Key audit matters - the answer?
An exploratory study investigating auditors’ possibility to accomplish the purpose of the new audit report

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ABSTRACT

Various institutional attempts to recapture confidence of the audit profession resulted in a new section ISA 701 which is likely to be game changing for stakeholders and the auditing profession. The new standard establishes that more entity specific information should be communicated through the new section key audit matters. Simultaneously, a prerequisite for auditors is the confidentiality duty towards their clients. As such regulation that reinforces increased communications in audit reports might conflict with auditors’ professional values and ethical implementation when conducting audit reports. By using qualitative interviews we investigated auditors interpretation of the new standard in order to forecast potential outcomes of the new reports. Our result indicates that auditors’ fear of trespassing the confidentiality duty might be reflected in the caution taken in the reporting process. The limitations of the confidentiality and auditors low willingness to provide entity specific information implies that it will be hard to move away from a standardized way of reporting. The results suggests that auditors need better prospects which enables an increased communication through audit reports, in other words a change of regulation that limits liability claims.

Keywords: Auditing, auditor reporting, key audit matters, confidentially duty, ISA 701

First and foremost we would like to thank our respondents for their participation and for taking the time to provide valuable insights. We also want to thank our seminar participants at Uppsala University for their opinions and comments during the writing process. Lastly we want to thank our supervisor Arne Sjöblom for well-appreciated directions and guidance throughout the paper.
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<tr>
<th>Abbreviation</th>
<th>Description</th>
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<tbody>
<tr>
<td>APA</td>
<td>Authorized public accountant</td>
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<td>FAR</td>
<td>Swedish institute of authorized public Accountants</td>
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<td>IAASB</td>
<td>The international auditing and assurance standard boards</td>
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<td>IESBA</td>
<td>The international ethics standards board for Accountants</td>
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<tr>
<td>IFAC</td>
<td>International federation of Accountants</td>
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<td>ISA</td>
<td>International standards on auditing</td>
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<td>KAM</td>
<td>Key audit matters</td>
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<td>RN</td>
<td>The Swedish supervisory board of public Accountants</td>
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<td>TCD</td>
<td>The confidentiality duty</td>
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I. Introduction

This chapter has been defined to motivate the area of interest by building on existing theories and literatures that ultimately proceed to the papers’ research area. Based on this papers’ intention, relevant areas have been addressed before presenting the papers’ research question. Finally, this chapter concludes with the purpose and the outline of the following chapters.

Background

As a consequence of the last decades controversies on issues such as auditors responsibilities and role in identifying fraud and errors several amendments have been brought to the fore. Well-known polemics such as Enron, World-Com, Tyco and Lehman Brothers have steered to a resilient need of a change and revision of audit reporting. The audit reports based on the financial statements are seen to act as the direct link between auditors and stakeholders and are associated with the audit. Therefore auditors play an important role as an independent assurance provider to stakeholders in the financial reporting chain. (Carrington, 2010). By adding credibility to company’s financial statements it facilitates stakeholders decision-making (Asare & Wright, 2012). As such, it can be argued that the relationship between auditors and the respective company’s stakeholders is considerably based on a trust framework (Bhattacharjee et al., 2005).

Nonetheless, given yesteryears accounting scandals where auditors were finger-pointed as playing a role in the scandal process, the publics’ trust on auditors has been impaired. It has also been reasoned that when there are business failures the public tends to interpret them as audit failures too, even if the auditors had correctly performed their job as stipulated by the internal standards of auditing (ISA). Criticism in the aftermath of prior crises gave rise to various institutional attempts across time and national borders to provide a report that serve users confidence in the reports (IOSCO, 2009; PCAOB, 2011; MARC, 2011; IAASB, 2015). That is because the current audit report is viewed as a pass/fail document which had been the subject of long-lasting discussions and debates due to concerns about its form, content and overall informative value (Church et al., 2008; IOSCO, 2009; PCAOB, 2011; FAR, 2013; Sirois et al., 2015).

So in the wake of all these events and in an attempt to better communicate the public role of auditors, IAASBs outreach activities revealed compelling evidence postulating a stronger demand by investors and user communities for a change in the audit report:
“More than ever before, users of audited financial statements are calling for more pertinent information for their decision-making in today’s global business environment with increasingly complex financial reporting requirements. (...) And while the auditor’s opinion is valued, many perceive that the auditor’s report could be more informative. Change, therefore, is essential”.

(IAASB, 2012 p. 1)

Following a consultation paper in 2011, IAASB released an exposure draft of the proposed ISA 701. The exposure draft aimed to enhance the future of audit reporting by seeking for opinions from users of audited financial statements (IAASB, 2012). After taking in to consideration the response, IAASB published the final new and revised auditor reporting in January 2015 (IAASB, 2015). The most significant change is found in the introduction of the new section: ISA 701 Communicating Key Audit Matters (hereinafter KAM) (IAASB, 2015; Cordos & Fulop, 2015; Sirois et al., 2015).

Problem discussion

In order to provide more relevant information for the users of audit reports, KAM require auditors to highlight the most significant matters for the respective entity. By stating their opinion through KAM, IAASB presume that the new audit report will become more entity-specific and less standardized (IAASB, 2015). The concept of KAM aims to enhance transparency in the reports by increasing the amount of information relevant for the respective entity. The decision-making framework for assessing KAM requires the auditor to apply his/her professional judgment to determine which matters are KAM for a specific audit engagement. KAM should be explicit to the reporting entity and performed in order to provide additional information that is significant to users of financial statements. So, in the milieu of constantly growing complexity and surplus of financial disclosures (Sirois et al., 2015) KAM are implemented to potentially increase the informative value by one, ‘increasing the prominence of potentially valuable information’ (PCAOB 2013, p. 16). And two, enhancing users ‘ability to navigate and better understand increasingly complex financial reports’ (IAASB 2012, par: 9).

While numerous accounting bodies such as the ACCA¹ and FEE² as well as the big four firms³ have supported the implementation of ISA 701 recent studies provide ample indications of decisive challenges following the implementation (Öhman, 2007; FAR, 2013; Cordos & Fulop, 2015; Sirois et al., 2015). From a Swedish perspective, FAR (2013) emphasizes that the auditing regulation in Sweden, might conflict with the new standard. This is because the new changes might carry higher risks for auditors since they access sensitive information about their clients.

¹ The association of Chartered Certified Accountants
² Federation of European Accountants
³ EY, Deloitte, KPMG and PwC
Therefore, auditors may feel insecure to express an opinion on the areas suggested by the IAASB (FAR, 2013). EY (2013, p. 6) had a similar approach arguing that management and those charged with governance might have concerns about specific KAM being disclosed. This is because of their profound nature or because those charged with governance deem that such exposure might be perceived as failure in governance. Therefore FAR (2013) argue that auditors should not form an opinion on matters classified as KAM but instead only provide a description of any problem found during the audit without revealing whether the issue has been adjusted (FAR, 2013, WPK, 2013).

The confidentiality duty (hereinafter, TCD) is considered to be a prerequisite for auditors to establish their clients' trust and access the financial information to be able to carry out the audit (FAR, 2013). In that sense, Humphrey et al. (2009) argue that there are different views on the achievement of strengths of audit regulations in the realm of the existing gaps. Therefore, an increase in regulation [through ISA 701] might conflict with the professional values and ethical norms of confidentiality since auditor's interpretations are controlled by regulatory frameworks and contribute to auditors being wary of leaving out too much information in the audit report. In addition Öhman (2007) states that additional content of financial statements can be beneficial to users but that it involves the publication of confidential information where a greater risk to the auditor is attached and in addition, higher costs for the company.

**Problem formulation**

Since transparency is a prerequisite for the new standard, it is fundamental that auditors have an open insight of the audited company in order to provide entity-specific information and eventually move away from standardized reports (IAASB, 2015). Simultaneously, experience from the UK contexts shows that the extended reporting model deemed to provide entity-specific information, and that more detailed risk reporting attached to the specific entity was encouraged (FRC, 2015). This was also questioned by Lennartsson (2015) who argue that chances are that the new report will remain standardized since the entity information relevant to the audit is a fractional amount in contrast to the rest of the entity information. Sirois et al. (2015) found that the new standard had an insignificant affect on the informative value. This was because users ability to comprehend the reports was associated with additional information where valuable was missing (Sirois et al., 2015).

Moreover, prior research (see, Adams et al., 1995; Claypool et al., 1990; Arnolds et al., 2005) found that auditors’ confidentiality towards their clients limited them in their disclosures. The obligation of not disclosing confidential information was of higher importance than the obligation to provide objective opinion to stakeholders. This is reinforced by recent studies that fears that the requirements [in accordance to ISA 701] might clash with the confidentiality duty on issues where descriptions of matters classified as sensitive is provided (FAR, 2013; WPK, 2013; Cordos & Fulop,
In addition, MARC (2011) argue that auditors which point out that management was not in full control would lead to endless discussions with them and most likely would end up as boilerplate statements, once again, bringing no informative value.

Therefore, in light of the recent changes in the audit report and the results of prior research we conducted a pre-study to test our assumption, that the confidentially duty might restrict auditors ability to deliver additional informative value in the independent audit report (see appendix II). We did this by conducting two interviews, more specifically, two semi-structured interviews. The interviews were with the Swedish supervisory board of public accountants (RN, referred to as ‘A12’) and with an authorized auditor4 (hereinafter, referred to as ‘A9’).

Pre-study

Through our pre-study we established the groundwork necessary to carry our study forward. We gathered compelling concerns by both interviewees: A9 questioned the actual benefit of the inclusion of additional information. The value of the added information is likely to be lost quite quickly because a qualified reader of the report will identify if there are any modifications, which is the only thing relevant for the market (A9). A9 also brought up some difficulties in terms valuation of certain matters and the assessment of those matters. Furthermore, A9 concerns was in-line with FAR (2013) stating that its difficult to determine how much information the auditor must submit in the audit report without clashes with TCD and that the comments might be over-tangible. TCD may cause that the disclosures of KAM will look similar for companies with similar risks; accordingly this would make the audit report standardized and thus bring no added informative value (A9). When discussing the relevance of the new standard A12 mentioned that the auditor (normally) does not give information that is not reflected in the annual report, which leads us to believe that the inclusion of additional information may just as well provide boilerplate statements. In addition A12 reasoned that it is difficult to balance the need for information and the need for confidentially and argued that the purpose of KAM may become inadequate if it does not convey informative value.

“The risk for revealing sensitive, confidential information that the client itself does not reveal in the annual report might lead to more generic writings in the description of KAM which will not be as informative as they should be”

Respondent A12.

As our pre-study indicate TCD might hinder the possibility to dispense KAM under IAASBs proposal, which strengthen the relevance to further process this paper. Prior research together with our pre-study identifies a gap between the purpose ISA

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4 Respondent ‘A9’ and ‘A12’ are also interviewed later on in the paper.
701 is seeking to fulfill and the regulatory requirements auditors are bound by. Since the requirements of ISA 701 might conflict with TCD and auditor's ability to increase transparency by providing more entity-specific information we question auditor's ability to provide the design and content desired by the IAASB.

Research question and purpose statement

Because of their novelty, research in the domain of the new changes of the audit report is scarce, meaning that our purpose is exploratory in nature. We seek to develop an understanding of how auditors interpret the new audit standard, ISA 701. By reflecting on the ongoing interpretation of the new standard with emphasize on factors that might restrain auditors’ ability to design KAM in accordance with IAASBs intentions this study aims to contribute with knowledge that are not previously known and presented in academic theories. So, to fulfil the purpose of this paper we examined the following research question:

How do auditors interpret the new audit standard key audit matters and how might it be reflected in the new audit report?

Theoretical and practical contribution

This paper has provided some of the practical difficulties auditors struggle with that should be taken into consideration in order to have accurate beliefs of how KAM might be disclosed in regards to design and content. The theoretical contribution is illustrated by demonstrating some of the practical restraints the implementation of KAM might cause. Since KAM is a decision-making framework, which relies on auditor’s professional judgment, this study contributes with insights on auditor’s practical assessment in their decision-making of how to implement KAM. Likewise it illustrates behind the scenes knowledge of auditors in form of thoughts and considerations about the implementation of the new standard and what difficulties it might bring. The study has developed a reflection of the reality, which is not defined in the academic theories. Therefore, we contribute by providing a true and fair view of the challenges the audit profession is facing and how it might be reflected in the audit report. Furthermore this study contributes with insights that regulations such as TCD might hinder the disclosure of KAM in terms of how regulators want it to be presented. By questioning the possibility auditors have to provide entity-specific information this study also highlights why auditors should not be given the role to provide informative value to users. Our findings indicate a number of limitations, which hinder the ability to decrease the information gap. However our respondents believe that the expectation gap might be reduced since auditor’s role, responsibility and the scope/difficulties of their work is clarified. This study also contributes with insights regarding the conflict auditors have when given the role as an information provider. Lastly, this study has presented conjunctions that question auditors’ ability to deliver entity-specific information, the possibility to move away from a standardized design. Eventually these findings contribute with knowledge of how KAM might be disclosed in the new audit report.
# Outline of thesis

## Introduction

This chapter has been defined to motivate the area of interest by building on existing theories and literatures that ultimately proceed to the papers’ research area. Based on this papers’ intention, relevant areas have been addressed before presenting the papers’ research question. Finally, this chapter concludes with the purpose and the outline of the following chapters.

## Theoretical framework

This chapter presents the study’s theoretical framework. Through this presentation it is possible for readers to gain a deeper understanding of the theories that has been used and might be related to auditors’ approach and interpretation of the new standard. The chapter concludes with a table illustrating how the theories will be applied to analyze the results of our data.

## Literature review

The literature review presents an overview of the current audit report and continues with arguments for and against the current report. Furthermore, new changes to the audit report are introduced and discussions on possible repercussions of these changes are held. Lastly, the chapter ends with a summary over the literature review and an illustration of the paper’s analytical framework.

## Methodology

This chapter presents the methodological choices that have been made in this paper. Furthermore, it gives a presentation of the methods that has been used for gathering data and discussions on why these where chosen. The chapter continues with a description of the papers’ respondents and how the empirical findings will be analyzed. The chapter concludes with a discussion of the papers’ trustworthiness.

## Empirical findings

This chapter presents the empirical findings collected for this paper. Each respondent’s views and interpretations are presented under specific headlines before the chapter ends with an empirical summary. The complete interview guide is to be found in appendix 1.

## Analysis

In this section the empirical findings of this paper will be analyzed. This analysis is based on our four presumptions presented in our analytical framework (see figure 4). Through our analysis we have sought to fulfill the purpose of this paper.

## Conclusion

This final chapter presents the conclusions of this paper. It also contains thoughts and reflections on the matter as well as practical and theoretical implications of the paper and ends up with suggestions for future research.
II. Theoretical framework

This chapter presents the study’s theoretical framework. Through this presentation it is possible for readers to gain a deeper understanding of how auditors' approach to a regulated change of standard can be affected by both direct and indirect factors. In previous section we argue that the audit assessment ascends from the function, which address the relationship between individuals and organizations. Ultimately, these relationships have proven to influence auditors on their decision-making. As such, theories that deliberate on factors as social impacts, obligation towards the client and ethical dilemmas provide the theoretical basis for our paper.

Social exchange theory

According to the social exchange theory (SET) relationships between individuals and organizations are considered to be subjective and relationship-oriented contracts characterized by commitment, trust and a long-term focus through positive interactions (Herda & Lavelle, 2013). SET is one of the most influential theoretical paradigms for understanding work behavior. The organizational behavior implies that positive social exchange relationship between organizations and employees results in that employees feel relationally obligated to support the organization and therefore employees are motivated to produce favorable outcomes and behave in a proper manner (Cropanzano & Mitchell 2005). The framework provides a better understanding of the multiple commitments and challenges the employee have against various parties such as organization, supervisors and clients (Lavelle et al., 2007; Herda & Lavelle, 2013). In our study auditors social exchange partner is specified as the audit client. Recent studies state that audit clients prefer a relational approach (social exchange-based) based on communication, trust and cooperation (Fontaine & Pilote, 2012) supporting the allegation that audit client can be a social exchange partner for auditors. The theory is thus applicable on any two-sided mutually rewarding process comprising a transaction or exchange of any type of socio-emotional benefit.

Professionalization theory

Professionalization theory (PT) is closely linked to auditors’ individual professionalization dependent on the code of professional ethics. Contemplating the concept more closely it refers to how practitioners serve the public interest and offer client services related directly to an intellectual based body of knowledge (Elg & Jonnergård, 2011). The theory is specifically applicable to our study since the new standard relies on auditors’ professional judgment and thus linked to their independency and integrity. According to Volcker (2002) auditors are the guardians of the truth in markets, asserting that the public society puts high demands for professionalization on the profession. Criticism originated from the publics concern regarding the ability for auditors to discharge legally based responsibilities effectively
and has emerged for decades into a concern about the flexibility of accounting practices and the insufficiency of audit procedures (Volcker, 2002). Today, criticism regards auditors’ ability to resist managerial pressures to misreport and to challenge those in charge with governance about specific disclosures in the financial statement. As a result of the major criticism auditors have been facing a crisis of confidence and trust, resulting in a change of reform by improving ethical standards. Ethical standards are presented in a code of professional ethics from which auditors are bound to observe and comply. The general application of the code states that the auditor shall observe five fundamental principles. These principles are presented as, integrity, objectivity, professional competence, confidentiality and professional behavior (IESBA, 2015). Ethical reasoning have showed to have a direct impact on decision-making (Brante, 2009), as such we believe it is important to include the professionalization theory because of its role in the dual-function auditors take in the auditor-client-user relationship.

### Application of theories

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<th>Theory</th>
<th>Function</th>
<th>Implementation</th>
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| Social Exchange Theory  | Relationship between organization and individuals is considered to be subjective and relationship-oriented which is characterized by commitment, trust and long-term focus creating a rational obligation to support the organization trough positive interactions and outcomes (Lavelle et al., 2007; Herda & Lavelle, 2013). | • The relationship between auditor and the client will be evaluated through SET that creates a rational obligation towards the client (Cropanzano & Mitchell 2005).  
• The fear of breaking the obligation and trust towards the client will impact what to include as KAM (Herda & Lavelle, 2013).  
• SET might restrict the possibility to deliver additional value in the audit report. |
| Professionalization theory | PT considers auditor’s individual judgment including factors such as integrity, objectivity, confidentiality, behavior and professional competencies sets the foundation for the audit profession (Volcker, 2005; Brante, 2009; Elg & Jonnergård, 2011). | • The PT will be implemented to analyze the relationship between auditor and the profession. By determining what the audit profession is responsible for, the outcome of what auditors include in the audit reports might be predicted (Brante, 2009).  
• The PT will likewise explain the relationship between balancing the requirements of KAM vs. TCD, to determine auditors’ possibility to deliver value in the audit report (IESBA, 2015). |

*Table 1. Application of theories*
III. Literature review

The literature review presents an overview of the current audit report and continues with arguments for and against the current report. Furthermore, new changes to the audit report are introduced and discussions on possible repercussions of these changes are held. Lastly, the chapter ends with a summary over the literature review and an illustration of the papers’ analytical framework.

The current audit report

The overall objective of the external audit is to assure stakeholders that the entity’s financial statements are free from material misstatements, and that the information provided represents a true and fair view of the entity (Bhattacharjee et al., 2005; Revision, 2005). According to Coram et al. (2011) there is ample indications showing the demand for audit supporting the allegation that stakeholders place more confidence in audited financial statements. During the performance of the audit the auditor shall follow auditing standards, ethics, and take into account generally accepted accounting principles. According to Lin et al. (2003) the purpose of the audit report is to communicate the results of the review process regarding the specific entity’s financial position for the company's stakeholders.

Arguments in support of standardized audit reports

Several academics argue that the audit report has a standardized design in order to be clear and easy to understand. Since the opinion states whether the financial statement present a fair view (pass) or not (fail) the auditor’s conclusion is simple and straightforward (IOSCO, 2009). Others argue that a deviation from the standardized audit report brings uncertainty to the fore. Therefore, user communities will have it more difficult to interpret the report (Chen et al., 2013) and the relevance of the report decreases as users receive more information to take into account (Church et al., 2008; Sirois et al., 2015). According to Simnett and Huggins (2014) the standardized approach is established on the basis that the manager is liable for the financial reports and that the audit report verifies to this information to increase its trustworthiness, rather than adding any new information.

Arguments against standardized audit reports

The simple and straightforward form is also viewed as one of the standards biggest shortcomings. Carrington (2010) argues that a standardized design has proven to provide similar, ‘pass’ audit reports, which decreases the relevance of the audit report to its stakeholders. Asare and Wright (2012) assert that users of financial reports need more specific information on how auditor’s transmits the review in order to obtain value of the audit. They argue, that limited insights into the auditor’s findings related
to the quality of the companies financial reporting compromises the information received by investors to enable them to distinguish between companies (Asare & Wright, 2012). IOSCO (2009) claims that the standardized report does not allow for anything ‘in-between’ pass and fail because the binary nature of the opinion does not acknowledge differences in the financial reporting system of different companies. However, the main drawback on the audit reports prepared in compliance to the standardized report is that the reports are too generalized—a one-size-fits-all product—rather than entity-specific (Hjelström, 2015). Responding to individual company’s needs is one of the greatest messages of the past decades economic changes and the current audit report deems to lack this requisite (Zhang, 2007).

**The value of audit reports**

Barker (2002) argues that the society’s confidence is the ‘heartbeat’ of all service professions. Therefore, if such confidence is betrayed, the professional function of the service becomes inadequate. Hence, interpreting Barker’s (2002) suggestion in the audit context, the gaps that exists between the audit reporting model associated with the audit of financial statement is grounded on the information provided through the report about the entity and the information users perceive as useful. As current literature suggest financial statements and disclosures are increasing in complexity. Such complexity has contributed to the gap between the auditor and the public that makes it hard for users to ascertain what judgments the auditor have used in their opinion (MARC, 2011). These prevailing gaps are viewed at and referred to differently in the literature (Mock et al., 2013). While the expectation gap refers to the difference between what users expect from the auditor and the financial statement audit and the reality of what an audit is. The information gap relates to “the existence of a gap between the information they [users] believe is needed to make informed investment and fiduciary decisions, and what is available to them through the entity’s audited financial statements” (MARC, 2011, p.6). The information gap is perceived to increase the challenges in terms of understanding how financial information such as, audited financial statements reflects the general picture of the entity’s financial performance (IAASB, 2011).

Louder et al. (1992), Chen and Church (1996), Soltani (2000), Ghicas et al. (2008) provides evidence that auditors issuance of certain types of opinions provided valuable information to investors in their decision-making. Other studies, conversely, found little evidence that the information provided were utilized in users decision-making (Turner et al., 2010). Mock et al. (2013) paper found that while audit reports per se are considered to be important to users some participants in their study suggested that the audit reports could be replaced by a simple checkmark or approval. These findings are inline with Church et al. (2008) who questioned the actual informational value, arguing that the current report very much present a symbolic value. Carcello (2012) tested whether investors were satisfied with the informative value of the current standard audit reports. By testing his experiment on 73 different
investors he found that 45 percent of the respondents believed that the current audit report gave no significant value (Carcello, 2012). What is more interesting is that he found that the majority of the respondents only skimmed through the report to see if there were deviations from the standard design. “73% of respondents simply skim the report looking for departures from the standard unqualified report, and 18% of respondents believe the report is of no use to them at” (Carcello, 2012, p. 24). Still, his results suggest that even though the majority of the respondents believes that the audit report has some value, it is not clear what that value is (Carcello, 2012). See figure 2, which shows that the information that is relevant to the audit is the small amount in contrast to the rest of the entity information. Yet the demand of providing additional information is on the auditor which only access a small share of the total entity information. As such, following the demand for more detailed and entity-specific information the new audit report marks a paradigm shift from the current standardized report to a more individualized with more space for auditor’s judgment.

Figure 1. Illustration of the “information gap” (IAASB 2011, p. 9)

Recent changes to audit reports

**Communicating Key Audit Matters in the Independent Auditor's Report**

After three years of development through interactions between auditors, policymakers and users worldwide, IAASB in January 2015 released the new audit report, which includes a set of standards that are likely to be game changing for stakeholders and the auditing profession (PwC, 2015). The new IAS intends to highlight the most significant entity-specific issues based on the auditor’s evidence and work carried throughout the audit process in order to provide more relevant information to the users of the report (IAASB, 2015). The standard is considered to be at the heart of the enhancements to reduce the existing gaps and its developed in order to assist the companies and their stakeholders in better understanding the matters, which according the auditor’s professional judgments were of most significant for that respective period. KAM should be explicit to the reporting entity and performed in order to
provide additional information that is significant to users of financial statements but also consider the nature and extent of communication with those charged with governance (i.e. audit committee or other subgroup). The decision framework for determining KAM is illustrated in figure 2.

![Figure 2. How do auditors select key audit matters? (PwC, 2015, p.4)](image)

In that determination ISA 701 (Par: 5) states the auditor should take into account:

I. Areas of higher assessed risk of material misstatement, or significant risks identified in accordance with ISA 315 (Revised).

II. Significant auditor judgments relating to areas in the financial statements that involved significant management judgment, including accounting estimates that have been identified as having high estimation uncertainty.

III. The effect on the audit of significant events or transactions that occurred during the period.

Once a KAM is determined, the auditor shall describe each KAM using an appropriate subheading under a specific section presented as KAM. The auditor shall clearly communicate that these KAM are “those matters that were of most significance in the audit of the financial statement and that they were addressed in the context of the audit of the financial statements as a whole and in forming an opinion thereon, and the auditor does not provide a separate opinion on these matters” (ISA 701, par: 11). Each description of KAM shall include a reference to the related disclosure(s), if any, in the financial statement and shall address, why those matters were considered to be of most significance in the audit and how those matters were addressed in the audit (ISA 701, par: 13).

While many points of IAASBs initial proposal were agreed upon, Cordos and Fulop, (2015) study implicates that legitimate concerns regarding the new standard have been raised. For instance the ACCA and the German audit chamber (WPK) brought confidentiality issues to the fore while the FEE and KPMG believed that
some paragraphs lacked clarity and could therefore vary considerably between different audit reports (Cordos & Fulop, 2015). ISA 701 requires for the description of KAM to provide a sufficient explanation based on the auditors’ professional judgments, which would enable the users to understand why those matters resulted in being most significant and how the company addressed them. However, the length and format of communicating KAM is left open by the standard so that it allows enough flexibility for the auditors to be more entity-specific focused. Still, Guénin-Paracini et al. (2014 p. 282) claims that the risk(s) attached with the scope of work often leads to auditors desire to apply standardized procedures. “To avoid thinking about the risks that are likely to make them feel too anxious, auditors tend to drastically reduce the scope of their investigation (...) and thus apply standardized procedures”. Likewise Catasús et al. (2013) argue that auditor’s practical judgment consists of different guidelines in the form of standards and manuals. Therefore the strict regulations have contributed to auditors’ increased willingness to stay within regulatory framework guidelines and therefore the switch to more entity-specific reports may prove to be tricky. This may be because new changes carry higher risks for auditors because they access sensitive information about their clients and accordingly feel insecure to express an opinion on the areas suggested by the IAASB (FAR, 2013).

Although the need to reduce the existing gaps is clear there is reasonable doubts regarding if the new auditor-reporting model allows the auditor to be the player who will fulfill that gap (MARC, 2011). While IAASB (2011) argues that the credibility of the information increases if it is delivered directly from auditors MARC (2011) argues that such information might conflict with auditors’ responsibilities. If users require more detailed commentary on the entities risks and business model this should be provided by management since auditors is only one of many different players in governance of business reporting (Turner et al., 2010; MARC, 2011). Ultimately, management is responsible to provide stakeholders with the information they need, therefore this liability cannot be assigned to auditors (MARC, 2011, p. 5). Still, recent changes to the audit report are seen by many as applicable means to alleviate the information gap (Simnett & Huggins, 2014) while the expected positive impact of KAM on increasing the informative value remains an empirical question.

**KAMs impact on audit reports**

Although user communities have encouraged auditors’ perspectives helpful and informative in understanding the financial statements the ultimate liability for disclosing fairly presented information lies on management (MARC, 2011). Because of their novelty, indications on the impact of KAM are scarce. Still, support from the auditing literature suggests that prior changes to the audit report have had at best a marginal impact in increasing the informative value (Church et al., 2008). Some valuable insights can be attained by the UK experience. In 2013, the financial reporting council (FRC) initiated an auditor-reporting standard that is similar to the
reporting of KAM required by ISA 701. In Mars 2015, the FRC published a review of the preceding years experiences of the new standard. By surveying both stakeholders and audit firms the assessment specified positive elements as well as areas that could be improved (FRC, 2015). Some of the more prominent elements included locating the audit opinion at the beginning of the report, improved presentation of auditors opinions through diagrams and graphs and addressing going-concern disclosures in the reports. The key areas identified with room for improvements encouraged increased granularity of risk reporting, improving the discussion of auditors’ application of materiality and more detailed reporting of audit findings with respect to identified risks. (FRC, 2015).

To further illustrate, we refer to an example of how KPMG (2014) (with agreement of their clients) identified and addressed key risks in accordance with the new extended reporting model. The risk identified on 2014 financial statements, brings out an example of the recoverability of intangible assets in regards to long-term contracts. That would be, the ability for the company to recover intangible assets which depends on the combination of a profitable business and customers ability to pay due amounts (KPMG, 2014). This kind of risk is not entity-specific; it is rather an industry specific risk that can be applied to any company whom operates in a business where there are long-term contracts. One of the main aspects of KAM is to move away from the standardized report by providing more entity-specific information. Therefore the illustration of the granularity of the risk identification in Rolls-Royce questions the actual added informative value when industry-specific risks are identified. Nor did their findings identify any weaknesses in how the entity addressed those matters. This example are in-line with Mock et al (2013) findings whom argued that auditors role in many cases can be addressed by an approval of how the entity addressed the matter. As such, if the concept of KAM aims to increase the informative value and provide a foundation for users to engage with management, one can question how the value will increase when a shortcoming that has been taken care of is presented.

Moreover, IODSA (2015) argues that there are instances where the auditor believes that a matter relating to the audit is one of the most significant matters experienced during the audit and should thereon be disclosed as a KAM. Management on the other hand may have a different view, would then the auditor disclose the matter as a KAM, stakeholders would questions why it was not transparent in the financial statement (IODSA, 2015). To illustrate, consider the possibility of impairments of a business unit, which ultimately results in no impairment write-off. In such instances, management can prefer to not disclose the matter in the financial statements (IODSA, 2015). This comes back to what MARC (2011) assumed about endless discussions with management, that most likely end up as boilerplate statements without any informative value. Another possibility that is brought up refers to users perception of audit reports, that they would be perceived as more informative than the financial statements. That would mean that audit reports become the main
roadmap when users try to understand the complexities associated to the entity. In that regard, Sirois et al. (2015) claimed that there is a risk that other important disclosures in the financial statements may be overlooked. These broad findings are inline with IODSA (2015) who states that there is a relationship between the number of KAM disclosed and users willingness to rely on KAM instead of the financial statements.

Other encounters, concerns auditors’ ability to impose obligations on boards of directors and audit committees (AC). Unlike the UK contexts, there are no obligations for the board or the AC to comment on the significant issues impacting the financial statements (FRC, 2015). Herein lies the crux for the auditor to challenge management on how particular KAM have been disclosed in the financial statements (IODSA, 2015).

**TCDs impact on audit reports**

Humphrey et al. (2009) states that the audit is based on laws and regulations and these regulations are the basis for conducting trust in the financial reports. Auditor’s interpretations and assessments of regulations are the result of the auditor’s statement in the reports (FAR 2013). Ultimately, auditors are only willing to disclose information on the evaluation of the financial statements if it is required by law and is not undermined by TCD (MARC, 2011). Simultaneously, the risk of increased litigation contributes to auditors being wary of leaving out too much information in the audit reports (FAR, 2013). Auditors have asserted the right of confidentiality, which by definition declares “A member in public practice shall not disclose any confidential client information without the specific consent of the client” (AICPA, 1993, Section 301).

There are various defining accounting scandals where auditors were finger-pointed as playing a role in the scandal process, questioning the proficiencies of auditors. Snyder (2011) illustrates an example where an auditor discovers unequivocal evidence of a fraud and confronts the client with the evidence. “The client admits to the fraud and agrees to make the requisite adjustments in the firm’s financial statements. The auditor also notifies the client’s audit committee of the fraud. However, the committee comes to the decision that no further action is necessary (…) the auditor, at this point, has no further recourse but to issue an unqualified opinion” (Snyder, 2011). In May 2015, the international ethics standard board for accountants (IESBA) released the second exposure draft tackling the complexity of auditor-client relationships (IFAC, 2015), including auditors’ confidentiality requirements. However, IFAC argues that, in terms of practical application there is a world of differences between IESBAs intentions and the current proposals. For instance, IESBA (2015) intends to allow “professional accountants to take such further action as may be need in the public interest (…) and thereon free to disclose confidential information outside the entity (…) to do so, even when disclosure is not required by law or regulation” (IFAC, 2015). Although this allows auditors to break client
confidentiality in certain circumstances it raises concerns on two fronts (IFAC, 2015). First, it brings uncertainty to the relationship of trust between auditors and their clients. Second, auditors are put in a difficult place because if a disclosed matter turns out to be unjustified the alleged perpetrators may seek recourse. While if they do not disclose what they should have done, they will be open to claims for damages (IFAC, 2015). Therefore, even though the protection of clients’ private disclosures is an important ideology for auditors, the declaration of a privileged auditor-client relationship is hard to justify in the audit contexts. This is confirmed by Adams et al. (1995) who examined how TCD limits auditors by exploiting cases where auditors were aware of confidential information gained by an audit. In their study, they refer to an example where a client was seeking a hefty loan, while being unaware about the company’s weak financial position. Their example showed that 78 percent of auditors thought that the right action would be to not disclose that information (Adams et al., 1995). Understanding their results it indicates that TCD is of high priority to auditors to maintain the auditor-client relationship. Simultaneously, the obligation of not disclosing confidential information was of higher importance than the obligation to provide objective opinion to stakeholders (Adams et al., 1995).

Summary of the literature review

One of the main shortcomings of the current audit report is argued to be its standardized design making the report to generalize rather than entity-specific (Hjelström, 2015). Therefore, it fails to fulfill the need for more specific information in order to obtain value from the report (Zhang, 2007). The prevailing gaps that have been discussed in the preceding sections has caused various implications for the auditing practice and the recurring accounting scandals have just added up to that bucket (Carrington & Catasús, 2007). IAASB responded to this call by developing the new audit report which provides more entity-specific information and thereon more relevant information to users of the report. Most of previous research supports the idea that expanded entity-specific audit reports can be used as a way to address the call for more specific information and this is exactly what ISA 701 aims to deliver. However, increased regulation might not necessarily always be the best solution to address socio-economic issues. Standards and regulations are the keystone for auditor’s practical judgment; therefore auditors have a high tendency to stay within regulatory frameworks (Catasús et al., 2013). The willingness to stay in the framework can be justified by TCD auditors have against their clients (FAR, 2013). We already provided our arguments on how an increase in regulation [through ISA 701] might conflict with the professional values and ethical norms of confidentiality, might contradict with the prevailing local legislation and it may be difficult to technically master the proper application of the ISA 701 standard. However, although all these probable downsides of ISA 701 can be successfully addressed, the major concern is whether the new auditor-reporting model allows the auditor to be the player who contributes with additional value. Likewise prior research (see Church et al., 2008 and Sirois et al., 2015) found that there is a negative relation between the increased information in the reports and users ability to designate essential
information. While several amendments have been made in order to clear auditors’ role in their relationship to their client’s, auditors are still placed between a rock and a hard place where they need to balance the threshold regarding what they can include without facing litigation (Snyder, 2011; IFAC, 2015).

Analytical framework

Based on our theoretical foundation and our literature review we have developed four presumptions that are used when conducting our empirical findings and analyzing our results. These presumptions provide the basis of our analysis and are presented in figure 4.

**Presumption I** – Based on the professionalization theory, there is a connection between how auditors portrait themselves with the establishment of the audit profession (Abbott, 1988; Volcker, 2002; Brante, 2009; Elg & Jonnergård, 2011).

**Presumption II** – Regulations such as the confidentiality duty and KAM requirements have a direct impact on the audit profession (Adams et al., 1995; Arnolds et al., 2005; MARC, 2011; FAR, 2013).

**Presumption III** – The fear of trespassing the confidentiality duty and damaging client-relationships is an indirect impact affecting the caution taken in the reporting process for fulfilling KAM requirement (Humphrey et al., 2009; EY, 2013; FAR, 2013; Guénin-Paracini et al., 2014; Cordos & Fulop, 2015).

**Presumption IV** – A combination of the defined audit profession\(^5\) and the social influences have an impact on the audit profession and thereon on the design of the audit report (based on presumption I-III).

![](image)

*Figure 3. Illustration of the analytical framework.*

\(^5\) Defined audit profession is the combination of auditors view regarding the profession in terms of responsibilities and purpose of the audit report.
IV. Methodology

This chapter presents the methodological choices that have been made in this paper. Furthermore, it gives a presentation of the methods that has been used for gathering data and discussions on why these were chosen. The chapter continues with a description of the papers’ respondents and how the empirical findings will be analyzed. The chapter concludes with a discussion of the papers’ trustworthiness.

Research method

Methodology is a tool to reach new knowledge, which indicates how scientists proceeded to collect data. There are several different types of data collection, i.e. interviews, observations, surveys, etc. The choice of data collection is directly linked to the study's purpose, what differentiates various studies is the type of knowledge researchers wish to obtain (Saunders et al., 2009). That means that epistemological considerations are at the forefront of an investigation. From the epistemological point of view the quality of a study enhances if the researchers ontological basis is clearly formulated. Following these concepts in relation to our research we conduct a constructionist approach for the ontological stance and an interpretivist approach for the epistemological stance. The constructionist viewpoint is based on the purpose of this paper. Auditors are influenced by social factors such as, client relationships, conflicts of interests and or their own incentives. This is why the objectivist stance is not compatible with our research. Likewise the interpretivist approach states that researchers will both influence and be influenced by the research activity they are involved with (Bryman & Bell, 2007). This statement identifies the importance of analyzing how social actors interpret activities; therefore our research is aligned with the interpretivist viewpoint.

Our pursuit of understanding auditor's position ahead of the new standard means that the collected data is qualitative in nature. The concept of qualitative research method is a common term for methods aimed to describe the phenomenon and explain its characteristics as thoroughly as possible (Bryman & Bell, 2013). Qualitative research method is an approach that could be used to describe and analyze different behavior of humans (Bryman & Bell, 2007) and is more appropriate for a deeper understanding of the studied phenomenon. How individuals interpret and perceive reality in a given environment is of great importance and emphasis of empirical data collection are therefore considered to lie on the words and not quantifiable data (Bryman and Bell, 2013). Since this paper focused on whether the new reporting-model allows auditors to be the player who fulfill the identified gap, the depth of each respondent’s statement was of importance. Ultimately, auditors are influenced by social factors such as, client relationships, conflicts of interests and/or personal incentives. Therefore it is necessary to understand how involved parties perceive their
social context (Bryman & Bell, 2007). In that regard the method used optimize the collection of data since it enables us to better grasp auditors thinking patterns in how they interpret the new regulation but also how they might apply it in the audit report.

Data collection – qualitative interviews

At first sight a research interview could be seen as something ambiguous due to the absence of evident guidance, but still it is a proficient conversation lead by the researcher(s) who outlines and regulates the situation. Qualitative research interviews are the most commonly used method when collecting data (Bryman & Bell, 2013). It is sometimes characterized as unstructured because of its lack of structure and guidance, but nevertheless it is a method that enables researchers to gather a deeper understanding of a phenomenon. As such, interviews were a suitable method in order to obtain relevant knowledge. Accordingly to collect knowledge about auditors view on the new standard face-to-face interviews were applicable. This is because it would be difficult to understand auditors’ interpretation and opinions regarding the standard by using surveys or observations. Furthermore, face-to-face interviews were justified on the basis that it was easier to develop and revise the order of the questions during the interviews depending on each interview. Before the interviews took place, a list was devised over the specific areas related to the study. These areas were not limited by detail-driven issues but were rather designed after themes to have a clear focus in the study.

Data collection was made through semi-structured interviews which according to Bryman and Bell (2013) is a flexible approach enabling the respondents to developed well thought and detailed answers. Likewise, the flexibility in semi-structured interviews allowed us to follow up on interesting opinions made during the interview. Being able to ask follow-up questions were important as a deeper understanding of respondents' perception was obtained. The semi-structured interviews have been beneficial as the interviews were not rigid but performed as a natural conversation. As a result of our semi-structured interview form, each interview was performed as a natural conversation where the respondents had the opportunity to describe their answers thoroughly. The interviews were a necessary instrument in order to interpret the social reality of our respondents and their views on the new standard.

Sample selection

We selected responses from authorized public accountants (hereinafter, APA) from the big four firms on the Swedish market. The reasoning behind our sample group comes naturally since these firms handle the majority of the larger entities on the stock market. The sampling choice is further justified on the basis that the new standard is mandatory for listed companies, in that sense APAs are the primary group of individuals required to adapt to the new change. Secondly, the approving auditor is
ultimately the one liable for the audit, as such the title ‘authorized’ illustrate the appropriateness of our representatives because they are well experienced in the industry and should therefore have the skills necessary to address the issues that might ascend from the audit. Finally, the limitation of our representatives can be justified on the basis that auditors from the big four firms together represent a large part of Sweden’s auditors enabling the results to be generalizable to the population.

Apart from our interviews with APAs we interviewed the Swedish supervisory board of public accountants (RN) and FAR (see figure 5). RN is the government authority for all matters concerning auditors, which means that RNs task is to supervise and regulate auditors. FAR, is the professional institute for APAs and plays a vital role in the development of professional standards for the audit profession in Sweden. As such, we believe that information gathered from RN and FAR has contributed to optimize the results of this paper. By interviewing the government authority and the professional institute for which APAs rely on, we were able to collect information from different perspectives. Since this paper consists of a small number of individual values and beliefs the reader should be careful to generalize our results in a wider context. This is because, Shenton (2004) states that it is important to clarify that any generalization is up to the reader to make since only a quantitative study can provide enough evidence to allow for generalization.

Likewise, Shenton (2004) states there are certain provisions that can be applied by researchers to address the trustworthiness criterion. In order to assume a high level of conformability in this research we prepared our interview questions in accordance to our theoretical framework from which we have demonstrated different views on some issues to provide an objective view of previous research. Secondly our respondents are picked because of their appropriateness in this matter that would be that they have the knowledge necessary to contribute. Finally, the interview questions were sent to the respondents before hand to ensure that they are prepared for the interviews. We are aware that sending out the interview questions before hand might have lead to more standardized answers from the interviewees which eventually would affect our results. However this risk was mitigated since the appendix we sent only included questions on a general level and not the deeper questions. After the interviews the respondents was provided with our material from the interview for their approval. Therefore, the respondents were able to correct any misunderstanding before published to increase the studies level of conformability.
Presentation of the respondents

<table>
<thead>
<tr>
<th>Designation</th>
<th>Employer</th>
<th>Title</th>
<th>Audits</th>
<th>Experience as APA (y=years)</th>
</tr>
</thead>
<tbody>
<tr>
<td>A1</td>
<td>EY</td>
<td>APA</td>
<td>PLC(^6) and SME(^7)</td>
<td>17y</td>
</tr>
<tr>
<td>A2</td>
<td>EY</td>
<td>APA</td>
<td>PLC and SME</td>
<td>20y</td>
</tr>
<tr>
<td>A3</td>
<td>EY</td>
<td>APA</td>
<td>PLC and SME</td>
<td>32y</td>
</tr>
<tr>
<td>A4</td>
<td>EY</td>
<td>APA</td>
<td>PLC and SME</td>
<td>18y</td>
</tr>
<tr>
<td>A5</td>
<td>EY</td>
<td>APA</td>
<td>PLC and SME</td>
<td>25y</td>
</tr>
<tr>
<td>A6</td>
<td>PwC</td>
<td>APA</td>
<td>PLC and SME</td>
<td>22y</td>
</tr>
<tr>
<td>A7</td>
<td>PwC</td>
<td>APA</td>
<td>PLC and SME</td>
<td>29y</td>
</tr>
<tr>
<td>A8</td>
<td>KPMG</td>
<td>APA</td>
<td>PLC</td>
<td>30y</td>
</tr>
<tr>
<td>A9</td>
<td>KPMG</td>
<td>APA</td>
<td>PLC and SME</td>
<td>13y</td>
</tr>
<tr>
<td>A10</td>
<td>FAR</td>
<td>APA and Development of Audit Standards</td>
<td>PLC and SME</td>
<td>36y</td>
</tr>
<tr>
<td>A11</td>
<td>FAR</td>
<td>APA and Development of Audit Standards</td>
<td>PLC and SME</td>
<td>34y</td>
</tr>
<tr>
<td>A12</td>
<td>RN</td>
<td>APA and Audit Director</td>
<td>PLC</td>
<td>17y</td>
</tr>
</tbody>
</table>

*Table 2. Overview of respondents*

Operationalization of the interviews

As mentioned above we conducted a total number of 12 interviews. Our initial intention was to gather 15 interviews, however lack of availability and time restraints restricted our original objective. Nevertheless our interviews were conducted with auditors containing different backgrounds and perspectives as a result of their own professional career path. This enabled us to analyze data coming from different individuals working at different organizations. Furthermore, it was also important to use strategies to help ensure that informants are honest when contributing with data, which thereon increased the level of validity in the research (Shenton, 2004). This was why each participant was given the opportunity to be anonymous, meaning that only the title and firm was disclosed. The duration of our interviews lasted between 45-70 minutes. All of which were recorded and supplemented by notes. By recording each interview we were able to focus on participating more actively in the dialog with the respondent where follow-up questions were enabled (Shenton, 2004; Bryman &

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\(^6\) Public listed companies

\(^7\) Small and medium-sized enterprises
Bell, 2007). All interviews were immediately transcribed after each interview in order to attain a structure in our empirical findings. The data was collected and handled in a systematic way. Since the interviews obtained much information, Denscombe (2009) argue that is important to make a distinction between the information to decide on what can be attached and what part that can be omitted. Furthermore, Denscombe (2009) state that a good way to analyze empirical data collected through interviews is to divide the information into themes. As such, depending on each respondents interview the data were divided into themes to facilitate the analysis. Recurring patterns and interesting views that were linked to the theoretical framework established these themes. Furthermore, these were founded on the responses on the given questions by identifying similarities or contradicting views. This ultimately helped us draw conclusions linked to our research problem.

The use of our pre-study was beneficial for several reasons, first it strengthen the relevance of this paper since it developed a deeper understanding regarding the challenges auditors might face when conducting the new audit report. It was also beneficial since it illustrated weaknesses in our interview guide, which enabled us to revise some of the questions (see appendix I and II). Furthermore, we only used open-ended questions, which reduce the risk of biased answers (Saunders et al., 2009). Accordingly, adopting open-ended questions indicates that there are no right answers; it is rather the personal experiences of our respondents that we were seeking to gather. Also, due to the fact that measurement is not a major concern in qualitative research, external reliability involves the degree to which a study can be replicated. This criterion is very difficult to accomplish in qualitative research. Since the social situation and conditions is constantly changing the ability to replicate the exactly same environment is doubtful. Our study is based on the auditors’ interpretation of KAM before the actual experience of KAM. Therefore the results of this issue might vary in the future making the study hard to replicate. However, the values, opinions and experience of how auditor(s) balance the requirement with providing new information to stakeholder while not trespassing TCD with their client can be replicated in any other field where such a liaison is established. Furthermore, in order to establish dependability to our research, we kept all records of all phases of our work, such as interview transcripts, interview notes and our method of analyzing data, which increases the level of reliability for future studies.

Another crucial aspect that might affect the study's trustworthiness negatively is the fact that the ISA 701 has not yet been put into practice. If instead, the study had been carried out during a time when the standard was implemented this would give more reality-based response based on their practical experience. However since the application of the new standard is based on the auditors’ professional interpretations and judgments this study has been possible to implement. KAM shall be established in accordance with auditors own interpretations and judgments which means that the response gathered throughout our interviews represents how they will establish their opinions in the audit reports.
V. Empirical findings

This chapter presents the empirical findings collected for this paper. Each respondent’s views and interpretations are presented under specific headlines before the chapter ends with an empirical summary. The complete interview guide is to be found in appendix 1.

Purpose of the audit report

In order to enable a natural conversation each interview started with an overview of the current audit report. The vast majority of our respondents were in agreement regarding the purpose of the report, which was that it marks a stamp of quality, authentication and confirmation that the figures provided present a true and fair view of the entity. In addition to a verification of the provided information, A7 argued that the purpose is to show whether it is qualified or not. Meanwhile A3 and A8 argued that it is purely a stamp of quality assurance since it does not provide any information on what has been touched upon during the audit. Still, although all respondents had a fairly similar understanding of the current report there were some disagreements on whether the standardized design is appropriate to fulfil the purpose that auditors believed it should. Respondents, A1, A3 and A12 argued that the current report meets the requirements to fulfil the purpose of the report. This is because the design is easy for users to understand and only competent users will have the knowledge necessary to obtain value of the report when its not standardized (A1). According to A12 a qualified audit report does not need to be more than standardized. “Auditors role is to review the information, not to be an information provider for the entity and for that, the report does not need to be more than standardized” (A12). One of the respondents’ believed that the introduction of KAM in itself might confuse users. This is because, today’s readers already have difficulties to understand what is conveyed in the report and by providing additional sections this will confuse users even more (A5). Another respondent also claimed that the extended audit report might cause difficulties since the messages is formulated using a language that is considered difficult for users and thus might increase the level of misconceptions.

“It is important that the audit report retains a certain standard design in order to maintain some form of comparability between the companies. The new auditor's report must be designed so that users can understand the message by retaining the standard formulation while it gets a little more individualized”.

Respondent A4.

Others claimed that the current report result in that auditors are highly controlled by the requirements that is to be found, such as checklists and templates that restrict
the amount of information that can be made public. As such, these requirements limit the value that users are looking for. A8 argued that by looking at today's report is does not convey much information and users have no idea of what the auditor actually looks at and how he/she has assessed those risks. These findings are supported by A9 whom argues that it is easier for auditors to ‘hide’ behind today's report.

In that regard, the majority of the respondents agree that the current report needed to change in order to create a report with a larger impact on users. According to A10 and A11 the current report is partially fulfilling its purpose, this is because the design is suitable for some entities but not all, i.e. it is of no value for entities that are functioning on the capital market with stocks and bonds.

**Auditors role and responsibilities**

Although some respondents argued that the standardized design is most appropriate there were consent among the respondents emphasizing that larger entities compel a stronger demand for more informative value in order to meet users needs. With that said it should be stated clearly that all respondents are in favor of the new regulation, the inconsistency arises when we discussed the standard in detail. The interpretation of what the new regulation means was a matter that obtained diverse opinions depending on the individual at hand. Based on our results it appears as if the new paradigm shift of auditor reporting is a complex matter, one that lacks clarity in terms of applied responsibilities. Respondents A2, A3, A5, A7 and A8 claimed that it is not auditor’s responsibility to provide entity-specific information. It is instead management that should bring up the risks and estimates before auditors step in to review those and tell which matters they assert as KAM and how these risks are being handled (A7). A6 argues that the ultimate responsibility lies on the company but that auditors are involved in the process, ergo also responsible for putting the information on the table. Although A1, A4 and A12 agree on that it is auditors responsibility to provide such information they were still cynical in their answers. A1 stated that the standard put that responsibility on auditors but that it cannot be to detailed. “It is a difficult task to handle, it must be enlightening but not to detailed, I think I will be standardized in the end” (A1). A12 are inline with A1 and claims that the new regulation put that responsibility on auditors even though it is still unclear to what extent that information can be provided. Interpreting the above it can be said that even though A1, A4 and A12 claimed that the responsibility is on them, their answer indicates otherwise. That would be that they are cynical to whether it will be possible to include such information in the reports.

The respondents all claimed that while they have a responsibility towards the client they are accountable towards the users as well. Auditors must combine both these elements when conducting the report. However some of the respondent mentioned that users believe that auditors knows (or should know) everything about the company
into the smallest detail which is not the case. According to A3 auditing is about materiality:

“One has only to focus on significant risks. Those big risks should be put on the table and how they are handled. The small fish have to swim through the net otherwise there will be information overload. This is essentially very important. It is up to the auditor to have a professional attitude to this and not write inessential page up and page down, that would be wrong”.

*Respondent A3.*

**Direct impact on audit reports**

**KAMs requirements**

Although all respondents were in agreement regarding the need for a new audit report there were different views regarding the purpose ISA 701 are hoping to fulfill. A2 and A9 are hopeful that the implementation will provide more professional users added information. To do so, the new audit report would have to cover more entity-specific information that is valuable to investors. Yet, when we touched upon this matter during the interviews most respondents were skeptical to how entity-specific the auditor can be. All of the respondents argued that it is impossible to move away from generic risks, which are similar to industry-specific risks. However if KAM are defined as generic risks, the risk is still applicable on the entity but the level of details is limited due to risk of exposing information. The main challenge for the industry is to ensure that they express themselves in a way that does not harm the company; thus resulting in an extended reporting process (A8 and A9). A major factor according to A1, A4, A12 is the confidentiality towards the client and that the freedom of prohibition hinders the chances of being to entity-specific. Simultaneously, the majority believed that providing entity-specific information is outside the scope of auditors’ responsibility.

Respondent A4 and A9 argue that the fact that it needs to be approved by multiple parties within the audit firms including lawyers and in house councils makes it impossible to move away from a standardized design. The process is a necessary action to increase the safeguard that the information provided does not expose the entity. The impossibility to move away for a standardized design is supported by most respondents. Likewise, A2 and A3 argued that in the end of the day, the client pays for auditor’s work therefore the tendency to increase the amount of hours spent on the reporting process every year is very low signifying that a standardized design might be a natural consequence in terms of resources. Also, respondents A1, A6 and A10 believed that the implementation of KAM will require a higher level of competence from users and that much of the information provided might be hard to grasp for non-professional users as well as understanding what is deviating. In addition, there were inconsistencies on what is possible to bring forward in the audit report. A3 argued that
it is a very difficult distinction. Transparency should be positive for both parties but it cannot affect the clients business. “If there are any risks that they company haven’t addressed then it’s a good thing that we bring them forward, but there are always some matters where we feel that we can not write about. Where that limit is? I don’t know” (A3). Respondent A7 were inline with the above mentioned, however she argued that If there are matters that in her opinion needs to be brought forward then we must dare to take that dialogue, “we must be accountable in those situations” (A7).

Others argued that the maturity phase of the entity would affect the entity’s willingness to disclose matters as KAM (A12). This is confirmed by A2 whom argue that large public companies are very stable because they are of public interest as such, the respondent does not believe that KAM will affect the transparency for larger entities. A11 support this allegation and argue that smaller entities that in their growth phase will consequently have larger insecurities and thus KAM may be of higher influence in those cases. Our respondents from FAR who play a vital role in the development of professional standards for the audit profession argued that the recent changes in the reporting model have caused fear among individual auditors who have contacted the organization with insecurities on how to establish KAM (A10, A11).

Likewise A10 argue that the audit judgment of what is most significant may vary depending on the auditor that might cause questions for the profession. A10 refers to an example in which the entity have changed the auditor, would there be inconsistencies between the previous auditors KAM and the new auditors KAM it will bring up a series of questions. This is confirmed by A11 and A12, whom claimed that a transition phase might impose complications for the industry.

Nonetheless A3, A5 and A8 argued that the standard might reduce the expectation gap from the perspective that it is clarifying auditors’ role and that it will be easier too see what has been done during the audit. A7 however does not believe that the expanded audit report in itself will affect the gaps; this is because the new section includes fairly self-evident matters, which does not add any valuable information to users. The respondent argues that users should be aware of which items that is significant resulting in that the expectation gap will persist (A7).

**Direct impact on audit reports**

**The confidentiality duty**

The increased risk of litigation contributes to auditors being wary of leaving out to much information in the audit reports (FAR, 2013). This entire section is built upon this statement and FARs prediction have proven to be right, at least according to the respondents of this paper. Respondent A11 belief that auditors are only willing to disclose information if its required by law and not undermined by TCD. Furthermore, the respondent argues that there is a grey area of what auditors can comment on
without the fear of litigation (A10). In that regard A10 refers to an investigation by FAR which shows that there needs to be clearer regulation regarding KAM contemplating on what the auditor may or may not include in order to not violating confidentiality. A3 mentions that TCD will have a big impact on what information that is possible to put into words in the reports; “our clients must be able to rely on the auditor, confidentiality is the basis of an effective audit. Clients must depend on that the auditor knows what they are doing, that they have made a proper supervision of the company” (A3).

Overall all respondents agree on that it is a difficult task to decide on what is possible to bring forward without damaging the company. There were some inconsistencies when we deliberated that question more closely. A3, A8 and A9 argue that even though the balancing act is difficult they were confident that prior experiences in the UK and the Netherlands would help clarify on what can be brought forward. A7 argued that it is important that there is a clear consensus between the auditor and the entity in terms of the risk that are presented as KAM. “If we bring forward a risk which the company does not see eye-to-eye on then we have a problem, but that is not a problem that have occurred in the last minute it has rather been a problem all along” (A7). Other respondents argued various scandals involving the auditor has led to auditor being more cautious when they express their opinions (A8, A10). Furthermore, those same respondents are convinced that more communication will be held with the board of directors since they will be more interested about what will be expressed.

More interestingly, there was not a single straightforward answer by any of our respondents on situations where auditors and management did not have a clear consensus on specific matters. Instead the answers referred to that if such a situation would occur then it is a big problem, but how they were going to handle such a situation was not answered. A6 argued that in a situation where there is not a consensus about a KAM there is a hassle with no good way of moving forward. “In that situation TCD outweighs otherwise, the risk of litigation is in the air” (A6). This answer does not come as a surprise since A6 argued that there is a risk that the industry is not brave enough to challenge management and board of directors.

According to A8 the trade-off is the biggest challenge and further argue that if a matter might be harmful to disclose then he leaves the matter to the chairman of the board and that it will be different depending on each case. Even more cautious was A7 whom argued that auditors are not allowed (!) to disclose entity-specific information and thereon only risks common to companies in the same industry will be brought forward. This statement suggests that the respondent is not willing to take the active responsibility that is expected by KAM. Others disclosed a more courageous answer pointing out that such situations require more consultation with those charged with quality insurance and claimed that the bottom line is that if they feel that this needs to be included then they put down their foot and write about it (A3).
Although a small minority of the respondents argued that it is important that auditors take responsibility and come forward when necessary, the majority held a passive opinion. It is clear that there is a belief in the industry that the TCD may produce similar KAM for companies within the same industry, which limits the level of informative value that can be delivered. This is because TCD outweighs the duty to deliver information to users since auditors could be facing litigation. Nevertheless, A10, A11, and A12 argued that a reduction of the secrecy and liability claims would most likely end up in a report where more information comes out which ultimately puts the audit report a step closer to reducing the existing gaps.

“One thing that could make that one becomes tougher would be to put a limit on the damages so we can have more space to provide more information to users. This gives auditors the support by law to make more public statements without damaging the company”.

Respondent A11.

**Indirect impact on audit reports**

**Client-relationships**

In terms of client-relationships most respondents argue that the new regulation will affect the relationship to their clients. However, there are differences as to what extent that affect will be. A3 emphasize the importance of professional attitude, which is the foundation in the relationship with management. Furthermore, A3 states that auditors have mandate over management to provide the information needed. A7 on the other hand states that KAM will be decided depending on what the entity decides to address. Other areas that KAM might affect is the audit process, which now will involve an increased dialog with management to reach a consensus so that the KAM brought up by the auditors is also presented by the entity. In that situation A1 mentions fears of having the dialog with management in the aspect that it will give an indication of what the auditor will focus their investigation on. A2, A5, A6, A7, and A9 state that KAM may increase the discussion with the client especially in cases where the auditor and the management do not agree. A1 have a somewhat neutral opinion, claiming that discussions will be more resilient, both for good and bad. Furthermore, A8 argues that it will have an affect, but that the affect is linked to the professionalism of the individual auditor. In addition A8 stated that “in my work I have already brought up similar matters before, but now that they will be put in to words I don’t know if they will be as tolerant”. A6 believe that as long as they see eye-to-eye with the client on certain matters the relationship will stay solid but in instances where they end up with different perceptions of a matter that’s when the relationship will be affected.
Empirical summary

Overall, the respondents of this paper have a positive approach to a change of the audit report. However, the point of view in this paper has focused on the potential shortcomings of the standard. As such, our empirical basis provides some positive elements but attention has been put on challenging elements that the standard might entail (see table 3). First and foremost most of our respondents argue that auditors role and responsibilities in forming the audit report have not been sufficiently clear meaning that users have put responsibilities on auditors that are outside their scope of the audit engagement. Although the respondents are in favor of an increased transparency in the reports they simultaneously underlines that such transparency is limited as a result of laws and regulations in the form of TCD. Likewise, the majority of the respondents’ consider the fear of trespassing TCD and the balancing act of what to bring forward without breaking confidentiality to be the toughest challenge.

It is clear that this matter have caused some insecurity since even those whom argue that the standard put that responsibility on auditors provides cynical responses as to how that will be possible without trespassing the confidentiality. Our respondents from FAR who argues that the implementation has increased the fear amongst auditors confirm this. The unclear path of the determination of KAM and how transparent one can be is further illustrated by many of the respondents who states that it will be hard to find the right balance between resulting in that the industry will glance at examples elsewhere to see how its been done before.

Furthermore, the majority of the respondents argue that the risk of litigation has a direct impact on the amount of information that is revealed in the reports. As such auditors are facing a big challenge to formulate themselves in a way to avoid harming the company. This insecurity resulted in that a few respondents implied that it is necessary to maintain some form of standardization in the audit report to maintain comparability between companies. Although the majority of our respondents consider that the individualization is beneficial for users they argue that it is difficult to apply in practice.
## Main considerations

The following table illustrate the main considerations brought forward by the respondents

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|A1 | The new standard will require a higher level of competence that might result in that non-professional users will miss valuable information.  
   | The standard require auditors to provide entity specific information, something A1 feel uncertain about.  
   | A major factor to auditors’ disability to provide such information is TCD.                  |
|A2 | The maturity phase of the entity might affect the willingness to disclose KAM.               |
|   | A standardized design might be a natural consequence of clients low tendency on the amount spent on the audit. |
|A3 | Transparency should be good for both parties, difficulties determining the trade-off between TCD and what to include.  
   | TCD will have a big impact on auditors since clients must be able to rely on them in order to have an effective audit. |
|A4 | Important to remain some form of standardization to be able to distinguish between entities.  
   | TCD hinders auditors’ ability to be to entity-specific.                                  |
|   | The standardized design might be a consequence of the extended reporting process.           |
|A5 | KAM will have an impact on the existing gaps since the roles and scope of work will be clarified. |
|A6 | TCD will outweigh in situations where there is uncertainty regarding a specific matter.  
   | The ultimate responsibility is on the entity but auditors are involved in the process.   |
|A7 | Auditors are not allowed to disclose entity-specific information.                           |
|   | The new standard will not reduce the existing gaps.                                       |
|A8 | Biggest challenge is to express opinions without harming the entity.                        |
|   | Auditors are being more cautious because of prior scandals.                                |
|   | TCD will outweigh in situations where there is uncertainty about KAM.                       |
|A9 | Difficulties in terms of valuation of certain matters and the assessment of those matters. |
|   | Difficult to determine how much information the auditor must submit in the audit report without clashes with TCD. |
|A10| The implementation has brought uncertainty from auditors.                                   |
|   | There is a need for clearer regulation on what is possible to put as KAM.                   |
|A11| Maturity phase and transition phase might affect KAM.                                      |
|   | The secrecy and liability claims should be limited to enable more information in the reports. |
|A12| The risk for revealing sensitive, confidential information that the client itself does not reveal in the annual report might lead to more generic writings in the description of KAM.  
   | The audit report does not need to be non-standardized because auditors are not information providers.  
   | Reduction of liability claims is needed.                                                  |

*Table 3. Empirical summary.*
VI. Analysis

In this section the empirical findings of this paper will be analyzed. This analysis is based on our four presumptions presented in our analytical framework (see figure 3). Through our analysis we have sought to fulfill the purpose of this paper.

Presumption I and II

![Diagram of Presumption I and II]

Figure 4. Presumption I and II of the analytical framework.

One of the underlying rationalizations of the development of the new reporting model was that they were to generalized- a one size fits all product (Hjelström, 2015) failing too satisfy users need whom called for more specific information in order to obtain value from the report (Zhang, 2007). Based on the PT, auditors’ interpretations create the basis of the audit profession. Therefore, their perspective on the purpose of the audit report together with guidelines found in standards and regulations indicate what auditors aim to deliver through the audit report. As such, the collection of empirical data started off by contemplating on the purpose of audit reports and the expected value it might deliver. All of the respondents agree that purpose of the audit report is to confirm and provide quality assurance on the entity’s financial statement, which is inline with Wallace (1980) and Lin et al. (2003). However, there was some disagreement on whether the standardized design is appropriate to fulfill that purpose. This can be explained using IOSCO (2009) and Simnett and Huggins (2014) as reference, those arguing for a standardized report states that it needs to be simple and straightforward in order for users to obtain value of the report. Other respondents confirm the studies by Asare and Wright (2012) and Carrington (2010) that the standardized report does not allow for anything in between the ‘passing range’ between a pass and a fail report meaning that there is no way to distinguish between companies.
The PT states that if an auditor does not accept that providing entity-specific is part of their responsibility then they will most likely not include such responsibilities in their scope of work. This is because that the audit profession is a reflection based on individual auditors interpretation of one, auditors’ view of their own responsibility and two, auditors’ view of the purpose of the reports. Comparing our results with our theoretical findings it can be interpreted as if auditors are taking a passive responsibility. This is because our findings imply that auditors are keener to follow laws and regulations rather than putting themselves in a position where litigations might occur. Respondent A10 and A11 from FAR strengthen this belief, they argue that the implementation has caused ambiguity among the audit profession resulting in that several auditors has raised concerns regarding how KAM are to be determined and to what extent information can be disclosed.

We mentioned in our empirical findings that the applied responsibilities of the new regulation obtained different answers depending on the individual respondent. Our findings imply that only a minority of our respondents argued that it is part of their responsibility to provide entity-specific information. Most of our respondents argued that such responsibilities lie on the entity and that auditor’s role is to verify the presented information. This is inline with MARC (2011), which argue that such responsibility should be put on the entity the obligation cannot be assigned to auditors.

PCAOB (2013) argue that KAM are implemented to reduce the information gap that exists between users and the entity. To do so, the new audit report would have to cover more entity-specific information that is valuable to investors. Still as we mentioned in our empirical findings most respondents were skeptical to how entity-specific the auditor can be. This is related to Humphrey et al. (2009) paper who found that the fear of trespassing TCD might have an indirect impact on the caution taken in the reporting process. Likewise the conflict between the standard and the ethical norms of TCD contributes to auditors’ willingness to stay within the regulatory framework guidelines (Humphrey et al., 2009; Catasús et al., 2013). This is further strengthened by using the SET, which states that auditors feel obligated to the client and wants to produce favorable outcomes (Lavelle et al., 2007). This is presented in our findings that respondents have a higher tendency to prioritize TCD to decrease the risk of litigation.

Simultaneously, our respondents declared that the uncertainty regarding the level of details that can be disclosed would lead to an extended reporting process since the report needs to be approved by multiple parties. Accordingly, the extended process increases the amount of resources spent (in terms of cost and time) suggesting that the audit report will not be able to be formed in a non-standardized design. This is justified on the basis that at the end of the day clients have a low willingness to increase the amount of hours spend on the reporting process meaning that a standardized design might as well be a natural consequence in terms of resources. All
of the respondents argued that it is impossible to move away from generic risks, which are similar to industry-specific risks. However if KAM are defined as generic risks, the risk is still applicable on the entity but the level of details is limited due to risk of exposing information. A possible solution to this would be to put a limit on the damages so that auditors have more space to provide more information to users (A11).

Other respondents pointed out that the requirements of KAM might affect entities differently depending on their maturity phase (A12). This brings another challenging aspect to see how auditors will act in those situations where entities that are in growth phase with higher insecurities choose what to report as KAM. This will perhaps affect the profession since auditors have to take entities maturity phase into consideration and the consequences different KAM have on such entities. Therefore, it will put the auditor in a difficult position when reasoning what to include and report. Nevertheless, our result implies is that there is a risk that audit reports are conducted differently depending on the individual auditor. This is according to Cordos and Fulop (2015) a consequence of the absence of clarity presented in the new standard. The respondents of this paper argued that a result of the new standard would be an extended reporting process such as in-house counseling for instance. This implies that while it might not differ among auditors within the same firm, audit reports might be conducted differently depending on the audit firm that has audited the audit report. However, this matter has not been the focus in this paper but it does provide an indication for future research.

**Presumption III**

![Diagram](image.png)

*Figure 5. Presumption III of the analytical framework.*

There were some inconsistencies among the respondents on whether KAM will have an impact on their relationship with their clients. One of the respondents argue that it is important that their clients feel trust towards the auditors and that the confidentiality towards the client is the primary factor in order to have an effective audit. Approximately half of the respondents supported this opinion. This could be explained using the SET, which states that relationship between professionals and individuals are characterized by trust and commitment developed by a long-term focus initiated by positive interactions (Herda & Lavelle, 2013). However, the theory
also argues that when such a relationship is built auditors tend to feel an obligation towards the client meaning that they tend to act in favor of the client to provide positive outcomes to not harm trust in the relationship (Cropanzano & Mitchell, 2005). This is confirmed by some of the respondents. In situations when a matter may be harmful to disclose one respondent argued that such decisions is passed over to the chairman of the board to determine whether it can be disclosed or not (A8). The statement above might be what MARC (2011) was referring to when arguing that such matters would lead to endless discussion with management that ultimately end up as boilerplate statements. Furthermore, this suggest that the auditor value the relationship towards the client and thus acts in favor of that client since it is up to the board to decide if it should be included or not. The SET also develops an obligation from the auditor towards the client (Lavelle et al., 2007) this obligation takes form legally through TCD. Another concern that was raised was the increased dialog that will be held with management, A1 claimed that such discussions might indicate what the audit will focus on which contradicts the ability to perform an effective audit.

Prior research provided ample indications showing that TCD outweighs auditors’ duty towards the users (see Adams et al., 1995; Arnold et al., 2005). This is further confirmed by respondent A6 who stated that the risk of litigation and prior accounting scandals have resulted in that auditors priorities TCD to maintain the auditor-client relationship. A2 are inline with the abovementioned but provides a different reasoning arguing that a non-detailed report would never lead to any legal actions. This strengthens the approach applied in this study that the fear of trespassing TCD and the consequences it brings such as damaging the client-relationship has an indirect impact on auditors. This is because auditors tend to be more careful when deciding what to include in the audit report which have lead to that they are more cautious when expressing opinions.

**Presumption IV**

![Diagram](image)

*Figure 6. Presumption IV of the analytical framework (Same as figure 3).*

Our empirical findings suggests that the profession does not accept the responsibility to provide such information that is required in order to reduce the
information gap since TCD hinders auditors in their opinions. As mentioned before, the consequences might increase the carefulness when conducting the audit report. As such this suggests that the implementation of KAM might fail to decrease the information gaps due to the (probable) standardized designed it will take. However, there are strong beliefs showing that the implementation of KAM will clarify auditors’ role and their responsibilities and thus, ultimately reduce the expectation gap. Likewise we mentioned earlier that the extended reporting process would increase the amount of resources (in terms of costs and time) spent suggesting that the audit report will not be able to be formed in a non-standardized design. All respondents do not see the risk that the report remains standardized as a problem. A6 argued that by moving away from the standardized report, users would direct their attention to what is highlighted as KAM and thus might overlook other valuable information. This is confirmed by Sirois et al. (2015) and Church et al. (2008) studies that identified that there is a negative relation between the amount of information received by users and the relevance of the report. Simultaneously A4 argued that it is important to remain a certain standard design to maintain some form of comparability between audit reports. This is further strengthened by Guénin-Paracini et al. (2014) who argued that the risks attached with the audit profession often lead to auditor’s desire to apply standardized procedures. Because breaking TCD will not only increase the risk for litigation it will also affect the client relationship and according to SET auditors feel obligated to client and want to produce favorable outcomes.

Also some respondents show concerns about the fact that KAM will contribute to a longer audit report and thereon put higher demand on users to have the competence needed to process the information. This is inline with (Church et al., 2008; Sirois et al., 2015) that address the difficulties users will have to interpret the report and that the relevance might decrease because users retrieve more information to take into account. FAR (2013) expressed concerns that the auditing regulation in Sweden, which regulates TCD might conflict with the new standard. This is because on one hand auditors are not allowed to harm the companies by publishing sensitive information whereas on the other hand in accordance with ISA 701 auditors are to inform about areas that they identified with significant risk during the review. On these grounds some of our respondents states that a change in the regulation is necessary in terms of auditors communications so that the audit report will be more efficient from the users perspective. Öhman (2007) also suggests that the additional content of financial statements can be beneficial to the users but that it also involves the publication of confidential information where a greater risk to the auditor is attached and in addition, higher costs for the company. Furthermore, some respondents assert that auditors want to become more transparent in the audit report but that it will result in that every word that adds up to the audit report must be carefully formulated so that they will not encounter any lawsuits.
VII. Conclusions

This final chapter presents the conclusions of this paper. It also contains thoughts and reflections on the matter as well as practical and theoretical implications of the paper and ends up with suggestions for future research.

Concluding discussion

This paper set out to develop an understanding of how auditors interpret the requirement of ISA 701 and how it might be reflected in the new audit report. This paper has shown that although the respondents of this paper are in favor of the implementation of the new standard, the industry is characterized by considerable uncertainties in terms of practical application. It appears as if there is a conflict between auditors and regulators in terms of applied responsibilities. Regulations assume that auditors respect the confidentiality towards their clients, while the new standard requires the auditor to express an opinion on the matters that have been most significant. Since auditors have a willingness to stay in the regulatory framework, the communication through the audit report might be limited seeing that auditors must make several considerations about what is appropriate to disclose in the audit report. We presented arguments showing that TCD is linked to auditors’ willingness and possibility to disclose entity-specific information. Professional secrecy is protected by TCD and is a prerequisite for the audit, which makes TCD a keystone in the audit profession. This is confirmed by our result, which suggests that auditors’ fear of trespassing TCD might be reflected in the caution taken in the reporting process. The caution taken in the reporting process does simultaneously have an impact on the ability to move away from the current standardized form. According to the SET, the willingness to expose the entity is small due to the fact that auditors’ feels obligated towards the client, which this study reinforces. It can also be stated that the increased transparency has put fear on auditors who claim that every word needs to be carefully formulated so that they wont encounter any lawsuits.

Similarly this study shows that some auditors believe that adding to much information could receive abnormal effects, resulting in that users ability to designate all valuable information and that a complete removal of the standardized design would attach a greater risk on auditors and higher costs for the clients. In addition, our findings confirm that there is relation between the types of significant risks chosen and the willingness to disclose these depending on the maturity phase of the specific entity. The presented results also imply that the increased dialog with management might have an impact on the client relationship. However, to what extent auditors will be affected by the obligation towards the client remains an empirical question. We believe that the two-sided mutually rewarding process between the auditor and the client will decrease auditors willingness to put themselves in a position where they
might trespass TCD. This argument is based on our respondents’ low propensity to put themselves in a risk position, which suggests that auditors with a low risk-appetite would most likely provide a more cautious approach in their statement. We also find that auditors consider the new paradigm shift of auditor reporting as a complex matter, one that lacks clarity in terms of applied responsibilities. In that regard it begs the question of whether the new auditor-reporting model allows the auditor to be the player who fulfills the gaps. Our findings indicate a number of limitations, which hinder the ability to decrease the information gap. However our respondents believe that the expectation gap might be reduced since auditor’s role, responsibility and the scope/difficulties of their work is clarified.

Furthermore, our respondents from FAR and the Swedish supervisory board of public accountants states that a change of the legislation is necessary in order to streamline auditors communication through the reports. We support the arguments mentioned above. This is because auditors are bound by laws, rules and recommendations. These settings provide the foundation in which trust can be created for financial reports. The audit report is the result of auditors’ interpretations and assessments of these regulations. Seeing that auditors are restricted in terms of confidentiality, a negligent behavior might expose themselves to lawsuits, which increases their willingness to stay within the regulatory framework. As such we believe that auditors are put in a higher risk position since the new report exposes auditor's work in a way that implies that a cautious approach might be a natural consequence. Since the standard require an increased amount of information it is important that auditors receive better prospects making them wanting to give more information. In other words a better balance where both transparencies of the audit report increases while auditors don’t fear providing too much information. In that regard one option would be to introduce a change of regulation that limits liability claims. This would move auditors from the vulnerable position where fear of litigation is in the air and simultaneously increase the value of audit reports and most importantly, serve the publics interest.

Limitations of the study

The readers of this paper should be aware of some limitations that might have affected the results. The purpose of the study was to examine how auditors perceived the new standard and how their views might be reflected in the new audit report. This paper has not focused on what defines the informative value or what users perceive as informative value. Instead the informative value in this study has been classified as added information in terms of audit opinions, which means that our assumptions about the informative value might not accurately reflect what users believe, is informative. Our findings are based on individual auditors subjective judgments, which means that it is not possible to draw the conclusion that these opinions are generalizable to a wider context. Secondly seeing that data has been gathered from the big four firms in Sweden therefore it cannot be generalized to other countries since
regulation about confidentiality might differ between countries. Also, this paper is based on auditors’ interpretation of the section ISA 701 before the actual implementation. As such the relevance of our findings might be questioned. However, since the application of the standard is based on individual auditors judgments this study has been possible to implement because it contributes with knowledge and understandings of auditors thinking patterns when establishing audit reports.

Additionally, our willingness to increase the number of respondents in our paper resulted in yet another limitation. We conducted interviews at various geographic locations, which meant that some of the interviews were conducted individually. The individual interview gave room for only one interpretation and only one individual’s follow-up questions. The limitations of the sample size were tackled by focusing on having longer and deeper interviews with each respondent. Lastly, when conducting a qualitative opinion there is always a risk that respondents provide answers they believe is appropriate and acceptable by society. However this risk is minimal in our paper because of two reasons: first, it was clarified before each interview that the respondents would be presented anonymously. Second, this paper focused on auditors’ opinions regarding a subject that will be based on their own judgments which means that the level of sensitivity was not a threat to our collection of data.

**Suggestions for future research**

This paper examined how the implementation of the new section key audit matters would affect the audit profession and how it might be reflected in audit reports. Although the paper delivered valuable implications of how it might affect audit reports it is conducted before it has been put into practice, as such a natural suggestion for future research would be to replicate this paper a couple years after the implementation. This has been done before in the UK where FRC published a review of the preceding years experiences that provided valuable implications on how the intended purpose of the standard deviated from the actual reports. Furthermore, our results imply that audit reports will be conducted differently depending on the independent auditor. This is according to Cordos and Fulop (2015) one of the consequences of the lack of clarity presented in the new standard. Considering that the process will be extended as a result of more in-house consolidations it is worth to investigate if audit reports differ depending on the firm who is auditing them. That would be to do a comparative study between audit reports conducted by auditors from the big four firms to see if they are conducted differently.

Lastly our results indicated that transition phases of an entity might enforce complications for the industry. That is if there are deviations between the former and the latter auditor when determining KAM. In that regard it would be interesting to investigate if different auditors have identified dissimilar KAM on the same entity.


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Appendix I

Interview guide

General questions about the respondent:
What is your current position and title in your firm?
How many years of experience do you have as an auditor?
What type of clients do you audit?

The current audit report
- How do you view today's audit report and the purpose it fulfills?
  A) Considering the purpose of the audit report, do you believe that a
     standardized format is the most appropriate? If yes, why?
  B) Would a more informative audit report to be of value?

- What tends to be the most problematic in an audit?
  A) How do you feel the need to report these in the report?

- What is your opinion towards an expanded audit report?
  A) What disadvantages/advantages do you acknowledge with a more detailed
     report?
  B) Do you believe that a increased audit report can lead to a better insight and
     understanding of the audit?

The new audit report and responsibilities
- Does an audit report that requires additional information and risk identification
  (KAM) than the now standardized form, pose any significant changes in the auditors
  scope of work?

- Do you believe that changes in the audit report may give readers a better
  understanding of the financial statements and the audited entity? As well as to reduce
  the information gap between management and the audit report users?

  A) Do you believe that it is included in the auditor's responsibility to reduce
     the information gap?
  B) Do you believe it is a part of the auditor's role to convey not previously
     known information?
  C) Do you believe it is a part of the auditor's role to contribute to increased
     information value? If not, who should be responsible for it?
  D) Do you think that it is part of the auditor's duties to provide company-
     specific information?
  E) What informational value do you believe KAM can contribute with?
- Several sources declared concerns that the informational value of KAM risks becoming standardized and that the expected benefits hence will be lost, what are your thoughts about this?

A) How do you feel to identify and publish entity-specific information?
B) Do you consider that the KAM will reduce standardized audit reports?
C) Do you believe there is a risk that the new audit report identifies industry specific risks rather than company-specific?

The confidentiality duty
- How do you handle the demand for information from stakeholders and the demand for secrecy towards the client?

A) How do you balance this?

- Do you think that extent of the confidentiality duty can limit the ability to provide additional information and express on client's risks?

A) How do you feel about the trade-off between the requirements to publish company-specific information and risks without the risk of exposing data that can be harmful for the company?
B) Do you consider that the auditor's obligation to protect professional secrecy is are of more importance than to meet users demand of information?
C) Do you believe it will be difficult to identify the KAM in combination with discussion with management?
D) Do you believe that the introduction of KAM will affect your relationship with your clients?
E) Where is the line drawn between KAM and the confidentiality of what you consider can be included in KAM?
Appendix II

Interview guide used in the pre-study

General questions about the respondent:
What is your current position and title in your firm?
How many years of experience do you have as an auditor?
What type of clients do you audit?

- Previous research have pointed out that evaluation and valuation issues are the most problematic in the audit, do you believe that KAM give sufficient guidelines to:
  a) Determine KAM?
  b) To communicate KAM in the audit report?
  c) Avoid the chance of different audit report outcomes?
  If not, what points do you think should be reinforced?

- Do you think that there is a risk that the user perceives that the reporting of the KAM undermines the auditor's statement?

- During the exposure draft - invitation for comments EY raised concerns regarding the clarification of the term “most significance” arguing that it wasn’t clear to whom it refers to, whether its fro the auditors or the users of the report, in that regard do you considered the new and revised audit report to accurately address that issue?

- PwC commented on the auditors determination of the matter to be most significance, arguing that the paragraph (10b) doesn’t appear to address the “why” matter but instead deals with other concepts detracting from the clarity of application material, do you believe that the standard provide that clarification?

- Several practitioners raised concerns regarding the confidentiality issue arguing that new changes carry higher risks for auditor because they access sensitive information about their clients, on that note, What risks / difficulties for the auditor on the balancing of the KAM and how much information they can make public without compromising their confidentiality?

- What possible disadvantages/risks do you see in the reporting of KAM?

- Some of the big four firms raised concerns claiming that management and/or those charged with governance might have concerns that certain KAMs being exposed could lead to be perceived as failure in governance and be openly critiqued. This over time could lead to a over-reporting of matters designated as KAMs, which could reduce the effectiveness of KAM disclosures, in that sense do you believe that the current standard address this issue?