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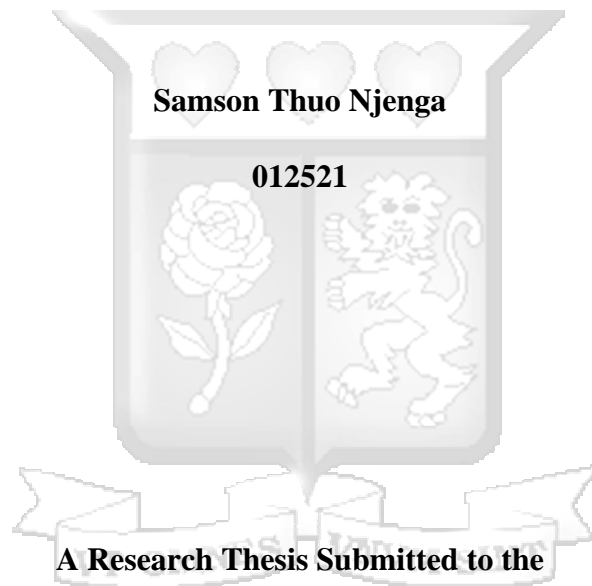
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**AN EXAMINATION OF THE DETERMINANTS OF KEY AUDIT MATTERS
REPORTED BY COMPANIES LISTED IN THE NAIROBI SECURITIES EXCHANGE.**



Strathmore University Business School (SBS) in

Partial Fulfillment for the Degree of Master of Commerce of Strathmore University.

June, 2019

DECLARATION

I declare that this work has not been previously submitted and approved for the award of a degree by this or any other University. To the best of my knowledge and belief, the thesis contains no material previously published or written by another person except where due reference is made in the thesis itself.

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ABSTRACT

The financial crisis of 2008 and other monetary embarrassments like Enron and WorldCom elevated worldwide enthusiasm for improving the chronicled two passage pass/fail institutionalized audit report, necessitating development of an expanded audit report in accordance with the issuance of ISA 700, The Independent Auditor's Report on Financial Statements, that are conveyed in a way that is meaningful, available and important to the users of financial statements. As for the enhanced audit report, standard setters chose to command the exposure of more review explicit subtitles like the Key Audit Matters (KAMs) in reaction to developing worries about the value of the audit report (ISA 701, IAASB 2015; PCAOB 2017). These additional communications were expected to further improve the communicative value of the auditor's report by, among others, helping "investors and other users of financial statement focus on aspects of the financial statements that the auditor also found to be challenging" (PCAOB 2013) and giving a guide to users to all the more likely explore complex financial reports and spotlight them on issues important to their decision making" (IAASB). The research study sought to establish what determines the KAMs reported in the independent auditor's report as proposed by IAASB and PCAOB in 2013, and by extension the auditors' judgement in deciding form and number of KAMs to report. The study utilized semi-structured questionnaire for data collection using purposive sampling of 136 respondents from auditors of firms listed with NSE to ascertain nature and form of KAMs being reported. The research adopted descriptive research statistics like scores and frequencies in analysing findings from primary data collected aided by Statistical Package for Social Scientists (SPSS) Version 23. Spearman's rho was used to test for relations among the variables. Findings were presented in frequency tables, pie charts and graphs. The major findings revealed positive relationships between KAMs and its drivers. The number and nature of KAMs were moderately correlated to the firm size and trend of reporting over years, positively and strongly correlated to subsidiaries, auditor type, cross listing status and the industry in which firm operates. Basically, the main drivers of KAMs reported are the international standards and legislations developed for various jurisdictions are general in nature hence giving leeway to auditors' judgement and justification of inclusion or omission of KAMs in the report. The study therefore recommends the need to develop guidelines on the forms, format and number of key audit matters reported in auditor's report as well as the need to harmonize the reporting of Key audit matters across the industry to prevent users of audited annual reports from misinformation. This is on the grounds that the big four audit firms will in general have their own specific manner of announcing KAMs. They likewise will in general report more KAMs than other review firms.

TABLE OF CONTENTS

DECLARATION	ii
ACKNOWLEDGEMENT	iii
ABSTRACT.....	iv
LIST OF TABLES	viii
LIST OF FIGURES	ix
ABBREVIATIONS AND ACRONYMS.....	x
CHAPTER ONE	1
INTRODUCTION	1
1.1. Background of the study	1
1.1.1. Key Audit Matters.....	5
1.2. Problem Statement	7
1.3. Research Objectives.....	8
1.3.1. Main Objective.....	8
1.3.2. Specific Objective	8
1.4. Research Questions.....	8
1.5. Scope of the study	9
1.6. Limitation of the Study	9
1.7. Significance of the Study.....	9
1.7.1. Firms’ Stakeholders.....	10
1.7.2. Academia.....	10
1.7.3. Regulators, standards and professional bodies.....	10
CHAPTER TWO	12
LITERATURE REVIEW	12
2.1. Introduction.....	12
2.2. Theoretical Literature Review	12
2.2.1. The Theory of Inspired Confidence	12
2.2.2. Signaling Theory	14
2.2.3. The Agency Theory.....	16
2.3. Empirical Literature Review.....	18
2.3.1. Content of KAMs reported in the enhanced auditors report of listed companies in NSE	18
2.3.2. Drivers associated with the content of KAMs reported by companies listed in the NSE	22
2.3.3. Nature and number of KAMs reported in enhanced audit reports of companies listed in NSE	25
2.4. Conceptual Framework.....	27
2.4.1. Company Size	28
2.4.2. Subsidiaries	28
2.4.3. Auditors Type.....	29
2.4.4. Cross listing Status	29
2.4.5. Industry.....	29
2.4.6. Trend Review over Years.....	30
2.5. Operationalization of Key Variables	30
2.6. Research Gap	32
2.7. Chapter summary	33

CHAPTER THREE	34
RESEARCH METHODOLOGY.....	34
3.1. Introduction.....	34
3.2. Research Philosophy.....	34
3.3. Research Design.....	34
3.4. Population	35
3.5. Sampling Techniques.....	35
3.6. Pilot Study.....	37
3.7. Data Collection Methods	37
3.8. Data Analysis	38
3.8.1. Testing the Models	39
3.8.2. Diagnostic Tests	40
3.9. Reliability and Validity of the Research Model	41
3.10. Data Presentation.....	41
3.11. Ethical Issues.....	41
CHAPTER FOUR.....	43
FINDINGS AND DATA ANALYSIS	43
4.1. Introduction.....	43
4.2. Demographic Information.....	43
4.2.1. Gender of respondents.....	43
4.2.2. Age of respondents.....	44
4.2.3. Highest level of education.....	45
4.2.4. Type of audit firm worked on	45
4.2.5. Years of experience.....	46
4.2.6. Audit committee	46
4.2.7. Effects of KAMs in Audit quality	47
4.3. The content of KAMs reported by auditors in the enhanced auditors’ report	47
4.4. Drivers associated with reported KAMs by companies.....	48
4.4.1. Firm size	49
4.4.2. Subsidiaries	49
4.4.3. Auditor's type	50
4.4.4. Cross listing status.....	51
4.4.5. Industry.....	52
4.4.6. Trend review over years	52
4.5. The nature and number KAMs reported in the enhanced audit reports	53
4.6. Inferential analysis	53
4.6.2. Correlation testing	55
4.6.3. Goodness of fit of the model	56
4.6.4. Regression analysis	57
4.7. Chapter Summary	58
CHAPTER FIVE	59
DISCUSSION, SUMMARY, CONCLUSIONS AND RECOMMENDATIONS	59
5.1. Introduction.....	59
5.2. Discussion of Findings.....	59
5.2.1. The content of KAMs reported by auditors in the enhanced auditors’ report.....	59
5.2.2. Drivers associated with reported KAMs by companies listed in the NSE.....	60

5.2.3. The nature and number KAMs reported in the enhanced audit reports	61
5.3. Conclusion	62
5.4. Recommendations.....	63
5.5. Limitations of the research.....	63
5.6. Contribution to Knowledge.....	63
5.7. Suggested areas for further research	64
REFERENCES	65
APPENDICES	73
APPENDIX I: RESEARCH AUTHORIZATION.....	73
APPENDIX II: THE QUESTIONNAIRE	74



LIST OF TABLES

Table 2.1: Operationalization of Variables	30
Table 4.1: Highest level of education	45
Table 4.2: Contribution of KAMs on audit quality.....	47
Table 4.3: Level of agreement with statements regarding effects of firm size on KAMs	49
Table 4.4: Level of agreement with statements regarding effects of subsidiaries on KAMs ..	50
Table 4.5: Level of agreement with statements regarding effects of auditor's type on KAMs	51
Table 4.6: Level of agreement with statements regarding effects of cross listing status on KAMs.....	51
Table 4.7: Level of agreement with statements regarding effects of industry on KAMs	52
Table 4.8: Level of agreement with statements regarding effects of cross section of year on KAMs.....	53



LIST OF FIGURES

Figure 2.1: Conceptual Framework.....	32
Figure 4.1: Distribution of respondents by gender	43
Figure 4.2: Distribution of respondents by age.....	44
Figure 4.3: Type of audit firm respondents ever worked for	45
Figure 4.4: Years of experience	46
Figure 4.5: Whether the company audited had an audit committee	47



ABBREVIATIONS AND ACRONYMS

BAC	Board Audit Committee
CAM	Critical Audit Matters
CMA	Capital Markets Authority
CCGSI	Code of Corporate Governance
GAAPs	Generally Accepted Accounting Principles
IAASB	International Audit & Assurance Standard Board
IFRSs	International Financial Reporting Standards
IOSCO	International Organization of Securities Commission
ISA	International Standards of Audit
KAM	Key Audit Matters
NSE	Nairobi Stock Exchange
PCAOB	Public Company Accounting Oversight Board
SAS	Statement of Auditing Standards
SPSS	Statistical Package for Social Sciences



CHAPTER ONE

INTRODUCTION

1.1. Background of the study

The audit profession has progressively gone through a series of attacks from various quarters, in light of its two-paragraph pass/fail standardized audit report (Smith, 2002). This has necessitated significant transformation in the last decade, aiming at achieving value addition in the communicative nature of financial reports to their users. This prompted the requirement for change and amendment of audit reporting (Bédard, Gonthier-Besacier and Schatt, 2015). The worldwide financial crisis expanded the need for standard setters to create proposals for improving the review work so as to increase financial steadiness. One of the thoughts was to expand the audit report disclosure to the general population, to guarantee that it is fit for reason. The changes were driven by the enduring discussions on the structure, substance and value of the audit report (Commission on Auditor's Responsibilities 1978; Geiger 1993; Church et al. 2008; Smieliauskas et al. 2008; Mock et al. 2013). Specifically, the institutionalized structure and restrictive substance of the past review report had been found to constrain its communicative and informative value (Coram et al. 2011; Vanstraelen et al. 2012).

A central role of independent audits is to build the unwavering quality of reliability of financial statements, for example the reason for audit review is to lend higher believability to financial reports by verifying accounting information as prepared by management (Nowell, Norris, White and Moules, 2017). As indicated by ISA 200, audit reviews are mainly meant to enhance degree of confidence of intended users in the financial statements and as a result expanding their dimension of unwavering reliability which isn't available in unaudited financial reports. The IAASB henceforth communicated that the key reason for its new and changed audit reporting standards is to re-establish and upgrade the confidence of users in the audited financial statements (IAASB, 2015; Bédard, Coram, Espahbodi, and Mock, 2016; Craig, Smieliauskas, and Amernic 2017).

Already, the Auditing Practices Board had presented SAS 600 trying to educate users on specific issues relating to auditors role, in a bid to lessen users' misconception. The justification for the amendment, framed as an endeavour to lessen users' expectations gap, was started on the supposition that audit review report can be utilized to educate users about the obligations and duties of auditors and directors (Behzadian and Nia, 2012). Verifiable in this, was a thought

that convictions held by users with regards to the idea of auditors obligations and duties are wrong and that if those perspectives can be corrected in line with those of the profession, audit expectations gap will be decreased. This, be that as it may, appeared not to address the desire hole fully, thus the lines requirement for upgrade of the structure, substance, and nature of audit report.

Prior to enhancement of the independent auditors report by standard setters, the substantive part of the audit report was a brief statement by the auditors, that could take any of the following four forms of audit report depending on auditors findings: qualified opinion, where the auditor felt that there was significant reason to believe that the financial reports were materially misstated, was unable to establish the impact of a given significant uncertainty or the going concern of the organization was in doubt. The auditor report could also give an adverse opinion, whereby despite getting all relevant information for his/her audit, the auditor concludes that the misstatement of the books is both significant and pandemic to the financial statements (Li, Hay & Lau, 2018). Also, the auditor could give a disclaimer of opinion in cases whereby in the course of his audit work, he felt that vital information that could have impact on the financial reports was unavailable and could have been instrumental in him/her forming an opinion about the financial reports of the organization (Quick & Schmidt, 2018). Lastly, the auditor could give an unqualified audit opinion where having reviewed the financial reports of the organization, he had no reservations concerning the financial reporting hence meaning the financial reports were a fair representation of the company and that the going concern of the organization for the foreseeable future was not in doubt (Quick, Schmidt & Thompson, 2014).

The audit report format then, despite being short form, easy to read and comprehend by both professional and non-professional users of financial reports, was very brief. The auditor's voice could not be heard in matters to do with the actual audit work conducted, challenges encountered and auditor's opinion on matters that are not necessarily material to warrant change of opinion but could impact on the decision making of the user of the financial reports if pointed out. Whereas there are many standards used by auditors in their work and form a foundation to support audit report, most of the ISAs provide a framework for judgement hence need for auditors' voice to be heard in the audit report. As indicated by Humphrey (1997), "auditing isn't viewed as a precise science, intended to determine to 100 percent exactness the data presented in financial reports. It is more a procedure of judgment, aimed at guaranteeing

that data is sensibly exact, genuine and reasonable, true and fair, adequate as opposed to outright".

The International Audit & Assurance Standards Board (IAASB) proposal came after noticing that user's confidence in audit quality has continuously dwindled. However, there are a few respondents who raised pertinent issues in regards to the implementation process of Key Audit Matters (KAMs), and the effect it will have on audit reporting (Kachelmeier et al., 2017). There has been evidence of material differences in perception between auditors and users in regards to kind of message conveyed by the audit report and hence need for enhancement.

So as to react to the quest by users for more information on issues essential to comprehension of audited financial statements and the audit report, the International Auditing and Assurance Standards, during a meeting convened on September 2014 affirmed another auditing standard requiring the communication of extra information in the Auditor's report; ISA 701 - communication of key audit matters in independent auditors report. ISA 700 - Forming an Opinion and reporting Financial Statements was likewise amended. The IAASB released these new and modified standards on 15 January 2015. On its part, the U.S. Open Company Accounting Oversight Board (PCAOB), amid a 13th August 2013 gathering proposed to upgrade the auditor's report to incorporate critical audit matters (CAMs), an equivalent of KAMs.

There are, however, different researchers' findings that propose that in spite of unassuming enhancements to substance and organization of the auditor's report over time, it is still to a great extent perceived as giving minimal informational incentive to users (Church, Davis, & McCracken 2008). Carver et al., (2017) researched whether revelation of CAMs in the audit report as required by PCAOB would influence comprehensibility of audit report by both experienced and non-proficient investors. The outcomes uncovered that disclosure of CAMs contrarily influences lucidness of the audit report and limitedly affects the enlightening substance for investors.

Overall, it was concluded that having KAMs in the audit reporting process is an important concept and that their introduction and applicability would have a positive effect ultimately. This resulted in introduction of KAMs in the enhanced audit report. KAMs are however, viewed as having both costs and benefits. Kachelmeier, Schmidt and Valentine (2017) contend

that whereas it's meant to give users of the financial reports some signals of areas to concentrate on as well as making auditors more accountable for their work, it also has the limitation of making users "skewed" in reviewing the financial reports and only focusing on matters pointed out by the auditors.

Moreover, Coram, Mock, Turner and Gray (2011) contend that communication of KAMs gives guidance to users to enable them explore complex financial reports and spotlight on issues featured by the auditor. Their study likewise shows that such featuring may skew clients' information procurement of other financial statements data, though having more issues in the auditor's report mitigates the consideration dedicated to issues featured by the auditor and in this way influencing the quality of audit report. Additionally, users accessed more easily a thing referenced in the report and gave it more elevated consideration where there was just one issue reported in the report than when they were three or four. Subsequently, as needs be, auditors should be cautious in the choice of the KAMs and the number of matters to communicate in the auditor's report.

This study intends to establish whether IAASB's proposal to include the new section in the audit report on KAMs, with the aim of improving audit communication was in line with users' expectations (IAASB, 2014) and ultimately reduce expectations gap. The study will also be reviewing what determines the content of KAMs reported, drivers to these KAMs and format of reporting and this was reviewed in Kenyan context by looking at companies listed in Nairobi Securities Exchange. In addition, experimental studies on effects of extra disclosures in the audit report relating to an entity's financials are uncertain in spite of some finding that there is no noteworthy effect on clients. There is also need to know whether the reporting process of KAMs has any influence on the auditors' independence and if there is any risk or misinformation to users given the judgmental nature involved in arriving at KAMs to report.

There are concerns that the changes on the audit report will only add complexity in nature and length but not value, to auditors reporting (Ghandar 2014). There are likewise second thoughts on whether the amendments genuinely comprehended what users needed and whether extra information will address their concerns (AUASB 2013). Moreover, there are likewise concerns that extra information and changes won't impact audit quality or improve the capacity of investors to decide (PwC2014), yet will increase the cost of reviews and auditors legal obligation (Turner 2013).

Within Kenya, in recent times the accountancy profession has come under public scrutiny with the media shining a spotlight on auditors in particular, highlighting financial accountability challenges in both public and private organizations. Of particular interest has been the perception that auditors have a fundamental role to play in stopping loss of funds through statutory auditors (Osodo, 2018). Auditors are not always necessarily innocent, but neither are they necessarily to blame (Osodo, 2018). So dire is the situation that it drew the attention of both the practitioners and academia. Mcfie 2017 , a leading accountant and academic, brought the matter to the fore highlighting that auditors have no magic wand to prevent fraud...”to put this perception matter in perspective, I believe it is important to appreciate what statutory audits are and what they are not. He continues to say, a statutory audit is not, as some would assume, a search for the proverbial needle in a haystack. Simply put a statutory audit is conducted to comply with set ‘statutes’ and to test financial statements for compliance with set ‘standards’”. The enhanced audit report is therefore a good place for any reader of financial statements to appreciate what an audit is and what the auditor does, and does not, do.

1.1.1. Key Audit Matters

KAMs is another prologue to auditing standards which is based on ISA 701 as issued out by the standards setting body, IAASB. ISA 701 focuses on the auditor’s responsibility to communicate KAMs in the audit report and is expected to address the auditors’ judgment with respect to what is report in the examiner's report, structure and substance of such correspondence. KAMs are chosen from issues previously communicated with those charged with governance, in our case being the Board Audit Committee (BAC).

Users of financial reports have communicated enthusiasm for those issues about which the auditors had the most robust exchange with oversight team as a component of the two way correspondence required by ISA 260. Users have called for extra straightforwardness about those exchanges. For instance, users have communicated specific enthusiasm for understanding noteworthy judgements made by auditors in shaping conclusion and opinion on the financial statements all in all, since they are frequently identified with the areas of significant management discernment while preparing the financial statements.

The ISA 701 applies to reviews of complete set of broadly useful financial reports of listed entities as well as in circumstances when the auditor generally chooses to convey KAMs in the audit report. This happens where it’s mandatory as per regulator for auditor to communicate

KAMs in audit report. Important to note however, ISA 705 prohibits auditors from conveying KAMs in instances where there is disclaimer of opinion on the financial statements except where revelation is legally necessary.

In spite of communication of KAMs being judgemental, ISA 701 gives guidelines dependent on which the auditor can review issues previously communicated with BAC to decide what to incorporate in KAMs. The guidelines incorporate; territories of higher evaluated danger of material error, or noteworthy dangers distinguished as per ISA 315, significant auditor judgements relating to areas in the financial statements that involved significant management discernment, including accounting estimates that have been recognized as having high estimation vulnerability and matters with impact on the review of significant events or transactions but must have occurred during the period under audit.

Communicating KAMs in the audit report is a follow up to the auditor having formed an opinion on the financial statements as a whole and is thus not by any means meant to substitute:(a) disclosures by management in the financial statements as per applicable financial reporting framework requirements, (b) for the auditor expressing a modified opinion as required by the circumstances of a specific audit engagement in accordance with ISA 705 (c) for reporting in accordance with ISA 570 when a material uncertainty exists relating to events or conditions that may cast significant uncertainty on an entity's ability to continue as a going concern; or (d) a separate opinion on individual matters.

Where there are no KAMs to report, it is the auditor to decide, that there are no KAMs to convey or that the main key review matters imparted are those issues tended to in the adverse opinion expressed by the auditor, by including an announcement to this effect.

Taking everything into account, the motivation behind communicating KAMs in the expanded independent auditors report is to upgrade its informative nature by giving more noteworthy insights about the review that was performed. It gives extra transparency to planned users of the financial statements to help them understand those issues that, in the auditor's expert judgment, were most noteworthy in the review of the fiscal reports for period under review (Coram, Mock, Turner and Gray, 2011). The imparting may likewise aid users better understand the substance and areas of significant management judgment in the audited financial statements and thus reduce audit expectations gap. Hence need to restrain the utilization of profoundly specialized auditing terms in the KAMs to enable users with limited

audit knowledge to understand the basis for the auditor's focus on particular matters during the audit and opinion thereof.

In Kenya's context, reported KAMs are as per the guidelines by ICPAK as borrowed from ISA 701 and as well based on auditors' judgment. The study therefore, seeks to understand the factors that auditors of listed companies put into consideration when making decision on what KAMs to report or not report in their audit report. Also, the study purposed to establish whether there is a format and order of presentation and whether there is a guideline on number of KAMs to include in any given audit report.

1.2. Problem Statement

Previously, the standardized one paragraph audit report, giving a pass or fail verdict was a source of discomfort to users of audited financial reports who felt information that could be important in guiding their decision making, even if not material to warrant change of opinion, was not being revealed (Chen & Tian, 2009). This resulted to the introduction of the enhanced audit report to include KAMs, but there is still a perceptual divergence of thoughts between auditors and users on content, drivers, nature, and number of KAMs reported as regards auditors' bias given the judgemental nature involved in arriving at KAMs thus resulting to users' misinformation.

There is still a strain in the audit profession in this regard, and the discussion on remodelling of audit report incites blended responses (Bedard, Bera and Sirios, 2018). It is still an open inquiry on whether the expected result of KAMs has been accomplished, with certain researchers proposing that the data in audit reports is adequate (Simnett, &Huggins, 2014). Beneish, Billings, and Hodder (2008), contend there is need to give more data to build user appreciation and trust in the audited financial statements. Christensen et al. (2014) and Sirois et al. (2014) also give proof that KAMs paragraph enhances the informational value of the audit report.

On the contrary, (Manoel and Quel, 2017) contest on the pertinence of these things in enhanced audit report saying they have no communicative value. Bedard et al. (2014) inspected financial market response to arrival of audit reports containing the justification of assessments (JOA) in France. Cade and Hodge (2014) demonstrate that in an environment where KAMs are publicly reported, the auditee limits the sharing of private data with auditor, along these lines making it counterproductive.

This being a relatively new compliance item in Kenya in conformity with the international standards of auditing, there are few or scarce studies done so far to highlight the nature and drivers of KAMs being reported by companies listed in NSE and impact of the additional disclosures across a wide range of users of the financial report. Previous researches on determinants of KAMs were mainly conducted in the more advanced western world. Recently, the Institute of Certified Public Accountants of Kenya (ICPAK) has put in place guidelines that require disclosure of KAMs, in compliance with ISA 701 (ICPAK, 2016). This paper sought to contribute to the scarce evidence on the determinants and nature of KAMs being reported in the Kenyan context and method of evaluation for disclosures. The researcher also sought to identify the impact of KAMs reported to users given the judgemental nature of KAMs, with no specific guidelines developed locally in this regard, thus leaving the moral burden with the auditor to ensure compliance to the letter and spirit of ISA 701.

1.3. Research Objectives

1.3.1. Main Objective

The key objective of this research is to examine the determinants of key audit matters in the revised auditor's report and its impact on the audit expectations gap.

1.3.2. Specific Objective

- i. To examine the content of KAMs reported by auditors in the enhanced auditors' report of companies listed in the NSE.
- ii. To investigate the drivers associated with reported KAMs by companies listed in the NSE.
- iii. To assess the nature and number KAMs reported in the enhanced audit reports of companies listed in the NSE.

1.4. Research Questions

- i. What is the content of KAMs reported in the revised auditor's report?
- ii. What determines content of KAMs for listed companies in NSE?
- iii. What is the nature and number of KAMs reported in the enhanced auditor's reports of listed companies in NSE?

1.5. Scope of the study

The study reviewed the addition of KAMs in the independent auditors' report as per the IAASB framework, which was originally not captured in the audited financial reports of the sixty-five (65) listed companies in the NSE for the period between 2015 and 2017. These listed companies are among the early adopters of the requirement in Kenya. In the study, content of KAMs, drivers of arriving at the KAMs, nature and number of KAMs reported in the audit report was also reviewed in regards to the quality of audit and impact on users of financial reports.

The research also reviewed the audited financial reports for the same listed companies for the period before and after the introduction of enhanced auditor's report to establish whether there was any improvement in regards to reduction of audit expectations gap. This covered the period between 2015 and 2017.

In comparing the enhanced audit report, for periods before and after the introduction of KAMS, the study based findings on the following independent elements of companies listed in NSE; Firm size, Subsidiaries, Auditors type, Cross listing status, Industry and Cross section of years. This was reviewed in an environment with the following control variables; corporate governance as aligned with CCGSI 2015; company profitability as measured by Return on Assets (ROA) and company performance in the security market measured through the company stock liquidity.

1.6. Limitation of the Study

Albeit earlier research of audit reports is broad, exploratory research so far carried out in regards to impact of the recently expanded audit reports, which rely on judgements and decisions of auditors in coming up with KAMs, is still scarce. Additionally, existing research has concentrated on inspecting the effect of the enhanced independent auditors report within the Western and European setting.

1.7. Significance of the Study

Investors, regulators, and academics are interested in the study on the expanded audit report and specifically the KAMs since it is the first time that auditors have had a "voice" in communicating audit scope decisions to the users.

1.7.1. Firms' Stakeholders

Stakeholders of the firm who are also referred to as users of the financial reports will find relevance in the research since they will be well informed on value addition capability of the enhance independent auditors report for their decision making unlike previously when the report was standard with no insights to the companies on goings. Consequently, stakeholders will be in a position to engage and give feedback to firms, thus making auditors, management and board of directors more transparent and accountable on information they provide hence improving on the expectations gap.

This issue is exacerbated for nonprofessional speculators, who in contrast with analysts, for the most part have poorly characterized decision models, have limited information about significance of specific financial statement items or the relations among financial statement thus failing to recognize explicit information required for related reviews (Lennox, Schmidt and Thompson 2018). Like less experienced analysts, nonprofessional investors will in general use hazy searches for information like reading financials in the order presented (Köhler and Theis, 2016). KAMs have thus come in to guarantee that users like investors and analysts, focus on key areas that, as per the auditors are significant for their decision making.

1.7.2. Academia

The study findings will add to existing literature and knowledge by scrutinizing determinants and drivers of KAMs as reported in the enhanced audit report and their impact in addressing audit quality and users expectations gap. There is little knowledge in this area more so in developing countries with most research being more global than local and the compliance requirements having been recently introduced and adopted through ISA 701. This study will be resourceful in advancing a different perspective by enlightening stakeholders on importance of reporting KAMs in enhanced audit report and possible areas of improvement.

1.7.3. Regulators, standards and professional bodies

The study also intended to guide the development of a national or international guideline of what should and what should not be included in the KAMs based on feedback from stakeholders. There is also need to standardize the enhanced independent auditors' report, especially the KAMs section to make it consistent in presentation and formulation to enable comparability more so by users who are reviewing various companies in diverse geographical regions. Moreover, there is a need to ensure that the enhanced report is protected from

management and board influence but formulated independently by the auditor in the course of his work. There should be a more detailed template to guide the auditors in deciding what and how the KAM items should look like. Currently, there is quite a huge leeway given to auditors' judgment which is bound to change based on other factors like experience, expertise in the field of audit, time available for the audit and also interactions with both management and the board audit committee (Bedard et al., 2014).



CHAPTER TWO

LITERATURE REVIEW

2.1. Introduction

This chapter presents an evaluation of past literature relating to revised audit reporting, and the determinants of KAMs reported. The theoretical framework is provided, which explores the theories relating to the study. Also, an empirical review of previous studies conducted discussing nature of KAMs reported in the enhanced auditor's report, determinant of the nature of KAMs and their form and order of presentation, all with the aim of minimizing audit expectations gap. This is then followed by presenting a conceptual framework which links the KAMs reported to independent variables that auditors consider when deciding KAMs to report. The section then concludes by providing the research gaps established what has been done in this area, what is the current situation and what is missing or needs to be done to ensure KAMs as presented help in reducing audit expectations gap.

2.2. Theoretical Literature Review

Various theories have been adopted to give clarity on the concepts, quality and impact of auditing of financial statements of an organization. The theoretical framework is anchored on three theories namely; theory of inspired confidence, signalling theory and agency theory.

2.2.1. The Theory of Inspired Confidence

This theory is also referred to as the theory of rational expectation. This principle was developed by Limperg (1920) and focuses on the demand and supply for audit services. In reference to scholars' findings, the demand for audit services is as a first-hand result of having external stakeholders in the company (Hayes et al., 2005). These stakeholders' also known as third parties demand for accountability from management in exchange for their investment in the company. It is assumed that information as presented by management might be biased due to possible conflicts of interests between management and the third parties thus the need to audit this information.

Audit function is established in the confidence and trust that society puts in the viability of the audit review and opinion. If audit work is to accomplish its target, at that point no more certainty might be put in its fulfilment than is supported by work completed and by expertise

of the auditor, however, this role must be performed in a way that legitimizes the credence placed in its satisfaction. (Limperg, 2002)

Various theories have come up to determine and specify the audit function. The theories and or principles explain and describe expectations of stakeholders on the auditor, including safeguarding against fraud, warning of future insolvency, re-assurance of financial stability and general understanding of the audit report. The expectations for the auditor are rather straight forward however there still exists a gap majorly as a result of diverse views held about the audit function. The mismatch is mainly from what public expectation of the auditor function is and what the auditor can and should do.

Russell (1986), revealed that external auditors in the Anglo-American world were confronted with ‘a liability crisis and a credibility crisis’ and this is yet to subside two decades later, rather, they have been fuelled by well-publicised corporate fiascos, particularly those that happened around the turn of the 21st century, for example, Enron and WorldCom in the USA, Barings Bank, and Equitable Life in the United Kingdom, Parmalat in Italy, HIH in Australia and Satyam in India.

Audit function plays an important role to the public interest, that of “strengthen accountability and reinforce trust and confidence in financial reporting” (ICAEW, 2005). The Anglo-American scandals have however tainted the profession due to this negative publicity. As a result, global opinions demanding the improvement of audit quality were voiced leading to changes aimed at promoting greater transparency and accountability within the audit profession. The demand for continuous improvement still exist which raises the questions as to what extent the demands and concerns can be addressed to minimize audit expectations gap. It is noted that to answer this question, there is need for users to distinguish what auditing means, its purpose and the limitation and relationships within the audit role.

When auditors do not meet their obligations and society expectations, it results to criticism and a loss of confidence in their work. That is the audit expectation – performance gap; this is a misalignment of society’s expectations of the auditors as compared to what it perceives they deliver. Previous research has noted three elements to this gap; ‘Reasonableness gap’ (unreasonably expectations of society on auditors performance) and performance gap – composed of a ‘deficient standards gap’ (responsibilities reasonably expected but not required

of auditors) and 'deficient performance gap' (existing responsibilities of auditors which society feels auditors do not perform well)

Up until 1990s, auditing profession concentrated on lessening society's (specifically, financial statement users') absurd expectations of auditors guided mainly by the recommendations of the Cohen (Commission on Auditors' Responsibilities, 1978). The profession tried to accomplish this objective by reforming the audit report into an educational tool. The Cohen Commission watched: 'the auditor's standard report is nearly the main formal method used to educate and advice users of financial statements on the role of the audit function. It in this manner suggested through SAS No. 58 the introduction of "long form" standard audit report which clarified individual duties of management and auditor on the financial statements. It incorporated concise description of review procedures and specified the level of affirmation given by the review feeling.

Audit function is necessary for validating the accuracy and correctness of the information provided by companies. The auditor acts as the go between management and users of the financial information and helps reduce information asymmetry, by communicating with those using the information provided. It is thus necessary for the relevant group to have clarity of the auditors' role. However there are several conflicting opinions regarding the introductions of KAMs in reducing the expectations gap. Humphrey (1997) gives the most prominent distinctions between perspectives on auditing: as a socially oriented function, where "the auditors are depicted as moral, socially dependable people," and auditing as a monopolistic business. This theory is relevant to the study as it focuses on understanding components within the expectation gaps and possibilities of eliminating these components by understanding and defining what KAMS are reported and their adequacy.

2.2.2. Signaling Theory

Signaling theory, which was first developed by Michael Spence, has transcendently been applied in corporate finance (Shehata, 2014), marketing (Sharma Davcik and Pillai, 2016) just as in other different fields of study. Signaling theory is helpful for portraying the conduct when two parties (people or associations) are accessible to distinctive information. Regularly, one party, the sender, must look on ways on how to impart (or signal) that information, and receiving party, who is the beneficiary, decides how to translate the signal. As needs be,

signaling theory holds a conspicuous position in an assortment of executives writing, including strategic management, entrepreneurship, and human resource management.

IAASB and PCAOB proposed a method named “signaling effect” to defeat the issue of information overload for users of the financial information. This fills in as a psychological inclination that modifies the presentation of information and predispositions the manner in which information is perceived and processed (Lennox and Pittman, 2011).). Information overload can be minimized by giving prompts on the most proficient method to utilize the accessible information. Tian and Chen (2009) propose that individuals adapt better where prompts are included that feature the association of the essential material. This predisposition can be presented in a few different ways, for example, featuring or underlining writings or drawing tables.

As much as signalling aides reduce the time spent choosing and sorting out important issues, it also makes accessibility of valuable information in the audit report faster by guiding users to sections of the financial statements that are alluded to in the audit report (Lennox and Pittman, 2016). All things considered, it is expected that users will get to the parts of the financial statements that are alluded to in the auditor's report quicker and give higher consideration to these parts. On the other side, the signal inclines the user's information procurement behaviour towards things featured in KAMs of audit report.

In an experimental study conducted in North American on impact of KAM disclosure (or CAMs, the term used by the PCAOB), Christensen et al., (2014) observed some nonprofessional investors who are business school graduates, who invest in individual stocks and follow closely company financial information. The study examined how these subjects respond to an audit report's CAMs paragraph that is focused on the review of fair value estimates and found that speculators are in reality bound to quit thinking about the company as an investment venture. The outcome speaks to an information impact. Kachelmeier et al. (2014) also structured a study to test the impact of disclosing CAMs in the US. Their subjects were however MBA understudies, and the authors demonstrate that such a revelation as above brings down users perception of audit assurance and responsibility.

Previous studies that analysed management reports as prepared by management, confirmed the complexity involved in communicating financial statement (Lewis, Parker, Pound, and

Sutcliffe, 1986), footnote disclosure (Griffin, 2014), corporate annual report (Rahman, 2012; Dainelli, Bin & Giunta, 2013) and analyst reports (Zhou, Wang, Zhang & An, 2018) hence need for guidance in their review. The theory is therefore relevant to the study since it emphasizes on need to have KAMs in the expanded audit report that serves to guide the users in narrowing down on their review of the financial reports to key matters, while also outlining the risk of KAMs giving users a skewed view of the overall reports. The theory also helps in bridging expectations' gap by signaling users to show them areas reviewed during the audit hence ensuring auditor and user are on the same page.

2.2.3. The Agency Theory

The 'agency-theory' brought about by Stephen Ross and Barry Mitnick is viewed in light of the clashing interests of investors and the executives of an organization, recommending that the less-informed parties, the shareholders, will have an interest for information that screens conduct and activities of the more informed manager. In the agency theory, (Watts and Zimmerman) a reputable auditor - an auditor who is seen to meet users expectations - is selected in light of a legitimate concern for third parties as well as in light of a legitimate concern for the executives. Along these lines, review of financial reports serves as one type of such information, furnishing shareholders with reliable affirmation of progress in the organization.

The theory applies where agency relationship ('principal-agent') appears when principal delegates work to an agent who performs the work with the objective of firm's shareholder wealth maximization but checked through separation of the management and control (Ferguson, Green, Vaswani, and Wu, 2013). Mitnick,(2015) clarifies that the ability of shareholders to successful apply control over management is decimated by such factors as, the inability of shareholders to on a day to day basis observed and remedy undesirable practices by management. Along these lines, there is plausibility of the executives seeking after targets more to its greatest advantage than in light of a legitimate concern for investors – 'agency losses'. Consequently, as a result of the mismatch in the principal-agent relationship, this necessitates what is called 'agency costs.' Principals will always endeavour to screen the conduct of managers to discourage such self-seeking practices by management by establishing controlling components such as contracts; intended to align the interests of agents to those of the principal (Ferguson et al., 2013).

Managers, acting naturally intrigued, look for approaches to raise their pay over their marginal productivity to the firm. Various devices exist to control the organization costs of self-intrigued administrators; chiefly, the board of directors, auditors,, stock-based remuneration plans, rivalries in the product markets, and rivalry from different managers inside and without the firm. Be that as it may, every one of these devices are exorbitant and consequently, are constrained in their capacity to control managerial self-dealing.

The fundamental role of statutory audits is to lessen agency costs by guaranteeing that the management is acting to the best interest of users of financial reports Be that as it may, there are additionally information asymmetries between the principals who are the recipients of audit reports and the auditors, this is, auditor has progressively, better and prior information on the performance of audit and its outcomes than recipient (Wiseman, Cuevas- Rodríguez, and Gomez- Mejia, 2012). The auditor can minimise such asymmetries by giving extra information and disclosures to the principal (i.e., the addressees of the audit) and the revised audit report is a potential methods through which more information can be availed to the principal (Wiseman et al., 2012).

Davis, Schoorman, and Donaldson (1997) submitted that the divergent interests in an organization could be aligned through proper monitoring which results in monitoring costs and a well-planned compensation system which results to bonding costs. The monitoring and bonding could, however, end up being ineffective if the board oversight is absent.

The independent auditors' report, which ideally is an agency cost, was previously viewed to be very economical with information to the stakeholders, regarding operations of the company whereby it was just limited to giving a pass/fail opinion (Soltani, 2007). The introduction of KAMs in the audit report, however, gives stakeholders more insights of the company and thus the assurance that the management is not only running the organization for self-interest but is also checking on the shareholder's wealth maximization. Therefore, the theory is relevant to this study since it emphasizes on importance of understanding the agency relationship and its implications in bridging the expectation gap between the principal (users or shareholders) and agent (management) by giving relevant KAMs that would guide users in better understanding the management operations.

2.3. Empirical Literature Review

With reference to the study objectives, this section reviews existing literature on revised independent auditors report in light of the nature of KAMs being reported, what drives the KAMs to be reported and the nature and number in which the KAMs are reported. Research conducted in this area has shown various inconsistencies which may be explained by differences in theories used, the judgmental nature of audit, auditors experience, conflicting role of auditors, lag in responding to changes in regulations, self-regulation nature of auditing profession, variables used and methodology (Lee and Ali, 2008). Hence, this section highlights the various inconsistencies presented in empirical findings.

2.3.1. Content of KAMs reported in the enhanced audit report of companies listed in NSE

The idea of auditor disclosure of KAMs isn't totally new given it has been operational in France, since 2003, where auditors are supposed to make commentaries referred to as "Justification of Assessments" (JOA), in their report (Pinto and Morais 2018). JOA are fundamentally the same as KAMs since they are aimed at "empower users of the report to better comprehend work done and explanations for the statutory auditors' opinion on the financial statements ". With respect to KAMs that are reported in a separate section, immediately after the audit opinion and where necessary, allude to the important financial statements and disclosures, which identify with unveiled issue.

In Kenya, communication of KAMs in the audit report was formally adopted by Institute of Certified Public Accountants of Kenya (ICPAK) in April 2015 and rendered effective for periods ending on or after December 2016 in compliance with ISA 701. Adoption of KAMs was made mandatory for all listed companies in Kenya as stipulated by the Capital Markets Authority guidelines of November 2016, with an option for voluntary application for entities other than listed companies. Subsequently, other regulators ensured adoption of KAMs as follows; all deposit-taking Sacco's as per the Sacco Societies Regulatory Authority (SASRA) guideline dated November 2016 and all insurance regulated entities as per the Insurance Regulatory Authority (IRA) guideline of August 2016.

The auditor decides the substance of KAMs to report based on issues previously discussed with board audit committee, and must require significant auditor attention due to unpredictability and judgment required in performing the review. In making this decision, the auditor shall

consider such aspects as: (a) areas of higher assessed risk of material misstatement or significant risks identified in accordance with ISA 315; (b) 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 vulnerability; and (c) their effect must be on the audit of significant events or transactions that occurred during the period under review.

KAMs communication is a follow up to an auditor having formed an opinion on the financial statements as a whole. However, it should be clarified that communicating KAMs in the auditor's report is not: (a) A substitute for disclaimer of opinion or adverse opinion; (b) A substitute for the auditor expressing a modified opinion when required by the circumstances as per ISA 705; (c) A substitute for reporting material uncertainty existence as per ISA 570, that cast significant doubt to an entity's going concern; or (d) a separate opinion on individual matters. (ISA 701)

While the absence of qualified opinion is adequate for most users of financial reports, research demonstrates that users are ending up increasingly more keen on getting greater substance explicit data far beyond the institutionalized audit report issued by the independent auditor (Ishak and Nor, 2018). They believe such information would help them to survey the financial condition and performance of the entity as well as evaluate the quality of the audit. PWC (2015) feedback on the new and revised audit reporting standards advanced some value-adding insights where they indicated, the hugest development in the new standards, without a doubt, is the presentation of KAMs as per ISA 701. This section on KAMs reveals insight into those issues in the period under review that, in the auditor's judgment, were of most significance.

Giving progressively explicit information on an organization review in the audit report may pass on added value or important insights to users. Hatherly, Brown, and Innes (1998) without a doubt propose that more disclosure on significant issues may influence the users' impression of the audit. They analysed impact of a freestyle review report, which, notwithstanding the standard report, incorporated a four pages freestyle report of key matters experienced throughout the review, alongside with their resolutions. In addition to other things, they discovered that the freestyle report altogether expanded users' recognition of audit report and consequently enhanced the credibility of financial statements.

Nonetheless, financial disclosure overload and the multifaceted nature of revised audit report has been tended to by numerous associations and researchers over the years (Radin, 2007; Kirkpatrick, 2009). The volume of disclosures is viewed as the hugest supporter of this issue. This is because, in regards to decision making, users are limited level-headed due to their constrained cognitive capacities to process and assimilate all data presented to them (Klueber, Gold and Pott, 2018).

At the point when information supply surpasses the individual's capacity to process it, an individual experiences issues in recognizing the pertinent information. All things considered, users may have challenges deciding where to start in reviewing the financials and disclosures presented due to the volumes and may end up concentrating on immaterial information and missing out on pertinent information (IAB publication, 2011). Undoubtedly, users may decide to react to information overload by either withdrawal, i.e., downplaying the quantity of data, or filtering, i.e., processing just information distinguished as having high need. To adapt to their constrained subjective capacity, users maintain a strategic distance from intemperate data supply by keeping information to a minimum.

The incorporation of extra information in form of KAMs may likewise influence users' view of the audit, to be specific their impression of audit quality by and large just as the consistency and similarity of assurance level among financial statements components. Bédard et al. (2014) uncovered that disclosure of such information has even more an emblematic than informative value. The flipside of introduction of KAMs has been seen in financial markets not responding to them as well as increase in audit cost and efficiency. Earlier studies on the expanded audit review report essentially centre on the presence and not the substance of the expanded audit report (Kachelmeier, 2017; Lennox et al., 2018).

Other researchers, however, have faulted KAMs introduction claiming it could result in extra review costs due to expanded review endeavours in the form of added procedures to react to higher obligation and notoriety dangers related with KAMs. They may also create additional quality control processes and increased consultations at the most senior level of engagement team with senior management and audit committee (IAASB, 2012). KAM may likewise influence the productivity of the review, subsequently causing more review slack. Truth be told, the "effort required to decide, get ready language for correspondence, and archive KAMs likely would happen amid the last phases of the review" (PCAOB 2013).

Besides, the assembly of KAM language to box-ticking consistency and a bull market in boilerplate are a conviction, to the debasement of significant worth to users. That is basically on the grounds that organization similitudes crosswise over areas and enterprises are far more noteworthy than individual contrasts between them, so the presentation of KAMs will develop to institutionalized terms. Looking at the various industries, almost all banks have issues with portfolio of non-performing credits while investors in exotic financial derivatives have issues with valuation. Revenue recognition is a major cause of concern in the technology sector since IBM designed the gaming techniques during the 1950s (Bini, Dainella and Giunta, 2013). It might therefore be safe to anticipate that — as a methods for fighting off the PCAOB's ticket-counting examination process — each Big Four review in the United States will in all respects rapidly be found to have some base number of KAMs while defensive reporting will win.

A post-implementation survey of KAMs by UK Financial Reporting Council (FRC) among 150 auditors' reports in the UK demonstrated that the prominent five most report KAMs in the UK incorporate; Impairment of both assets and goodwill, Tax matters, the board abrogate of controls and misrepresentation in revenue recognition. In any case, what to incorporate into a specific audit report depends exclusively on auditors' expert judgment.

Likewise, discourse on the substance of KAMs with management and board audit committee before finalizing the auditor's report may also cause delay in issuance of audit report. In reality, IAASB (2012) demonstrates that the more iterative procedure before completion of audit may influence timing of the release of audited annual reports. Cade and Hodge (2014) with alumni of a noteworthy US university as participants disseminated the impact on managers' correspondence transparency after expanding the audit report. Their outcomes uncover that additional disclosure on accounting estimate subtleties in the audit report diminishes management's eagerness to impart private information to their auditors. This accordingly results in counter-productive outcomes as opposed to the expected value addition.

Scholars' who have researched on the content of audit reports for the most part demonstrates that the data substance of the previous audit reports was low, and henceforth, the expectations gap. Church and Shefchik (2011) concluded that the audit report was fundamentally emblematic than informative. This may even be the situation with the expanded report when the reviewers issue going-concern assessment or mention basis of their audit scoping to arrive

at an opinion since investors for all time keep reconsidering and changing their expectations and don't sit tight waiting for the auditor's report (Simnett and Huggins, 2014). In this specific case, the response of the financial market is not reliant upon substance and nature of audit report, regardless of whether the report is increasingly itemized. This is all the more so the situation where expanded audit report is excessively standardized ("boilerplate"), or too complex and mind boggling in terms of readability, or too heavy to digest due to cognitive overload. Criticism by review firms, from polls sent to them, PWC demonstrate that they bolster the new segment in the evaluator's report, yet their in-house reviews through discussions with clients revealed that it is viewed as standard with no increased transparency. E&Y additionally focused on this perspective while proposing that clients may find it difficult to comprehend the utilization of particular terminologies in this segment which users probably won't be acquainted with therefore expanding instead of reducing users expectations gap.

In summary, KAMs have attention directing impact on the financials report (Bedard & Bera, 2018). However, the content of KAMs reported is purely based on the auditors' judgment after discussion with management and board audit committee. It is thus prone to bias due to human element involved which could include lack of adequate audit expertise, limited understanding and knowledge of the business auditing, personal relationship with the auditee, all which could impact on quality and independence of audit and ultimately content of KAMs reported. This is a likely case in Kenya where auditor rotation for listed companies is recommended but not made mandatory and there is no regulatory enforcement behind it.

2.3.2. Drivers associated with the content of KAMs reported by companies listed in the NSE

Generally, the guidelines by IAASB on how to arrive at KAMs are usually; must come from among all matters already communicated with board audit committee; the auditor must have narrowed down on matters requiring special auditor attention in the course of auditing; then rank the matters in order of significance, based on his judgment, from the most significant to the least before finally including them in the auditor's report, having reviewed and gotten permission where necessary to curve out sensitive matters, from management.

Specifically, ISA 701 gives guideline of what ought to be included in the KAMs as;(a) areas of identified high risks as per ISA 315 or involving significant auditor judgment;(b) areas where auditor encountered significant challenges auditing, including with respect to obtaining

sufficient appropriate audit evidence (c) circumstances that required significant modification of the auditor's planned approach to the audit, including as a result of the identification of a significant deficiency in internal control (d) should be limited to those matters of most significance in the current period audit.

There are instances, when things resolved to be KAMs are not conveyed in the report. If the law or regulations preclude public revelation of some issue; or in very rare circumstances, the auditor establishes that the matter ought not to be conveyed in the report in light of the fact that the antagonistic results of doing that would logically be expected to exceed the public intrigue advantages of such correspondence. This discussion will however not have any significant bearing where the entity has already publicised information on key audit matter at hand. ISA 220 encourages engagement partner to always undertake wide and appropriate consultation on any matter he/she finds contentious or troublesome.

In previous periods, the European Parliament brought on board audit reforms related legislations like the Regulation No. 537/2014 and Directive No 2014/56/EU on statutory audits. Whereas these regulations do not refer to the new changes introduced by IAASB, it is believed that the input by the EU as well as other jurisdiction regulatory bodies is welcome in future in driving the audit reforms. Legislative jurisdictions governing audit reports are very diverse, from those governed by IAASB that issue the International Standards of Auditing Standards (ISA), to those governed by Audit Standards Board (ASB) and PCAOB of America that issue the Generally Accepted Auditing Standards (GAAS), to those governed by Audit and Assurance Standards Board (AUASB) of Australia that issues Australian Auditing Standards (AAS), all aiming at giving clarity and disclosure in the audit report on the applicable guidelines in coming up with the report and probably address specific geographical and cultural related expectation gaps.

IAASB in its invitation to comment, recommended that communication of KAMs in the audit report may as well widen expectations gap should users see them as giving explicit confirmation on individual records or disclosures alluded to in the audit report (IAASB, 2012). Because of these worries, the IAASB proposition does not expect auditors to incorporate review techniques performed in their communication of KAM (IAASB 2013), rather simply required to make reference to the premise of review checklist, assessment and opinion in general and note that ethical requirements have been conformed to.

Whereas financial statement users may request more prominent substance and engagement explicit disclosures in the audit report, the advantages of such revelation remain questionable and any such unproven advantage would need to be reviewed hand in hand with non-trivial difficulties and issues encountered as a result of increased disclosure. Among such issues is the danger of incorporating an excessive number of issues in the audit report which may diminish the overall adequacy of the auditor's correspondence on the issues (Hardies, Hossain and Chapple, 2016). Users may likewise improperly substitute in-depth review of financial reports with highlights as shown on auditor's disclosures thus missing out on valuable information in the financial statements that was not alluded to in the KAMs (IAASB). Thus, the objective of standard setters objective of "improve users' capacity to settle on informed decisions on the premise regarding the audited financial report might be undermined.

Statutory audits, which are a requirement for all listed companies in Kenya, other than giving an opinion, additionally mirror every jurisdiction's orders and usually have constrained objectives that are often identified with jurisdictional tax assessment. Amid casual discourses of statutory audit impacts with fellow IAASB members, the accompanying articulation is frequently heard "You should be able to distinguish statutory reviews from financial statement audits for public companies." This is to imply that other than complying with the international audit standards, they are additionally bound by the legislative requirements of the particular jurisdiction. By clarifying jurisdiction and legislative requirements auditor is working within, in the enhanced audit improved review report, deficient standards gap (users expectation of auditors but not a requirement) is reasonably addressed to the users

At long last, it was found that contrary to expectations by standards setters', correspondence of additional matters, in the form of KAMs in the audit report does not necessarily build the apparent dimension of improved audit quality, but rather even lowered users' perception of quality as per results of a study in one of the settings tried. This is because the driver of KAMs reported which are the international standards and legislations developed for various jurisdictions are general in nature hence giving leeway to auditors' judgement and justification of inclusion or omission of KAMs in the report (Daske, Hail, Leus & Verdi, 2011).

Additionally, where audit report contains KAMs, users tend to feel that level of affirmation given by the auditor may vary crosswise over components of the financial statements. By and

large, these outcomes demonstrate that while the communication of additional information may have attention directing value, it might equally have negative impacts thus increasing the expectation gap. This necessitated this study to hence identify the genuine drivers for KAMs reported beyond the standard setters' guidelines.

2.3.3. Nature and number of KAMs reported in enhanced audit reports of companies listed in NSE

The continuous attacks on the over the decades has necessitated critical reforms within the profession (Pourheydari and Abousaiedi, 2011). Financial crisis and scandals of the last decade acted as trigger whereby EU launched a broad discourse process among member countries in regards to audit reforms. The reforms were targeted at issues relating to purpose of financial audit, independence of auditors and transparency of information provided in the audit report as well as audit compliance with transparency principle, in the line with corporate governance. To expand transparency within the auditors work and consequently reduce expectation gap, there were such new proposition like revision of the audit report, so as to build the dimension of disclosure provided by the auditors. IAASB was involved, in a procedure of elucidation of auditing standards, concentrating on audit reporting and audit quality.

To demonstrate transparency in audit procedure and improve the communicative value of audit, it was made a requirement to communicate KAMs in the audit report per ISA 701. The regulation likewise illuminates the judgmental nature in arriving at what to report in the audit report, structure and substance of such reports. KAMs are chosen from issues already communicated with board audit committee (ISA 701, para. 8). There is however no rule with respect to how to exhibit the KAMs and what number of KAMs ought to be in a given review report. Paragraph 10 of the regulations considers the auditor competent enough to figuring out which of the issues raised were more significant than the others from the audit of the period under review. In spite of the fact that changes introduced provide additional information, none of the changes add more responsibilities to the auditor than they previously had.

Going by this criteria of deciding on what qualifies to be KAM and also guided by other factors such as complexity and size of the entity, type of client business and environment it operates in, facts and circumstances under which the audit engagement was entered, the auditor might end up with very many or very few KAMs (Cordoş & Fülöp, 2015). ISA 701 however does not give guidance on number of KAMs are adequate in an audit report and hence leaves the

decision to the auditor's professional judgement. Generally, the more the number of matters considered to be KAMs, the less useful the auditor's communication may be, hence more reason why auditor need to reconsider whether each of the matters meets the definition of a key audit matter in regards to significance.

Whereas the PCAOB has been quiet with regards to the effect of the quantity of KAMs reported in the audit report, IAASB (2012) determines that "as a rule, the more the number of KAMs, the less helpful the audit communication of KAMs might be." This recommends that by giving multiple signals, you may make disarray and be less compelling in lessening the information overload than when just a couple of things are conveyed, consequently the danger of incorporating an excessive number of issues in the audit report and hence diminishing overall effectiveness of the auditor's communication on KAMs (IAASB 2013).

A laboratory experiment that employed unobtrusive eye-tracking technology was conducted using post-graduate accounting whereby participants assumed the job of junior financial analysts and analysed the financial statements of a manufacturing company. The financial reports of the manufacturing company introduced one of four variations of the reviewer's report: original pass/fail audit report, audit report with one or two KAMs, and lastly report with three KAMs presented alongside related audit procedures. This between-subjects configuration permits assessing user behaviour variation with (1) the present audit report and a report with additional KAMs reported, (2) the quantity of KAMs presented in the auditor's report, and (3) the inclusion of audit procedure in the discussion of the KAMs.

Results from the experiment demonstrate that participants were very keen with supplementary information introduced in the auditor's reports and that the issues referenced in the report influence the participants' information acquisition. The number of KAMs referenced in the report (one versus three) additionally affects their information acquisition (Simnett and Huggins, 2014). In particular, users got to all the more quickly a thing referenced in the review report and gave it a larger amount of consideration when just one issue is imparted in the review report than when three issues were conveyed. This findings therefore show that such spotlighting of matters may bias the users' information acquisition and that having more issues in the report reduces consideration dedicated to issues featured by the auditor. Therefore, auditors should be cautious in determination of the nature and number of KAMs to convey in the audit report for it to be impactful.

This finding has direct policy implications from a standard setter perspective since it tends to answer questions raised by both the IAASB and PCAOB in regards to proposed changes in the audit reporting model. For instance, while expanded audit report disclosures affects the manner in which users navigate complex financial statements, IAASB and PCAOB should address the likelihood that the proposed model may really magnify expectations gap the proposed changes looks, to some degree, to address (Gunny and Zhang, 2013). Regulators ought to likewise explore further the finding proposing that users are less mindful to other information contained in the financial reports when multiple issues are disclosed by the auditor as it may infer that significant information is not incorporated by readers.

The real exposure on the auditors with introduction of KAMs, even in the Kenyan setting is the issue of liability. The Chamber omits the genuine presentation, which is that investor offended parties' attorneys will salivate over the narrative record to be made under the PCAOB's assessment procedure, and the four-layered mischief to be exacted by its deficiency-seeking process (Shaikh and Talha, 2003). In cases where the engagement partner is grilled in the lawsuits after the stock-price busts, antagonistic attorney will have a cross examination menu to browse through, that is the KAMs report: Squirring in the witness seat will be equalled just by unease in the jury box and a dire call for settlement financing. To counter this, each audit firm will in all respects rapidly be found to have some base number of KAMs reported while defensive reporting will prevail. This will eventually be counter-productive to the original expectation of KAMs.

2.4. Conceptual Framework

Conceptual framework of this study explains the relationship between the independent, and dependent variables. The relationship developed provides basis for research design and data analysis. In this study, figure 2.1 illustrates the dependent variables which are KAMs as reported, independent variables will are factors considered by auditor when coming up with KAMs including Firm Size, existence of subsidiaries within the group company, Auditor Type, Cross listing status, Industry and Cross section of years under review. The control variables are firm corporate governance alignment to CCGSI 2015, firm profitability and company stock market performance. This was in line with the three objectives adopted by the study.

Figure 2.1: Conceptual Framework

Independent Variable

- Company Size
- Subsidiaries
- Auditors Type
- Cross listing Status
- Industry
- Trend Review over Year

Dependent Variable

- Key Audit Matters
- Content and drivers of KAMs
 - Nature and Number of KAMs

Source: Author (2018)

2.4.1. Company Size

The size of the firm was added to the research as an independent variable and is to be measured as the total assets of the company in that year in consistency with previous research (Lakhali et al., 2014; Anderson & Frisk, 2016; Li, 2017). Various potential reasons have been advanced by scholars in support of an a priori expectation that the level of disclosure is positively associated with the size of the company. The bigger the size of a company, the higher the probability of reporting KAMs due to complexity of operations and depth of management involvement in operations than shareholders lack proper understanding of.

2.4.2. Subsidiaries

Subsidiaries in a company were included in the study as independent variables and were measured depending on whether the company is a multinational with a network of subsidiary companies across jurisdictions or is a domestic entity. Organizations with subsidiaries across various jurisdictions are bound to have more disclosures due to complexity of accounting, audit and reporting requirements across the jurisdictions (Tabachnick, Fidell, Ullman, (2007). There are also additional disclosures as a result of the complex nature of operations at the consolidation level which might require auditor's judgement ability to report the same to the users without using complex and hard to understand accounting terms. Majority of listed companies at NSE had subsidiaries.

2.4.3. Auditors Type

The auditors type was added to the research as an independent variable and was reviewed in terms of either the audit of the company was conducted by a big four or non-big four. Though there is no proven research to show that big four audit firms are better than non-big four, the research intends to find out whether there was any relationship in reporting going by nature, format and number of KAMs reported by big four organizations as compared to the non-big four (Turner et al., 2010). For the period under review, listed companies were audited by a total of eleven audit firms, the big four, taking the majority at 56 companies, while seven small and medium audit firms audited the remaining 9 listed companies.

2.4.4. Cross listing Status

Cross listing status was taken as an independent variable in the regression. To illustrate, the extent of disclosure is generally greater for cross listed as opposed to firms listed in one jurisdiction or even for unlisted firms, with the differences in disclosure relating to the required information subset and disclosures, specific to each jurisdiction in which the firm is listed Zhou, Wang, Zhang and An (2018). In the Nairobi stock exchange there were nine firms cross listed across Uganda Securities Exchange (USE), Rwanda Stock Exchange (RSE) and Dar es Salaam Stock Exchange (DSE) in the period under study of 2015 to 2017. Since then there has however been an addition of one more company, the Bank of Kigali, as well as suspension of Uchumi supermarkets from trading despite being cross listed.

2.4.5. Industry

The industry in which a listed company belongs was taken as an independent variable in the conceptual framework. Research conducted by the Financial Analysts Federation's Corporate Information Committee indicates that extent of disclosure in annual reports may vary by industry. Furthermore, Sprouse (2002) has stated that it is quite possible that accounting policies, techniques, and (by implication) the extent and nature of disclosure vary by industry. If the extent of disclosure is industry related, it would confound the interpretation of the differential disclosure scores. Companies listed in the NSE are classified into eleven industries, these are, Agricultural, Automobile & Accessories, Banking, Commercial & Services, Construction & Allied, Energy & Petroleum, Insurance, Investment, Investment services, Manufacturing & Allied and Telecommunication & Technology.

2.4.6. Trend Review over Years

The cross section of years under study, 2015 to 2017, was taken as an independent variable for review. This period was chosen because it reflects period just prior to implementation of KAMs, period when KAMs was implemented in Kenya and period immediately after implementation. This is meant to help in comparison of audit report prior, immediate and after introduction of KAMs and impact on audit quality and addressing audit expectations gap.

2.5. Operationalization of Key Variables

Operationalization facilitates the reduction of the abstract notion of constructs into observable characteristics so that they can be measured using indicators. A scale ranging from 1=strongly disagree to 5=strongly agree will be used to measure both the dependent and independent variables. The indicators that were used in the studies are summarized in the below table.

Table 2.51: Operationalization of Variables

Variables	Constructs	Definition	Rating Measures	Source(s)
Dependent Variables;	Content and drivers of KAMs reported	How the auditor determined those matters that, in his judgment, were of most significance and ought to be included in KAMs	A Likert scale of five was used where; 1-strongly disagree, 2-disagree, 3-somew agree, 4-agree & 5-strongly agree.	Cordos et al., (2015)
	Nature and Number of KAMs reported	How many KAMs to include in the report and in what order are they presented for effectiveness	A Likert scale of five was used where; 1-strongly disagree, 2-disagree, 3-somew agree, 4-agree & 5-strongly agree	Choudhary et al., (2018)
Independent Variables	Company Size	Does KAMs reported depend on the size of the organization?	A Likert scale of five was used where; 1-strongly disagree, 2-	Sirois and Bédard, Bera (2018).

			disagree, 3-somew agree, 4-agree & 5-strongly agree	
Subsidiaries	Do companies with subsidiaries report more KAMs than those without?		A Likert scale of five was used where; 1-strongly disagree, 2-disagree, 3-somew agree, 4-agree & 5-strongly agree	Tabachnick,, Fidell, Ullman, (2007).
Auditors Type	Does use of big four or other audit firms have an impact on type of KAMs reported		A Likert scale of five was used where; 1-strongly disagree, 2-disagree, 3-somew agree, 4-agree & 5-strongly agree	Turner et al., (2010)
Cross Listing Status	Does the nature of KAMs reported change where company is cross listed.		A Likert scale of five was used where; 1-strongly disagree, 2-disagree, 3-somew agree, 4-agree & 5-strongly agree	Zhou et al., (2018).
Industry	Are there similarities of KAMs for companies in same industry?		A Likert scale of five was used where; 1-strongly disagree, 2-disagree, 3-somew agree, 4-agree & 5-strongly agree	Sharma et al., (2016)

	Trend Review in KAMs reporting	Have nature of KAMs reported changed over the years since introduction?	A Likert scale of five was used where; 1-strongly disagree, 2-disagree, 3-somew agree, 4-agree & 5-strongly agree	Baboukardos and Rimmel(2016)
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Source; Author (2019)

2.6. Research Gap

Expansion of the independent auditors report to include KAMs disclosure by auditors around the world was envisioned by the IAASB as a means to further improve the informative value of auditors' reports. From one viewpoint, the financial market does not respond fundamentally to these JOA. Hence, past research affirm the possibility that the disclosure of additional information by the auditors preferably has an emblematic incentive over an informative value

Moreover, study by Coram, Mock, Turner and Gray (2009) found that regardless of the form of audit report, whether long-form or short-form, users have little enthusiasm for the real substance of the audit report, past confirming if it is an unqualified audit report. Along these lines, enhancing the wording in the report does little to close the communication and expectation gap.

The main research question being examined in this study is what determines the KAMs reported in the auditor's report. This is due to nature of judgemental element involved in arriving at the KAMs to report and also due to lack of specific guidelines on the nature and content of KAMs to report, how to report them and number of KAMs to report to avoid information overload. Prior research on the determinants of KAMs reported has provided somewhat mixed results. There is no evidence yet on what exactly guides the auditors' judgement rather than the generalist guidelines as per ISA 701 which could be influenced by other factors like the industry, auditor's expertise and knowledge of the business, company performance and corporate governance (Turner, 2010; Gray et al., 2011). In reality, there are concerns about the value addition aspect of these communications. Over time, they may move toward becoming standard as a result of potential liability concerns thus results in auditors reporting about as few issues as could reasonably be expected or giving an extensive rundown

of repetitive exposures which may not be effectively justifiable as a result of the use of technical language that may result in excessive other reporting, along these lines making the examiner's report to be ambiguous (IFAC, 2012), and extra costs with questionable benefits.

Therefore the research on this area is not conclusive and this study aimed at determining the consistency or lack of it, of determinants of KAMs reported in Kenyan context from previous research finding, bearing in mind the diversity in geopolitical, socioeconomic and institutional contexts under study given previous research has mainly focussed on Western and European study. Thus, the results will enrich and supplement the current international debate on the determinants of KAMs in the independent auditor's report.

2.7. Chapter summary

The expansion of independent auditors report to include KAMs could results in better quality audit and reduction of audit expectations gap. More disclosures to show that some key elements were analysed may make users feel more confident with the quality of financial reports as presented and, lead them to engage those charged with governance more constructively and ultimately make more informed investment decision. A few investors have confidence in such a beneficial outcome. For instance, reaction to CII (2014) contends that we could foresee "quality challenge among audit firms, especially in the area of professional scepticism, which strengthens the value of the audit to investors." Moreover, these key components are progressively becoming noticeable to users, which may potentially increase the costs to the auditor if problems occur with the reported elements subsequently.

However, there is still lack of clarity in how auditors arriving at the KAMs they report given it is purely based on their judgement which is subjective. This is because there is no specific guidelines on nature of KAMs to report, how to report them and number of KAMs acceptable to report in any given audit report.

CHAPTER THREE

RESEARCH METHODOLOGY

3.1. Introduction

In this chapter, the research design, research philosophy, population, census, data collection and analysis are discussed. According to Kothari (2004), an appropriate research methodology should be adopted which explains the technical aspects of the research procedures in an understandable format. Ethical considerations of data collection and the quality of data are also outlined.

3.2. Research Philosophy

Researchers have developed four main research philosophical assumptions including: ontology, epistemology, axiology and methodology. In order to examine the three hypotheses forwarded in this study, the study adopted ontological assumption which concerns with human being and nature of world in the social contexts (Bryman, 2001). There are different presuppositions to see the world by outside individual and therefore effort is made to experience these realities through different perspectives of different individuals and through different experiences (Creswell, 2014). Therefore, ontology in normative emphasis that social phenomenon is independent from other factors. In this study, primary data was collected using questionnaires given to respondents, one-to-one in-depth interview and web-based questionnaires respectively.

Philosophical assumptions are deeply rooted within various interpretive frameworks that researchers use when they conduct a study, including: positivism; post-positivism; interpretive; constructivism; transformative; and post-modernism among others (Creswell, 2014). This study will employ an interpretive research philosophical approach. In this research philosophy, the researcher pays critical attention on personal subjective significance about human beings conceiving logic of their environment and conveying meanings to it (Sarantakos, 2005). The major impact of this paradigm is that all the knowledge depends on the person interpreting it based on his or her experience and understanding.

3.3. Research Design

Descriptive research design (Saunders, Lewis, & Thornhill, 2007) was adopted in this research. The design was aimed at accomplishing the study objectives by evaluating the determinants of

KAMs as reported in the enhanced audit report of companies listed in NSE in Kenya, through data collected based on a survey of auditors of these companies. Hypothesis testing was conducted to establish the relationship between the independent and dependent variables.

This study used descriptive research design to enable researcher show influence, effect, relationships and associations between independent and dependent variables. Mugenda and Mugenda (2003) contended that descriptive studies are the best methods for gathering information which demonstrates the relationship and describes the existing situation. Quantitative analytical technique of regression equations was used to draw inference from the data collected regarding existing relationships in the variables of the study.

3.4. Population

Sekaran and Bougie (2011), contends that a population of study refers to all the people, objects or events of interest that the research investigator aspires to study. A population is therefore the entire group a researcher is interested in, to answer questions to a research study as well as to come up with conclusion concerning the same study. The target population of this study was auditors of all 11 firms, both big four and small and medium audit firms, involved in the audit of 65 listed companies in the Nairobi Securities Exchange (NSE) for the period 2015 to 2017 when the various enhancement of the audit report were implemented. The selection of NSE was based on ease of acquisition of audited financial reports and the fact that they are among the early adopters of enhanced audit reporting which is a requirement by the regulator, CMA.

This study however differed from other prior studies going by the fact that it selected auditors of listed companies rather than investors to participate in the survey. This was premised on their professional training and their judgemental element in coming up with KAMs to report. It is believed that auditors would be more aware of determinants of KAMs reported in enhanced auditor's report and its mechanisms, given they are the ones who come up with them and as such, provide a better assessment of their effectiveness in addressing audit expectations gap.

3.5. Sampling Techniques

Cooper and Schindler (2014) define sampling as the selection of a few members from total population to participate in a study. Few members are selected to represent the whole population in the study as there are practical or technical limitations that would limit the

inclusion of the whole population. Cohen, Manion and Morrison (2007) argued that the total expenditure for studying a whole population can be overwhelming and unfeasible to be incurred based on the researcher's budgetary constraints.

Both non-probability and probability sampling techniques were used in the study. In non-probability sampling, purposive sampling was used because data is not readily available to the researcher due to the fact that it's still a new area of study and target respondent group was already known. Purposive sampling was used to sample the participants relevant to this study who have knowledge about the determinants of KAMs reported expanded auditor's report. They comprise of auditors from firms that audit companies listed in NSE.

Simple random sampling, a probability technique, was used to sample the aforementioned participants for the study. The study settled for simple random sampling because according to Kothari (2004) it gives each component of the population equal chance of being picked up for the sample and all choices are independent from each other, given it's a homogenous group. Moreover when compared to systematic random sampling, it does not portray the danger of order bias (Mugenda & Mugenda 2008).

Limitation of the sampling techniques to be used is that, though quick and efficient methods of getting information, it cannot scientifically make generalizations about the total population from the sample because it would not be representative enough. This was thus subjective but will however guide in future research on the area of study.

Most qualitative studies used purposive sampling since subjects was selected based on their expertise or experience in the subject. Different respondent categories were treated as a homogenous group hence a proportion of the same was gotten based on purposive sampling and size of audit firm to represent the group and achieve the census of all 65 listed companies and all the 11 audit firms found to have been involved in the audit of the listed companies in the period under study 2015 to 2017. Purposive sampling was done by allocating 20 respondents to each of the big four audit firms given they conduct 86% of audits of all listed companies, and allocating 10 respondents to each of the small and medium audit firms to arrive at a sample size of 150 respondents.

3.6. Pilot Study

Pilot testing was done to pre-test instruments to be used in data collection in order to eliminate ambiguity and improve its relevance to the study objectives (De Vaus, 2014). The pilot study involved 5% of the respondents translating to 3 respondents. The respondents were selected conveniently since statistical conditions are not necessary for pilot studies (Cooper & Schindler, 2003).

Pilot study was meant to help refine research instruments; frame the questions appropriately; obtain relevant background information; ascertain the degree of observer bias and develop research procedures that ensure the respondents in the main research study do not have problem in answering the questions. Expert opinion was sought to comment on representativeness and fitness of the questions as well as make suggestions on the corrections to be made.

The pilot study is intended to help in improving the content reliability and validity for the data to be collected. Questionnaires were sent electronically via Google forms to the respondents' place of work to ensure objective response and reduced non-response rate. Data from the pilot study was however not included in the final data analysis.

3.7. Data Collection Methods

Primary data was used in the study. The questionnaires were self-administered, sent via email or distributed online using a survey link as per respondent's preference. These questionnaires were only sent after getting respondents acceptance to voluntarily participate in the study. The questionnaires were filled by auditors working or who have worked with firms involved in audit of companies listed in the NSE.

Use of primary data is justified on the basis that it gives fundamental and original evidence (Sapsford & Jupp, 2006). Primary data is more dependable compared to secondary data since it is more reliable given that data is retrieved originally from the research field and not from secondary sources that can be prone to errors, inaccuracies or can even be outdated (Hox & Boeijs, 2005).

Questionnaire is used as a research instrument since it is both cost and time effective method of collecting data when compared to other research instruments (Kothari, 2004). The instrument gives the respondents adequate time to provide well thought answers compared to

other methods (Kothari, 2004). Moreover, it is free from interviewer`s biasness when compared to interviews and it covers a very large sample of participants when compared to interviews. Data was collected in May 2019.

Structured questions include a Likert scale that is used to measure different aspects of the variables under study. Quantitative data was collected by use of semi-structured questionnaires. Unstructured questions were also included to provide the respondents with the freedom to capture any other important dimensions of the variables that they felt was missing (Williams, 2003).

The questionnaire consisted of two sections. Section A focused on the respondents` profile, Section B focusing on determinants of KAMS, but with sub-sections addressing the various variables involved in the study.

3.8. Data Analysis

Data analysis is the application of statistical tools to process data into meaningful information. Quantitative data was be coded to assist in placing the responses in groups, according to categories presented in the questionnaire. This study used both descriptive and inferential statistical techniques to analyze data collected. The descriptive techniques comprised of frequencies, percentages, mean scores and standard deviation, whereas the inferential statistical tools will use Spearman`s rho correlation analysis, analysis of variance (ANOVA) and regression analysis.

Based on cognitive psychology from comments by respondents, we draw inferences, conclusion and recommendations as to how auditor judgment is used at arriving at the KAM information in the auditor`s reports. In this research regression analysis was carried out whereby a model of a relationship was hypothesized in the form $Y = \beta_0 + \beta_1 X + \varepsilon$ where β_0 and β_1 are model parameters and ε is the probabilistic error term that accounts for any variability in Y that cannot be described by the linear relationship with X (Cooper & Schindler, 2014). Independent variables dealing with determinants of KAMs were regressed against dependent variable which is KAMs to be included in the enhanced audit report. The equation was as shown below:

$$\text{KAMS}_{it} = \beta_0 + \beta_1 \text{FS} + \beta_2 \text{SUB} + \beta_3 \text{AT} + \beta_4 \text{CL} + \beta_5 \text{IND} + \beta_6 \text{TRY} + e$$

Where:

KAMS – Key Audit Matters (Dependent variable)

FS – Firm Size

SUB – Subsidiaries

AT – Auditor Type

CL – Cross Listing Status

IND – Industry

TRY – Trend review over the years

$\beta_1, \beta_2, \beta_3, \beta_4, \beta_5, \beta_6$ = coefficients for which we are trying to predict the value of Y

β_0 = constant

ε = Error term

3.8.1. Testing the Models

The following tests were performed and explained; correlation coefficient, the coefficient of determination, model fit (ANOVA) and regression coefficients.

3.8.1.1. Correlation Coefficient (R)

This helps the researcher to determine to what degree variable movements were associated. The correlation coefficient is usually within a range of values between -1 and 1 (Ronchetti, 2018). A correlation of -1 indicates a perfect negative correlation while a correlation of 1 indicates a perfect positive correlation. One of 0 indicates no relationship. The closer the correlation coefficient is towards -1 or 1, the stronger the association between the variables.

3.8.1.2. The coefficient of Determination (R²)

This enabled the researcher to explain how well the response variable variation was explained by the linear model. According to Allen (2004) when the differences between observed values and the model's predictions are small and unbiased, then the model is fit. R² ranges from 0 to 1. The closer the R² is to 1 the better the model fits the data.

3.8.1.3. ANOVA

This enables the researcher to test whether the dependent variables were individually influenced by the independent variable. F-values can be obtained from the regression output and interpreted such that if the values are less than 0.05, then they are significant and should be included in the model, otherwise insignificant (Higgins, 2005).

3.8.2. Diagnostic Tests

3.8.2.1. Normality Tests

The normality test of data collected was checked by conducting the Skewness-Kurtosis (Jarque-Bera) test for normality where the null hypothesis under this test is that the distribution of the data is not significantly different from that of a normal distribution. If the p-value is less than 0.05, the null of normality at the 5% level will be rejected. If variables are found not to be normally distributed, the conversion of data to natural logarithms instead of absolute values is undertaken.

3.8.2.2. Multicollinearity

Multicollinearity was tested in the study using correlation matrix whereby the cut-off point for severe Multicollinearity is 0.8 (Gujarati, 2003; Cooper & Schindler, 2008). Variance inflation factor (VIF) was also used to measure multicollinearity since it is more conclusive than Pearson correlation coefficients. The assumption for multicollinearity states that, when the VIF value lies between 1 and 10, then there is no multicollinearity. Multicollinearity leads to large standard errors that affect the precision and accuracy results.

3.8.2.3. Heteroscedasticity

Since the data for this study is a cross-section of firms, this raises worries about the presence of heteroscedasticity. The CLRM expect that the error term is homoscedastic, that is, it has constant variance. On the off chance that the error variance isn't steady, at that point there is heteroscedasticity in the data. To test for heteroscedasticity, the Breusch-Pagan/Koenker test will be utilized. The null hypothesis of the study will be that the error variance is homoscedastic. On the off chance that the null hypothesis is rejected and a conclusion made that heteroscedasticity is available in the panel data, at that point this would be accounted for by running a FGLS model.

3.9. Reliability and Validity of the Research Model

The research instruments were pre-tested in order to test and assess validity, reliability and objectivity of the research. Validity is the degree by which items in the research instrument represents the content the test is designed to measure (Mugenda and Mugenda, 2008). To establish the validity of the research instrument the researcher sought opinions of experts in audit and financial reporting as well as the researcher's supervisor and lecturers.

Reliability is a measure of degree to which a research instrument yields consistent and stable results or data after repeated trials (Eriksson and Kovalainen, 2015). The reliability and internal consistency was evaluated using Cronbach's Alpha. The test is utilized to check if questionnaires with multiple Likert scale questions are reliable. SPSS software was used to compute the Cronbach's Alpha. From the test, the overall reliability scale was 0.65 with the independent variables exhibiting the following coefficients of alpha: firm size (0.64), subsidiaries (0.57), and auditor type (0.63), cross listing status (0.59), Industry (0.58) and cross section of years (0.62). Gliem and Gliem (2003) recommended a value of 0.6 or greater as acceptable for the reliability test. 0.6 was the benchmark value the study used to test the reliability of the questionnaire.

Objectivity ensures that the researcher should as far as possible remain distanced and independent from the study so that finding will depend on the nature of what was studied rather than the personality, beliefs and values of the researcher (Payne & Payne, 2004).

3.10. Data Presentation

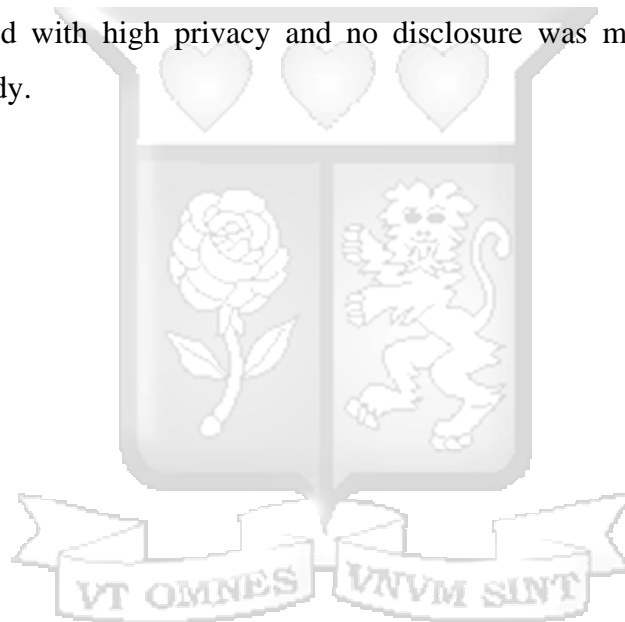
It encompasses the process of describing the disseminated dataset with the main variables covered, the breakdown and classifications used. The study used bar graphs, pie charts and frequency tables to present collected data. This is important because it gives a visual way to look at data.

3.11. Ethical Issues

In research ethics is important for two significant reasons. In the first place, ethics in research is critical to enhance the aims of the research such as knowledge, truth and avoidance of error. Second, since research regularly involves a great deal of cooperation and coordination among a wide range of individuals in various disciplines and organizations, ethical standards advance the qualities that are basic to communitarian work, for example, trust, responsibility, common

regard, mutual respect and fairness. While undertaking our study the researcher ensured to abide by the ethical standards of research that includes getting voluntary informed consent from the respondents on the intended use of the research and procedures to be adopted in the data collection and analysis. The researcher ensured privacy and confidentiality of participants as well as sensitive data that may be shared.

The conduct of this research was guided by Strathmore University's code of ethics and permission to carry out the research was obtained from the university. Ethical issues concerning research subjects are confidentiality, privacy, anonymity, voluntary and informed consent (Saunders et al., 2015). The researcher ensured anonymity by separating the identity of individual firm from the information found. Therefore, in this research, the information gathered was regarded with high privacy and no disclosure was made beyond using the information in the study.



CHAPTER FOUR

FINDINGS AND DATA ANALYSIS

4.1. Introduction

This chapter encompasses analysis and presentation of the research findings from results of primary data collected through questionnaires supplemented by interview guides. The data was collected from the auditors working for audit firms in Kenya. The findings addressed the determinants of KAMs as reported by companies by listed in the Nairobi stock exchange.

Secondary data from annual reports was also reviewed by the researcher to help in understanding and rank the size of companies listed in NSE, the number of companies cross-listed, those with subsidiaries and hence collaborate primary data.

The findings are organized according to the objectives. First, the demographic information of respondents is presented followed by information responding to each of the specific objectives. The study had an anticipated sample size of 150 respondents but only 136 responded giving a response rate of 91% which was sufficient for analysis. The high response rate was as a result of adopting both manual and online questionnaires which could be accessed and completed even through WhatsApp.

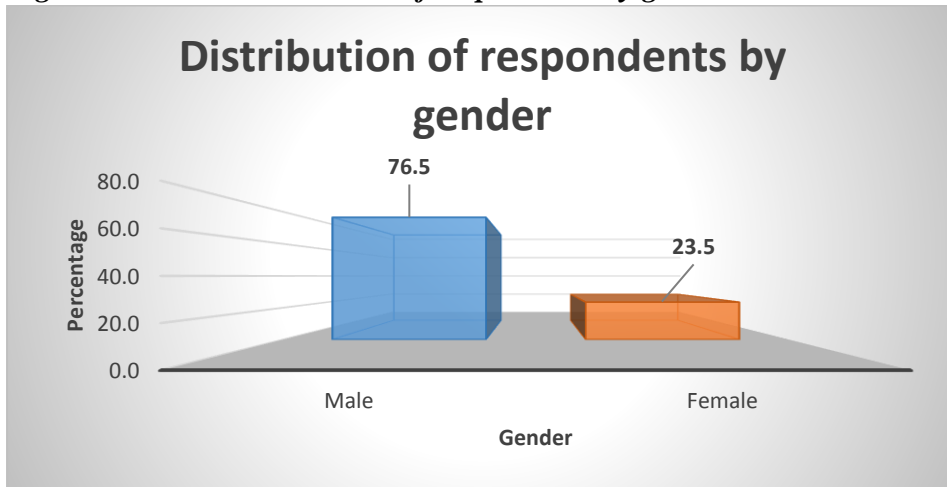
4.2. Demographic Information

The study presents respondents information in terms of their gender, age, education, type of audit firms they have worked for, department they work in, experience and presence of audit committees in the firms they audited.

4.2.1. Gender of respondents

In terms of gender distribution, 76.5% were males and 23.5% were females. This shows that the field of auditing is dominated by males.

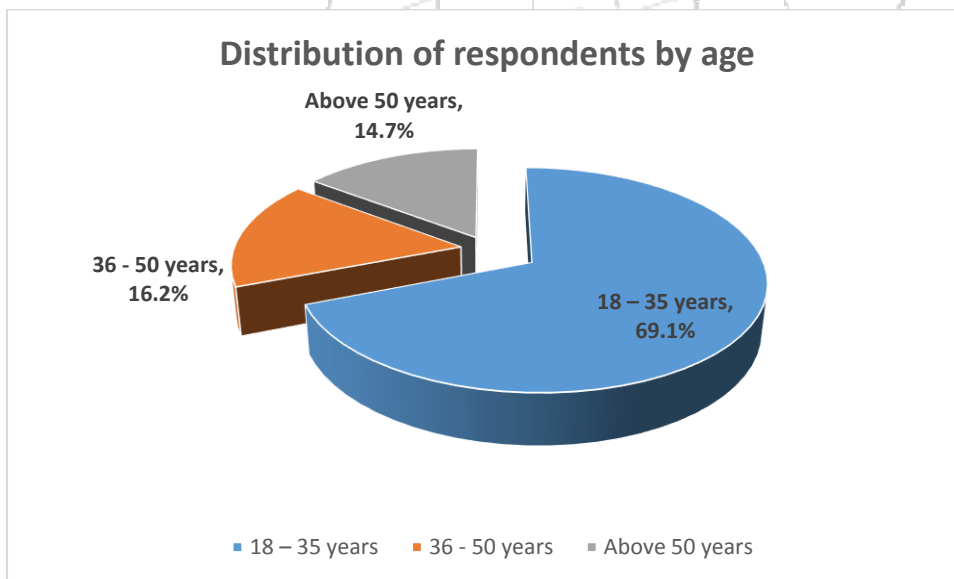
Figure 4.4.2.1.1: Distribution of respondents by gender



4.2.2. Age of respondents

The study targeted respondents of different age categories where both young and old were selected to participate in the study. On this note, 69.1% of the respondents were young people aged between 18 - 35 years, 16.2% of the respondents were aged between 36 – 50 years, while those who were above 50 years accounted for 14.7% as shown in Figure 4.2. This implies that more audit firms are getting younger auditors probably due to the rigorous work auditing involves.

Figure 4.4.2.2.1: Distribution of respondents by age



4.2.3. Highest level of education

The study further sought to establish the highest level of education the respondents had attained. In this regard, therefore, most of the respondents (64.7%) had university degrees while 35.3% had master's degree. Overall the respondents were qualified enough academically to understand the research topic and respond adequately. This indicates that all the auditors were qualified personnel with adequate knowledge and skills in auditing.

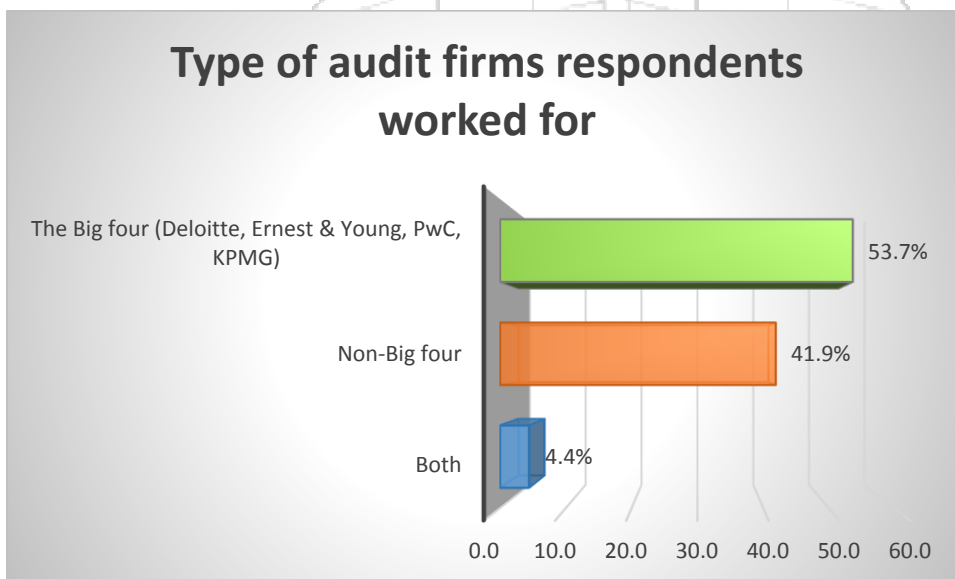
Table 4.1: Highest level of education

	Frequency	Percent
Degree	88	64.7
Masters	48	35.3
Total	136	100.0

4.2.4. Type of audit firm worked on

Majority of the respondents in this study (53.7%) reported that they had worked for the big four audit firms in Kenya which include Deloitte, Ernest & Young, PwC and KPMG. In addition, 41.9% reported to have worked with non-big four audit firms whereas 4.4% had worked with both the big four and non-big four audit companies. It therefore shows that the information presented in this study was from mostly those who have worked with the elite audit firms thus enhancing its quality.

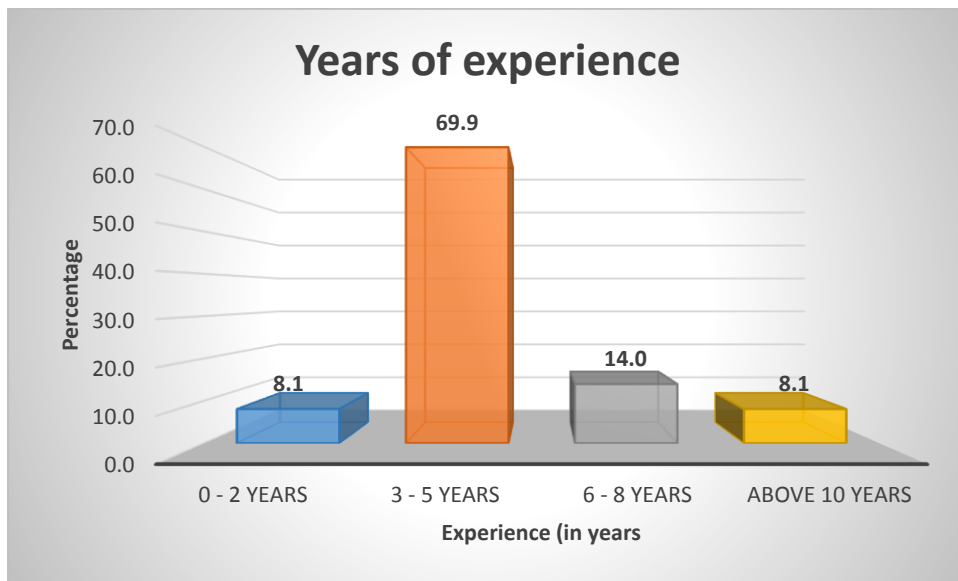
Figure 4.4.2.4.1: Type of audit firm respondents ever worked for



4.2.5. Years of experience

In terms of years of experience in auditing, more than two thirds of the respondents reported to have worked in auditing between 3-5 years. Moreover, 14.0% reported experience of between 6-8 years, followed by those who had 0-2 years of experience and those with more than ten years of experience (each 8.1%). This therefore shows that majority of the respondents had adequate audit experience to understand what KAMs are and how they are arrived at.

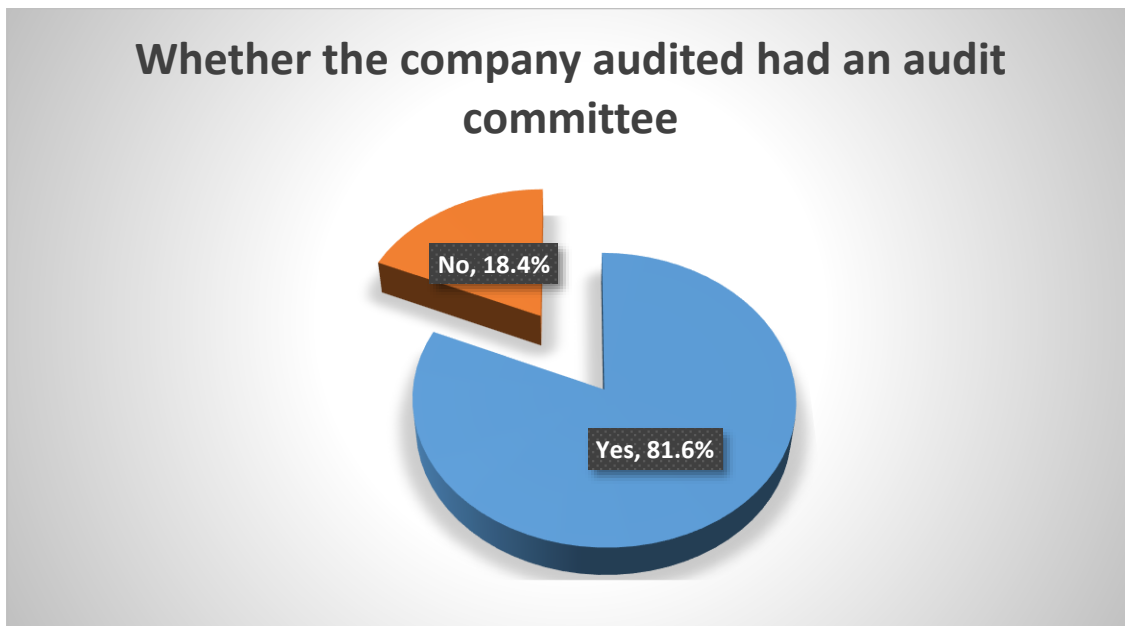
Figure 4.4.2.5.1: Years of experience



4.2.6. Audit committee

Most of the companies that the respondents had audited (81.6%) had an audit committee whereas 14.4% of the respondents indicated that the companies they audited had no audit committees. This means that majority of the listed companies have a well-established governance structure that helps in oversight and to whom the auditor's report on matters they deem significant from their audit. This however differs with secondary data obtained for the population from the regulatory, Capital Markets Authority (CMA), which showed it was mandatory for all listed companies to have an audit committee. Further study should be carried out to understand the conflicting results between the regulators and the auditors who were our respondents.

Figure 4.1: Whether the company audited had an audit committee



4.2.7. Effects of KAMs in Audit quality

Respondents were asked whether enhancement of Auditor’s reports to include Key Audit Matters (KAMs) have made any contribution towards audit quality in the company. In response to this, 82.4% ascertained that indeed enhancement of Auditor’s reports to include Key Audit Matters (KAMs) had made contribution towards audit quality in companies while only 11.0% held a contrary view.

Table 4.2: Contribution of KAMs on audit quality

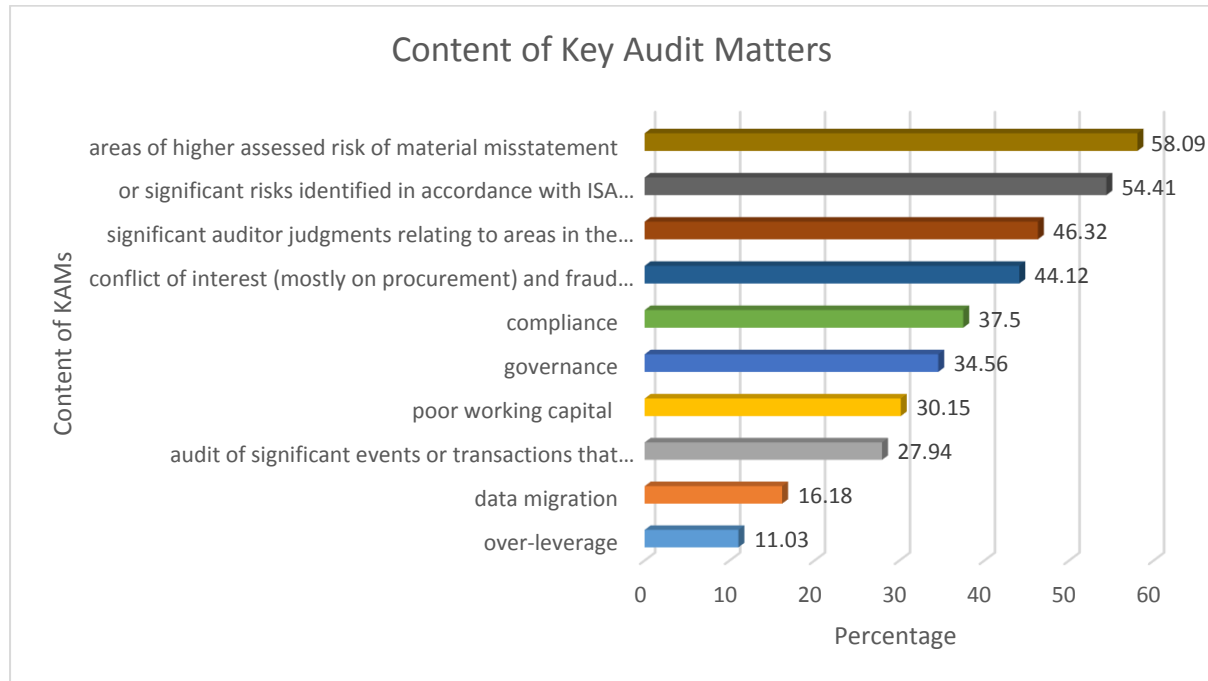
	Mean	Std. Dev.
Do you agree enhancement of Auditor’s reports to include Key Audit Matters (KAMs) have made any contribution towards audit quality in the company?	4.14	1.260

4.3. The content of KAMs reported by auditors in the enhanced auditors’ report

The study tried to investigate the substance of KAMs reported in auditor’s report. The respondents were solicited to explain what was the content of KAMs they had reported and the greater part of them informed the study that KAMs included areas of higher assessed risk of material misstatement, or significant risks identified in accordance with ISA 315, significant auditor judgments relating to areas in the financial statements that involved significant management judgment, including accounting estimates, revenue recognition, valuation of

assets, and valuation of actuarial liabilities that have been identified as having high estimation uncertainty.

Figure 4.3.1: Content of Key Audit Matters



In addition, it was reported that KAMs involves the effect on the audit of significant events or transactions that occurred during the period. It also looks at compliance, governance, conflict of interest (mostly on procurement) and fraud involving senior management, data migration, poor working capital as well as over-leverage. Other mentioned determinants of content of KAMs reported included business complexity (such as extent of reliance on technology) & the regulatory framework, nature of operations and impact of these matters on the performance and going concern of the company, materiality of the values in question, The level of risk, judgment and impact on the audit.

However, the overall nature of KAM that will be reported is determined by the auditor's professional judgment which decides on the issues that were of most significance in the audit of the financial statements of the current period, all this in consultation with those charged with governance.

4.4. Drivers associated with reported KAMs by companies

The study sought to establish the drivers of key audit matters in listed companies. Drivers explored, going by secondary data previously collected, include firm size, Subsidiaries,

Auditor's type, Cross listing status, Industry and Trend Review over Year. Here, the respondents were asked to give their level of agreement with statements regarding each of the drivers.

4.4.1. Firm size

The study was focused on determining effect of firm size on the nature of key audit matters reported. In this regard, respondents were required to give their level of agreement with statements on the effect of firm size on KAMs. Based on results presented on Table 4.3, the respondents tended to agree that the size of the organization by turnover determine the nature of Key Audit Matters (KAMs) reported as was indicated by a mean score of 3.46. Moreover, with a score of 3.63, most of the respondents indicated that the nature and number of Key Audit Matters reported in the audit report are discretionary on the auditor and are not determined by firm size. A mean score closer to 3 shows that the respondents were divided about an issue. In this way, the influence/ effect of the size of firm on the number of KAMs reported was not determined as the respondents were neutral about it (3.07). Moreover, the respondents were torn in between the influence of governance on KAMs. With a score of 3.29 there were neutral opinions on whether those charged with governance have an influence on number and nature of Key Audit Matters included in the audit report as shown in Table 4.3 below. A higher mean indicates that the variables have a major effect on KAMs while a low mean score implies that the aspect does not affect the number and nature of KAMs reported.

Table 4.3: Level of agreement with statements regarding effects of firm size on KAMs

	Mean	Std. Dev.
The size of the organization by turnover determine nature of Key Audit Matters (KAMs) reported	3.46	1.053
The bigger the firm the more the Key Audit Matters reported	3.07	1.001
The nature and number of Key Audit Matters reported in the audit report are discretionary on the auditor and not determined by firm size	3.63	1.108
Those charged with governance have an influence on the number and nature of Key Audit Matters included in the audit report	3.29	1.408

4.4.2. Subsidiaries

The study sought to establish whether subsidiaries had any effect on determining the number and nature of key audit matter in a company. Based on the results in Table 4.4, there was

agreement among majority of the respondents that companies with subsidiaries report more Key Audit Matters than those without. The higher level of agreement is informed by the high mean score of 3.65. Although respondents had divided view on this, most of them were skewed towards the positive side. The results also revealed that the respondents had divided opinion on the nature and number of KAMs reported. In this view, with a mean of 3.15 the respondents did not conclusively give the effect of subsidiaries on the format and order of reporting KAMs. This implies that the number of KAMs may vary depending on whether the company has subsidiaries but the nature would be similar regardless of the presence of subsidiaries.

Table 4.4: Level of agreement with statements regarding effects of subsidiaries on KAMs

	Observations	Mean	Std. Dev.
Companies with subsidiaries report more Key Audit Matters than those without	136	3.65	0.783
The nature and number of reporting Key Audit Matters is different depending on whether company has subsidiaries or not	136	3.15	1.060

4.4.3. Auditor's type

The study sought to determine the effects of auditor type on reporting of KAMs. The auditor type was categorized into two; the big four audit firms comprising of Deloitte, PwC, KPMG as well as Ernest & Young; and other audit firms. In regard to the influence of auditor type, there was almost unanimous agreement that areas requiring significant auditor's judgment are the most reported topics under Key Audit Matters with a score of 4.10. This shows it is the discretion of the auditor to determine what qualifies to be reported as KAMs. On the other hand, there were varied opinions on difference in reporting KAMs between the big four and other audit firms. For instance, the respondents were neutral about the big 4 audit firms reporting different Key Audit Matters compared to other audit firms (a score of 3.16), it was also contested that the big four audit firms have a uniform format and order of reporting Key Audit Matters (3.22), and big four audit firms report more Key Audit Matters than other audit firms in any given audit (3.22). This implies that there is no difference in the manner which KAMs are reported and number of KAMs reported be it audit was done by a big four company or auditors from other audit firms.

Table 4.5: Level of agreement with statements regarding effects of auditor's type on KAMs

	Mean	Std. Dev.
Big 4 audit firms tend to report different Key Audit Matters compared to other audit firms	3.16	1.266
Big 4 audit firms have a uniform format and order of reporting Key Audit Matters	3.22	1.001
Big 4 audit firms report more Key Audit Matters than other audit firms in any given audit	3.22	1.093
Areas requiring significant auditors judgment are the most reported topics under Key Audit Matters	4.10	.945

4.4.4. Cross listing status

On issues to do with cross listing of companies, it was revealed that companies that are cross listed have more Key Audit Matters reported than companies that are not (as indicated by a mean score of 3.43). In addition, with an average score of 3.95, respondents agreed that matters most significant to users of financial reports per jurisdiction are the most reported topics under KAMs, and there was agreement that the various regulatory environment for the cross listed companies determine Key Audit Matters reported (3.79) as shown in Table 4.6 below. This finding implies that various regulatory environment for the cross listed companies determine Key Audit Matters reported, cross listing status does not greatly influence the number of KAMs reported while KAMs mostly include matters that are of highest significance to the users of financial reports per jurisdiction.

Table 4.6: Level of agreement with statements regarding effects of cross listing status on KAMs

	Mean	Std. Dev.
Companies that are cross listed have more Key Audit Matters reported than companies that are not	3.43	1.066
Matters most significant to users of financial reports per jurisdiction are the most reported topics under Key Audit Matters	3.95	.945
The various regulatory environment for the cross listed companies determine Key Audit Matters reported	3.79	.645

4.4.5. Industry

The study further sought to establish the effect of industry type on reporting of key audit matters. In this, the study focused on whether firms in the same industry reported similar key audit matters, whether KAMs were dependent on level of regulations in an industry and risk of material misstatement. Based on the findings, most respondents (83.1%) reported that organizations in the same industry tend to report similar KAMs, 87.5% agreed that areas with highest assessed risk of material misstatement in the financial reports per industry are the most reported topics under KAMs. Moreover, 81.6% of the respondents were in agreement that the level of regulation of an industry determines KAMs reported whereas 95.6% concurred that some industries tend to report more KAMs than others.

Table 4.7: Level of agreement with statements regarding effects of industry on KAMs

	Mean	Std. Dev.
Organizations in the same industry tend to report similar KAMs	3.64	.814
Areas with highest assessed risk of material misstatement in the financial reports per industry are the most reported topics under KAMs	4.15	.865
The level of regulation of an industry determines KAMs reported	4.01	.803
Some industries tend to report more KAMs than others	4.26	.534

4.4.6. Trend review over years

Generally, there is a gradual shift in the nature and number of KAMs reported over the years. With mean score of more than 4, it means that majority of the respondents agreed with the statements regarding effect of trend reviews over the years. For instance, it was agreed that the number of presentation of KAMs is changing over the years (4.29) meaning that more and more KAMs are reported with each year of audit. Moreover, it was indicated that the form and order of presentation of Key Audit Matters is changing over the years (4.32), the nature and drivers of Key Audit Matters reported are changing over the years (4.46), and that format of presentation of KAMs is becoming more standardized as years progress (4.48) as shown in table 4.8. The implication here is that the more companies get audited, the more KAMs are reported with the changing nature, form, order and format of reporting.

Table 4.8: Level of agreement with statements regarding effects of cross section of year on KAMs

	Mean	Std. Dev.
The form and order of presentation of Key Audit Matters is changing over the years	4.32	0.641
The nature and drivers of Key Audit Matters reported are changing over the years	4.46	0.583
More Key Audit Matters are being reported as years progress	4.29	0.844
The format of presentation of Key Audit Matters is becoming more standardized as years progress	4.48	0.769

4.5. The nature and number KAMs reported in the enhanced audit reports

In reporting the KAM, we start with the KAM in order of significance in terms of significant auditor’s judgement, significant risk, significant estimates and materiality. Majority of the respondents (90.5%) reported that the form and order of presentation of KAMs is changing over the years. In addition, 87.5% indicated that format of presentation of KAMs is becoming more standardized over time. All the respondents further reported that number of KAMs reported in enhanced auditor’s report vary from three to five and are dependent on key events and areas identified to have high risk during that year.

4.6. Inferential analysis

4.6.1.1. Normality Tests

The normality of the data will be checked by conducting the Skewness-Kurtosis (Jarque-Bera) test for normality - null hypothesis under this test being that the distribution of the data is not significantly different from that of a normal distribution. For data to be normally distributed, the skewness value is between -1 and 1. The value is likewise required to be less than three times the standard error of skewness. This is also similar to the Kurtosis test. From the table below, data from all the variables was found to be normally distributed.

Statistics								
		Key Audit Matters	Firm size	Subsidiaries	Auditor's type	Cross listing status	Industry	Cross Section & Year
N	Valid	136	136	136	136	136	136	136
	Missing	0	0	0	0	0	0	0
Skewness		.060	-.233	-.290	-.577	.010	.051	-.892
Std. Error of Skewness		.208	.208	.208	.208	.208	.208	.208
Kurtosis		1.076	-.859	-.327	-.218	-.063	.108	-.236
Std. Error of Kurtosis		.413	.413	.413	.413	.413	.413	.413

4.6.1.2. Multicollinearity

Multicollinearity will be tested in the study using correlation matrix whereby the cut-off point for severe Multicollinearity is 0.8 (Gujarati, 2003; Cooper & Schindler, 2008). Variance inflation factor was also used to measure multicollinearity since it is more conclusive than Pearson correlation coefficients. The assumption for multicollinearity states that, when the VIF value lies between 1 and 10, then there is no multicollinearity. Multicollinearity leads to large standard errors that affect the precision and accuracy results. Based on the results below, all the VIF values lie between 1 and 10 thus there is no multicollinearity in the data. With a cut-off point of 0.8, there was a risk in having severe collinearity between firm size and KAMs.

Coefficients^a

Model		Collinearity Statistics	
		Tolerance	VIF
1	Firm size	.813	1.230
	Subsidiaries	.720	1.390
	Auditor's type	.681	1.468
	Cross listing status	.563	1.777
	Industry	.517	1.933
	Cross Section & Year	.725	1.379

a. Dependent Variable: Key Audit Matters

4.6.1.3. Heteroscedasticity

The data for the study is from a cross-section of firms, thus raising the concerns about the existence of heteroscedasticity. The CLRM assumes that the error term is homoscedastic, that is, it has constant variance. If the error variance is not constant, then there is heteroscedasticity in the data. To test for heteroscedasticity, the Breusch-Pagan/Koenker test was used and results of the test are as presented in the table below.

OLS outputs with heteroscedasticity-robust standard errors:

	b	se	t	sig	95%LB	95%UB
Constant	0.091	0.22	0.415	0.679	-0.287	0.47
Firm size	0.146	0.025	5.736	0.000	0.101	0.192
Subsidiaries	0.094	0.033	2.89	0.005	0.037	0.152
Auditor type	0.256	0.029	8.793	0.000	0.203	0.309
Cross listing	0.279	0.043	6.536	0.000	0.192	0.366
Industry	0.078	0.047	1.675	0.096	-0.017	0.173
Trend Review over Years	0.139	0.033	4.252	0.000	0.069	0.21

* Note: standard error is HC4 variant

Breusch-Pagan and Koenker test

Breusch-Pagan and Koenker test statistics and sig-values

	LM	Sig
BP	17.637	.007
Koenker	30.471	.000

Null hypothesis: heteroscedasticity not present (homoscedasticity).

If sig-value less than 0.05, reject the null hypothesis.

Therefore, we reject the null hypothesis and conclude that there is presence of heteroscedasticity in the data.

4.6.2. Correlation testing

Correlations

			Key Audit Matters	Firm size	Subsidiaries	Auditor's type	Cross listing status	Industry	Trend Review over years
Spearman's rho	Key Audit Matters	Correlation Coefficient	1.000	.450**	.520**	.593**	.578**	.592**	.397**
		Sig. (2-tailed)		.000	.000	.000	.000	.000	.000

** . Correlation is significant at the 0.01 level (2-tailed).

A spearman's rho correlation was carried out to establish the relationship between the dependent variable (Key Audit Matters) and the independent variables. The results showed positive relationships with the variables measured which were significant at $p=0.01$. The number and nature of KAMs were moderately correlated to the firm size ($\rho = 0.450$). This implies that the bigger the firm, the more KAMs will be reported and vice versa. There was also a moderate correlation between KAMs and trend review over the years ($\rho = 0.397$) meaning that KAMs would increase as the years progress. The results further revealed strong

positive correlations between KAMS and subsidiaries ($\rho = 0.520$), auditor type ($\rho = 0.593$), cross listing status ($\rho = 0.578$) and the industry in which firm operates ($\rho = 0.592$). This implies that an increase in any of the independent variables would significantly lead to increase in the dependent variable.

4.6.3. Goodness of fit of the model

Goodness of fit of the model refers to how well the model explains the variations in the dependent variable (Gujarati, 2012). It evaluates whether the model is good, reliable and valid to be used for prediction. In this study, the R squared, Standard error of estimate (S.E.) and the F-test statistic were used respectively to evaluate the goodness, reliability and validity of the various models.

Coefficient of Determination

Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.898 ^a	.806	.797	.226

a. Predictors: (Constant), Cross Section & Year, Auditor's type, Cross listing status, Firm size, Subsidiaries, Industry

Coefficient of Determination explains the degree to which the adjustment in the dependent variable can be explained by the adjustment in the independent variable or the percentage of variation in the dependent variable that is explained by all the independent variables. The coefficient usually lies between 0 and 1 whereby 0 indicates a complete lack of fit while 1 indicates a perfect fit. Therefore the closer it is to 1 the better the fit. An R-square value of 0.806 was established and adjusted to 0.797. The adjusted R squared is a better measure in this case because it is used to make comparison of a regression model that has the same dependent variable but different number of independent variables. This means that the independent variables could explain 79.7% of the key audit matters while only 20.3% of KAMs can be explained by factors not studied in this study. The standard error of estimate is the standard estimate of the deviation of the dependent variable about the regression line (Gujarati, 2012; Brooks, 2014). The smaller the estimate the better the fit to the actual data.

ANOVA^a

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	27.315	6	4.553	89.423	.000 ^b
	Residual	6.567	129	.051		
	Total	33.882	135			

a. Dependent Variable: Key Audit Matters

b. Predictors: (Constant), Trend Review over the Year, Auditor's type, Cross listing status, Firm size, Subsidiaries, Industry

Analysis of Variance (ANOVA) was used to test the overall significance of the regression model. The null hypothesis for this test is that the independent variables do not have explanatory power ($\beta_1=\beta_2=\beta_3=\beta_4=\beta_5=0$). The p-Value of 0.001 means that the R squared is significantly greater than zero thereby our predictors are able to account for a significant amount of variance in key audit matters. With a significant p-value, we reject the null hypothesis and adopt the alternative hypothesis and conclude that the predictors have explanatory power. Therefore, the regression model is significant ($F_{(6,135)} = 89.423, p < 0.001; R^2 = 0.806$).

4.6.4. Regression analysis

Coefficients^a

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	.091	.193		.473	.637
	Firm size	.146	.023	.271	6.312	.000
	Subsidiaries	.094	.029	.146	3.206	.002
	Auditor's type	.256	.027	.443	9.432	.000
	Cross listing status	.279	.044	.326	6.304	.000
	Industry	.078	.049	.086	1.604	.111
	Trend Review over Year	.139	.036	.176	3.862	.000

a. Dependent Variable: Key Audit Matters

$$KAMs = 0.091 + 0.146 FS + 0.094Sub + 0.256AT + 0.279 CL + 0.139TRY$$

Where;

KAMs – Key Audit Matters

FS - Firm size

Sub – Subsidiaries

AT - Auditor's type

CL - Cross listing status

TRY–Trend review over the years

The results of linear regression showed that all the independent variables, except industry had effects on KAMs reported in enhanced audit report. In this regard, size of the firm being audited would increase the content, nature and number of KAMs by 0.146 points when other factors are held constant. The study further revealed that, all factors are kept constant, a unit increase in the number of subsidiaries would significantly increase KAMs by 0.094 points. Moreover, a unit increase in the stature of auditor type (the big four) would significantly increase nature and number of KAMs by 0.256 points. Besides, if a company is cross listed the content, nature and number of KAMs would significantly increase by 0.279 points other factors held constant. In addition, other factors controlled at zero, an increase in Trend review over years by 1 year would significantly increase the nature and number of KAMs by 0.139 points.

4.7. Chapter Summary

The study sought to examine the determinants of KAMs in the revised auditors report and impact of KAMs on audit quality and audit expectations gap using primary data collected from auditors who are the originators of this reports. The study began by discussing findings from the questionnaires under response rate, demographic characteristics and descriptive results from specific question on the questionnaire about each driver of KAMs studied, that is, Firm size, Subsidiary, Auditor type, Industry, Cross listing and trend review over years. A correlation analysis was then applied to determine association between the independent and dependent variable as shown in the conceptual framework and fitness for purpose of the model for the study being done. Finally these variables were put in a regression model to determine significance of their relationship to each other.

CHAPTER FIVE

DISCUSSION, SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

5.1. Introduction

This chapter presents the summary of findings, conclusion and recommendations from the study. The research findings were summarized as per the research objectives outlined in chapter one of the study. This chapter also provides recommendations and suggestions on areas of further study in regards to KAMs.

5.2. Discussion of Findings

The study was carried out in May 2019 among auditors working with various audit firms within Kenya. The main of the study being to identify determinants of KAMs reported in audit reports of 65 listed companies in the Nairobi Securities Exchange.

5.2.1. The content of KAMs reported by auditors in the enhanced auditors' report

From the first objective, the study findings explored the content of KAMs as reported by auditors in revised audit report. The substance of KAMs reported is simply founded on the auditors' judgment after consultation with management and board audit committee. The study revealed that KAMs included areas of higher assessed risk of material misstatement, or as alluded to by ISA 315, areas of significant auditor judgments, areas of significant management judgment, including accounting estimates, revenue recognition, valuation of assets, and valuation of actuarial liabilities. Content of KAMs additionally included the impact on the review of noteworthy occurrences during period under review. It additionally takes a look at compliance, governance, conflict of interest (mostly on procurement) and fraud involving senior management, data migration, poor working capital as well as over-leverage.

Much as it is a great idea to incorporate KAMs in the audit report, the inclusion of additional disclosure may also affect users' perception of the audit, more so in regards to audit quality, comparability and uniformity across organizations or audit areas. As Bédard et al., (2014) revealed, the disclosure of such information has more of a symbolic than an informative value. Hatherly, Brown, and Innes (1998) in fact recommend that additional communications in the audit report on significant issues may influence the users' view of the review.

In summary, from the study done, the content of KAMs reported was found to be mainly judgemental by the auditor but guided by the International Standards of Auditing general guidelines and also consultations with those charged with governance. This element of consultation with those charged with governance puts on the line the auditors independence given his/her judgement might be impaired depending on the kind of relationship the auditor has with the directors of the company.

5.2.2. Drivers associated with reported KAMs by companies listed in the NSE

In regard to the second objective which sought to investigate the drivers associated with reported KAMs by companies listed in the NSE, the findings showed that all the drivers studied had positive effect on KAMs. The results showed positive relationships with the variables measured which were significant at $p=0.01$. The number and nature of KAMs were moderately correlated to the firm size ($\rho = 0.450$) and cross section of years ($\rho = 0.397$); strong positive correlations between KAMS and subsidiaries ($\rho = 0.520$), auditor type ($\rho = 0.593$), cross listing status ($\rho = 0.578$) and the industry in which firm operates ($\rho = 0.592$). The positive correlation between KAMs and the various drivers studied implies that an increase in any of the independent variables would significantly lead to increase in the dependent variable. However, as Daske, Hail, Leus & Verdi (2011) pointed out that the communication of KAMs does not necessarily increase the perceived level of audit quality, but rather even lowered it going by one of experiments conducted. This is because driver of KAMs reported which are the international standards and legislations developed for various jurisdictions are general in nature hence giving leeway to auditors' judgement to justification of inclusion or omission of KAMs in the report.

This study focused on the firm size, subsidiaries, auditor type, cross listing status, industry type and cross section of years as the main drivers of nature and number of KAMs. An R-square value of 0.806 was established and adjusted to 0.797. This means that independent variables could explain 79.7% of the key audit matters while only 20.3% of KAMs can be explained by factors not studied in this study. There is therefore need for more research to establish what these other variables that determine the nature are and number of KAMs as reported by the auditors in their report given there is no specific standards or guidelines stipulating the drivers.

Furthermore, the correlation testing for drivers of KAMs showed that firm size has moderate positive correlation to the nature and number of KAMs reported as compared to the other

drivers that have strong positive correlation. This means to show that auditors are not really guided by size of company to decide KAMs to report but by other factors like materiality and risk element. The cross section of years also has moderate positive correlation to the KAMs reported meaning there has not been much progress or development in improving KAMs to make them more informative or communicative as initially envisioned.

5.2.3. The nature and number KAMs reported in the enhanced audit reports

In regards to third objective of the study, which sought to assess nature and number KAMs reported in the enhanced audit reports of companies. IAASB, while clarifying audit standards with a focus of improving audit reporting and quality agreed on more disclosure to increase transparency and thus address the audit expectations gap. Moreover, to display transparency of the audit process and enhance the communicative value of the engagement, the auditor is expected to disclose KAMs in the auditor's report per ISA 701. This helps throw light on the auditor's judgment basis and highlights key issues he/she feels ought to be communicated to users.

While there is no guideline as to how to present the KAMs and how many KAMs should be in a given audit report, all the respondents further reported that number of KAMs reported in enhanced audit report vary from three to five and are dependent on key events and areas identified to have high risk during that year. It is auditors mandate to determine which of the matters are considered to be most significant in the audit reviews and hence decide which matter to report as KAM and which to leave in the management letter. Therefore, going by this criteria of deciding on what qualifies to be KAM and also guided by other factors such as complexity and size of the company, nature of client business and environment, the auditor might end up with very many or very few KAMs (Cordoş & Fülöp, 2015). This is also dependent on the judgement of the auditor due to lack of guideline as to how to present the KAMs and how many KAMs should be reported.

The issue of legal liability to auditors out of their audit report more so inclusion or omission of some KAMs that users deem key is a real exposure on the auditors, even in the Kenyan context. The shareholder plaintiffs' lawyers will be salivating over the documentary record to be created under the revised PCAOB's and IAASB inspection process, and the four-layered mischief to be inflicted by its deficiency-seeking process (Shaikh and Talha, 2003). Auditors being alive to this risk are working on mitigating it and very soon, every audit firm will be found to have

some minimum number of KAMs while defensive reporting will prevail. This will ultimately be counter-productive to the original intention of KAMs.

This thus explains why the audit report especially for the big four are tending to take a standardized format as they seek to mitigate on the exposure. This has also led the audit firms especially the big four to reporting more KAMs than the small firms as they try to cover themselves from liability where there is a risk.

5.3. Conclusion

The study's broad objective was to understand the determinants of KAMs in the revised audit report and impact of KAMs on the audit expectations gap. First objective explored the content of KAMs reported by auditors in the enhanced audit report and it was noted that the content of KAMs reported is purely based on the auditors' judgement after discussion with management and board audit committee. The study revealed that most reported KAMs included areas of higher assessed risk of material misstatement in accordance with ISA 315, areas of significant auditor judgments and areas of significant management judgment, including accounting estimates, revenue recognition, valuation of assets, and valuation of actuarial liabilities that have been identified as having high estimation uncertainty.

In regard to the second objective which sought to investigate the drivers associated with reported KAMs by companies listed in the NSE, all the drivers studied had positive effect on KAMs. The driver of KAMs reported which are the international standards and legislations developed for various jurisdictions are general in nature hence giving leeway to auditors' judgement and justification of inclusion or omission of KAMs in the report. The number and nature of KAMs were moderately correlated to the firm size ($\rho = 0.450$); positively and strongly correlated to subsidiaries ($\rho = 0.520$), auditor type ($\rho = 0.593$), cross listing status ($\rho = 0.578$) and the industry in which firm operates ($\rho = 0.592$). This would therefore mean that an increase in any of the independent variables would significantly lead to increase in the dependent variable. The drivers studied however represent 79.7% of the driver of what guide auditors in deciding what KAMs to report. There are still other 20.3% variables that also guide auditors in their judgement but were not included in this study.

The third objective sought to assess the nature and number KAMs reported in the enhanced audit reports of companies. Even though there is no guideline as to how to present the KAMs

and how many KAMs should be in a given audit report, all the respondents further reported that the number of KAMs reported in enhanced audit report vary from three to five and are dependent on key events and areas identified to have high risk during that year. In this regard, therefore, the auditor is allowed to communicate KAMs in the audit report per ISA 701 in order to display transparency of the audit and enhance the communicative value of the engagement in whatever way he/she deems fit, but taking care not to introduce information overload which is counterproductive.

5.4. Recommendations

While the study has established that firm size, subsidiaries, auditor type, cross listing status, industry type and cross section of years have effect to the nature and number of KAMs reported in enhanced audit report it suggests the following recommendations based on its findings:

There is need to develop guidelines on the nature and number of KAMs reported in auditor's report.

There is also need to develop guidelines on nature and level of consultation between the auditor and board audit committee before arriving at KAMs to report to ensure auditors independence is protected at all times.

There is need to harmonize reporting of KAMs across the audit profession. This is because the big four audit firms tend to have their own way of reporting KAMs. They also tend to report more KAMs than other audit firms.

5.5. Limitations of the research

The first limitation of the study is that as a result of using questionnaires to collect data, there was non-response and thus had to extend my data collection period as I followed up with my intended respondents thus causing delay in finalizing the research. The other limitation was that the study excluded companies not listed in the Nairobi Securities Exchange despite them being the majority. Another limitation was in the tool of analysis used i.e. regression. The regression analysis tool has various assumptions such as linearity which assumes that relationship between the dependent and independent variable is linear.

5.6. Contribution to Knowledge

This study sought to build on to the agency theory by determining impact of the KAMs as reported by auditors to the users for annual report in reducing audit expectations gap. The study

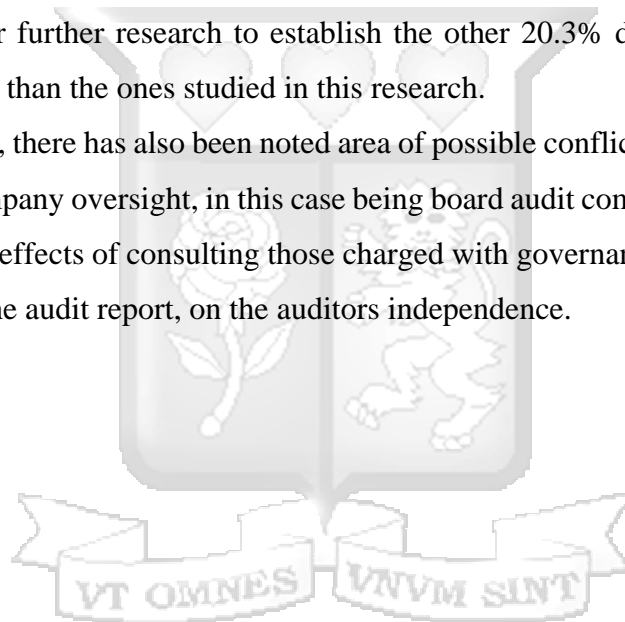
also sought to build on signalling theory by determining the impact of nature and number of KAMs reported on guiding the users of annual report to better understand them without getting information overload. Additionally, the study sought to add to the existing body of knowledge by highlighting the drivers of KAMs reported in Kenya where scanty research has been done in relation to KAMs in Kenya. Further, the study sought the views of industry players in an attempt to better understand the basis of decision making while coming up with KAMs.

5.7. Suggested areas for further research

Further study can be conducted to determine effects of firm profitability, corporate governance as well as Market performance (Stock Liquidity) on KAMs reported in enhanced audit reports.

There is also need for further research to establish the other 20.3% drivers for determining KAMs reported, other than the ones studied in this research.

Finally from the study, there has also been noted area of possible conflict between auditors and those in charge of company oversight, in this case being board audit committee and hence need to do further study on effects of consulting those charged with governance, before deciding on KAMs to include in the audit report, on the auditors independence.



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APPENDICES

APPENDIX I: RESEARCH AUTHORIZATION



13 May 2019

TO WHOM IT MAY CONCERN

Facilitation of Research for Njenga Samson Thuo Student No. 12521

Mr. Njenga Samson Thuo is a postgraduate student in our Master of Commerce (MCom) programme. In partial fulfilment of the MCom degree, students are required to carry out a research project and write a thesis on a contemporary subject within their field of specialisation. Among other activities, the project involves data collection and analysis.

Samson is requesting to gather information to be used in his research. The information he will obtain from your organization will be used for this academic purpose only and will be kept confidential. The results of the survey will be in summary form and will not disclose any individual, company name or company information in any way.

Our MCom seeks to establish links with industry, and one of these ways is by directing our research to areas that would be of direct use to industry. We would be glad to share the findings with you after the research, and we trust that you will find them of great interest and of practical value to your organization.

The research study is entitled “An examination of the determinants of key audit matters reported by companies listed in the Nairobi securities.”

We appreciate your support and shall be willing to provide any further information if required.

Yours faithfully,



Quindos Karanja
Coordinator – Master of Commerce (MCom)
Strathmore University Business School
Email: qkaranja@strathmore.edu

APPENDIX II: THE QUESTIONNAIRE

This questionnaire is a data collection tool for the study, “Examination of the determinants of KAMs reported by companies listed in the Nairobi Securities Exchange, Kenya.”

Kindly answer the questions by putting a tick (✓) in the appropriate box or by writing in the space provided.

Confidentiality

All the information collected will be treated with utmost confidentiality and used only for academic purposes. In addition, no reference shall be made to any company or respondent.

SECTION A: DEMOGRAPHIC INFORMATION

Name of respondent (optional)

Name of Company

1. What is your age?
 - a. 18 – 35 years []
 2. 36- 50 years []
 3. Above 50 years []
2. Gender of respondent
 1. Male []
 2. Female []
3. What is the highest level of education you have attained?
 - a. Certificate []
 2. Diploma []
 3. Degree []
 4. Masters []
 5. PhD []
4. Which department do you work in?
 - a. Audit []
 2. Tax []
 3. Financial Advisory
 4. Other []
5. For how long have you been working in this department?
 - a. 0 -2 years []
 2. 3 – 5 years []
 3. 6 – 8 years []
 4. 9 – 10 years []
 5. Above 10 years []
6. Does the company you audited have an audit committee?
 1. Yes[]
 2. No[]
7. Do you agree enhancement of Auditor’s reports to include KAMs have made any contribution towards audit quality in the company?
 - a. Strongly disagree []
 2. Disagree []
 3. Neutral []
 4. Agree []
 5. Strongly agree []

8. In your opinion, what do you think is the impact of including KAMs in the enhanced auditors report in respect to companies you have audited?
9. What is the content of KAMs reported in listed companies you have audited?
10. What determines nature of KAMs reported in these companies?
11. What is the nature and number of KAMs reported in the company you audited?

SECTION B: DETERMINANTS OF KAMS

The following statements relate to determinants of KAMs. State the extent to which you agree with the following statements with regards to enhanced Auditor's reports in a listed corporation you have audited (where 1-strongly disagree, 2-diasagree, 3-neutral, 4agree, and 5-strongly agree).

Variables	Parameters	Respondents Ranking of Parameter				
Independent Variables		1= S D	2= D	3 = N	4= A	5= S A
Key Audit Matters (KAM)						
a) Firm Size						
i.	The size of the organization by turnover determine content of KAMs reported.					
ii.	The bigger the firm the more the KAMs reported.					
iii.	The nature and number of reporting KAMs in the audit report are discretionary on the auditor and not determined by firm size.					
iv.	Those charged with governance have an influence on the number and nature of KAMs included in the audit report.					
b) Subsidiaries						

v.	Companies with subsidiaries report more KAMs than those without.					
vi.	The nature and number of reporting KAMs is different depending on whether company has subsidiaries or not.					
c) Auditors Type						
vii.	Big 4 audit firms tend to report different KAMs compared to other audit firms.					
viii.	Big 4 audit firms have a uniform format, nature and number of reporting KAMs.					
ix.	Big 4 audit firms report more KAMs than other audit firms in any given audit.					
x.	Areas requiring significant auditors judgement are the most reported topics under KAMs					
d) Cross Listing Status						
xi.	Companies that are cross listed have more KAMs reported than companies that are not					
xii.	Matters most significant to users of financial reports per jurisdiction are the most reported topics under KAMs					
xiii.	The various regulatory environment for the cross listed companies determine KAMs reported					
e) Industry						
xiv.	Organizations in the same industry tend to report similar KAMs					
xv.	Areas with highest assessed risk of material misstatement in the financial reports per industry are the most reported topics under KAMs					

xvi.	The level of regulation of an industry determines KAMs reported					
xvii.	Some industries tend to report more KAMs than others.					
f) Trend of Reporting over Year						
xviii.	The nature and number of presentation of KAMs is changing over the years.					
xix.	The content and drivers of KAMs reported are changing over the years.					
xx.	More KAMs are being reported as years progress.					
xxi.	The format of presentation of KAMs is becoming more standardized as years progress.					

Thank you for your participation.

