Key audit matters: a systematic review

Abstract: Key audit matters (KAMs) play a substantial role in financial reporting and have garnered increasing attention in recent years. This systematic review of 117 papers and reports published between 2013 and 2023 contributes to the audit and financial reporting field by identifying research gaps and suggesting areas for future research. The findings show that KAMs impact financial reporting and emphasise the need for further investigation into their effectiveness in improving financial reporting quality. This study provides valuable insights for regulators, stakeholders, and the academic and professional community and highlights the importance of future research on KAMs to assess the success of regulatory changes in audit reporting.

Keywords: KAMs; key audit matters; extended audit report; audit quality; financial reporting.

1 Introduction

This paper aims to review and synthesise the key audit matters (KAMs) literature in order to

1 identify and synthesise the current state of knowledge related to the determinants and consequences of KAMs

2 identify the current concerns and challenges related to KAMs

3 identify gaps in the existing literature and provide suggestions for future research.

Key audit matters (KAMs) are "those matters that, in the auditor's professional judgement, were of most significance in the audit of the financial statements of the current period. Key audit matters are selected from matters communicated with those charged with governance" (ISA 701, Para. 8). Determining and communicating KAMs are based on the auditor's professional judgement and assessment of the risks involved in the audit. KAMs are required to be communicated in the Extended Auditor Report (EAR), as they are considered to be of critical importance to the understanding of the financial statements. KAMs are intended to provide users of financial statements with more insight into the audit process and to enhance the transparency of the financial reporting and audit. An increasing number of prior studies investigate the practices of extended auditor reports with more focus on KAMs. Our study reviews prior studies on KAMs aiming to shed more light on the determinants and consequences of KAMs and proposing areas for future research.

In early 2011, the Financial Reporting Council (FRC) published a Consultation Paper titled "Effective Company Stewardship – Enhancing Corporate Reporting and Audit", which included several recommendations. One of these recommendations was the implementation of extended audit reports to improve the communicative value of the auditor's report. Another recommendation stressed the importance of rebuilding stakeholder trust by including all material matters, known as key audit matters (KAMs), in the report. These recommended changes were incorporated into auditing standards in response to the Consultation Paper. As a result, the EU passed new regulations (2014/56/EU) and (537/2014/EU) on June 16, 2014. The implementation period for these regulations lasted until June 17, 2016, during which companies were expected to adopt the new standards (Löw and Lukas, 2019). Since this implementation, several phases of global approaches have been in place to change the independent audit report's style and contents (Sierra-García et al., 2019).

The outburst of the financial crisis and corporate scandal brought a global phenomenon to the attention of policymakers and academics. Stakeholders demanded new auditing regulations to increase transparency and the level of information. Consequently, the UK mandated the new ISA 701 KAMs to decrease the information gap between auditors and stakeholders. However, academic research has not conclusively determined whether the new regulation achieved its target. The lack of standardised templates for KAMs makes it unclear how impactful they are empirically. Therefore, this paper's findings are relevant to academics and standard setters by providing research opportunities to fill the gaps in the KAMs literature.

Our review shows that there is a debate in the literature on the determinants and consequences of KAMs (Bédard et al., 2014, 2016, 2019; Jermakowicz et al., 2018; Al Lawati and Hussainey, 2022; Elmarzouky et al., 2022a). Some studies consider the market and investors' reactions to KAMs (e.g., Velte and Issa, 2019; Christensen et al., 2014). Other studies investigate the impact of KAMs on audit and financial reporting quality (e.g., Reid et al., 2019; Gold et al., 2020). At the same time, the third group of studies investigate the determinants of auditors' disclosure in the EARs, particularly in the KAMs section (e.g., Wuttichindanon and Issarawornrawanich, 2020; Abdelfattah et al., 2021; Florou et al., 2022).

One of the key issues surrounding KAMs is their perceived value and usefulness to stakeholders. While proponents argue that KAMs provide more transparency and insight into the audit process, critics claim that they are often too generic, overly positive, and fail to capture the actual risk of material misstatements in financial statements. Several studies have attempted to explore the value and effectiveness of KAMs from various stakeholder perspectives, such as auditors, audit committees, investors, and regulators. However, the findings have been mixed and inconclusive, with some studies suggesting that KAMs have a limited impact on decision-making, while others argue that they enhance the credibility and reliability of financial reporting. Therefore, further research is needed to clarify the value and effectiveness of KAMs and to identify factors that influence their perception and interpretation by different stakeholders.

Our review also shows that KAMs have a significant impact on the financial reporting process, and there is a need for further research to understand their effectiveness in improving the quality of financial reporting. Our review includes theoretical and empirical studies on KAMs and their role in financial reporting. The review identified gaps in the literature, such as a lack of studies on the implementation and effectiveness of KAMs and their impact on the quality of financial reporting. The study provides a comprehensive overview of the current state of research on KAMs and suggests avenues for future research. The key value of this paper is to shed light on the importance of KAMs in the financial reporting process and the need for further research to understand their impact on the quality of financial reporting.

Finally, our review shows no agreement on the determinates and consequences of KAMs. Interestingly, our conclusion shows significant limitations in the current literature. These limitations on the previous literature are mainly because of not considering the industry type and the sample size was relatively small due to the newness of KAMs topic in the research domain (Bédard et al., 2014, 2016; Jermakowicz et al., 2018; Reid et al., 2019; Velte and Issa, 2019).

Our paper contributes to literature by reviewing academic and professional papers on KAMs. It provides a framework for understanding of KAMs at international and national levels, which helps better understand the rationale beyond KAMs. We also reviewed literature on the determinants and consequences of KAMs. Finally, we identify a number of research gaps and suggest ideas for future research.

The paper is organised as follows. Section 2 discusses the research method. Section 3 critically and systematically reviews the current literature on the determinants and consequences of KAMs. Sections 4 discusses the main concerns and challenges on KAMs. Section 5 concludes the paper and offers a discussion on research gaps and suggestions for future research.

2 Research method

Following Snyder (2019), we conduct a systematic literature review to critically evaluate the literature on the determinants and consequences of KAMs. We include papers with an empirical or review section on the determinants and consequences of KAMs. When embarking on a comprehensive critical review, carefully highlighting the main objectives to consider the research parameters, including scope and timespan, is vital. This review will clarify the evidence base of journals and abstracts on this topic.

Methods and criteria for including studies in the review

Although the most recent review relies on published papers in high-ranked journals, we decided to include all internationally recognised peer-reviewed papers on this topic. This is vital because the new extended audit report was recently introduced in the UK in 2013, and KAMs became mandatory internationally in 2016. Therefore, we are not able to conduct a sufficient number of research and investigations based on restricted rules. Our paper complements the work of Velte and Issa (2019) and Gold and Helimann (2019), which provides a literature review of the impact of KAMs disclosure in audit reports on stakeholders' reactions. It provides up-to-date literature on KAMs and includes papers not included in the previous reviews. As a systematic literature review should have a specific purpose and research question to be addressed (Snyder, 2019), our review aims to shed light on the KAM and EAR literature to identify research gaps and suggest areas for future research. We also refer to the standard setters reports such as FRC, ICAEW, IOSCO, IAASB and PCAOB linked to the Extended Audit Report (EAR) or KAMs.

Snyder (2019, pp.336–337) argues that "once the research question has been identified and an overall review approach considered, a search strategy for identifying relevant literature must be developed. This includes selecting search terms and appropriate databases and deciding on inclusion and exclusion criteria". We, therefore, set the following inclusion and exclusion criteria:

Inclusion criteria:

We set the following inclusion criteria:

- Articles should be directly related to KAMs and mentioned in the title or the abstract.
- Articles should be directly related to the EAR and mentioned in the title or the abstract.
- Reports issued by standard setters and professional bodies linked to EAR or KAMs.

Exclusion criteria:

We set the following exclusion criteria:

- Any incomplete research such as conference abstract, comments, or if is no abstract available.
- Studies that primarily targeted different objectives or focused on different empirical effects.
- Studies that are not published in the English language.

Search method:

We use keywords such as key audit matter(s), KAM(s), and EAR(s) to search relevant papers in Google scholar and Scopus. We also track papers' references using the google scholar tool. We search for relevant research by contacting experts or academics in the field. We also consider conference papers. Our search covers the period from June 01, 2013, till March 31, 2023. Our review covers 117 academic papers and reports. We review standard setters reports such as FRC, ICAEW, IOSCO, IAASBY and PCAOB. In addition, we review the relevant reports issued by Big4.

3 Literature on KAMs

This section reviews prior studies on KAMs and highlights the research gaps in recent literature. We start with studies on the determinants of KAMs, followed by the prior studies on the consequences of KAMs.

3.1 The determinates of KAMs

A few prior studies investigate the determinants of KAMs, focusing mainly on firm and auditor characteristics. Looking at the factors affecting the number of KAMs, Pinto and Morais (2019) find that complexity, accounting standards precision, and audit fees are related to the high number of disclosed KAMs. Similarly, Ferreira and Morais (2019) provide empirical evidence of a significant relationship between firm characteristics and KAMs. This relationship was positive in terms of Big4 and the complexity but negative with audit fees. The study also finds that the relationship with profitability is insignificant. Focusing on state ownership and political connection as determinants of KAMs' disclosure, Florou et al. (2022) provide evidence from China that State-Owned Enterprises are more likely to receive fewer KAMs and avoid having KAMs on topics such as inventory and related party transactions than non-state-owned enterprises. This relationship is more pronounced in firms with a politically connected chairperson and concentrated ownership. Kitiwong and Srijunpetch (2019) investigate the impact of national culture on the choice of KAMs in Thailand, Malaysia and Singapore. The authors conclude that national cultural characteristics do not affect the number and type of disclosed KAMs. However, auditors in a country with high uncertainty avoidance avoid reporting entity-specific KAMs in the first years of KAMs adoption (Kitiwong and Sarapaivanich, 2020). Another strand of literature investigates the impact of audit partner characteristics on KAMs reporting (Rousseau and Zehms, 2020; Abdelfattah et al., 2021). Rousseau and Zehms (2020) document the role of the audit partner and find that the audit partner's style affects the similarity KAMs reporting more than the audit firm's style. Abdelfattah et al. (2021) provide evidence from the UK that audit partner gender is a determinant of KAMs disclosure. They find that female audit partners disclose more KAMs in more detail than male audit partners. The study also finds that the audit reports from female audit partners are less readable and have a less optimistic tone than male audit partners. Looking at the relationship between audit-firm profitability and KAM reporting, Chen et al. (2023) find empirical evidence that audit-firm profitability positively affects audit effort and audit outcomes, disclosing more KAMs. The study also finds that the effect of profitability on KAMs is weaker in loss-making client firms, which is consistent with the notion that audit-firm profitability is less likely to affect audit outcomes in more risky clients.

3.2 KAMs readability

Investigating the link between financial expertise and KAMs readability has also been highlighted in the literature. Velte (2019) examines the association between audit committee financial expertise and the readability of KAMs. The study finds that the combination of financial and industrial expertise has a more even positive effect on the readability of KAMs. While the study focused on the notion that the audit committee shaped KAMs, the role of the audit partner characteristics and the alignment with the audit committee report might deserve more investigation.

A cross-country research by Ciğer, Vardar, and Kınay (2019) aims to check the similarity and the difference in the heading and subheadings across CEE countries (Central and Eastern Europe countries) and Turkey. The study suggests that the heading is similar across the CEE countries, and KAMs are not unique across the sample.

However, the study applied only to the manufacturing industry sector. Further research might consider all the industries to examine the stability of this finding.

Velte (2018) also investigates the association between the level of females on the audit committees and KAMs; this study applied to the UK context from 2014 to 2015. He finds that the higher percentage of women on the audit committees, the more readable KAMs using the Flesch index. He also provides evidence using additional Fog and Blau index analysis to assess the readability. The study also did not consider the independent auditor characteristics as determinants for KAMs, which can be investigated in future research.

3.3 The consequences of KAMs

3.3.1 KAMs and audit quality

Auditors are considered an agent for the stakeholders and intend to ensure an appropriate level of audit quality (Velte and Issa, 2019). There is a current global argument on the KAM's consequences and the effectiveness of the audit quality (Wu et al., 2019; Knechel et al., 2013; Czerney et al., 2019). Previous literature even wholly disagrees with the nature and the benefit of KAMs to the stakeholders (Abdullatif and Al-Rahahleh, 2020) as they argue it is just a change in style with no additional benefits to the stakeholders. However, the lengthy format might provide additional information to the stakeholders.

Previous literature suggested a positive association between KAMs and audit quality (Li, 2020; Reid et al., 2016; DeFond and Zhang, 2014; Kitiwong and Sarapaivanich, 2020). Further studies assess the management and director's perception of KAMs, such as; Boolaky and Quick (2016), who explore banking directors' perception and Christensen et al. (2014), who assessed investors' reaction to KAMs. Using the New Zealand context, Li et al. (2019) find that the existence of KAMs will increase the audit quality. From the USA context, Kachelmeier, Rimkus, Schmidt, and Valentine (2020) support the view that the forewarning effect of CAM disclosures involving measurement uncertainty could mitigate perceived auditor responsibility for CAM-related material misstatements. Bens et al. (2019) document a reduction in bid-ask spread and the variability of earnings forecasts made by security analysts when the new audit reporting standard was in place. The decline was more significant in UK firms subject to the new regulation, as determined by a difference-in-difference analysis between the UK firms and non-adapting firms in the same country. The research also finds that the quality of financial reporting improved under the new regulation with higher earnings response coefficients, lower discretionary accruals, an increased perception of earnings quality by an independent financial firm, fewer accounting restatements, and a higher likelihood of a going concern opinion.

Sirois et al. (2018) highlight that the implementation of KAMs had increased the attention of the stakeholders regarding the risk topics on the annual reports, increasing the audit quality. In contrast, Gutierrez et al. (2018) provide evidence that there is no such relation between the existence of KAMs and audit quality. Lynch et al. (2021) investigate the effects of tax KAMs and find that they can have unintended impacts on the relationship between auditors and clients and on firms' tax avoidance practices. The study finds that firms that no longer receive tax KAMs tend to increase their future use of auditor-provided tax services and engage in more tax avoidance in subsequent years. Tax-related disclosures through KAMs can create proprietary and political costs as it reveals the firms' tax strategies to tax authorities, competitors, and the public. According to the findings of Porumb et al. (2021), the implementation of the expanded auditor's report is connected to decreased loan spread and extended maturity for loan facilities of adopting firms compared to non-adopting firms in the UK. When examining adopting firms in the post-adoption period, the study discovered that a higher number of KAMs mentioned in the auditor's report but not in the audit committee report is positively correlated with loan spread. However, it does not affect loan maturity or the number of lenders in the loan syndicate. Further analysis shows that the advantages of having a lower number of 'unique RMMs' primarily benefit adopters with a poor information environment. This concludes that KAMs effect on the audit quality remains a mystery and uncertain.

Using the Big 4 as a proxy for audit quality, Smith (2022) suggest that Big 4 and industry expert auditors write more readable audit reports in the post-ISA 700 regime. The study assessed the transparency as a dummy variable, which takes one of KAMs to explain the effect of KAMs on the firm profit and loss and zero otherwise, which can be enhanced by looking deeper into the type of KAMs themselves. Honkamäki and Ojala (2019) also use the Big 4 as a proxy for audit quality to explore whether the audit quality will improve KAMs transparency. The study applied to the property sector and found a positive association between the Big4 and the industry and the transparency of KAMs and an insignificant association between the firm size and KAMs' transparency.

3.3.2 KAMs and audit cost

There is an ongoing debate on the association between KAMs and audit fees. Reid et al. (2019) suggest a slight increase in audit fees, which may be because of the average yearly increase. At the same time, other studies refer to increased audit fees due to increased independent audit report length (Reid et al., 2019; Gutierrez et al., 2018). In contradiction, other studies suggest that audit cost is not likely to increase after the implementation of ISA 701 (Lennox et al., 2015; Bédard et al., 2014). They suggest auditors are not required to do more jobs but to disclose more information about how they build their opinion. It is noted that KAMs effect on the audit cost remains a mystery and uncertain.

3.3.3 KAMs and the level of information provided to the stakeholders

Other literature investigates the association between KAMs and the level of information provided to the stakeholders. Liao et al. (2019) examine two years of data on the Hong Kong and Mainland China exchange market and did not find proof that KAMs increase or incrementally add to the stakeholders' information nor significantly affect audit quality or fees. They suggest that the stakeholders still need more specific information than the one reported within the new extended audit report. A study in France (Bédard et al., 2014) reported that KAM (JOA in France) minimally affects the level of information provided to the stakeholders. Further study on France context also suggests that KAMs have no or minor change in the perceived knowledge of the stakeholders (Jean et al., 2019). This comes in consistence with a study that used eye-tracking technology to assess the level of attention to KAMs within a group of undergraduate accounting students (Sirois et al., 2018). They suggest that the existence of KAMs will decrease the attention to the other information provided by the management in the rest of the annual report.

However, the students were required to read the whole annual report, which is not the actual case on the market. (Bédard et al., 2016). According to Moroney et al. (2021), adding KAMs to the audit report increases its perceived value and credibility. However, this is only the case when carried out by a Non-Big 4 firm. On the other hand, audits conducted by a Big four firm are perceived to have high value and credibility regardless of the inclusion of KAMs. The research also revealed that perceived credibility plays a mediating role between KAMs and audit firm size in determining the perceived value of the audit. Further analysis showed that including KAMs draws investors' attention to new and expanded information, causing them to shift their focus away from core messages in the audit report.

3.3.4 KAMs and financial reporting quality

Reid et al. (2019) provide empirical evidence that the existence of the new audit report has a positive association with financial reporting quality. The paper uses the audit report as a dummy variable: Zero if it is pre-the new regulations and one if it posts them. The study assesses financial reporting using earning management. However, the study is applied to one financial year and focused on financial reporting numerically from the financial statements rather than the narrative reporting, which can affect the generalisation of the results. Gold et al. (2020) also investigate the impact of KAMs on the financial reporting quality from the financial statement's perspective. The study by Christensen et al. (2019) finds that binary signals in audit reports, such as improvement in internal control effectiveness or absence of substantial doubt about a company's going concern, cannot effectively communicate the underlying continuous risks that a company may face. The study showed that companies with improved internal control and those deemed no longer in danger of bankruptcy are still more likely to restate financial statements or declare bankruptcy, indicating the residual risk that cannot be fully communicated through binary signals in the audit report.

Although other researchers investigate various aspects of KAMs, such as the consequences of KAMs on investors and market reactions (Cohen et al., 2017; Wright and Bhattacharjee, 2018; Chen et al., 2018; Gaynor et al., 2016; Hobson et al., 2017), some studies suggest there is no real impact on the invertors' reaction (Jean et al., 2019; Tušek and Ježovita, 2018). Köhler et al. (2020) found that KAMs will lead to goodwill impairment. Altawalbeh and Alhajaya (2019) provide empirical evidence using the abnormal trading volume as a proxy for the market reaction in Jordan, showing a positive relationship between KAMs and the investor's reaction.

3.3.5 The usefulness of KAMs

Minutti-Meza (2021) highlights that the effectiveness of External Audit Reports (EAR) is contingent upon three factors. Firstly, EAR must provide new information or indirectly prompt companies to reveal new information. Secondly, the new information must be relevant to the investment decisions made by users. Lastly, the new information must shed light on potential threats that were not adequately addressed during the audit process. If these assumptions are not met, EAR will not have an impact on valuation, even if it includes more information.

The literature also investigates the usefulness of KAMs; previous research analyses the content of KAMs in the annual reports (i.e., Kend and Nguyen, 2020). Research links

KAMs with decreasing the uncertainty disclosure without considering the impact on the management disclosure behaviour (Kachelmeier et al., 2020). Segal (2019) conducts a detailed interview with audit experts from South Africa. The researcher concluded that KAMs failed to meet or beat the regulator's expectations. Detailed interviews with 20 expert auditors revealed that the experts have various perceptions of what makes a matter "key". These vary from materiality to subjectivity and difficulty and incorporate a time-based consideration. Concerns identified include a significant cost increase and potential liability, triggering the need for thorough internal risk management policies. The audit experts conclude that KAM has ultimately failed to achieve its goal of greater transparency, with clients virtually ignoring KAM reports. Additionally, the interviews suggested that the existence of KAMs did not increase transparency. While this study focused on South Africa, learning more about the auditors' perspective in different countries would be interesting. According to the findings of Seebeck and Kaya (2022), the communicative value of EAR (KAMs sections) improved over three years from the implementation. Utilising techniques from computational linguistics, the study discovered that various indicators of communicative value, such as readability, evaluative content, visual aids, and specificity, show improvement in post-ISA 700 periods. Cross-sectional tests indicate that this improvement varies among audit firms, clients, and KAM disclosure attributes. The results, consistent with similar studies, do not provide evidence that the communicative value proxies are informative to investors. However, the study found initial evidence that a more precise description of KAMs significantly and positively impacts capital market reactions, indicating that investors appreciate clear information. Also, Smith (2022) examine the effect of the new audit report on the communication value using readability as a proxy for the communication level. The study suggests that the new audit report improves the quality of communication with the stakeholders, and the audit report became more readable. Masoud (2017) provides initial evidence that the word choice in the communications between the auditor and the management has changed.

Yau (2021) investigates the relationship between the unexpected positive tone of Risks of Material Misstatements (RMMs) in audit reports and various measures of financial reporting outcomes. The findings suggest that the unexpected positive tone of RMMs is related to lower future earnings uncertainty and reflects the auditor's judgement about the client company. While the tone of RMMs does not affect stock market reactions, it does influence analysts' forecast revisions and dispersion. Results also show that investors react positively to an unexpected positive tone when RMM disclosure is easy to read, while analysts do not react differently based on readability. Instead, their assessments are influenced by specific elements of the disclosure, such as the use of specific entity names, materiality, word complexity, and length of the risk section. This study provides a potential explanation for the differing results of previous research on the value relevance of expanded audit reports, suggesting that financial statement users with different levels of sophistication process and perceive RMMs differently.

Nicole and Theis (2019) investigate the impact of KAMs on auditor performance. They used the (present vs. absence) of KAMs items and the stakeholder's pressure. They find that the reaction of the auditor is weak to KAMs and stakeholders' pressure. The association between KAMs and the risk reported by the management has also been discussed in descriptive analysis by Brouwer, Eimers, and Langendijk (2016). The authors argue that not all the risks highlighted by the management had been transferred to the KAMs section on the extended audit report. They conclude that auditors tend to disclose the most important risks in their judgement. If the same risk topic is discussed by both the management and auditors, that will increase the level of the relevant information. Further studies are needed to examine the reverse effect of KAMs on management risk disclosure.

Gimbar et al. (2016a, 2016b) investigate the potential effect of KAMs (CAM in the USA) on auditor liability. The paper provided a literature review of the moderate effect of KAMs on auditor reliability on the most recent academic research on this perspective.

As the CAMs requirement was phased in gradually in US, starting with large accelerated filers in 2019 and extending to all other companies in 2021, Daugherty et al. (2021) aim to gain insight into the process of identifying and reporting critical audit matters (CAMs) in the audit reports of large accelerated filers with year ends on or after June 30, 2019. The study surveys audit engagement partners, audit committee chairs, and chief financial officers of certain US issuers and found that the independent auditor largely controls the CAM reporting process, resulting in higher audit fees. While concerns about increased audit fees were valid, there was no adverse impact on audit quality, effectiveness, or independence. Participants reported little to no added value in reporting CAMs, with liability and PCAOB inspections being identified as contributing factors to costs. The study has limitations due to the uniqueness of the population of inaugural issuers, but its results provide valuable preliminary insight and suggest the need for additional research on CAM issues.

Luo (2021) discusses the determinants and consequences of CAMs disclosure in the US setting. The paper highlights that the characteristics of both audit clients and audit firms play a role in determining the number, sentiment, and readability of CAM disclosures, and auditors have significant discretion in determining the intensity and language of the disclosure. Studies on the consequences of CAM disclosure provide mixed evidence of its effectiveness in improving the informativeness and relevance of audit reports. The paper also suggests research opportunities in examining the impact of CAM disclosures on smaller, non-accelerated filers, the use of archival data to corroborate findings, and the impact of economic and political uncertainty on CAM disclosure. Field studies based on surveys or interviews with audit practitioners, audit committee members, and management can provide critical insights into how CAMs are identified, worded, and discussed.

Burke et al. (2023) conduct a study using difference-in-difference analyses to examine the consequences of the US critical audit matter (CAM) disclosure requirement for preparers and users of financial reports. The authors find that CAM disclosures result in changes to financial statement footnotes referenced by CAMs, indicating an indirect consequence where management disclosure changes in areas that are expected to be scrutinised following auditor-provided disclosure. However, CAM disclosures do not provide incremental information to the market, and there is limited evidence of a negative market reaction when unexpected CAMs are disclosed. The study provides insights into the new CAM standard and demonstrates its relevance to management disclosure decisions and the market. However, the study focuses on only two years of CAM disclosures available, and further research is needed to fully understand their impact in the US context.

Asbahr and Ruhnke (2019) also contribute to the current debate about the audit reporting model by showing that reporting a KAM might have unintended ‘real effects’ on auditors’ actions. Using an experimental study, they examine whether reporting an accounting estimate as a KAM can affect auditors’ judgement and action. The study finds that sceptical action in the form of proposed adjustment amounts is significantly lower when the accounting estimate is reported as a KAM. This suggests that disclosing a KAM can serve as a moral license to waive an adjustment. The study also shows that the KAM disclosure does not affect auditors' sceptical judgements, indicating the existence of a judgement-action gap. Furthermore, implicit client pressure does not enlarge the moral licensing effect of the KAM disclosure, and audit effort is not affected by reporting a KAM.

Zeng et al. (2021) conduct a study using Chinese data on KAM reports to assess whether the KAM rule improves audit quality and how KAM disclosures relate to audit quality. The study find that auditors report both industry-generic and firm-specific KAMs, and the wording of KAMs is largely firm-specific and differs in reporting components. The research reveals that audit quality is improved following the mandatory KAM rule, and the number of KAMs and their disclosure characteristics signal auditors' concerns about clients' earnings quality, audit effort, and the propensity of issuing modified opinions. The results suggest the significance of analysing reporting characteristics when studying the communication and implementation of KAMs. The study has implications for future studies, indicating that textual analysis could shed light on the features of KAM communication and implementation and supports the theoretical framework that audits quality disclosure motivates audit efforts in developing and emerging markets.

According to Li et al. (2022), the mandatory adoption of EARs in the U.K. significantly reduces stock price crash risk. The study shows that EARs' disclosure of risks of material misstatement on revenue recognition induces firms to disclose smaller pieces of negative information without changing firms' accruals management. The negative effect of EARs adoption on crash risk is more pronounced for firms with scant public information and non-Big-4 or non-industry-specialist auditors. The study suggests that EARs play a vital role in urging managers to make timelier bad news revelations to investors, and policymakers and practitioners need to consider the findings while addressing the adoption of EARs in other developed markets.

4 KAMs: concerns and challenges

Many concerns have been raised so far, not only for the early adopters but also, and especially for future implementations (Abernathy et al., 2017; Mock et al., 2013: Elmarzouky et al., 2022c). In 2017, the ICAEW predicted "increasing homogeneity over time if the auditor has nothing new to say and the market punishes outliers", indeed the FRC (2016) states that "the pace of innovation has unsurprisingly slowed in the second year, a period of consolidation and improvement". The originality, innovations and professional scepticism, deriving from the enthusiasm demonstrated by the auditors as soon as the EAR was just introduced, has waned over time, leaving room for standardised procedures which, despite more extensive information, are again producing limited innovations and relevant updates (FRC, 2016, 2019).

Directly associated with the challenge mentioned above is the risk of boilerplate reporting, "complacent over time; that the reports become boilerplate such that not only are they not interesting or useful, but they become misleading in their portrayal of the current audit" (PWC, 2019). This concern can be avoided by updating the content of the reports, preventing to re-use of documents, updating methodologies and procedures, keeping high standards of originality, and showing an effort to assess the risks (Kitiwong and Srijunpetch, 2019). The dominance deriving from the use of the previous year's report as a work paper-based to carry out the audit report of the current year systematically leads to carrying out a qualitatively lower result because it is adapted to a previous perspective that can prove out-of-date (Bonner et al., 2018). Based on empirical evidence, prepopulated audit work papers, compared to blank ones, are sometimes misleading since they conceal originality, leading to a lack of effectiveness and reducing risk rating accuracy (Bonner et al., 2018). The consequences of the practices of using prepopulated audit papers or standardised lists of risk factors are 'Sticking and fast responses' that usually result in inaccurate, especially in terms of risk assessment. The concerns of increasing homogeneity and boilerplate need more studies to investigate not only the extent of boilerplate but also the factors and institutions that promote and/or mitigate such practices in EAR and KAMs.

Further concerns are identified as "potential increased liability and cost" (ICAEW, 2017). Indeed, better quality usually requires more care, attention to detail, and benchmarking; therefore, it is also time-consuming. Contrary to what may be believed, however, empirical evidence in the UK shows that the audit costs for companies, in terms of audit fees, have not undergone a significant increase (Reid et al., 2019); this could mean that the audit firms have decided to bear the higher audit costs, bearing the higher cost in a difficult time of financial crisis. In this regard, future studies can extend the literature by looking at different contexts and considering auditor specialisation and the client barging power.

Noticeably quality also heavily depends on the auditors' skills and experience, and suggested areas of improvement can be identified in the following:

a entity-specific risk reporting

b discussion of the auditor's application of materiality and why a particular benchmark or level was chosen

c clearer linkage between the discussions of risks and materiality and the description of how these influenced the scope of the audit (FRC, 2015b).

UK has set a positive example by disclosing materiality in the latest audit reports (Quick et al., 2023).

International research studies demonstrated that in countries where the early adoption of the new audit report occurred, there had generally been positive reactions from the various stakeholders (Abernathy et al., 2017; Chen et al., 2018). At the end of the first year of adoption, there has been an improvement in the 'two-way dialogue' between the auditing firm and the governance bodies on the areas of risk and on the auditing procedures identified to oversee them, promoting the monitoring of these committees on the financial statements audit process (Lennox et al., 2015). Adopting the new audit report has meant that the specific departments in charge of drafting the reports have paid specific attention to the disclosures on the issues identified, such as KAM, thus contributing to improving financial reporting (Gold et al., 2020). The interaction with the governance bodies and the management departments of the companies, as well as a more comprehensive dialogue throughout the review process, from planning to completion, also increased transparency on the activities carried out by the auditors, laying the foundations for continuous improvement of audit quality (Li and Lau, 2019; Kitiwong and Sarapaivanich, 2020). Looking at a different angle, we call for more studies to investigate the impact of EAR and KAMs disclosure on the audit firm and audit work, especially the audit team's training, selection, and workload.

The application of the new accounting standards, such as IFRS 9, IFRS 15, IFRS 16 and IFRS 17, are expected to require significant attention in carrying out the audits of the financial statements and that consequently, in the circumstances in which the related aspects are relevant, the same may be illustrated among KAMs. The recent review of EAR practices in the UK shows that the most reported KAMs relate to complex accounting topics such as revenue recognition, impairment, and financial instruments (FRC, 2016, 2022). This calls for more effort from and coordination among standards setters to enhance the reporting and assurance of such topics and highlights the role of future research in informing interested parties on the current practices.

Furthermore, it is for many organisations; financial transactions are highly dependent on IT and the automated nature of the underlying systems. Entities often have a complex infrastructure of IT systems, relying on both new and old to work together. This level of automation requires auditors to respond by increasing the use of IT specialists on audits. It is worth dwelling on the need to strengthen knowledge in the field of Information Technology since, today, for many audited companies, financial transactions, operations, and revenues depend heavily on IT management. Therefore, controls must have sufficient mastery of complex IT infrastructures and the related systems that control and manage them (FRC, 2019). Adequate information must be provided in the EAR regarding the analysis of the IT systems, the risks associated with them, and the skills adopted to assess their efficiency. This information can be reported among the 'other information' and the risks in the KAMs (Stoel and Havelka, 2020). Remarkably, the review of EARs shows that most of the reported KAMs on Controls and IT related were in the banking sector (FRC, 2022). In addition, many auditors consider macro-level factors in the KAMs section, reporting KAMs on climate change and Covid-19.

Recently, FRC (2022) reviews the practices of auditor reporting in the UK and summarised the findings in a number of snapshots, including one on KAMs. In addition to the reduction in the average number of disclosed KAMs, the FRC (2022) highlights the wide variations in the number of KAMs reported in the auditor reports and the stability in the KAMs types. Furthermore, the FRC found evidence of boilerplate language in KAMs sections of FTSE 350 audit reports. A few auditor reports contained graduated findings, where the auditor provides a view on key management estimates and judgements in the financial statements. The report also highlighted that the disclosure of KAMs likely follows a template and is not adjusted by the same audit partners. The language used is simple and formulaic (FRC, 2022).

Arguably, the above discussion clarifies the need for a more proactive role from regulators and policymakers to ensure more granular and fewer boilerplate disclosures in auditor reports.

5 Conclusion and future research ideas

In this paper, we provided a background for KAMs at the national and international levels. We further discussed some concerns and challenges related to KAMs and critically discussed the current literature in this domain.

This study signposts fruitful avenues for further research. We propose that additional research be conducted on the following areas:

We find a large number of studies focused on the impact of KAMs on audit quality, audit fees, or the readability of the audit report. However, there is no agreement on the effect of KAMs on audit quality. Some of them prove it positive, others negative, and even more, some of the researchers suggest no impact of KAMs. This may be expected due to the lack of agreement on the audit quality definition and proxies as well as the different methodologies, models and timeframe covered in prior studies that may affect the generalisation of their results.

The academic research on this domain has yet to fill the gap that links KAMs as a risk disclosed by the independent auditor and the level of risk disclosed by the management (Elmarzouky et al., 2022a). The alignment between risks reported by audit committees and KAMs could be investigated over time. We call for a longitudinal study of the impact of KAMs and EARs. In addition, future research may investigate how firms react to the disclosed KAMs.

Most of the studies have been based on data from the UK and a few other countries, leaving room for further research in the USA. Given that as of December 15, 2020, fiscal year-end, public US companies have been required to implement Critical Audit Matters (CAMs), future studies in the USA would be highly relevant and informative. It would be interesting to conduct a comparative analysis between the CAMs in the US and the KAMs in other countries. Such an analysis will provide valuable insights into the similarities and differences between the two and inform the development of best practices for the effective communication of auditing matters to stakeholders.

Based on the findings discussed in the latest FRC report (FRC, 2022), there is a need for further studies on the style, structure, and linguistics used in audit reports. The report highlights the issue of boilerplate language in KAMs sections, with only 9 out of 396 reports including graduated findings. Further research is needed to understand why the style does not vary from firm to firm and if this limits innovation. Regulators and policymakers should proactively ensure granular and informative auditor reports. As the report shows a high percentage of boilerplate language in the big four audit reports, more research is needed to understand how to make the audit reports more informative.

While many studies focused mainly on KAMs, auditors might disclose significant matters in different sections other than the KAMs section. Thus, future research might investigate the relationship between KAMs disclosure and other sections in the report, such as the going concern section.

Based on Minutti-Miza's (2021) findings, we suggest further studies are needed to evaluate the usefulness of EARs. Specifically, research can be conducted to determine the extent to which KAMs/EARs provide incremental information compared to other financial reporting disclosures. Also, assess the relevance of the incremental information to investment decisions made by users. Evaluate the effectiveness of EARs in revealing potential threats that were not adequately addressed during the audit process. Compare the impact of EARs on valuation across different industries and countries. Investigate the factors that influence the usefulness of EARs and how these can be improved. By investigating these areas, we can gain a deeper understanding of the effectiveness of EARs and determine if they have the potential to have a positive impact on firm valuation.

Furthermore, more research is needed to explore the implications of individual KAMs specifically. We argue that examining constructs specifically related to KAM topics is important to draw valid inferences about them. There is a need for more papers on specific topics related to individual KAMs, rather than the whole audit report. In addition, based on the findings of Abdelfattah et al. (2021), more research is needed to understand better the factors that influence the selection of audit partners and the characteristics of auditors. These studies will help to deepen our understanding of the impact of KAMs and auditor selection on auditing practices and ultimately improve financial reporting.

Another area for future research is to investigate the potential for long-term effects on financial reporting quality, earnings forecasts, and market liquidity. Further studies can examine the potential for the findings to generalise to other countries that adopt similar audit reporting standards. Also, future research might explore the effects of the new audit reporting standard on small and medium-sized firms as well as larger firms.

Future research could explore the relationship between the introduction of extended auditor's reports and loan facilities in different industries and different countries. This can enhance the discussion on the role of institutional and cultural factors in shaping auditor reporting and financial reporting in general.

Finally, the debate on the role of KAMs in predicting financial distress (Camacho-Miñano et al., 2021; Elmarzouky et al., 2022c) provides an opportunity for future research. It would be valuable to examine real-world cases to assess the impact of new audit regulations. For instance, it would be intriguing to know why some companies around the world went bankrupt shortly after receiving an unqualified audit opinion. It is critical to determine if there were any warning signs of financial distress and whether KAMs could have provided insight into potential issues earlier. This will help evaluate the effectiveness of KAM reporting and address whether KAMs provide users with more meaningful information.

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