard offers a simple, but precise definition of the concept: “Key audit matters are those matters that, in the auditor's professional judgement, were of most significance in the audit of the financial statements; KAMs are, in all cases, a selection of matters communicated with those charged with governance” (IAASB, 2013: ISA 701 p. 8).

Communicating KAMs requires the auditor to apply his professional judgement but also to take in account the nature and extent of communication with those charged with governance (TCWG). This is done to determine:

- whether any matters present a risk in accordance with ISA 315;
- whether, for the matter in discussion, it was difficult to obtain sufficient and appropriate audit evidence;
- whether the matter has required difficult judgement;
- whether the internal control system has drawbacks relating to the analysed matter (IAASB 2013, ISA 701: p. 11).

This process can be summarised as in the figure below (Figure 1):



Figure 1. Interpretation of the process of determining Key Audit Matters
(Source: authors' projection based on IAASB's ISA 701)

The key audit matters requirements are (AICPA, 2013):

- Describing the matters in key audit matters section of the report using appropriate subheadings for each matter;
- Including a reason the auditor considered the matter to be one of most significance in the audit, and its effect on the audit;
- Referring to a statement regarding the management's disclosure about the matter, if applicable;
- Including standard wording about key audit matters;
- When applicable, adding an explicit statement that the auditor determined there were no key audit matters to report;
- The requirement to determine and communicate key audit matters for a qualified or adverse opinion, prohibited for disclaimer of opinion.

The number of matters to be included in the auditor's report differs from case to case. KAMs are dependent of the size and complexity of the analysed entity, the nature and conditions of its business, and "the facts and circumstances of the audit engagement" (IAASB, 2013: ISA 701, p. A10). While the number of KAMs is not mandated, the IAASB considers that a number of two to seven matters should be included.

The wording of the questions from the invitation to comment, regarding the Key Audit Matters concept is listed below (IAASB, 2013: ITC):

- 1) **Question 1:** Do users of the audited financial statements believe that the introduction of a new section in the auditor's report describing the matters the auditor determined to be of most significance in the audit will enhance the usefulness of the auditor's report? If not, why?
- 2) **Question 2:** Do respondents believe the proposed requirements and related application material in proposed ISA 701 provide an appropriate framework to guide the auditor's judgment in determining the key audit matters? If not, why? Do respondents believe the application of proposed ISA 701 will result in reasonably consistent auditor judgments about what matters are determined to be the key audit matters? If not, why?
- 3) **Question 3:** Do respondents believe the proposed requirements and related application material in proposed ISA 701 provide sufficient direction to enable the auditor to appropriately consider what should be included in the descriptions of individual key audit matters to be communicated in the auditor's report? If not, why?
- 4) **Question 4:** Which of the illustrative examples of key audit matters, or features of them, did respondents find most useful or informative, and why? Which examples, or features of them, were seen as less useful or lacking in informational value, and why?
- 5) **Question 5:** Do respondents agree with the approach the IAASB has taken in relation to key audit matters for entities for which the auditor is not

required to provide such communication – that is, key audit matters may be communicated on a voluntary basis but, if so, proposed ISA 701 must be followed and the auditor must signal this intent in the audit engagement letter? If not, why? Are there other practical considerations that may affect the auditor’s ability to decide to communicate key audit matters when not otherwise required to do so that should be acknowledged by the IAASB in the proposed standards?

- 6) **Question 6:** Do respondents believe it is appropriate for proposed ISA 701 to allow for the possibility that the auditor may determine that there are no key audit matters to communicate?
 - a) If so, do respondents agree with the proposed requirements addressing such circumstances?
 - b) If not, do respondents believe that auditors would be required to always communicate at least one key audit matter, or are there other actions that could be taken to ensure users of financial statements are aware of the auditor’s responsibilities under proposed ISA 701 and the determination, in the auditor’s professional judgment, that there are no key audit matters to communicate?
- 7) **Question 7:** Do respondents agree that, when comparative financial information is presented, the auditor’s communication of key audit matters should be limited to the audit of the most recent financial period in light of the practical challenges (e.g., there would be an expectation that prior period matters would be updated even if not key in the current period, whether the inclusion of a matter might call into question why it was not included in the prior period)?
- 8) **Question 8:** Do respondents agree with the IAASB’s decision to retain the concepts of Emphasis of Matter paragraphs and Other Matter paragraphs, even when the auditor is required to communicate key audit matters, and how such concepts have been differentiated in the Proposed ISAs? If not, why?
- 9) **Question 13:** What are respondents’ views as to the appropriateness of the changes to ISA 700 described in paragraph 102 and how the proposed requirements have been articulated?
- 10) **Question 14:** What are respondents’ views on the proposal not to mandate the ordering of sections of the auditor’s report in any way, even when the law, regulation or national auditing standards do not require a specific order?

The other questions presented in the invitation to comment were omitted for this analysis because they refer to other aspects covered by the IAASB in the exposure draft, such as: going concern (the ISA 570 revision), transparency and compliance with independence and other ethical requirements.

2.1 Research methodology

This research method of content analysis has been used before in studies by authors such as Yen *et al.* (2007), Tiron & Muller (2009), Holder *et al.* (2013) and Simnett & Huggins (2014) for analysing comment letters of exposure drafts published by the IASB or FASB. Tiron & Muller (2009) apply the same method in a both quantitative and qualitative study which focuses on the European response to changes in Financial Reporting Standards. Concentrating on the European geographical space is also our approach for this study because there is a large number of EU replies (47, out of a total of 138), which also include many professional accounting or audit bodies, thus we consider that it is important to analyse the EU perspective on audit reporting proposed changes.

For this study, the data used comes from the replies (within the comment letters) to the ten selected questions regarding the Key Audit Matters concept, addressed by the IAASB within the exposure draft. The Exposure Draft was published in July 2013 and comments were received until November 2013. A number of 138 comment letters was received, most of them coming from English-speaking countries, like the US, Canada and the UK. These responses were collected and published by the IAASB on their website. The first step was to collect the data and construct a database of all the responses. For this analysis, we have only selected responses from comment letters issued by organisations, regulating bodies or individuals from within the EU. This counts for a total of 47 responses.

Subsequent, these answers were recorded and coded, in order to identify a similar pattern that would allow us to effortlessly work with the unstructured character of data, due to the fact that all of IAASB's questions are open. Each comment letter was inspected through a qualitative analysis of the text. Not all the respondents gave a specific answer to each question (or to all questions), and some have limited themselves only to the expression of a general opinion regarding the work plan of the Board. Thus, we have recoded the answers, as follows:

- Y (Yes), if the comment letter answers a question from the discussion paper, and generally agrees with what is proposed;
- Y* (Yes, with concerns), if the comment letter answers a question from the discussion paper, and although it agrees with what is proposed, several concerns are stated;
- N (No), if the answer in the comment letter is not in agreement with what is proposed, by offering a detailed reason for this, or by providing an altogether different vision;
- N/A (Not applicable), if the comment letter does not provide an answer to the question.

Using the above-mentioned coding, we introduced the data in SPSS and subsequently created a database that includes the following information (and coding in SPSS):

- Respondent type: 1 - Audit and assurance firms, 2 – Users of audit reports (preparers, investors, bankers, analysts), 3 - Professional accounting/audit bodies, 4 – Standard setters, 5 – Public sector organisations, 6 – Academics and other individuals.
- Country of origin;
- Each of the selected question, and the answers: 1 – Yes, 2 – Yes, with concerns, 3 – No, 4 – N/A.

We then extracted Graphs using the Chart Builder function and Crosstabs, to better illustrate differences between answers provided by different respondent types, or between answers at different questions, etc.

2.2 Responses analysis - quantitative analysis

Taking into consideration the proposed objectives, methodology and importance of this study, in the following paragraphs we expose our findings and provide some insight on each aspect depicted by each question.

As we've stated before, we have only selected those questions from the published Exposure Draft, which are related to our focus: aspects related to the concept of Key Audit Matters. This means that we've analysed Questions 1, 2, 3, 4, 5, 6, 7, 8, 13 and 14.

Only comment letters sent from individuals, regulating bodies or companies from within the EU (EU-28) were selected, because we wanted to focus our research on the opinion of these categories of interested parties from the European Union. Thus, we have counted the number of 47 comment letter replies of the 138 total comment letters.

We would like to start our analysis with general remarks regarding our data. From the 47 received answers, five have been sent by EU institutions, such as the European Federation of Accountants, the European Court of Auditors or the European Banking Authority. However, most of the comment letters were sent from the UK, a number of 20 replies. Amongst these, we can find three "Big 4" audit companies (PwC, KPMG and E&Y) but also several other relevant bodies such as the ACCA or the ICAEW. A detailed analysis of the country of origin from where the comments were sent can be seen in **Figure 2**.

A vast number of comment letters were received from the United Kingdom (43%), followed by Germany and the Netherlands (with 9%) and Belgium and Denmark (with 6%). 11% of the comment letters come from respondents that represent the

interest of more than one member country of the EU (11%). While many European countries are not represented in the figure because no interested parties have submitted any replies to the IAASB, one of the comment letters (from the European Audit Inspection Group) contains answers agreed and discussed by bodies from other EU countries such as: Austria, Greece, Denmark, Estonia, France, Germany, Ireland, Lithuania, Luxembourg, Portugal, Slovakia, Slovenia and Romania (the Public Interest Oversight Body of the Accounting Profession).

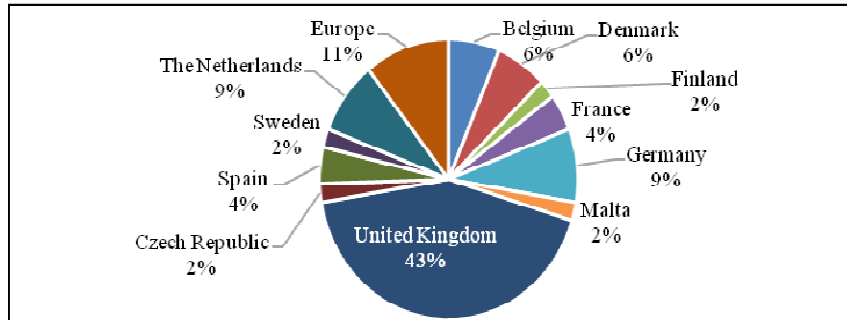


Figure 2. Percentage of answers origin (by country)

As seen in **Figure 3**, 34.0% of the answers are provided by Professional accounting/audit bodies, while 21.3% are responses provided by audit firms (such as KPMG, PwC, Ernst&Young, but also smaller audit firms like Grant Thornton or BDO International). Another 21.3% is expressed by users of audit reports, either investors or investments funds, bankers or banking analysts or preparers of audit reports. 14.9% is represented by public sector organisations (like the European Court of Auditors or the Spanish Accounting and Audit Institute). Several academics (three) have sent comments to the IAASB proposal, while only one standard setter (the European Audit Inspection Group, which comprises audit regulators from many EU countries).

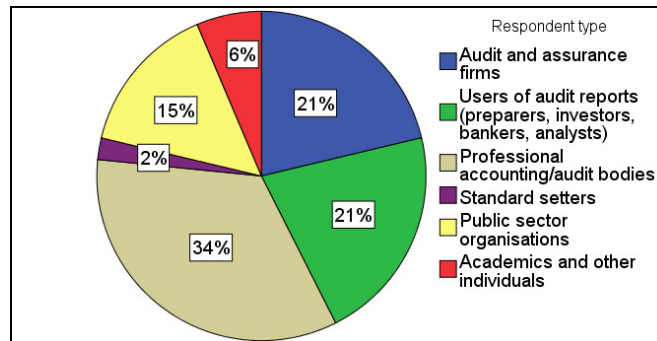


Figure 3. Percentage of answers by respondent type

In the next section, we will present our findings regarding each selected question.

1. **Question 1:** Do users of the audited financial statements believe that the introduction of a new section in the auditor’s report describing the matters the auditor determined to be of most significance in the audit will enhance the usefulness of the auditor’s report? If not, why?

Table 1. Question 1

Count		Yes	Yes, with concerns	No	No answer	Total
Respondent type	Audit and assurance firms	4	3	1	2	10
	Users of audit reports (preparers, investors, bankers, analysts)	7	1	2	0	10
	Professional accounting/audit bodies	12	4	0	0	16
	Standard setters	1	0	0	0	1
	Public sector organisations	5	2	0	0	7
	Academics and other individuals	3	0	0	0	3
Total		32	10	3	2	47

As seen in **Table 1**, the inclusion of a new section in the auditor report regarding key audit matters is regarded as beneficial to 32 users (66% percent of the cases) – these responses entirely agree with the IAASB proposals and believe that they would bring further insight from an audit mission. Most of the professional accounting/audit bodies agree with IAASB’s proposals.

21% of the answers (10 answers), such as the one by PricewaterhouseCoopers and KPMG, raise concerns regarding the manner in which this section will be drafted in order to achieve its purpose or what exactly “most significant matters” are and how they should be selected. Others also argue that the new proposals would delay the reporting process or would reduce the impression of auditor responsibility (Germany’s Wirtschaftsprüferkammer).

Only 6% (3 answers) of the respondents believe that such a section is not necessary, on the basis that it would complicate the report even more than it is, while others consider that more information is needed. Last but not least, in 6% of the cases there are either no comments regarding this aspect or the respondents have decided not to comment.

2. **Question 2, 1st Part:** Do respondents believe the proposed requirements and related application material in proposed ISA 701 provide an appropriate framework to guide the auditor’s judgment in determining the key audit matters? If not, why?

34% of the respondents agree that the framework is appropriate and sufficient in determining KAM. Another 32% of the respondents have certain concerns, such as a lack of guidance illustrations where situations can be interpreted as key audit

matters, but also the length of the KAM paragraph – all these concerns are related to the hindrance of providing boilerplate information.

However, 21% of the replies consider that the framework for assessing KAM are more or less experimental, and should provide further guidance. Moreover, many have said that more time will be needed to determine the best practices; also, some believe that these proposals will add difficulty in formulating an audit report, at least in the commencement phase of the implementation. Finally, 13% have not commented this question.

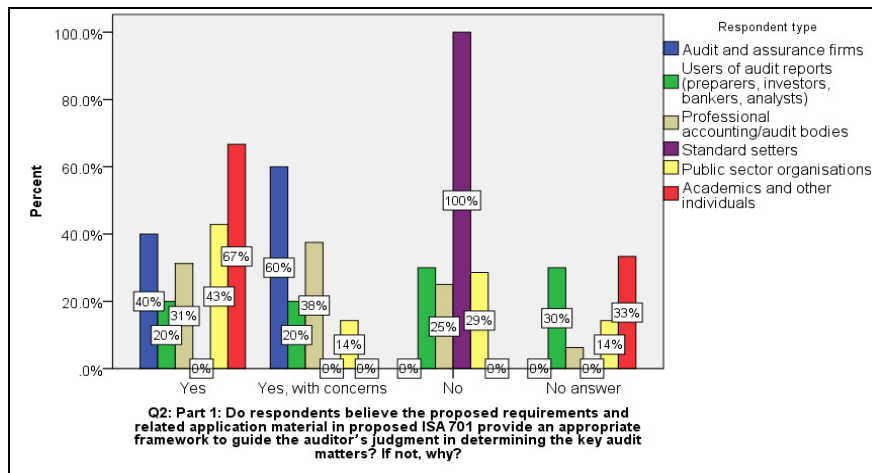


Figure 4. Question 2, 1st part

Figure 4 contains an analysis of responses regarding the appropriateness of the proposed framework, by respondent type. We can note that the European Audit Inspection Group (standard setter) disagrees with this proposal. 40% of audit firms are in agreement with the proposed requirements (but not Big-4 auditors), and the other (60%) audit firms agree, but have some concerns (KPMG, PwC and E&Y). A third of the academics and users have chosen to not answer this question. Another observation is the fact that only 20% of the users who have responded either agree or have concerns (20%).

3. **Question 2, 2nd Part:** Do respondents believe the application of proposed ISA 701 will result in reasonably consistent auditor judgments about what matters are determined to be the key audit matters? If not, why?

A third of the comment letters replies have not provided an answer to this question – 32% as seen in Figure 5. It is worrying to see that 60% of the users have not provided an answer, given that the IAASB has proposed these changes to fit user’s needs. Also, many audit firms have not provided an answer here.

Only a total of 19% of the respondents believe that the application of proposed ISA 701 will provide reasonably consistent auditor judgements about KAM because the suggestions focus on key risks, difficulties and deficiencies in the audit process. 67% of the academics consider that the application of proposed ISA 701 will result in reasonably consistent auditor judgments.

Some of the replies (21%) bring into discussion several concerns mainly because regardless of the provided framework, professional judgement will differ because of exterior factors – either regional, regulatory or because of a company’s activity sector.

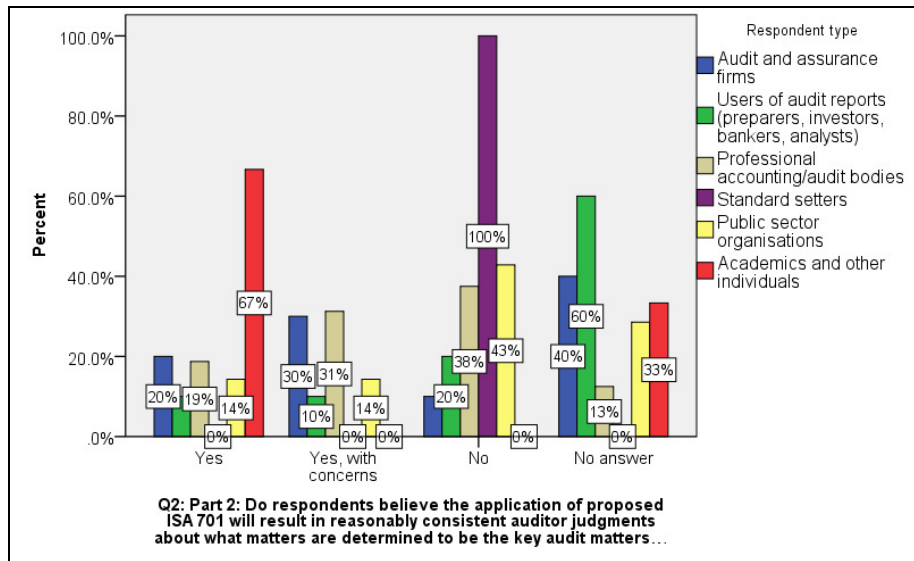


Figure 5. Question 2, 2nd part

In 28% of the replies, respondents believe that more efforts are needed in this aspect especially in ways to link the KAM with the Emphasis of Matter paragraph. Some have suggested that the IAASB should provide a list of aspects that should not be considered as KAMs – in order to mitigate the risk of diluting their importance. Also, the Board will need to provide educational materials for users to facilitate their understanding of the new proposals.

As noted at the first part of this question, the European Audit Inspection Group disagrees with this proposal. We also take notice that many professional accounting/audit bodies do not agree with IAASB on this matter: many find the ISA 701 is not clear enough as to where to include a matter within the audit report, in the EoM paragraph, or in the KAM new paragraph. On behalf of 43% of the public sector organisations that disagree, the European Court of Auditors considers

that the proposals will bring implementation problems. Among the audit firms that do not agree with proposals is PwC, who consider that the proposed ISA 701 needs to be substantially improved in order to provide reasonably consistent auditor judgments.

4. **Question 3:** Do respondents believe the proposed requirements and related application material in proposed ISA 701 provide sufficient direction to enable the auditor to appropriately consider what should be included in the descriptions of individual key audit matters to be communicated in the auditor’s report? If not, why?

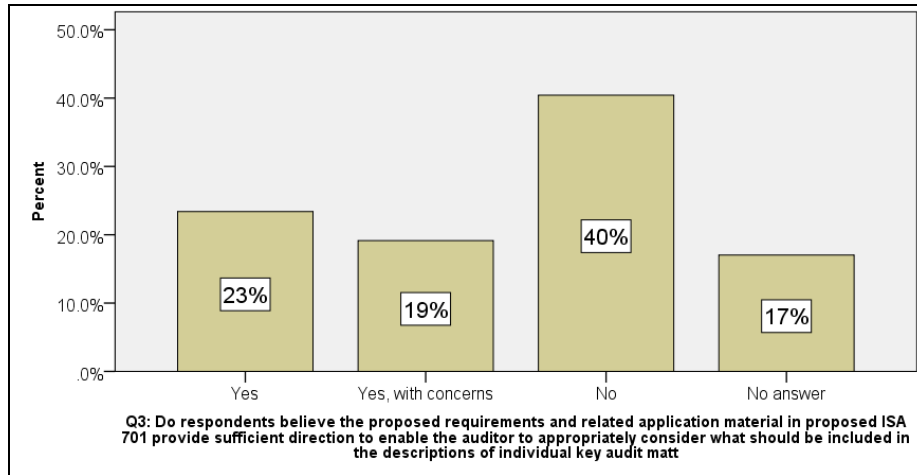


Figure 6. Question 3

As discussed in the analysis of answers to the 2nd question, many respondents (40%) believe that the proposed requirements do not provide sufficient direction on what descriptions each KAM an auditor should provide, but offer input with regards to improvements. FEE (Federation of European Accountants) and PwC believe some paragraphs of the proposed ISA 701 lack clarity and could be interpreted in numerous ways – one particular concern is whether KAM’s should be included in the Going Concern section, if they refer to this point. This is contrary to what the ACCA believes – that by prescribing how KAMs should be reported, innovation would be undermined. The German Auditor Chamber raises questions regarding confidentiality issues with KAM communication, while others believe the Board should adopt a different approach and specify what items qualify as KAMs.

17% of the replies have not commented on this aspect, while 23% agree that the Board has provided all that is necessary. 19% of the respondents also agree but

have some concerns. Ernst&Young believes that a clarification on the term “of most significance” is needed – should the audit provide KAMs that are thought to be of most significance to the users or to the auditors?

5. **Question 4:** Which of the illustrative examples of key audit matters, or features of them, did respondents find most useful or informative, and why? Which examples, or features of them, were seen as less useful or lacking in informational value, and why? Respondents are invited to provide any additional feedback on the usefulness of the individual examples of key audit matters, including areas for improvement.

Many of the respondents have chosen not to reply to this question as seen by the percentages of N/A. Others (15%) argue that such examples should not have been included because they are prone to become boilerplate or influence report language – which is already considered too standardised. Others have chosen one of the four provided examples as either useful or less useful as seen in Table 2 and Table 3.

Table 2. Examples of KAMs found useful by respondents

Revenue Recognition	Goodwill	Valuation of Financial Instruments	All	None	N/A
6%	9%	15%	11%	15%	45%

Many (15%) of the answers consider that none of the provided examples are of value. KPMG, for instance, considers that “they are very generic and without context”. PwC disagrees with this and reflects that all the illustrations are useful, and are a good start for examples of KAMs but should be improved for the final standards. The illustrative example of “Valuation of Financial Instruments” was considered useful by 15% of the respondents. The FEE ponders that the background, the audit response and the conclusion are well presented. The French Accounting Experts organization (CNCC) considers that the “Goodwill” example is useful because “it includes a description of audit procedures performed and the outcome”.

Table 3. Examples of KAMs found less useful by respondents

Revenue Recognition	Goodwill	Valuation of Financial Instruments	Acquisition of XYZ Business	Explanatory Memorandum	N/A
6%	2%	2%	15%	4%	70%

“Acquisition of XYZ Business” is considered a weak example provided by the IAASB, by 15% of the respondents. The FEE considers it brings no added value to users and can be actually considered an EoM, and not a KAM. Other believe that the information it conveys is already available in the disclosures available prior to the audit mission. Grant Thornton is among the 6% that reflect that the weakest example is “Revenue Recognition” because of the potential of becoming boilerplate over time.

6. **Question 5, 1st Part:** Do respondents agree with the approach the IAASB has taken in relation to key audit matters for entities for which the auditor is not required to provide such communication – that is, key audit matters may be communicated on a voluntary basis but, if so, proposed ISA 701 must be followed and the auditor must signal this intent in the audit engagement letter? If not, why?

Table 4. Question 5, 1st part

Count		Response				Total
		Yes	Yes, with concerns	No	No answer	
Respondent type	Audit and assurance firms	7	3	0	0	10
	Users of audit reports (preparers, investors, bankers, analysts)	3	0	1	6	10
	Professional accounting/audit bodies	11	3	1	1	16
	Standard setters	0	1	0	0	1
	Public sector organisations	5	1	0	1	7
	Academics and other individuals	1	0	1	1	3
Total		27	8	3	9	47

57% of the replies agree with the approach taken by the IAASB regarding the mandated inclusion of KAM in auditor reports of listed companies. Most of the „Professional accounting/audit bodies” are in agreements in IAASB’s approach for this matter, like the ACCA. ACCA and KPMG see no problems with communicating KAMs on a voluntary basis for other companies as well, but, like the IAASB proposes, such intentions need to be agreed upon with the management.

17% of the replies have raised some concerns regarding this aspect: Ernst&Young, for instance, argue that the ISA 701 is unclear as to whether the decision to report KAMs has to be made in each reporting period or if the standard is to be applied on an ongoing basis. Other replies disagree with the IAASB’s approach and imply for firmer rules in order to limit the practice of “opinion shopping”.

6% of the respondents believe that more need to be done in implementing the KAMs: the IAASB should extend their use to public interest entities. Also, several concerns are raised regarding the voluntary use of KAMs only when it’s convenient.

Last but not least, 19% of the answers have not commented on this question. Many respondents from the „users” category have not provided an answer to this question as seen in **Table 4**.

7. **Question 5, 2nd Part:** Are there other practical considerations that may affect the auditor’s ability to decide to communicate key audit matters when not otherwise required to do so that should be acknowledged by the IAASB in the proposed standards?

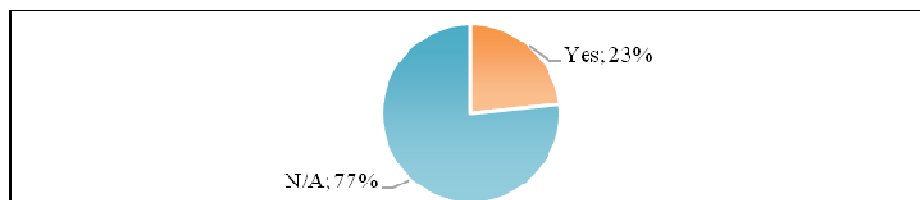


Figure 7. Question 5, 2nd part

Regarding practical considerations that could affect KAM communication, 77% of the respondents have not explicitly answered, but we believe this is because they have found none. The other 23% agree that there are some practical considerations, such as: FEE reports the need of a mechanism to prevent the voluntary applicability of ISA 701 only when it’s convenient, while the ACCA brings confidentiality and fee issues in discussion. In other replies, the respondents have reported that more information is needed as they are unclear whether they could apply the ISA 701 mid-way through an audit mission, for instance.

8. **Question 6:** Do respondents believe it is appropriate for proposed ISA 701 to allow for the possibility that the auditor may determine that there are no key audit matters to communicate?
- a) If so, do respondents agree with the proposed requirements addressing such circumstances;
 - b) If not, do respondents believe that auditors would be required to always communicate at least one key audit matter, or are there other actions that could be taken to ensure users of the financial statements are aware of the auditor’s responsibilities under proposed ISA 701 and the determination, in the auditor’s professional judgment, that there are no key audit matters to communicate?

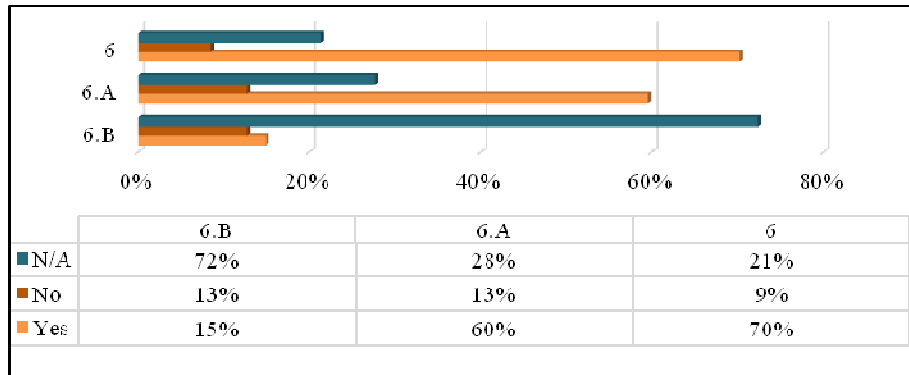


Figure 8. Question 6

Regarding the possibility for the auditor to not report any KAMs, 70% of the responses argue that this possibility should be allowed, while 9% believe that it should not, as seen in Figure 8. Germany’s Auditor Chamber, for instance, “find it hard to imagine situations in which no KAM can be identified in listed companies”. The remaining 21% of replies have not commented Question 6.

As for Question 6.a), which is the sequel of 6, dealing with the proposed actions should the situation presented at Question 6 occur, 60% of answers find them to be appropriate. Still, we would like to point out that while they agree, many answers show that users consider that this situation will rarely or never appear. Germany’s Auditor Chambers is amongst the 13% that do not agree with the proposed requirements regarding these circumstances and believe that the sole presence of paragraphs dealing with this situation may lead to problems in communicating KAMs.

Regarding Question 6.b), as to whether the auditor should be required to always communicate at least one KAM, 72% have chosen not to answer while 15% agree and 13% also disagree. On one hand, some respondents (such as PwC) agree with this on the basis that it’s impossible not to find at least one KAM, but on the other hand, other respondents plead for flexibility (especially since the ISA 701 can be voluntarily applied to non-listed entities, where KAM would not mandatory).

9. **Question 7:** Do respondents agree that, when comparative financial information is presented, the auditor’s communication of key audit matters should be limited to the audit of the most recent financial period in light of the practical challenges explained in paragraph 65? If not, how do respondents suggest these issues could be effectively addressed?

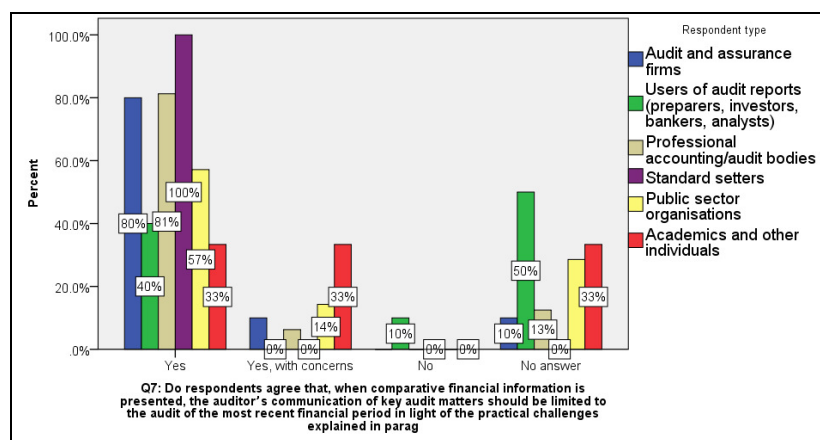


Figure 9. Question 7

Concerning the 7th question, 66% of the responses are in favour of limiting the KAMs to the audit of the most recent financial period. Almost all audit firms agree with this aspect (80%). 81% of the accounting/audit professional bodies are also in agreement.

9% agree, but have some concerns and consider that, while the KAMs should limit to the most recent financial period, adjustments from previous period should be taken into consideration – and if they had led to a KAM, they will probably lead to the inclusion of a KAM in the current period as well. The ACCA, for instance, considers that the possibility to include a KAM from the previous period should exist.

2% of the respondents disagree and argue that KAMs from the preceding period should also be analysed, with their effect on the current reporting period. They should be presented in an Appendix, according to the International Corporate Governance Network (UK).

- Question 8:** Do respondents agree with the IAASB's decision to retain the concepts of Emphasis of Matter paragraphs and Other Matter paragraphs, even when the auditor is required to communicate key audit matters, and how such concepts have been differentiated in the Proposed ISAs? If not, why?

Almost half (49%) the answers in the comment letters agree with the IAASB's decision to retain the Emphasis of Matter (EoM) and Other Matters sections in the report. As seen in Table 5, 9 out of ten audit firms agree with the decision, while only 50% of professional accounting/audit bodies have the same opinion. KPMG,

the WPK and the ACCA, amongst others, agree that these paragraphs contain other matters that do not qualify as KAMs but are still relevant in auditor’s judgement and to users’ understanding of the audit.

Table 5. Question 8

Count		Yes	Yes, with concerns	No	No answer	Total
Respondent type	Audit and assurance firms	9	1	0	0	10
	Users of audit reports (preparers, investors, bankers, analysts)	2	2	3	3	10
	Professional accounting/audit bodies	8	5	1	2	16
	Standard setters	1	0	0	0	1
	Public sector organisations	2	4	1	0	7
	Academics and other individuals	2	0	0	1	3
Total		24	12	5	6	47

28% are in favour of retaining these paragraphs, but consider there is a need to further clarify the interaction between KAM and the aforementioned paragraphs (FEE) or if they should be used together. Grant Thornton, for instance, considers that the EoM paragraph should be re-thought, because it seems redundant once KAMs are introduced.

However, 11% of the answers reflect that if KAMs are introduced, EoM of other matter sections should no longer be permitted (European Court of Auditors). As seen in Table 5, 13% of the respondents have not provided an answer to this enquiry.

- Question 13:** What are respondents’ views as to the appropriateness of the changes to ISA 700 described in paragraph 102 and how the proposed requirements have been articulated?

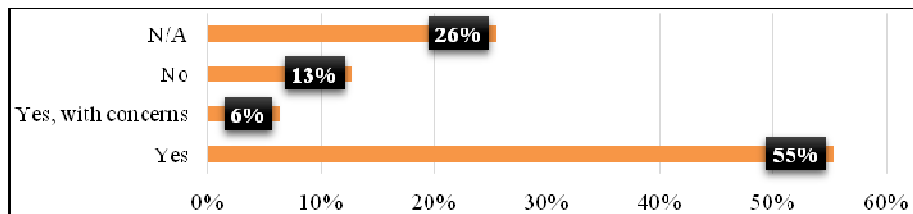


Figure 10. Question 13

55% believe that the changes to ISA 700 described in paragraph 102 of the Exposure Draft are appropriate and that the proposed requirements provide a fuller, more robust audit report, with improved clarity. However, while most respondents welcome the description of the auditor’s responsibilities in the revised ISA 700,

some (6%) have concerns concerning their potential relocation to a website of the appropriate authority or to an appendix of the auditor report. With regards to the same aspect, 13% are against these changes: Germany’s WPK believes that no information should be relocated to a website because it might affect user’s perception of auditor responsibility and increase the audit expectation gap.

12. **Question 14:** What are respondents’ views on the proposal not to mandate the ordering of sections of the auditor’s report in any way, even when law, regulation or national auditing standards do not require a specific order?

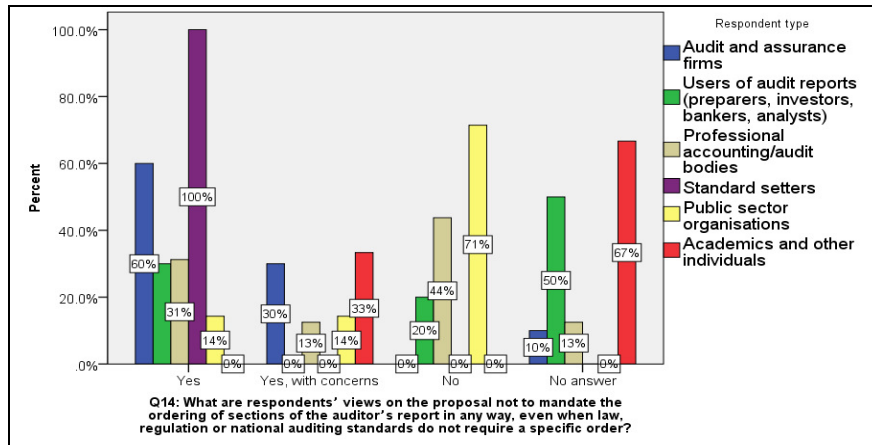


Figure 11. Question 14

When it comes to the section orders of the audit report, the IAASB has proposed more flexibility, but the responses provided in the comment letters suggest that opinions on this matter are divided. 34% of the respondents agree with this proposal because it provides flexibility in order to allow the tailoring of the report in different jurisdictions or circumstances, as the ACCA points out. 60% of the audit firms are in this position, and 30% of the users as well.

Another 15% of the respondents are in agreement with this proposal, but have several concerns: some believe the report should always have a consistent structure and should start with the opinion. On the contrary, others suggest the report should first provide the findings, and only after that, the opinion.

30% of the total responses consider that a mandated order of the report section should be kept, in order to enable users to identify concerns quickly and easily across any jurisdiction. The rest of 21% of all the replies have not commented on this aspect, which includes 67% of the academics and 50% of the users.

3. Conclusions

Auditor reporting has become a key topic in the accounting and audit sphere because of its impact on the reliability of financial statements, and, in the end, on the decision-making process of investors and stakeholders. Nowadays, the users of audit reports feel that the auditors have more knowledge about their companies than themselves, which in their opinion is frustrating and unsettling. Auditors are being criticised for using a much too standardised language, for not explaining how they have reached the opinion they provide within the audit report, and for not communicating sufficiently with the people whose interest they should protect – shareholders and potential investors. Thus, the IAASB has pushed for, in the last years, the clarification of auditing standards, with a focus on audit reporting and audit quality. The need for new and improved audit reports is not a new necessity. In this aspect, though the 2013 Exposure Draft, the IAASB is proposing the introduction of Key Audit Matters. In answering the question “how and why we need Key Audit Matters”, we have analysed the answers given by the respondents to the invitation to comment, in order to emphasize the importance of the Key Audit Matters. A summary of the responses can be seen in Table 6:

Table 6. Summary of questions answers, with answer percentages

Question / Answers	Yes	Yes, with concerns	No	N/A
1	66%	21%	6%	6%
2. 1 st part	34%	32%	21%	13%
2. 2 nd part	19%	21%	28%	32%
3	23%	19%	40%	17%
5. 1 st part	57%	17%	6%	19%
5. 2 nd part	23%	0%	0%	77%
6	70%	0%	9%	21%
6.A	60%	0%	13%	28%
6.B	15%	0%	13%	72%
7	66%	9%	2%	23%
8	49%	28%	11%	13%
13	55%	6%	13%	26%
14	34%	15%	30%	21%

Most of the answers regarding the introduction of KAMs in the auditor report are favourable, with more than 87% being in agreement (with 21% raising several legitimate concerns). While many agree with the IAASB’s proposal, almost 50% of the replies either have small concerns regarding the implementation or believe that the regulating body still has to put in efforts in order to provide an appropriate framework to guide the auditor judgement in determining KAMs. Although the

IAASB has even provided examples of KAMs, we agree with most respondents who believe they are not enough. While we agree that this new section should be mainly implemented by listed companies, we consider that, sooner or later, it should be extended as a mandatory addition to all audited companies. This is because we believe KAMs provide more information relevant to users.

The audit profession continues to face numerous, multifaceted challenges. Investors and markets rely on the ability of the profession to overcome them. As it has in the past, the profession will do so – meeting not only the known challenges, but also the unknown, as they unfold. Regarding the need of more transparency in audit missions, the IAASB has released a 2014 Feedback Statement on Audit Quality, in which it reaffirmed its desire and goal to improve audit quality by making audit missions more transparent to users.

One limitation of this study is that we have chosen to only use answers provided to the ITC from EU interested parties. Another limitation is the fact that we could not engage in a more in-depth statistical analysis of the data, because of the ambiguous nature of “open” questions and responses. In future studies we plan on analysing all answers provided by respondents at the Invitation to Comment, and find a better coding system, that would allow a more thorough analysis. Also, we plan to expand our research to other audit-related issues, which are IAASB’s concerns.

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