

4th International Conference on

BUSINESS ETHICS & CORPORATE COMPLIANCE

May 15-16, 2023 | Paris, France

Does the auditors' voluntary disclosure in the KAMs section matter? An evaluation of audit risk disclosure on the stock market

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Before 2013 UK audit reports were extremely brief as they formed merely a small part of companies' overall annual reports, and they lacked detail. Specifically, they provided only lists of material risks but omitted details about these risks, causing limitations in auditors and their reports, lack of proper understanding and users consequently making uninformed decisions, and thus not have value relevance in the stock market. New regulations were brought in to address these and other issues, especially by having detailed Key Audit Matters (KAMs) whereby auditors should likewise list risks of material misstatement but also provide much greater respective detail about each risk. Subsequent research on how effective the new audit reports are at identifying and communicating desired detail and whether these reports impact on the stock market have generally used only the number of KAMs topics disclosed without analysing details of risks disclosed under each topic, undermining such research but also contravening the intentions of new regulations and perpetuating old problems. This paper argues that without considering details under each topic such studies are misleading and audit reports will remain limited and even problematic.

Biography

Mahmoud joined Aston University in August 2022. Mahmoud is the PhD/DBA coordinator for the Accounting Department. Mahmoud won the Student Experience Excellence Lecturer Award 2019 while working at the University of Portsmouth. He has a (BSc) and (MSc) from Egypt. He earned his (PhD) from the University of Portsmouth, the UK. He also has a (PGCert) along with over 15 years of experience between academic and professional careers - including time at the Egyptian Tax authority and various roles at universities in the UK and Egypt. He is an experienced lecturer with teaching experience in higher education and professional experience in tax authorities since 2004, alongside lecturing at The University of Portsmouth, International College of Portsmouth, Anglia Ruskin University, University of Westminster, and Kingston University.

This study therefore addresses these noted issues and empirically investigates whether the level of audit risk disclosure (ARD) in post-2013 extended audit reports under the KAMs section has any stock-market reaction (MR). To measure the level of ARD in the KAMs section, this study develops a novel risk disclosure index based on 39,369 KAMs content from 603 firms over six years, with 3,618 firm-year observations from 2013 to 2019. While finding that companies show significant variability and inconsistency in KAMs content, this research particularly conveys how shareholders pay less attention to the number of KAMs topics and instead tend to focus mainly on content comprehensively. It further provides empirical evidence for KAMs content being significantly associated with MR. The results suggests that KAMs reveal credible and relevant risk information to the shareholder, thus driving the stock market. They also shed new light on this under researched area and provide managers and policymakers with better insights into how KAMs content can contribute to enhancing the disclosure of audit risk.

Keywords: Key Audit Matters; Audit Risk Disclosure; Textual analysis; Market reaction.

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