

RGC Ref. No.: UGC/FDS14/B10/20 <p>(please insert ref. above)</p>

**RESEARCH GRANTS COUNCIL
COMPETITIVE RESEARCH FUNDING SCHEMES FOR
THE LOCAL SELF-FINANCING DEGREE SECTOR**

FACULTY DEVELOPMENT SCHEME (FDS)

Completion Report
(for completed projects only)

<p><u>Submission Deadlines:</u></p> <ol style="list-style-type: none"> 1. Auditor's report with unspent balance, if any: within <u>six</u> months of the approved project completion date. 2. Completion report: within <u>12</u> months of the approved project completion date.

Part A: The Project and Investigator(s)

1. Project Title

What do Expanded Audit Reports Tell? Initial Evidence from the United Kingdom

2. Investigator(s) and Academic Department(s) / Unit(s) Involved

Research Team	Name / Post	Unit / Department / Institution
Principal Investigator	YAU Belinda Ling-Na, Assistant Professor	Department of Accountancy, The Hang Seng University of Hong Kong
Co-Investigator(s)	(1) WU Donghui, Professor (2) CHIU Peng-Chia, Assistant Professor	(1) School of Accountancy, The Chinese University of Hong Kong (2) School of Management and Economics, The Chinese University of Hong Kong Shenzhen, China
Others	(1) CHAN Sze Nam, Research Assistant (2) XU Jinhao Christopher, Research Assistant	(1) Department of Accountancy, The Hang Seng University of Hong Kong (2) Department of Accountancy, The Hang Seng University of Hong Kong

3. Project Duration

	Original	Revised	Date of RGC / Institution Approval (must be quoted)
Project Start Date	11 Nov 2020	N/A	
Project Completion Date	31 Oct 2022	30 Apr 2023	14 Sept 2022 (approved by HSUHK)
Duration (<i>in month</i>)	24	30	
Deadline for Submission of Completion Report	31 Oct 2023	30 Apr 2024	

- 4.4 Please attach photo(s) of acknowledgement of RGC-funded facilities / equipment.
N/A

Part B: The Final Report

5. Project Objectives

5.1 Objectives as per original application

1. *To examine and describe typical RMM topics and common audit procedures in response to the risks;*
2. *to investigate whether auditor's own template affects the RMM topic choice and audit work choice;*
3. *to investigate whether audit expert affects the RMM topic choice and audit work choice; and*
4. *to investigate whether fellow auditors blindly follow audit expert on RMM topic choice and audit work choice, specifically when:*
 - (i) *the fellow auditor is a smaller audit firm with fewer resources;*
 - (ii) *the audit expert itself is perceived to be of "higher audit quality," and*
 - (iii) *both the fellow auditor's client and the audit expert's client are similar along several audit risk dimension.*

2. Revised objectives

Date of approval from the RGC: N/A

Reasons for the change: N/A

3. Realisation of the objectives

(Maximum 1 page; please state how and to what extent the project objectives have been achieved; give reasons for under-achievements and outline attempts to overcome problems, if any)

The research team completed all the project objectives.

Objective 1

As per Mid-term Progress Report, the research team hand collected annual reports of companies listed on the London Stock Exchange between 30 Sept 2013 and 31 Dec 2019, extracted the auditor's report from each annual report, and manually coded audit data statistics, including the name of the auditor and audit partner, audit office location, number of KAMs disclosed, materiality amount, audit fee, audit report date, and audit tenure. The final sample consisted of 2,948 firm-year observations. The research team then further read all KAMs and manually categorized KAMs into 24 topics. Since there was a natural cutoff in the frequency between the seven most popular KAM topics and the remaining topics, the research team focused on the seven most popular KAM topics and manually categorized audit responses for each specific KAM topic into various audit-work categories. The research team thus completed objective 1.

Objective 2

The research team first started empirical analysis by using conditional logistic models to estimate the relationship between KAM topics (or audit work), client firm's attributes, and auditor's characteristics. After drafting a paper and receiving referee reports from *Accounting Horizons*, the research team adopted an audit partner change setting to examine how audit partner own style may affect KAM topic choice and audit work choice. Specifically, the research team found that audit partner heterogeneity existed, and individual audit partners exhibited persistent audit traits, in which they tended to add (drop) KAM topic or audit work in their newly audited client as their other audit engagements. The research team thus completed objective 2.

Objectives 3 & 4

Considering auditors may read prior year audit reports and learn from audit expert, the research team matched each client firm in industry x and year t with all other client firms in the same industry x and year t as well as all other client firms in the same industry x and year $t-1$ in the sample. This sample matching allowed the research team to investigate how audit expert affected KAM topic choice and audit work choice. The empirical results showed that auditors were more likely to share higher textual similarity with the audit expert in the prior year, and follow more KAM topics and audit work as the audit expert. The research team thus completed objective 3.

Cross-sectional analyses further revealed that auditors tended to follow the audit expert's KAM topic choice when the audit expert was perceived to have higher audit quality. Surprisingly, non-Big 4 auditors, who were considered to be smaller and with fewer resources, were less likely to follow the audit expert's KAM topic choice and audit work choice. Meanwhile, similarities between client firm and the audit expert's client did not significantly affect KAM textual similarity, KAM topic choice, or audit work choice. The research team thus completed objective 4.

4. Summary of objectives addressed to date

Objectives (as per 5.1/5.2 above)	Addressed (please tick)	Percentage Achieved (please estimate)
1. To examine and describe typical RMM topics and common audit procedures in response to the risks	√	100%
2. To investigate whether auditor's own template affects the RMM topic choice and audit work choice	√	100%
3. To investigate whether audit expert affects the RMM topic choice and audit work choice	√	100%
4. To investigate whether fellow auditors blindly follow audit expert on RMM topic choice and audit work choice	√	100%

Research Outcome

6.1 Major findings and research outcome

(Maximum 1 page; please make reference to Part C where necessary)

The research team noted that the seven most popular KAM topics included: revenues, intangibles / goodwill impairment, properties / investment valuation, inventories / receivables provisions, taxation, acquisitions and disposals, and pension schemes. In addition, common audit work for these seven KAM topics were: assessing management's judgment, benchmarking to external data, performing analytics, reviewing historical performance, engaging an expert, reviewing contracts, sampling, reviewing financial statements disclosures, testing controls, reviewing accounting policies, and discussing with management.

Using audit partner rotation as a setting, the research team found that when a client firm experienced audit partner switches within the same audit firm, the incoming audit partner tended to change KAM topics and the corresponding audit procedures. Moreover, the newly added (dropped) topics and audit procedures were more (less) likely to appear in other audit reports issued by the same partner, supporting the notion that audit partners exhibited different and persistent audit traits.

Combing the descriptive results and the empirical analyses of audit partner rotation, the research team drafted the paper “Are All Auditors the Same? KAM Topic Selection and Audit Procedure Choices in the UK.” The paper was accepted to JAAF 2023 Conference and 2023 Academy of International Business Asia Pacific Regional Conference. The paper has been currently under the first round of Revise and Resubmit with *Journal of International Accounting Research*.

The previous version of the paper, “What Do Expanded Audit Reports Tell? Evidence from the United Kingdom,” was accepted to 2020 Academy of International Business Southeast Asia Regional Conference, 31st Audit & Assurance Conference, and 2021 AAA Annual Meeting. The paper was submitted to *Accounting Horizons* but rejected after the second round of submission.

The research team also utilized a client firm-matching sample to examine the effect of audit expert on KAM topic choice and audit work choice. Empirical results showed that auditors tended to share higher textual similarity with the audit expert in the prior year, and follow the audit expert’s KAM topic choice and audit work choice.

Cross-sectional analyses further revealed that auditors were more likely to follow the audit expert’s KAM topic choice when the audit expert was perceived to have higher audit quality. Surprisingly, non-Big 4 auditors, who were considered to be smaller and with fewer resources, were less likely to follow the audit expert’s KAM topic choice and audit work choice. Meanwhile, similarities between client firm and the audit expert’s client did not significantly affect KAM textual similarity, KAM topic choice, or audit work choice.

The research team is performing more analyses and plans to draft another paper with the empirical results.

6.2 Potential for further development of the research and the proposed course of action (Maximum half a page)

The research team is currently developing a new measure of KAM topic similarity and audit work similarity. Specifically, the research team considers each KAM topic (audit work) as a word, thus each client firm has a vector of KAM topics (audit work), and similarity with other client firms can be calculated just like textual similarity. This novel measure allows the research team to examine KAM topic similarity and audit work similarity across client firms over years and audit firms, which improves the generalizability of the current audit partner rotation setting in the paper “Are All Auditors the Same? KAM Topic Selection and Audit Procedure Choices in the UK.” This measure can also be adopted to examine the effect of audit expert on KAM topic choice and audit work choice.

6. Layman’s Summary

(Describe in layman’s language the nature, significance and value of the research project, in no more than 200 words)

KAM disclosure is a groundbreaking audit standard change that aims to improve audit transparency and communicative value of audit reports. This research project provides descriptive statistics of typical KAM topics and audit procedures. The results will be relevant to industry practitioners, financial statements users, and accounting students as they understand more about auditor’s risk assessment and audit behaviors.

Additionally, KAM disclosure opens the black box of audit and provides researchers with an opportunity to examine audit partner heterogeneous style or learning mechanism among auditors. For instance, empirical results show that audit partners have different and persistent audit traits. Another set of empirical analyses reveal that auditors tend to follow audit expert’s auditing and reporting choices. These results improve our understanding of auditor’s audit style and interaction among auditors, thereby contributing to audit literature.

Part C: Research Output**7. Peer-Reviewed Journal Publication(s) Arising Directly From This Research Project**

(Please attach a copy of the publication and/or the letter of acceptance if not yet submitted in the previous progress report(s). All listed publications must acknowledge RGC's funding support by quoting the specific grant reference.)

The Latest Status of Publications				Author(s) (denote the corresponding author with an asterisk*)	Title and Journal / Book (with the volume, pages and other necessary publishing details specified)	Submitted to RGC (indicate the year ending of the relevant progress report)	Attached to this Report (Yes or No)	Acknowledged the Support of RGC (Yes or No)	Accessible from the Institutional Repository (Yes or No)
Year of Publication	Year of Acceptance (For paper accepted but not yet published)	Under Review	Under Preparation (optional)						
		√ (first round Revise and Resubmit)		Peng-Chia Chiu, Donghui Wu, Jing Xue, and Ling Na Belinda Yau*	Are All Auditors the Same? KAM Topic Selection and Audit Procedure Choices in the UK <i>Journal of International Accounting Research</i>	N/A	Yes (Annex I)	Yes	No

8. Recognized International Conference(s) In Which Paper(s) Related To This Research Project Was / Were Delivered

(Please attach a copy of each conference abstract)

Month / Year / Place	Title	Conference Name	Submitted to RGC (indicate the year ending of the relevant progress report)	Attached to this Report (Yes or No)	Acknowledged the Support of RGC (Yes or No)	Accessible from the Institutional Repository (Yes or No)
12/2020 / Hong Kong	What Do Expanded Audit Reports Tell? Evidence from the United Kingdom	2020 Academy of International Business Southeast Asia Regional Conference	2021	No	Yes	Yes
05/2021 / Virtual	What Do Expanded Audit Reports Tell? Evidence from the United Kingdom	31 st Audit & Assurance Conference	2021	No	Yes	Yes

08/2021 / Virtual	What Do Expanded Audit Reports Tell? Evidence from the United Kingdom	2021 AAA Annual Meeting	N/A	Yes (Annex II)	Yes	Yes
05/2023/ Helsinki	Are All Auditors the Same? KAM Topic Selection and Audit Procedure Choices in the UK	JAAF 2023 Conference	N/A	Yes (Annex III)	Yes	Yes
12/2023/ Bangkok	Are All Auditors the Same? KAM Topic Selection and Audit Procedure Choices in the UK	2023 Academy of International Business Asia Pacific Regional Conference	N/A	Yes (Annex III)	Yes	Yes

9. Whether Research Experience And New Knowledge Has Been Transferred / Has Contributed To Teaching And Learning

(Please elaborate)

The PI teaches auditing courses in The Hang Seng University of Hong Kong. Since the research project, the PI has shared in class some descriptive statistics of KAM reporting in the UK and compared the results with those in HK.

10. Student(s) Trained

(Please attach a copy of the title page of the thesis)

Name	Degree Registered for	Date of Registration	Date of Thesis Submission / Graduation
N/A			

11. Other Impact

(e.g. award of patents or prizes, collaboration with other research institutions, technology transfer, teaching enhancement, etc.)

N/A

12. Statistics on Research Outputs

	Peer-reviewed Journal Publications	Conference Papers	Scholarly Books, Monographs and Chapters	Patents Awarded	Other Research Outputs (please specify)	
No. of outputs	0	2	0	0	Type	No.

arising directly from this research project					N/A	
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13. Public Access Of Completion Report

(Please specify the information, if any, that cannot be provided for public access and give the reasons.)

Information that Cannot Be Provided for Public Access	Reasons
N/A	