

Process of Disclosing Key Audit Matters in Audit Report: Grounded Theory¹

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Research Paper

INTRODUCTION

After the occurrence of international financial scandals, the global financial crisis, the complexity of business environments, etc and in response to the increased demand for improving auditors' reports, audit standards have changed audit report from old form to extended audit report (new form) and mandated the disclosure of Key Audit Matters (KAMs) in this report, with the hope of increasing its quality and informational content. KAMs are challenging issues that have played a vital role in the audit process. Disclosure of such issues in the auditor's report can reduce information asymmetry and the gap between expectations from the audit. This helps users to understand the audit process and better assess the risks faced by companies while making economic decisions.

KAMs are divided in to 2 classes: account-level KAMs and entity-level ones. Entity-level KAMs are related to the entire business unit and are not related to a specific account, but account-level ones are related to a specific account or note.

In Iran, since 2022, disclosing KAMs has been required, aimin to enhance information content of audit report. Due to the newness of the standard in Iran, limited research has been done on it, so there is not enough knowledge about the disclosure process of these matters. The aim of this research is to model this relatively new process so that while creating a comprehensive perspective, we can gain knowledge about the challenges and solutions to achieve this goal. Especially, the disclosure of these matters is affected by the characteristics of each environment and cognitive

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factors such as the characteristics of the auditor and the employer. Therefore, considering the newness of this requirement in our country, which has different environmental and cognitive conditions from other countries, it will be important to know the process followed until the disclosure of these issues and the factors influencing this process.

MATERIALS AND METHODS

This study uses grounded theory for its purpose. This method collects data in an inductive way to extract the theory about a process and its goal is to discover the theory from the data inductively.

Moreover, its research instrument is in-depth interviews with experts, in order to understand the current situation and discover the bottlenecks and challenges this process. The experts include academic experts, managers and partners of auditing firms. The research period covers the year 2022. The sampling method is snowball and sampling continues until theoretical saturation is reached. 27 interviews were conducted in this study.

The grounded theory has three components: primary concepts, categories, and propositions, which are obtained through three stages of open, axial, and selective coding. Open coding is used to determine the primary explanatory components and then the main categories, and in the next step, axial coding is used to determine the relationships between categories, and finally, selective coding is used to explain a comprehensive model of the disclosure process of KAMs. Finally, to validate the extractive model of the research, the acceptability index of Corbin and Strauss is used. Acceptability indicates how reliable the research findings are in reflecting the experiences of the participants, the researcher and the reader in relation to the phenomenon under study. Hence, the final model was represented to 3 experts and previous participants and their additional ideas were received and applied in the model.

RESULTS AND DISCUSSION

According to obtained findings in open coding 74 concepts were obtained. These concepts are classified in to 13 categories including: Legal requirements, the information content of the auditor's report, features of the auditor, features of the client, reporting consequences, external consequences, internal consequences, job characteristics, reporting strategies, information strategies, profession strategies, profession stature, accounting standards stature, disclosure of key issues and audit report users, stature. Based on axial coding, among the extracted categories, "disclosure of key issues" is known as the central category and the heart of the research model; because its traces are found in most of the data and other categories are related to it. Other categories are identified as causal

conditions, background conditions (infrastructures), strategies, consequences, intervening factors.

According to selective coding findings, the narrative of the process of disclosing KAMs is summarized as follows: the main reason for the need to disclose the KAMs was synchronizing with international authorities in order to increase the information content of audit reports and its requirement by Iranian policy makers. The necessary infrastructures for such disclosures include improving the status of the profession, clarifying the status of accounting standards, and improving the knowledge status of users of audit reports. Appropriate strategy is to evaluate and identify risky and challenging points in the audit process and disclose these issues and how the auditor deals with them in the report, while informing the company's management. Various factors affect the implementation of this strategy, including the characteristics of client, the characteristics of the audit firm, and the characteristics of the audit work. Finally, the disclosure of KAMs has different consequences for the company and the auditor (internal), for financial reports (reporting), and for the public of users and the entire profession (external).

CONCLUSIONS

The process of disclosing KAMs in Iran is far from reaching the desired point and faces big challenges (such as the challenges alluding to users, standards and audit profession). If these challenges are not solved, the profession will not reach its ultimate goal, i.e., increasing the information content of the audit report and subsequently helping users make decisions and ultimately public trust in the profession. Due to the novelty of the requirement to disclose these issues in the auditor's report and the little research conducted to understand this process and the challenges it faces, this research can provide guidelines and add to the relevant knowledge in understanding the mentioned process until reaching the desired point for policymakers and relevant stakeholders. In addition, identifying the challenges on the way of this process and its necessary infrastructures is an effective step to guide those involved in order to improve and smooth this way.

According to the results obtained, it is suggested to the policy makers of the audit profession and the community of certified accountants to create social awareness through holding training classes, seminars and publishing guidelines and instructions and examples of major issues and by standardizing and clarifying them on the one hand and revising some

related laws. with the audit labor market (for example, the rules for the formation of audit institutions in order to enlarge and merge them with the aim of strengthening their powers in front of employers) on the other hand, to help audit firms in implementing the necessary strategies to disclose KAMs.

Keywords: Key Audit Matters (KAMs), Entity-level KAMs, Account-Level KAMs, Grounded Theory.

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