

The Communication of Audit Report: Key Audit Matters in United Kingdom

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Abstract : Financial scandals and financial crisis have led to an international debate on the value of auditing. In recent years there have been significant legislative reforms aiming to increase markets' confidence in audit services. In particular, there has been a significant debate on the need to improve the communication of auditors with audit reports users as a way to improve its informative value and thus, to improve audit quality. The International Auditing and Assurance Standards Board (IAASB) has proposed changes to the audit report standards. The International Standard on Auditing 701, Communicating Key Audit Matters (KAM) in the Independent Auditor's Report, has introduced new concepts that go beyond the auditor's opinion and requires to disclose the risks that, from the auditor's point of view, are more significant in the audited company information. Focusing on the companies included in the Financial Times Stock Exchange 100 index, this study aims to focus on the analysis of the determinants of the number of KAM disclosed by the auditor in the audit report and moreover, the analysis of the determinants of the different type of KAM reported during the period 2013-2015. To test the hypotheses in the empirical research, two different models have been used. The first one is a linear regression model to identify the client's characteristics, industry sector and auditor's characteristics that are related to the number of KAM disclosed in the audit report. Secondly, a logistic regression model is used to identify the determinants of the number of each KAM type disclosed in the audit report; in line with the risk-based approach to auditing financial statements, we categorized the KAM in 2 groups: Entity-level KAM and Accounting-level KAM. Regarding the auditor's characteristics impact on the KAM disclosure, the results show that PwC tends to report a larger number of KAM while KPMG tends to report less KAM in the audit report. Further, PwC reports a larger number of entity-level risk KAM while KPMG reports less account-level risk KAM. The results also show that companies paying higher fees tend to have more entity-level risk KAM and less account-level risk KAM. The materiality level is positively related to the number of account-level risk KAM. Additionally, these study results show that the relationship between client's characteristics and number of KAM is more evident in account-level risk KAM than in entity-level risk KAM. A highly leveraged company carries a great deal of risk, but due to this, they are usually subject to strong capital providers monitoring resulting in less account-level risk KAM. The results reveal that the number of account-level risk KAM is strongly related to the industry sector in which the company operates assets. This study helps to understand the UK audit market, provides information to auditors and finally, it opens new research avenues in the academia.

Keywords : FTSE 100, IAS 701, key audit matters, auditor's characteristics, client's characteristics

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