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The implementation of Key Audit Matters in Norway

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## 1.0 Introduction

Throughout this master thesis, we pursue to analyze the effects of introducing the new auditing report format in Norway (ISA 700 Revised), with particular focus on Key Audit Matters (KAM). When this thesis is written (spring 2017), the format has just been applied by Norwegian auditing firms, hence all data from Norway will be collected within the time-period of January to June 2017. Our goal is to be pioneers in collecting and analyzing the first impressions of the new standard. We will collect data to disclosure how the communication of the auditor's has improved, seen from the view of financial statements users (banks, analysts, shareholders, accountants etc.). Secondly, we will investigate if and how the communicative *value* obtained from reading the auditor's report have increased as a result of KAM and the new auditor report.

Over the past years, financial crisis have led to serious problems for investment banks where some have gone bankrupt. After several global financial crises, financial statement users have highlighted the auditor and their role in formulating the auditor's report. Investors, lenders, regulators and other users have criticized the auditor report for being too influenced by standard text with insufficient information about the actual content of the audit or the items in the financial statements that are considered risky or of high importance. Undoubtedly, the auditor has insight to several areas of the company and its condition, and additional information about the auditor's evaluations would create confidence in the auditor's work. This would also provide useful information about uncertainties, which items the financial statement users should focus on and finally, in which areas the users should challenge what the companies highlight in their financial statements (Rafen, 2016).

After the financial crisis in 2007, the users of financial statements called for an auditor report that is more informative and relevant (Revisorforeningen, 2016). As a result, the International Auditing and Assurance Standards Board (IAASB) have set a new standard for the auditor's report, which will be implemented in Norway with effect for the fiscal year 2016. The new standard will be referred to as ISA 700 Revised. ISA 701 is a part of ISA 700 Revised, and includes the auditor's responsibility to communicate key aspects of the audit in the auditor's report, or

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*key audit matters* (KAM). We will focus on ISA 701 in this thesis, but ISA 700 Revised will also be discussed to provide a broader informative foundation.

Both national and international investors have shown to be positive to the implementation of KAM, and many believe that the new standard will contribute to increased relevance and information for the users of financial statements (Rafen, 2016). A wide range of professionals explain that this is a revolutionary change to the single most tangible output of the audit, which up until now has been binary. KAM is intended to enhance the communicative value of the auditor's report, to provide greater transparency about the audit that was performed, and to increase user's confidence in the audit performed in the financial statements (IAASB, Exposure Draft, Reporting on Audited Financial Statements: Proposed New and Revised International Standards on Auditing", 2013).

## **2.0 Structure and methodology**

The objective of this thesis is to provide an insight of the implementation of Key Audit Matters in Norway, and analyze how this has contributed to improved value for the financial statement user. Hence, our problem statement is:

*"How does Key Audit Matters (KAM) contribute to increased value for the financial statement user in Norway?"*

We will seek answers to our problem based on an empirical analysis of selected theory, consultation responses to IAASB, and a descriptive analysis of the implementation of KAM in Norwegian annual reports.

The main purpose of the theory is to provide an overview of relevant literature published concerning KAM. To acquire an understanding of the research topic, in which way this topic has been researched in other countries, and which key issues have been found, theoretical literature as well as empirical research literature will be identified and evaluated. We will use general auditing theory and practice to explain how the need for an independent audit report has occurred. We will also focus on the audit and auditor's role in the society, as well as Porters theory

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related to expectation- and performance gap. In this thesis, we will explain the difference between ISA 700 and ISA 700 Revised, as well as a thoroughly explanation of the new ISA 701 regarding KAM.

We will cooperate with an audit-team in KPMG Norway throughout the process. The team has established a great interest within the field of Key Audit Matters, and they have already started examining how the reform potentially will affect the Norwegian market, as well as how the implementation of KAM has been received in foreign countries, such as the UK. Since there exists few relevant articles about KAM in Norway, we find it useful to share our theories and findings with professionals. The KPMG-team will have good knowledge on how the existing auditing report function, not the least in which areas there exists shortcomings. We believe it will be easier for us to develop a thorough understanding on how the reform affect the Norwegian auditing industry, the auditors and the financial statement users when cooperating with people that are already part of the industry, and which will deploy the reform when it implements in Norway in 2017.

In order to provide an analysis of the financial statement users' expectations, we will review responses to the Exposure Draft (ED), which IAASB published in July 2013. IAASB received 139 consultation responses, which they have evaluated and taken into account in the preparation of the new standard. Consultation responses are general opinions/attitudes to the new auditor report, and the section related to KAM is particularly emphasized, as this represents the most significant change. We will focus on the consultation responses from the big four, as well as other important international organizations.

Further, we will provide an analysis regarding the utilization of the new auditor's report in the UK. It is important to emphasize that there is not a matter of ISA, but the standard in UK is quite similar to ISA 700 (Revised) and hence we believe this will be important in the complete analysis of the financial statement users' expectations and impressions in Norway. The review will provide an insight to how KAM is communicated in the auditor reports in the UK, and how the communication of KAM develops from the first to the second fiscal year. We

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believe this is an important aspect, as our thesis only test the first fiscal year in Norway.

### **3.0 Auditing practices**

#### ***3.1 The Auditing process***

Audit is a control and scrutiny of accounts, carried out by an independent and qualified auditor. The Auditors Act stipulates strict requirements for both independence and qualification. For instance, an auditor cannot have financial interest or trust in the company he/she audits, and cannot be close family with someone who has large holdings or responsibility in the company (Altinn, 2017).

Normally an audit firm will be elected as auditor. The auditor firm will hence designate an in-charge auditor, which will have the title registered or chartered accountant. For public listed companies, the in-charge auditor is required to be a chartered accountant. The Financial Supervisory Authority of Norway has a public, updated list of all registered and chartered accountants, as well as the certified auditor firms (Altinn, 2017).

The purpose of auditing is to determine, in an objective and factual manner, if the accounts satisfy the given requirements. The requirements are given by laws and regulations, such as the Auditors Act, and international standards, such as IFRS or GAAP. The auditor evaluates the company's internal control, and if he/she finds it reassuring, they concentrates further on analytical controls.

#### ***3.2 Auditors report***

The result of the audit is an auditor's report in which the auditor comments on the financial statement and certain sections of the annual report. The auditor shall comment on whether the financial statement is made in accordance with law and generally accepted accounting principles, or notice if it does not provide such information. For the users of the financial statements, the auditor's report is hence a security that the presented statements does not contain material misstatements (Kaurel & Halbo, 2017). According to Elder, Beasley and Arens (2010) "A misstatement in the financial statements can be considered material if knowledge

of the misstatement would affect a decision of a reasonable user of the statements."

### 3.3 Auditors Act

Auditors are subject to the Auditors Act when auditing annual accounts. This law applies to audit, approval of auditors and the auditor's duties and requirements. Audit of the financial statements should be made in accordance with regulations of this Act (IFAC, 2016).

### 3.4 Audit expectation gap

"The audit expectation gap refers to differences between the public's perceptions of the role and responsibilities of the auditor and the auditor's perception of these roles and responsibilities" (Schelluch & Gay, 2006).

Porter (1993) defined the audit expectation gap as the gap between society's expectations of auditors, and auditors' performance as perceived by the society. The structure of the audit expectation gap is shown in the model below.

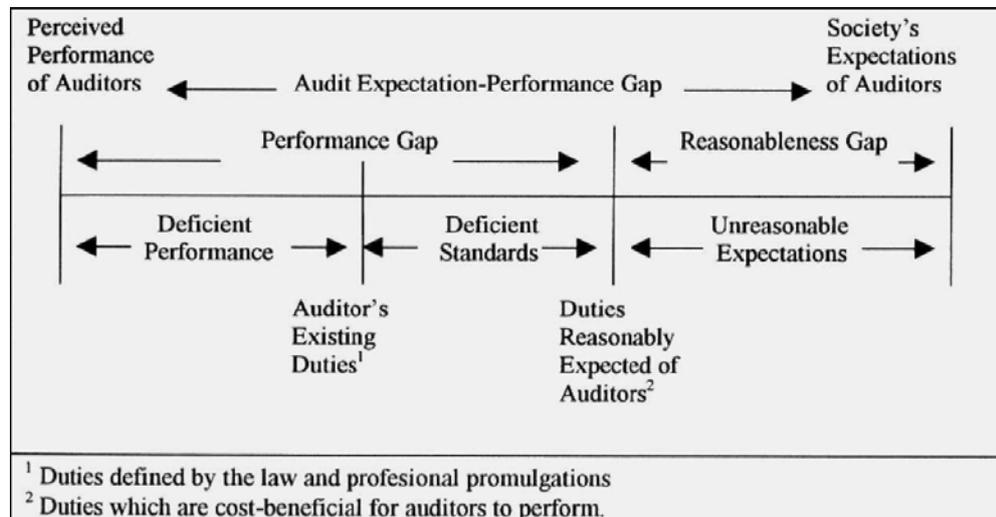


Figure 1: Structure of the Audit Expectation-Performance Gap (Porter, 1993, 50)

According to Porter (1993), the audit expectation gap has two main components:

- 1) A gap between what society expects auditors to achieve and what they can reasonably be expected to accomplish. This is often referred to as a "reasonableness gap"
- 2) A gap between what society can reasonably expect auditors to accomplish and what they are perceived to achieve. This is called a "performance gap".

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### ***3.5 Audit information gap***

While narrowing the audit expectation gap has been the main objective of previous changes to the audit report (e.g revised ISA 700), currently the focus is placed on narrowing the information gap. As explained in the IAASB consultation paper (2011), 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 or other publicly available information”.

### ***3.6 Developing a new standard***

*The International Auditing and Assurance Standard Board (IAASB)* is an independent standard-setting body that serves the public interest by setting high-quality International Standards on Auditing (ISA). IAASB is a part of the International Federation of Accountants (IFAC), but is not subject to IFAC's governing bodies in the standard setting process. The work of the IAASB is monitored by The Public Interest Oversight Board (PIOB), which is an independent body composed of members that are not practicing audit (International Federation of Accountants, 2016).

The standard- setting work in IAASB are subject to a detailed process description that will ensure a thorough job and good-quality auditing standards. Prioritization and approval of projects taken by IAASB are discussed with PIOB and the Consultative Advisory Group.

A special Task Force often carries out the implementation of a standard development. This group's mandate arises from the project approval and are headed by a member of the IAASB. If the project is of great significance or of great public interest, the IAASB decides to submit a Consultation Paper. The hearing statements will be included in the future standards work.

The Task Force submits a proposal to a draft for IAASB, which decides whether this will be submitted to a hearing. It is not unusual that IAASB have several amendments of a proposal before it is approved submitted for the public consultation. All consultation drafts are publicly available, as they are posted on

the Internet. A draft should be submitted for consultation for at least 90 days. Any interested party has the opportunity to submit consultation responses, and these will also be posted on the Internet.

The Task Force reviews received submissions, summarizes and evaluated these before they present to the IAASB. Based on this, IAASB prepares a revised standard draft and establishes it as an ISA. In addition they prepare a separate document explaining the background for the choices made in the standard. Before an ISA can be published, PIOB have to approve the process, for determining the appropriate standard, has been in accordance with the requirements (International Federation of Accountants, 2016).

**3.7 The difference between ISA 700 and ISA 700 (Revised)**

As a result of IAASB implementation of ISA 700 (Revised), the structure of the audit report is brand new. In the figure below, an overview of the differences between ISA 700 and ISA 700 (Revised) are presented.

ISA 700	Changes
Introduction	Becomes a part of the conclusion
Management responsibility	Moved to the end of the auditor's report
Auditors responsibility	Moved to the end of the auditor's report
Conclusion	Moved to the start of the auditor's report
Declaration according to laws and other regulation	None

Table 1 - ISA 700

ISA700 (Revised)	Comment
Conclusion	
The reason for the conclusion	New
Going concern, ISA 570	New
Key Audit Matters, ISA 701	New
Management responsibility	
Auditors responsibility	
Declaration according to laws and other regulation	

Table 2 - ISA 700 (Revised)

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### 3.7.1 Conclusion and the basis for the conclusion

IAASB received comments that the financial statement users' preferred the conclusion presented earlier in the audit report. Hence, the conclusion is the first part of the report with ISA 700 (Revised). A new paragraph related to the conclusion is also added, in which the auditor must explain the basis for the conclusion. In this paragraph, the auditor gives a description of the audit process, explains that he/she has followed international standards, and refers to the description of auditor's responsibility. The purpose is to increase the transparency of the auditor's work, and hence reduce the expectation gap. (IAASB, ISA 700 Revised , 2015, p. 6)

### 3.7.2 Going Concern

The financial crisis in 2007 has been an important factor for implementing *Going Concern*<sup>1</sup>. Several users of financial statements believe that a clean audit report means that the company is healthy and well consolidated. However, this is not always the case. Although the organization's annual reports are prepared on the assumption of going concern, and the auditor concludes that this assumption is correct, there will always be unknown factors that could ultimately lead to bankruptcy. IAASB has therefore determined that auditors must issue a declaration whether there, based on the audit, has been identified material uncertainties regarding events or circumstances that may raise material doubt about the company's ability to continue operations. It is important to emphasize that the auditors are unable to predict all future events or conditions, so regardless of the quality of the report, it is never a guarantee that the company's operations continues (IAASB, ISA 570 Revised, Going Concern, 2015)

### 3.7.3 Key Audit Matters

The third new paragraph is called Key Audit Matters, and represents the biggest change in the auditor's report. This means that the auditor for all listed companies must describe the essential conditions they specifically highlighted in the audit, and the auditor's work related to this. As this is an essential part of the thesis, we will describe this thoroughly in chapter 4.

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<sup>1</sup> ITC: Improving Auditor's Report, p.19

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#### *3.7.4 Management's responsibility*

The organization's management prepare the financial statements, hence they are responsible for the accounts. There is no major changes in the new audit report regarding management's responsibility. The paragraph is although elaborated, and requirements related to the description of management's responsibility has increased. As an extension of the implementation of going concern, it must become clear that the management is responsible for assessing the business to be a going concern. In this section, it is specified whether the principle of going concern is relevant for the organization. A general description of the use of going concern, referring to ISA 570 is also presented. (IAASB, ISA 700 Revised , 2015, p. 7)

#### *3.7.5 Auditor's responsibility*

The aim of the new auditor's report is to increase the transparency of auditor's work, as a part of the attempt to reduce the expectation gap. A part of this appears through changes in the section about auditor's responsibility. IAASB has increased the requirements related to the description of auditor's responsibility, that is, the section has been improved and become more specific. The purpose of these improvements is to clarify that the auditor is responsible for obtaining a high degree of assurance that the financial statements are free from material misstatements. However, it is important to mention that a high degree of assurance does not mean that the auditor guarantees that the financial statements are free from material misstatements. In the new audit report, it is however possible to specify or describe the materiality level the auditor used, so that the user of financial statements understand what the auditor defines as a material misstatement. (IAASB, ISA 700 Revised , 2015, pp. 7-8)

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## 4.0 Key Audit Matters

In this section, we will attempt to explain the purpose of implementing KAM. In addition, we will go through the rules for KAM covered by ISA 701 (IAASB, ISA 701, 2015).

### *4.1 The purpose of implementing Key Audit Matters*

The most significant enhancement in auditor reporting in recent history, from the perspective of investors and other users of audited financial statements, and their wish for more entity-specific and relevant information, is the reporting of key audit matters. The overall objective of the new and revised auditor reporting standards is to enhance the value and relevance of the auditor's report (Accountancysa, 2015). That is, the objective behind the first draft of the new standard from IAASB was to make sure that the auditor addressed all significant matters, in addition to comment on important accounting issues, with reference to the belonging descriptions in the account statement.

Originally, the section was called "Auditor Commentary", but were later changed to "Key Audit Matters" in the Exposure Draft (ED), which was issued in July 2013. It became clear from the Comment Responses that many were concerned that the section of Auditor Commentary would cause confusion regarding who was delivering the financial statement information – the auditor or the management. In addition, there were concerns regarding whether or not the name indicated that the auditor would reveal information outside the financial statement information. This made IAASB change the name from Auditor Commentary to KAM.

The Exposure Drafts revealed a wish for more information from the auditor to the financial statement users, and IAASB emphasizes that the users will get more information both regarding the most important matters from the financial statements, and the auditing process itself, through KAM.

Originally, the Auditor Commentary was applicable to all companies of public interest, but after several consultation responses and a new issue of ED, the section of KAM were changed to apply for only listed companies. The purpose of

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implementing KAM from IAASB's perspective was to increase the relevant information about the audit process- and work, and to make sure that the financial statement user got a broader insight and confidence in the audit and the financial statements. Additionally, KAM is supposed to help the users understand the most important aspects of the company and especially the areas exposed to management judgement in the financial statements.

#### ***4.2 Identification of Key Audit Matters***

KAM can be defined as follows:

*"Key audit matters are defined as those matters that, in the auditor's professional judgement, were of most significance in the audit of the financial statements of the current period. Key audit matters are selected from matters communicates with those charged with governance."* (IAASB, Exposure Draft, Reporting on Audited Financial Statements: Proposed New and Revised International Standards on Auditing", 2013)

Key audit matters, or the key aspects of the audit, are characterized as conditions that according to the auditor has the greatest impact in the process of auditing. KAM are determined from the auditor's perspective. The judgement-based decision-making framework in ISA 701 is designed for the auditor to select a smaller number of matters, which all are of particular significance in the audit. Those matters are the KAM. There are several conditions that could be of importance, such as areas with higher risk of significant errors, areas where critical judgment were necessary and areas where significant events or transactions has an impact on the audit (Accounting and Business Magazine, 2016).

Among those matters that are communicated to the management, the auditor is supposed to highlight the matters that has required extra attention. The following has to be taken into consideration:

1. Areas with high risk of substantial misstatement or significant risk identified in accordance with ISA 315 (revised)
2. Significant assessments by the auditor concerning areas of the financial statement, which have involved substantial management judgement,

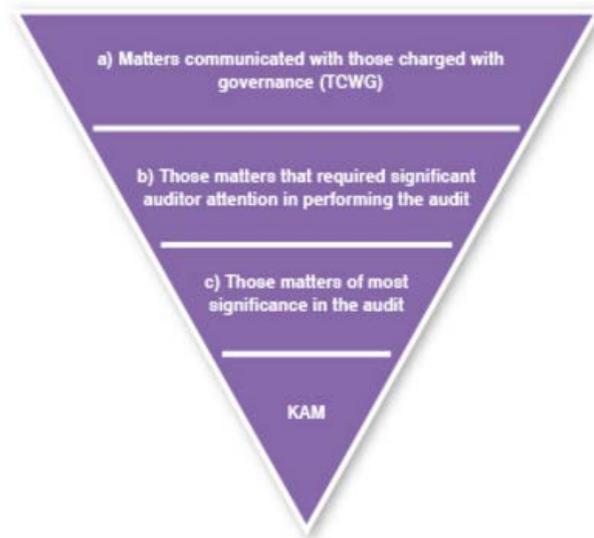
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including significant accounting estimates, with high discretionary uncertainty

3. The impact of the revision of significant events or transactions that have taken place in the period

From the listing above, it is up to the auditor to decide what factors are of most significance for the auditing of the financial statements of the current period.

Those factors chosen must be included in the section about KAM (IAASB, ISA 701, 2015)



*Figure 2: Key Audit Matters (Accountancysa, 2015)*

It is not of IAASB's interest to set a number of minimum conditions that must be communicated in the report, nor do they intend to limit the number of conditions that can be communicated. In their first draft, however, they expressed that an appropriate number could be somewhere between 2-10 conditions for a listed company. The number of KAM depends on the nature, size and complexity of the company. IAASB states, however, that a very long list of conditions most likely will reduce the effectiveness of the auditor's communications of KAM.

#### ***4.3 Communication of KAM***

In the description of each KAM, the auditor should make a reference to the associated information in the financial statement (Ernst & Young, 2016). There should be a review of the following:

- Why the matter was considered one of the most significant in the audit
- How the matter has been addressed in the audit

If it is the auditor's judgement that there are no KAM to report, or that the only conditions to mention are part of the ISA 705 or 570, it should be mentioned in the section of KAM (IAASB, ISA 701, 2015).

In terms of the communication with the management, the auditor should make sure to communicate all the conditions that has been significant in the audit. In addition, the auditor should communicate to the management if there are no relevant KAM to address.

There are two circumstances under which a matter determined to be KAM is not required to be communicated in the auditor's report. The first is where law or regulation precludes public disclosure about the matter. The second is in extremely rare circumstances, where the auditor determines that the possible consequence of the disclosure would be expected to outweigh the public interest benefit of the communication.

ISA 701 includes a 'judgement-based decision-making framework' to assist auditors in determining which matters should be communicated as KAM. In short, this framework consists of the following;

- a) matters communicated with those charged with governance,
- b) those matters that required significant auditor attention in performing the audit,
  - i) areas of higher assessed risk of material misstatement or significant risk
  - ii) areas in the financial statements that involved significant management judgement
  - iii) significant events or transactions that occurred during the period, and
- c) those matters of most significance in the audit of the financial statements of the current period (Accountancysa, 2015). KAM are supposed to be described in a separate section of the auditor's report, under the heading 'Key audit matters'.

For every key audit matter, the auditor has to describe why it is considered a key aspect and the main actions done to deal with the condition. The description of each KAM must include:

- Why the matter was considered to be one of the most significant in the audit and therefore a KAM, that is, the factors considered.

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- A reference to any related disclosures in the financial statements to enhance the intended user's understanding of how management has addressed the matter in preparing the financial statements, and
  - How the matter was addressed in the audit, for example descriptions of the auditor's approach, a brief overview of procedures, outcome and key observations, or a combination of these (KPMG, 2016).

The communication in KAM happens in conjunction with the auditor's conclusion on the financial statement as a whole. It is important to notice that KAM is not supposed to replace any modification of the auditor's report. All modifications shall be processed by the relevant ISA. In cases where the auditor has made reservations in the conclusion, those should not be included in the section of KAM, according to ISA 701. This also applies for cases where the auditor expresses a lack of conclusion for the financial statement. KAM should rather include a referring to the section containing the relevant modification (IAASB, ISA 701, 2015).

In order to create value added for the financial statement user, IAASB emphasizes the importance of a detailed description of the relevant KAM. It is essential that the description is adapted to the actual circumstances, and that standard formulations is minimized.

The importance of a trivial language also emerges – for the users to understand, the auditor have to describe KAM in a clear and specific manner. This means that the auditors need to avoid standard formulations and advanced terminology. The new auditor's report will require more dialogue, discussions and close cooperation with the management and audit committee/board. This will be a complex process which are both difficult and time intensive, particularly in Norway where several companies have accounts in both English and Norwegian (Rafen, 2016).

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## 5.0 Expectations and hypotheses

### *5.1 Advantages and disadvantages*

The new standard (ISA 700 Revised and ISA 701) has already been implemented in several countries in Europe, including France. Here, some of the advantages and disadvantages has been mapped, derived from a survey of different financial statement users. The positive respondents highlight a strengthened communicative value, more accounting information support, increased room for accentuation and explanation of red flags and that the auditors to a higher degree can explain what revision involves. The negative respondents have specified some cases of conflicting views. They highlight a more complex auditing report, which makes the financial statements harder to read. Also, they fear that descriptions will become more and more standardized and thus will lose its value. Finally, they emphasize the consequence of increased information derived from the auditors – namely an expansion of the auditor's exposure to liability (IAASB, 2011).

### *5.2 KAM in the UK (based on the Rolls-Royce case)*

The objective of our thesis will be to investigate the impressions and value added after implementing KAM in the Norwegian audit reports, with the perspective of the financial report users. In terms of expectations for the implementation, it will be interesting to look at similar countries to investigate their experiences of KAM. In the coming, we will analyze how KAM has been applied in the UK. We will look at the changes of KAM from the first year of the new standard to the coming few years. We will also try to review some of the published reactions to KAM in order to obtain an understanding of the importance of implementing a new and more informative standard.

Several British companies have already presented the audit after the new standards (they were first implemented for FY 2013), and a review of some of those reports will give a glimpse of what is required from the Norwegian auditors when they implement KAM in 2017.

The annual reports of Rolls-Royce Holding have received particular praise by the public. They have been recognized for providing good and useful information to

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the readers, as well as giving a better understanding of the auditor's work.

However, not all reports have been equally praised, and there are big differences on how the implementation has been conducted in the companies where the new standard first was applied. Since Rolls-Royce have received excellent feedback, we will review the audit reports of Rolls-Royce Holdings, from both the year before the new report standard, and the first two years after implementation. We find it interesting to see which matters are included to obtain an understanding of why this report have been considered successful.

The Rolls-Royce audit report for FY 2012 was reported under the old standard. This report consists only of one side, similar to the current rules in Norway. There is issued an "unqualified" audit report, including only general information about the opening, responsibility, conclusion etc. Since this report is similar to the audit report we are familiar with in Norway today, we find no need for further discussion (Rolls Royce, Annual Report, 2012)

For FY 2013, the new audit report was implemented in the financial statements of Rolls-Royce Holdings, and this contained six pages instead of one, where the vast majority of the space was used to describe KAM. The financial statement users were thus left with a lot more information about the company than earlier. The new report were structured corresponding to the new ISA 700 (Revised) standard, starting with the conclusion, followed by a detailed description of the risks, corresponding to KAM. The audit report of FY 2013 describes ten different risks, within the areas of recognition, measurement and the presentation of income and profit (4), intangible assets (1), consolidation of accounting and valuation of subsidiaries and options (3), measurement of costs relating to financial instruments (1), bribery and corruption (1) (Rolls Royce, Annual Report, 2013).

For FY 2014, the structure of the audit report is essentially the same as in 2013. However, the risks that has been treated differently in 2014 than in the year before, has been thoroughly described. For example, there was an increased focus on sales and profit, as a result of the risk related to management's attempt to achieve budgeted revenue and profit. Also, revenues from the "sharing

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agreements" and valuation of options was not present to the same extent as in 2013 (Rolls Royce, 2014).

In comparison to the auditor's report prepared for FY 2012, the reports for 2013 and 2014 provides significantly more information to the users of financial statements. The structure of the reports are consistent, and the formulations of KAM are similar, where the risks for 2013 is maintained. The same applies for the descriptions of the audit procedures, which in most cases are identical in 2013 and 2014. In the section of the findings, the auditor arrives at the same statements as the previous year. It is a positive sign that the risks and belonging descriptions are adapted to Rolls-Royce and that there seems to be no standard formulations.

However, already in year two (2014) we find a tendency of re-usage of the descriptions from the year before, which we think can reduce the positive effect of KAM in the long run. The risk of standard formulations was expressed as a general concern in several consultation responses, and if the re-usage of descriptions continues in the coming years, this will be negative for the value added by KAM. However, it is impossible to conclude after only two years of utilizing the new auditor's report, and especially when only looking at Rolls-Royce.

### ***5.3 KAM in the UK (an overall perspective)***

When analyzing different annual reports from UK, it becomes clear that there are big differences between the reports, and almost none are as extensive as the Rolls-Royce report. In 2014, several reports identified standardized risks, which would apply to the majority of all companies, and communicated this in a very concise way. This means that the financial statement user understands that there is a significant factor in the accounts in which the auditor has spent time, but they do not necessarily get much more information that is useful.

However, from 2014 to 2015, there has been a change in the level of details, and the "standard risks" that applies to all companies have been removed. The UK auditors seems to have adjusted the identification of the KAM, and precise wording has been emphasized to a greater extent. Hence, the financial statement

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users are left with a better understanding of the risks as well as the auditor's work related to that specific risk. However, several UK auditors tend to use advanced terminology in their reports, which may cause confusion and misunderstandings for those without an audit background.

Generally, we find a trend in terms of extended descriptions of the individual KAM from the first fiscal year to the next. The auditor presents important factors in a more detailed and specific manner, and refers to the company's own descriptions of the accounts to a greater extent. Hence, there seems to be a positive development of the quality of the reports in the UK, and it is reasonable to believe that the same will apply for Norway. This means that the Norwegian auditor reports probably will improve over time, and hence we cannot expect "perfect" reports this spring in Norway (2017).

#### ***5.4 Hypotheses and expectations***

The content of the Norwegian auditor reports including KAM, as well as the impressions from the Norwegian financial statement users, will be highlighted in this master thesis. The relevant data will be collected during the spring of 2017. Based on the impressions and findings from the UK, we have been able to derive certain hypotheses that could be worth investigating for the Norwegian case. All of the hypotheses are in accordance with our main research question, and they will be emphasized in our final thesis if they provide useful information to our conclusions.

*Hypothesis 1.* Standard risks, which applies to most companies, will be presented as KAM, providing minimal additional information to the financial statement user

*Hypothesis 2.* The level of details (/audit responses) and hence information provided, will be significantly different between companies, resulting in unequal value creation, depending on which company deriving the report

*Hypothesis 3.* There will be no significant differences in KAM or the level of details (/audit responses) between the Big Four audit companies (KPMG, EY, PwC, Deloitte)

*Hypothesis 4.* Standard formulations of the auditor's response will not be found within the banking and financing industry

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*Hypothesis 5.* A majority of the investigated audit reports will include advanced and complex terminology resulting in an increased information gap between the auditor and the financial statement user

It seems reasonable to believe that the implementation and utilization of the new report standard including KAM will be similar in Norway to what we can see in other, comparable countries. Our expectations of findings is that we will find few standard formulations of risks or responses. This assumption is based on the complex industry we will investigate (banking and finance), and also the fact that we will only examine the first year of which the new standard and KAM is utilized. We expect most auditors to invest a lot of time and effort in preparing high quality reports, and it is likely that the audit companies will compete in developing the best reports, especially the first year. Further, we expect no major differences between the reports coming from the Big Four audit companies. KPMG, EY, PwC and Deloitte in Norway are constantly keeping an eye on their biggest competitors, imitating methods and routines, as well as exchanging tips and tricks. We believe it will be hard to distinguish the reports coming from the Big Four, both in terms of KAM, responses, the level of details and terminology. Lastly, we expect to find some cases of advanced terminology in the reports (especially from the biggest audit companies), which we believe will make the information gap bigger between the financial statement user and the auditor in cases where the user has little proficiency in the subject. When the reader has a high level of prerequisites, we expect the information gap to decrease with the new standard.

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## 6.0 Research Design and Method

For the quantitative part, we plan on selecting data both independently and in cooperation with KPMG. The data will consist of Norwegian auditing reports implemented with ISA 701, based on the banking and finance-industry. We have narrowed the selection to banking and finance since those reports are published within March 31 2017, which gives us sufficient time for data analysis. Hence, we will collect information about the audit reports of listed companies in the banking and finance industry, and systematize the data in an Excel file. The data will then be analyzed in a descriptive way. We will investigate whether there is an incipient standardization both in terms of selection and description of KAM, and the auditor's response of findings. We have chosen such an analysis because there in several consultation responses to IAASB were expressed a general concern that KAM will become too standardized, and hence the value of the new standard will be limited. This means that we will evaluate the value of the new audit report based on the level of standardization and detailed descriptions. The main focus will be the auditor's response of findings, and how precise and detailed they are. Additionally, the absence of advanced terminology is essential for the financial statement user's understanding, and hence the value added.

To substantiate our analysis, we will also contact a selection of financial statement users, and investigate their perceived value of the KAM and how the matter was addressed in the audit. Various groups of users could be distinguished. In order to realize a well-founded portrait of the users' opinions, different classes of financial statement users, such as institutional investors, bank lenders, financial analysts as well as the big audit companies in Norway, will be involved. These user groups have different approaches in processing information and making economic decisions and consequently will use and analyze the audit report in a different manner.

Considering the breadth and the diversity of the financial statement users, it will not be possible to select unbiased or random subsets of individual users. However, this research has not the intention to be accurately representative of its population; applying a qualitative research strategy will be satisfactory in this case.

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