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Feature Articles

This month's focus: Use of KAMs in Auditor Reports

Three-Year Trend Analysis of "Best Practices for Key Audit Matters"

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Key audit matters (KAMs) have been made a disclosure requirement in audit reports in response to strong demand from users of financial statements. In each fiscal year from 2021 to 2023, the Securities Analysts Association of Japan (SAAJ) published its "Best Practices for KAMs," providing users with guidance on how to read and use KAMs and conveying users' messages to auditors and audit & supervisory board members of auditees.

As support staff for the Corporate Accounting Committee of the SAAJ, we were responsible for the publication of "Best Practices for KAMs." In this paper, we review the background to the publication, provide an overview, and analyze the three-year trend.

KAMs highlight areas of high audit risk. Through this three-year trend analysis, we have confirmed that these areas have generally been identified as KAMs. On the other hand, due to the nature of KAMs, we have also confirmed that the matters identified as such do not change significantly from year to year.

Use of Key Audit Matters Pertaining to Asset Assessment

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Since changes in asset assessment are linked with changes in the balance sheet and future cash flow, analysts have a keen interest in key audit matters (KAMs) associated with asset assessment. In view of the many instances where KAMs—typically those relating to the impairment of fixed assets and the recoverability of deferred tax assets—facilitate understanding of areas involving significant judgment calls by management, they are increasingly used by analysts in their analysis. Auditors' responses are also useful, given the similarity between audit procedures and the analysis approach of analysts.

Utilization of KAMs Relating to Revenue and Expense Recognition: Using KAMs to Grasp Risks from Multiple Perspectives and Deepen Governance

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This paper introduces examples of best practice and focus points when using KAMs relating to recognition of revenues and costs, centered on attribution of revenues/costs by period and recoverability of provisions and deferred tax assets. KAMs can help us to grasp risks in a variety of ways, including comparison over time to gauge how risks change as well as comparison with industry peers to find differences. They can also be useful in evaluating governance. There is a tendency of bipolarization between companies in the level how extensively KAMs are discussed in audit reports, and the fullness of discussions is reflective of management attitudes to governance. Investors need to engage proactively with KAMs in order to lift the base level and thereby enhance the quality of audits and governance.

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Insights into KAMs Practice Abroad: Implications for Analysts

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The practice using of key audit matters (KAMs) is now stably in its fourth year in Japan. The content, however, tends to be conservative and limited in informational value. In Japan, a KAM often undergoes review by the audit firm's quality control department and the audited company, and is based on references to notes in financial statements and Practical Guidance on Auditing Standards of JICPA. In contrast, the use of KAMs overseas has evolved in terms of both quantity and quality, and KAMs are regarded as a useful communication tool. The International Standards on Auditing are expected to expand the application of KAMs to areas such as the going concern assumption and fraud risk. This paper compares examples of the use of KAMs in Japan and abroad and examines what constitutes a useful KAM for analysts as the main users.

Articles

Corporate Valuation with a Focus on Intangible Capital: Study on the Relationship between Employee Engagement and Corporate Value

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It is important to measure intangible capital, which is a driving force for improving profitability and efficiency leading to sustainable growth expectations, and use it in corporate valuation. Our study examines whether OpenWork's corporate evaluation scores, which constitute data related to human capital, are effective in measuring corporate value through a regression analysis using the logarithm of the PBR as the dependent variable. In addition, we conducted a similar analysis on the subcomponents of the same score and confirmed that higher evaluations of "employee motivation" are particularly associated with higher corporate value.