

# Determinants of Key Audit Matters Disclosure in Listed Financial Services Firms in Nigeria

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## Abstract

*The global accounting scandals that resulted in financial crises and corporate bankruptcies as a result of an unmodified opinion received by companies has resulted in the loss of confidence in independent auditing. Stakeholders of organizations seek to make informed decisions from the disclosed key audit matters from the audit report received from their auditors and to allow for a greater level of transparency by increasing the information content, to promote the credibility and reliability of audit reports. Hence, the study investigated the effect of firms' characteristics on key audit matters disclosure in financial services firms in Nigeria. The longitudinal research design and census sampling method were adopted. The study sampled 49 companies which is also population of financial services firms listed on the Nigeria Exchange Group as of 31st December 2022. Data were collected from annual reports of the financial services firms from 2017 to 2022. Data were analysed using Poisson regression analysis and descriptive statistics. The findings revealed that firm size, audit fee, and auditors' independence have a positive and significant effect on key audit matters disclosure in financial services firms listed in Nigeria. The study recommended that small firms should ensure the disclosure of key audit matters, audit fees should be prioritized as it aids the disclosure of KAM, and adequate standards to ensure auditors' independence should also be enforced.*

**Keywords:** Disclosure of key audit matters, firm size, audit fee, auditors' independence, financial services firms

**JEL Codes:** M40, M42, M48

## 1. Introduction

The primary function of auditor reports is to act as a communication tool for providing information to various stakeholders on the result of the audit exercise. Although, the auditor reports have often been criticized in recent times for being uncommunicative, too standardized, using non-specific language, and, with less firm-specific information contents (Lennox et al., 2022). Moreover, companies frequently receive unqualified audit report opinions which makes it tough for stakeholders to do intercompany comparisons of the results of audit reports (Carlé et al., 2023). The limitation in the information provided in auditors' reports led to the negative effects of the expectation gap as stakeholders were not properly informed as regards the responsibility of the board of directors on annual reports and the duty of auditors on the audit of such reports (Carlé et al., 2023; Seebeck & Kaya, 2022). To reduce the adverse effect of the expectation gap, and improve the value and information relevance of auditors' reports, standard setters, and regulators across the globe have initiated reforms to improve the scope of the auditors' reports by including elements of extensive reporting (Public Company Accounting Oversight Board, 2019). The major example of such reforms is the promulgation made by the International Auditing and

Assurance Standards Board (IAASB) in 2016 concerning key audit matters (KAM) disclosure, and in 2019, the obligation of the Public Company Accounting Oversight Board (PCAOB) to disclose key audit matters (KAM) in the United States of America in 2019 (Al Lawati & Hussainey, 2022).

Key audit matters (KAM) relate to those matters in the auditor's professional judgment that is of most significance in the audit of the financial statements of the current period and are selected from matters communicated with those charged with governance (International Standard on Auditing, 2015). The disclosure of KAM is to identify the most significant matters in the firm and to provide more relevant information for users of audit reports (Oghuvwu & Orakwue, 2019). The addition of KAM in the audited annual financial statement of firms or industry significantly increases stakeholders' and other financial data users' reliability and confidence in the financial statement presented by companies and increase the value of the audit report (Bedard et al., 2015). Determining KAM in annual reports helps to identify the areas of higher assessed risk, the significant management judgment including accounting estimates that have been identified as having high estimation uncertainty, and the effect on the audit of significant events or transactions that occurred during the period (International Standard on Auditing, 2015). The disclosure of KAM allows for a greater level of transparency by increasing the information content of audit reports to promote audit quality, reliability, transparency, and credibility (Oghuvwu & Orakwue, 2019).

The major determinants of KAM disclosed in the annual report of financial services firms in Nigeria are the valuation of insurance contract liabilities, expected credit loss, impairment of loans and advances to customers, and loss allowance on financial assets at amortized cost (Oghuvwu & Orakwue, 2019). The concept of firm size has been used to proxy for numerous studies and interpreted in many ways to explain everything and thus means nothing, it refers to the strength of the firm (Ozcan, 2021). The auditor's fee is the economic remuneration for auditors who provide audit services, which can be referred to as an agency fee or commission according to certain standards (Cordos & Fulop, 2015). It can also be used to refer to the cost incurred by a firm paying an auditor to carry out his audit activities on the firm's financial statement (Carcello & Li, 2013). The independence of an auditor enhances the effectiveness in producing a true and fair report that reflect the disclosure of KAM. This makes financial statement reliable and credible. Also, the opinion of auditors on the financial statement which is usually relied upon by various stakeholders, builds their confidence on the managements and makes the dependable, hence the need for an auditor's independence in the disclose of KAMs (Oghuvwu & Orakwue, 2019).

Significant changes in the firm size, audit fees, and auditors' independence are likely to affect the KAM disclosed. Oghuvwu and Orakwue (2019) explain that audit matter disclosure can be dependent on the size of the audited firm as large companies are expected to carry out an extensive and thorough audit investigation. Carlé et al., (2023) affirmed that similarity rate is significantly negatively associated with an audit firm change, and positively associated with client firms. Extant studies on determinants of KAM revealed that firm size is largely a factor that affects KAM disclosed by auditors while others showed that audit fees have no significant relationship with the KAM disclosed. Some studies examined the impact of the determinants of KAM on the credibility, transparency, and reliability of financial statements and the firm's management. From the literature, there are few studies on financial services companies as the majority of research work is based on manufacturing firms. The majority of these studies have been carried out in international countries, examining their industries, and a few studies conducted in Nigeria and the financial services sector. As a result of the above gap, this study, therefore investigated the determinants of

KAM disclosure in the financial services firms listed in Nigeria.

## **2. Literature Review**

### **2.1 Conceptual Review**

#### **2.1.1 Key Audit Matters (KAM)**

According to International Standard on Auditing (2015) (KAM) are defined as those areas in the auditor's professional judgment that is of utmost significance in the audit of the annual financial statements of the current period and are selected from matters communicated with those charged with governance. From the matters communicated with those charged with governance as KAM, the auditor is expected to disclose the reason why those matters are considered as such, and how he addresses it in the audit (IAASB, 2016). The standard states that KAM are not individual opinions on the risks disclosed and that the KAM so disclosed should be related within the period covered by the audited financial statement. In determining KAM, ISA (2015) states that the auditor is expected to take into consideration the following; areas of higher assessed risk of material misstatement, or significant risks identified; 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.

#### **2.1.2 Firms Specific Characteristics**

The firm's specific characteristics include selected factors that are generally known to be the determinants of KAM. They largely affect the auditors' disclosure of KAM, and they include; firm size, audit fees, and auditors' independence.

Firm size has been a poorly defined concept. Also, the concept of firm size has been used to proxy for numerous theoretical works. According to Bujaki and Richardson (1997), the concept of firm size has been interpreted in many ways to explain everything and thus to also mean nothing. Vijn and Yang (2013) in their study provided a list of proxies used for firm size and their corresponding coefficients and models. From the data gotten by them, they discovered that the coefficients and models on firm size are sensitive to which firm size measure is being used. In previous literature, the most prominent variables used to measure firm size includes; total assets, total sales, market value of equity, and number of employees. Oghuvwu and Orakwue (2019) discovered that increasing audit disclosure is dependent on the size of the audit firm as large firms are considered to carry out an extensive check.

An audit fee is defined as the economic remuneration for auditors who provide audit services, which is an agency fee according to certain standards. According to Cordos and Fulop (2015), audit fees can also be defined as those costs incurred by a firm in paying an auditor to carry out his audit activities on the firm financial statement. The audit fees cover the total cost incurred by the auditor throughout the audit work, risk, and profit. In carrying out audit work, the audit fees largely affect the quality of the audit. An exploration of the determinants of audit fees using empirical evidence showed that the complexity of a business, asset size, etc. affects the level of audit fees. Suneerat and Panya (2020) posited that audit fees are hinged on two main perspectives; the audit client and the audit firm. From the perspective of the audit client, it was discovered that the complexity of the business and its asset size largely affects the amount of audit fees charged. In addition, Sierra et al. (2019) carried out research using data from different countries at different times and found out that the complexity of the business and its asset affect the level of audit fees. From the perspective of the audit firm, it was discovered that the firm's size does not have a significant relationship with the audit fees. However, it was discovered that Firth and Francis argue that the firm size has a significant relationship with audit fees (Inês & Morais, 2018).

The auditor's independence does not require him to be completely free from all the factors that may affect his ability to make an unbiased opinion, but only free from those that may compromise his ability (McGrath et al. (2001). The independence of an auditor compels him to make a personal assessment of his or her objectivity, to identify if external factors do not compromise his ability to give an unbiased opinion (Çiğer et al., 2019). The auditor's independence is a crucial part of the audit report and should not be influenced not compromised. According to section 46 of the Federal Reporting Council of Nigeria (FRCN) Act, an auditor is mandated to carry out its audit duty independently by the Code of Conduct and Ethics in force and not engage in any activity which is likely to impair his independence. According to Ertan and Kızılk (2019), an auditor is also expected to carry out his duties with care, diligence, and skill as is reasonably necessary for each particular circumstance. Some of the threats to an auditor's independence are self-interest threats, self-review threats, etc. An auditor's absolute reliance on a particular firm as its major source of income may impair his independence due to the fear of losing them since they act as a major source of his income (Akdoğan & Bülbül, 2019).

## **2.2 Theoretical Review**

### **2.2.1 Inspired Confidence Theory**

This theory is also referred to as the theory of rational expectation and was first introduced by Theodora Limperg (1920) as a result of the increasing demand for auditing services due to activities and the influence of external stakeholders to address the demand and supply of audit services (Oghuvwu & Orakwue, 2019). The increasing demand for auditing service is a result of the participation of third parties who seeks accountability from the firm's management for their investment in the company (Ozcan, 2021). It also points out the need for the management of an organization to provide users of financial statements with sufficient relevant information needed to make informed decisions and also boost public confidence in the credibility and transparency of a firm (Elif & Başak, 2021). The inspired confidence theory is found to be more appropriate in explaining the importance of the disclosure of KAM as it helps to build public confidence in financial statements and helps to promote credibility, transparency, and accountability of firms.

## **2.3 Empirical Review**

### **2.3.1 Firm Size and Key Audit Matters (KAM)**

Ozcan (2021) investigated the factors affecting the disclosure of KAM of listed firms on Borsa Istanbul for the accounting period of 2019. Poisson regression and sample data used was the audited financial statements of 164 firms. The findings show a positive relationship between firm complexity and the disclosure of KAM, and that auditors tend to disclose more KAM for large-sized firms and firms with high sales growth. Oghuvwu and Orakwue (2019) examined the determinants of KAM in the listed financial services sector in Nigeria. Longitudinal research design and population includes all banks listed on the Nigeria Exchange Group as at 2017 with a sample size of 15 banks for the period of 2016 and 2017. The findings of the study show that firm size presents a positive non-significant relationship in the disclosure of KAM. Elif and Başak (2021) investigated the matters which should be included as KAM and the factors affecting them. The data used were collected from two main sources; the Thomson Reuters EIKON database and the audited financial statement presented by each company on its website with sample size of 18 firms. The findings show that some of the firm-level characteristics have a significant impact on KAM disclosure. A negative relationship exists between company size and KAM disclosed in the audit report. and large firms have the capacity to negotiate with auditors in terms of audit fees and can

put pressure on auditors to disclose fewer KAM in their reports.

### 2.3.2 Audit Fees and Key Audit Matters (KAM)

Inês and Morais (2018) investigated the factors that influence the number of KAM disclosed by auditors. The data collected were obtained from the annual financial statements of 142 firms provided on their DataStream for 2015 and 2016. The research hypothesis was tested using the cross-sectional regression model. The findings show that a large number of the business segment (complexity) and accounting standards that regulate the affairs of the company leads to the disclosure of a larger number of KAM. Contrary to their initial expectations, audit fees show a positive relationship in the number of KAM disclosed in the audit report. Laura et al. (2019) worked on understanding the determinants of the magnitude of entity-level risk and account-level risk KAM and carried out research on 100 companies in the United Kingdom within the period of 2013-2016. The findings of the study show that auditors of companies that pay higher audit service fees present more entity-level risk and fewer account-level risk KAM and that clients' characteristics are relevant to the number and type of KAM disclosed. The industry sector in which the client operates is another variable that can determine the number of KAM disclosed.

### 2.3.3 Auditors' Independence and Key Audit Matters

Olagunju (2011) in his study investigated the impact of auditors' independence on the credibility of financial statements in Nigeria. The data used for this study were obtained from both primary and secondary sources. The results of the study showed that auditor independence largely affects the credibility of financial statements which is examined through the disclosure of KAM. Allen et al. (2019) carried out a study on the relationship between auditor independence and fee dependence. The study performed a univariate test to examine the differences in the audit fees paid by clients and the resultant effect of receiving a qualified or unqualified audit report. The findings of the study showed that the auditors' fee dependence does not affect their opinion on issuing an unqualified audit opinion.

Extant studies were majorly in the developed nations, neglecting the developing countries of Africa of which Nigeria is inclusive. The few studies in Nigeria were conducted on manufacturing firms and failed to consider the financial services firms which contribute greatly to the gross domestic product. In view of these and based on the research objective, theoretical in addition to the empirical background that these null hypotheses were formulated.

H<sub>01</sub>: Firm size does not have a significant effect on KAM disclosure in listed financial services companies in Nigeria.

H<sub>02</sub>: Audit fee does not have any significant effect on KAM disclosure in listed financial services companies in Nigeria.

H<sub>03</sub>: There is no significant effect of auditor's independence on KAM disclosure in listed financial services companies in Nigeria.

## 3. Methodology

The longitudinal research design was adopted for this study. The population and sample size were 49 financial services firms listed on the Nigeria Exchange group as of 31<sup>st</sup> December 2022. Data were obtained from annual reports of listed financial services companies from 2017 to 2022. Data were subjected to pairwise correlation tests, panel unit root tests, variable inflation factor, and Wald test. To investigate the effects of the variables,

data were analyzed using descriptive statistics such as mean, median, maximum, minimum, standard deviation, skewness, kurtosis, Jarque Bera, probability, structural equation modelling, and Poisson regression analysis.

### 3.1 Model Specification

The econometric form of the model is estimated to be:

$$KAM_{it} = \beta_0 + \beta_1 FS_{it} + \beta_2 AUDF_{it} + \beta_3 AUDI_{it} + \mu_{it} \dots \dots \dots \text{equation (i)}$$

Where KAM represents (rep) KAM, FS rep firm size, AUDF rep audit fee, AUDI rep auditors Independence,  $\beta_0$  rep Constant,  $\beta_1 - \beta_3$  rep slope coefficient,  $i$  rep ith firm,  $t$  rep time period (2017-2022),  $\mu_{it}$  rep model disturbance term.

**Table 1:**  
**Measurement of Variables**

S/N	Variables	Description	Measurement	Source
<b>Independent Variable:</b>				
Firm-specific characteristics				
1	Firm size FS	It can be referred to as the strength of the firm.	This is measured as the natural logarithm of the total asset	Oghuvwu and Orakwue (2019)
2	Audit fees AUDF	This is the economic remuneration for auditors who provide audit services, which are an agency fee according to certain standards	This is measured as the natural logarithm of audit fees paid	Oghuvwu and Orakwue (2019)
3	Auditor independence AUDI	It is the ability of the auditor to carry out his audit exercise without any influence from the management or external stakeholder so as to state clearly if the financial statement presents a true and fair view.	This is measured as the ratio of audit fees to the company's revenue.	Adeniyi and Mieseigha (2013)
<b>Dependent Variable:</b>				
Key audit matters				
4	Key audit matters (KAM)	They are those matters that, in the auditor's professional judgment, were of most significance in the audit of the financial statements of the current period	A score between 0 and 1 is based on the criteria listed in IAS for determining KAM which will be examined in the annual report.	Elif and Başak (2021)

Source: Author's computation (2023)

## 4. Data Analysis and Discussion of Findings

### 4.1 Descriptive Statistics

Table 2 provides information about sample statistics. The variable of KAM report with a mean of 0.8800, maximum of 1 and minimum value of 0.00 which indicates that over fifty percent of the sampled firms disclosed KAM. The average variable audit fees of 7.47 and median 7.25, maximum of 8.77 and minimum value of 6.47. Moreover, auditor independence of sampled firms stood at 0.0478 with positive skewness of 8.48 which is significantly greater than the median value. The firm size report average value of 24.88 with median of 24.00, maximum size of 30 and minimum of 21.3. It is worthy of note at, the descriptive statistics were carried out in order to ensure that the estimated coefficient of the model does not suffer from the problem of inconsistency and lack of efficiency and also

called for caution when analysing the variable.

**Table 2:  
 Descriptive Statistics**

	KAM	ES	AUDITFE EP	AUDITIND E	FIRMSIZ
Mean	0.88000		7.474017	0.047857	24.88486
Median	1.000000		7.255272	0.002143	24.00000
Maximum	1.000000		8.770852	3.365381	30.00000
Minimum	0.000000		6.477121	0.000000	21.30523
Std. Dev.	0.327150		0.658375	0.388261	2.391546
Kurtosis	6.469697		1.907984	73.00626	2.229443
Jarque-Bera	105.9925		6.934780	16215.27	8.729842
Probability	0.000000		0.031198	0.000000	0.012716
Observations	294		294	294	294

**Source: Author's Computation (2023)**

#### 4.2 Correlation Analysis

The correlation test shows the degree of relationship between the independent variables and also shows the symptoms of multi-collinearity. The result displayed in Table 3 indicated that there is existence of relationship between KAM the dependent variable and independent variable (firm size, audit fees, and audit independence). This shows that independent variable can affect the dependent variable, but independent variable shows no strong relationship to the symptoms of multi-collinearity.

**Table 3:  
 Pairwise Correlation**

Variables	(1)	(2)	(3)	(4)
(1) KAM	1.000			
(2) firmsize	-0.044 (0.709)	1.000		
(3) auditfees	-0.036 (0.761)	0.221 (0.000)	1.000	
(4) auditindep	0.045 (0.699)	-0.093 (0.426)	-0.110 (0.347)	1.000

**Source: Author's Computation (2023)**

#### 4.3 Variable Inflation Factor

The result in Table 4 shows the variable inflation factor of the explanatory variables reports the degree of correlation among the variables. The VIF must be less than 10. The result of the VIF shows that all the variables report VIF less than 10, this implies that there is no high degree of correlation among the variables. It is a pointer to the independence of the variables.

**Table 4:  
 Variance Inflation Factor**

Variable	VIF
Firmsize	6.600
Auditfees	6.580
Auditindep	1.010

**Source: Author's Computation (2023)**

#### 4.4 Panel Poisson Regression Model

In achieving the study objective, the study adopted the Panel Poisson regression model because the dependent variable is the count response. The explanatory variables include firm size, audit independence, and audit fees. The explanatory power of the model shows that 32.67% of the variation will be captured by the explanatory variables, while 28.98 percent will be captured by the variables after adjusting for the loss in degree of freedom. The LR statistic of the model shows that the model is statistically significant and the coefficients are different from zero. This indicated that firm size is a key determinant of KAM disclosure in listed financial services firms in Nigeria, with a p-value of 0.0332, a coefficient of 0.0504, and t-value of 2.1704.

Conversely, audit fee of the banks decreases with a rise in KAM disclosure in listed financial services companies in Nigeria with a coefficient of -0.1211 and p-value of 0.0081, thus, the coefficient of -0.015 implies that audit fees is a key determinant of KAM disclosure in listed financial services firms in Nigeria. Also, audit independence has a coefficient of -1.9178 and a p-value of 0.0011. Audit independence is a key determinant of KAM disclosure KAM disclosure in listed financial services companies in Nigeria at a 5% level of significance.

**Table 5:**  
**Panel Poisson Regression Model**

Dependent Variable: KAM

Method: ML/QML - Poisson Count (OPG - BHHH / Dogleg steps)

Variable	Coefficient	z-Statistic	Prob.
FIRMSIZE	0.0504	2.1704	0.0332
AUDITFEES	-0.1211	-2.7210	0.0081
AUDITINDEP	-1.9178	-3.2515	0.0011
C	-0.4605	-1.4412	0.1495
R-squared	0.3267		
Adjusted R-squared	0.2898		
LR statistic	9.0047		
Prob (LR statistic)	0.0000		

**Source: Author's Computation (2023)**

#### 4.5 Test of Hypotheses

##### 4.5.1 Testing of Hypothesis One

$H_{01}$ : Firm size does not have a significant effect on KAM disclosure in listed financial services companies in Nigeria.

The null hypothesis state that there is no significant effect of firm size on KAM disclosure in listed financial services companies in Nigeria. The result of the Wald test restricts the coefficient of the firm size to zero. The outcome of the test shows that the null hypothesis is rejected and the alternative is accepted. Thus, firm size plays a key role in determinant of KAM disclosure in listed financial services companies in Nigeria.

**Table 6:  
 Wald Test**

Equation: Untitled			
Test Statistic	Value	df	Probability
t-statistic	2.170422	71	0.0332
F-statistic	5.369888	(1, 71)	0.0233
Null Hypothesis: FIRMSIZE =0			
Null Hypothesis Summary:			
Normalized Restriction (= 0)		Value	Std. Err.
FIRMSIZE		0.050450	0.023324
Restrictions are linear in coefficients.			

**Source: Author's Computation (2023)**

#### 4.5.2 Testing of Hypothesis Two

$H_{02}$ : Audit fee does not have any significant effect on KAM disclosure in listed financial services companies in Nigeria

The null hypothesis state that audit fee does not have any significant effect on KAM disclosure in listed financial services companies in Nigeria. The result of the Wald test restricts the coefficient of the audit fee to zero. The outcome of the test shows that the null hypothesis is rejected and the alternative is accepted. Thus, audit fee is key determinant of KAM disclosure in listed financial services companies in Nigeria.

**Table 7:  
 Wald Test:**

Equation: Untitled			
Test Statistic	Value	df	Probability
t-statistic	-2.721099	71	0.0081
F-statistic	7.519984	(1, 71)	0.0077
Null Hypothesis: AUDITFEES =0			
Null Hypothesis Summary:			
Normalized Restriction (= 0)		Value	Std. Err.
AUDITFEES		-0.121118	0.044511
Restrictions are linear in coefficients.			

**Source: Author's Computation (2023)**

#### 4.5.3 Testing of Hypothesis Three

$H_{03}$ : There is no significant effect of auditor's independence on KAM disclosure in listed financial services companies in Nigeria.

The null hypothesis state that there is no significant effect of auditor's independence on KAM disclosure in listed financial services companies in Nigeria. The result of the Wald test restricts the coefficient of audit independence to zero. The outcome of the test shows that the null hypothesis is rejected and the alternative is accepted. Thus, auditor's independence does play a key in the determinant in KAM disclosure in listed financial services companies in Nigeria

**Table 8:**  
**Wald Test**

Equation: Untitled			
Test Statistic	Value	df	Probability
t-statistic	-3.251530	71	0.0011
F-statistic	10.57245	(1, 71)	0.0018
Null Hypothesis: AUDITINDEP =0			
Null Hypothesis Summary:			
Normalized Restriction (= 0)		Value	Std. Err.
AUDITINDEP		-1.917811	0.589818
Restrictions are linear in coefficients.			

**Source: Author's Computation (2023)**

## 5. Conclusion and Recommendations

This study in consonance with the findings, therefore, concluded that firm size, audit fee, and auditors have a significant positive effect on KAM disclosure in listed financial services companies in Nigeria. The following recommendations were made in line with the three hypotheses:

- i. It is evident from the findings of this study that firm size plays a key role in KAM disclosure of the financial services companies in Nigeria, therefore small firms are encouraged to declare KAM.
- ii. Increase in audit fees should be prioritized in Nigeria's financial sector because it aids the key matter of audit disclosure.
- iii. Also, audit independence aids the KAM disclosure in *financial services companies in Nigeria*. Therefore, the regulators and the governing board should encourage an increase in the independence of audit engagements.

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