

The Consequences of Disclosing Key Audit Matters on Investors' Judgment and Decision-Making¹

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Research Paper

INTRODUCTION

The auditor communicates with users of financial statements through the auditor's report (Gray et al; 2011). The auditor's report is the only publicly available document that provides information about the observations and conclusions derived from the audit process. Following a period of significant criticism regarding the limited value and informativeness of auditor reporting (Carcello, 2012; Turner et al; 2010), the International Auditing and Assurance Standards Board (IAASB) introduced a new standard, ISA 701, which directly impacts auditor reporting. Effective since December 15, 2016, this standard requires auditors to disclose Key Audit Matters (KAMs) in their reports.

According to International Standard on Auditing 701 (ISA 701), key audit matters are those issues that, in the auditor's professional judgment, were of greatest significance during the audit of the current period's financial statements. These matters are addressed within the context of the audit of the financial statements as a whole and in forming the auditor's opinion thereon. The auditor does not provide a separate opinion on these matters (ISA 701). When describing each key audit matter, the auditor should reference related disclosures in the financial statements (if any) and address the following:

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1. The reasons why the selected issues are considered among the most significant in the audit and, consequently, designated as key audit matters.
2. How the auditor addressed these issues during the audit process.

The primary objective of disclosing Key Audit Matters (KAMs) in the independent auditor's report is to provide valuable information to support investors' decision-making processes. The disclosure of KAMs reduces investors' willingness to purchase shares (Christensen et al; 2014), enables better assessment of company performance (Kohler et al; 2020), and directs investors' attention to relevant elements of the financial statements (Sirvis et al; 2018). Additionally, KAM disclosure influences investors' perceptions of audit value and auditor credibility (Moroney et al; 2020).

Notably, if KAMs provide investors with material and novel information, they can play a critical role in evaluating earnings benchmark performance. Earnings benchmarking, particularly earnings per share, is a key factor influencing investor decisions and a vital financial indicator for assessing company performance (Vadiei & Shokouhizadeh, 2012). Given the role of financial analysts as key intermediaries in reducing information asymmetry and conflicts of interest between companies, investors, creditors, and other stakeholders—by guiding rational investment and enhancing the efficiency of capital markets through improved forecast quality and accuracy—the informational content of KAMs offers deeper insights. It refines analysts' profit forecasts, ultimately influencing investors' valuation judgments.

Global developments in audit reporting, particularly the introduction of ISA 701, have been driven by the demands of users, especially investors. In Iran, the implementation of this standard became mandatory at the beginning of 2022. Therefore, this research investigates the implications of disclosing Key Audit Matters.

MATERIALS AND METHODS

A 2x2 between-subjects experimental design was employed, aligned with the research topic and objective. This design allows the researcher to simultaneously examine the effects of different manipulations on participants. This applied post-doctoral study targeted a population of university academics and professionals. All data were collected in 2024 (1403 in the Iranian calendar). Initially, 209 participants (109 professionals

and 100 academics) were involved; however, the final sample consisted of 176 participants (96 professionals and 80 academics), divided into four groups of 24 professionals and four groups of 20 academics. Both participant selection and group assignment were randomized. The influence of experience as a variable was controlled through group matching. Hypotheses were tested using SPSS 25.

It should be noted that the Key Audit Matter considered in this research, which began in 2022 (1401 in the Iranian calendar), was the allowance for sales returns. The independent variables were the type of auditor's report and earnings benchmarking performance, while the dependent variable was investors' judgment evaluation.

RESULTS AND DISCUSSION

The findings reveal that the final sample included 96 professionals and 80 academics. Men accounted for 58% of the professionals and 50% of the academics. Among the academics, 80% had 1–5 years of investment experience, while over 62% of the professionals had more than 6 years of investment experience. Doctoral degrees were held by 70% of the academics and approximately 24% of the professionals. Familiarity with financial statement auditing was reported at 40.6% for professionals and 40% for academics, while familiarity with ISA 701 was 37.5% for professionals and 18.75% for academics. Approximately 38.5% of the professionals held senior positions (e.g; senior specialists or managers) in financial institutions, such as companies, investment funds, brokerage firms, and related entities.

Hypothesis testing results indicate that Key Audit Matters significantly influenced the judgment and decision-making of professional investors, reducing their inclination to invest. However, KAMs did not affect the judgment or decision-making of non-professional investors. Earnings benchmark performance impacted the valuation judgments of both groups, with no interaction observed between earnings benchmark performance and Key Audit Matters.

CONCLUSION

Since the research suggests that Key Audit Matters provide informational content and influence the decision-making processes of professional investors but lack specific relevance for non-professionals, it is recommended that legislative bodies and the auditing profession establish platforms to enhance understanding of these matters among investors and

the general public. This could include educational courses and awareness workshops. Additionally, they should issue necessary guidelines and share successful studies and experiences from developed countries in this field for public benefit.

Keywords: Key Audit Matters, Auditing Standard Report, ISA701, Investor Valuation Judgment, Experimental design.

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