Swedish Bank Directors’ Perceptions of Extended Audit Reports

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Key terms: extended audit report, assurance level, materiality level, key audit matters, lending decisions

Abstract

Background: Audited financial statements are the most substantial source of information concerning bank loan decisions, and investors mainly base their investment decisions on the financial statements in combination with the audit report. The financial crisis brought attention to the existing expectation gap between auditors and stakeholders. An attempt to narrow the gap has been done by IAASB. The new standards require auditors to provide additional information in the audit report.

Purpose: The purpose of the study is to investigate how the extended audit report is perceived by Swedish bank directors.

Method: The study has a quantitative research strategy with an experimental design. The experiment includes one control group and seven experimental groups, and the participating Swedish bank directors amounted up to 122. An ANCOVA is performed to test the research questions regarding the bank directors’ perceptions and decisions.

Conclusion: The empirical findings and analysis reveal that the disclosure of the assurance level has a positive impact on bank directors’ confidence in the financial statements, perceived quality of the audit report, perceived value of the information the audit report contains, as well as the probability of granting a credit. The results also indicate a significance for key audit matters (KAM) regarding the perceived value of information, meaning that the disclosure of KAM improves bank directors’ perceptions of the informational value the audit report contains. The disclosure of the materiality level does not appear to have a significant impact on the extending of the audit report, implying that a disclosure of the applied materiality level may not be beneficial for bank directors’ perceptions and decisions.
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1. Introduction

1.1. Background

Bank loans perform one of the principal functions of financial markets, namely the transportation of financial capital from actors without investment opportunities to actors with investment opportunities. The distribution of credit lies in the hands of financial intermediaries, in most cases commercial and investment banks. It is the financial intermediaries who have the power to grant a bank loan and make decisions about its size and price (Koulafetis, 2017).

When making bank loan decisions, there are a number of different lending technologies to use. One type of lending technology is financial statement lending. Financial statement lending is a technology which is mainly based on a client’s financial statements and their strength. This technology requires that the debtor has audited financial statements and a solid economic health that can be seen through financial ratios computed from the audited financial statements (Berger & Udell, 2006). Further, in a study by Berry and Robertson (2006) concerning loan decisions, audited financial statements appeared to be the most substantial source of information. This accounting information is often used together with audit reports to evaluate the financial well-being of loan applicants (Schneider, 2018).

The audit report is an important communication tool between the auditor and the users of the auditor’s work (Libby, 1979), and in many cases, the audit report is the only contact an investor, lender, or other stakeholder have with the auditor (Pound, 1981). The audit report is either unmodified, meaning that the financial statements are free from material misstatements, or modified, meaning that the financial statements are not free from material misstatements (Firth, 1979). By that, the central function of the audit report is to provide credibility to the financial statements (Watts & Zimmerman, 1986), which investors mainly base their decisions on (ISA 200.3).

The audit report provides explanations of the audited financial statements, the accountabilities of the auditor and the management, the process of the audit, and the auditor’s opinion (ISA 700). Consecutively, the objective of the audit report is to curtail
agency costs (Jensen & Meckling, 1976). Nevertheless, since the auditor has more knowledge about the audit and the audit information than the users of the auditor’s work (Antle, 1982; Baiman, Evans, & Noel, 1987; Ng, 1978), information asymmetries exist (Jensen & Meckling, 1976). The problem of information asymmetries can be solved by providing additional information in the audit report (Krishansing & Quick, 2016). Attention to audit reports has also arisen as a consequence of the financial crisis (Kandemir, 2013; Mareque, López-Corrales, & Pedrosa, 2017). It has been implied that some failures could have been prevented with more explanatory audit reports since risks then could have been recognised and thus, avoided.

The fact that failures could have been avoided with more information signifies that an information gap exists. An information gap can be described as the difference between what an investor wants to know from the financial statements and the audit, and what information is accessible for an investor to base its investment decisions on (IAASB, 2012). An information gap can be connected to an expectation gap (Porter, 1993), which is the difference between what an investor expects from the financial statements and the audit, and what is actually provided by the auditor (IAASB, 2012). In order to reduce the expectation gap, two different approaches are primarily used. A defensive strategy, which focuses on teaching and restoring confidence of the public, and a constructive strategy, which aims to alter activities of auditing to meet the interests of the public (Humphrey, Moizer, & Turley, 1992).

Today’s society can be described as an information age where transparency is desired in an increasing number of situations (McAllister & Bell, 2011), and the audit profession is no exception. The current execution of an audit report has been a subject for debate and the issue has led to mixed opinions, where some suggest that more information needs to be disclosed in the audit report (Krishansing & Quick, 2016). The people promoting change in the audit execution claim that more transparency concerning meaningful issues in the financial statements should be presented in the audit report (IAASB, 2012). Also, since the assurance level of a company’s financial statements depends on the audit report (Firth, 1979), an extended audit report could make the audited financial statements more reliable. For example, Bandyopadhyay and Francis (1995) argue that a higher level of
auditor assurance seems to increase the likelihood of loan approval. This is in both the stakeholders’ and creditors’ interests since it contributes to strong and flexible capital markets, and by that, more authentic lending decisions. Since the audit report is a standardised work, users of the audited financial statements have information concerning whether the auditor is satisfied with a company’s reflecting of its past, but no information concerning to what degree or in what specific way (Moizer, 2005). Furthermore, in order to make the information in the audit report more relevant to stakeholders and to enhance the value of the audit report, the International Auditing and Assurance Standards Board (IAASB) has issued ISA 700 and ISA 701, which became effective in 2016. The essential element of these new standards is the communication of key audit matters (KAM). KAM are the matters that were of most importance in the audit of the financial statements of the current period (ISA 701.8). These matters can, for example, concern risks and uncertainties regarding fair value estimates, and impairments of goodwill and intangibles (ACCA, 2018).

1.2. Problem

The performed audit should be completed by an audit report which brings value (IAASB, 2012) and transparency (IAASB, 2015a) to the users of the audited financial statements. By extending the audit report, the informational value and relevance of it increase. Further, this strengthens the confidence in the financial statements and the audit (IAASB 2015a, 2015b), and enhances the investor’s capability to make more knowledgeable investment decisions (IAASB, 2012).

Between the years 2007 and 2009, many banks disclosed substantial losses which generated the question of how clients to auditors could have been receiving unmodified audit reports (Sikka, 2009). Even if a firm broke down soon after it had been given an unmodified audit opinion, the audit opinion was identical to an audit opinion of a firm with a strong and healthy financial performance (Ciesielski & Weirich, 2012). An unmodified audit report should indicate that a company’s financial statements demonstrate a true and fair view of its financial condition so providers of capital in a reliable way can make accurate lending decisions. If an audit report more specifically would explain the reasons for an unmodified or modified audit report, banks and creditors
could enhance the basis of their decision making (Firth, 1979). Substantially, more specific audit information is an integrated part of the extended audit report.

Confidence is attained by the auditor’s opinion on the financial statements and how they are prepared, with regards to financial reporting frameworks (ISA 200.3). In order for the auditor to form an opinion, the auditor must have reasonable assurance that the financial statements are without material misstatement. Reasonable assurance indicates that the level of assurance is high, but not absolute. When the auditor has gathered sufficient audit evidence to reduce audit risk to a tolerably low level, a reasonable assurance level is acquired (ISA 200.5). Since there are inherent restraints of an audit, the assurance level cannot be absolute. The inherent restraints emerge mainly from the nature of financial reporting and auditing, making the opinion of the auditor more persuasive than conclusive (ISA 200.A45). In order to recover and strengthen the confidence of investors and other stakeholders who use the audited financial statements, IAASB has adjusted the audited reporting standards (IAASB 2015a, 2015b). Thereby, investigating the extended audit report and its influence on confidence and assurance level is necessary.

Further, confidence in the financial statements can only be completed if the quality of the audit is satisfactory to stakeholders. Stakeholders’ perceptions of the audit quality are linked with the reported accounting information. Consecutively, the perception of the audit quality relies upon the stakeholders’ judgement of the auditor’s competence to both discover and report material misstatements (DeAngelo, 1981). Misstatements are believed to be material if they in a legitimate way can be predicted to affect decisions that are based on the financial statements. Decisions about materiality are based on prevailing conditions and are influenced by the size and nature of the misstatements, or the auditor’s understanding of the financial information needs of the investors and other stakeholders, or a mixture of both. The auditor is not accountable for the discovery of misstatements which are not material to the overall financial statements, since the opinion of the auditor concerns the financial statements as a whole (ISA 200.6). IAASB (2015a) states that the new auditor standards should improve the disclosed information about the audit process, and thereby materiality, and that the extended audit reports are crucial for the perceived
quality of financial statements. Therefore, it is imperative to analyse the results of extended audit reports on perceived audit quality.

If investors and other stakeholders do not observe an informational value from the audited financial statements, the extended audit report will affect neither the confidence nor the perceived quality of the financial statements and the audit (Krishansing & Quick, 2016). The extended audit report should contribute with insight and understanding to users of the financial statements of what the auditor has done (FRC, 2016). In order to enhance the value of the audit report, an auditor should provide the users of the audited financial statements with additional information, namely KAM. The identification and communication of KAM provide additional transparency about the audit process and help investors and other stakeholders understand meaningful aspects of the company and its financial statements (ISA 701.2). Since audit information is mainly of relevance when it has an impact on investment decisions, the perceived value of KAM needs to be examined.

Previous research regarding bank directors as a user group of financial information has mainly been conducted in the United States (Danos, Holt, & Imhoff Jr, 1989; Stanga & Benjamin, 1978) and in the United Kingdom (e.g., Berry & Robertson, 2006). A similar study by Krishansing and Quick (2016) has been conducted in Germany, but there is an existing need for more research on Continental European countries (Krishansing & Quick, 2016).

This study will focus on bank directors’ perceptions of the extended audit report in the context of Sweden, and thereby help to reduce the current research gap. Sweden is a member of the European Union, and due to the internationalisation of auditing (Humphrey, 2001), Sweden complies with international auditing and accounting standards, such as IFRS and ISA. Nevertheless, the entities and auditors must also follow nation specific regulations. The 2005 Swedish Companies Act (Aktiebolagslag SFS 2005:551) requires the auditor to audit the board of directors as well as the managing director, and not only the financial information which is the case for the rest of the European Union, except for Finland.
In a study from 2006, Öhman, Häckner, Jansson and Tschudi (2006) argued that Swedish auditors are more concerned with doing things right than doing the right things. It was also noted that Swedish auditors are traditionalists and did not seem enthusiastic to integrate a more forward-looking quality control and thereby, not eager to diminish the expectation gap. Consequently, further research concerning the extended audit report in Sweden is needed.

The purpose of this study is to investigate how the extended audit report is perceived by Swedish bank directors. To conduct this investigation, two research questions have been developed. RQ1 is divided into three sub-questions.

RQ1: Does additional information in the audit report affect the perceptions of bank directors?
   RQ1a: Do extended audit reports affect confidence in the financial statements?
   RQ1b: Do extended audit reports affect the perceived quality of the audit?
   RQ1c: Do extended audit reports affect the perceived value of the information it contains?

RQ2: Do extended audit reports affect the probability that credit will be granted by banks?

The following chapter provides a thorough understanding of the extended audit report together with previous research about the assurance level, the materiality level, KAM, and lending decisions by banks. The next section explains the method used for conducting the study, followed by a presentation and an analysis of the results. Finally, the concluding chapter discusses the outcome of the study and gives implications for further research.
2. Literature Review

2.1. Audit Report and the Development of ISA

When using financial statements, investors, lenders, and other stakeholders require assurance that the financial information is trustworthy (Ng, 1978). To a large extent, users of financial statements rely upon auditors to provide confidence to financial statements and the corporate information they disclose (Wisdom, Oyebisi, Dorcas, David, & Oyedeji, 2017). The auditor prepares either an unmodified audit report or a modified audit report. An unmodified audit report implies that the financial statements are free from material misstatements (Firth, 1979; ISA 700 Revised) and in accordance with a general purpose framework (ISA 700 Revised). A modified audit report implies that the financial statements are not free from material misstatements (Firth, 1979; ISA 700 Revised), and thereby not in accordance with a general purpose framework (ISA 700 Revised). For the most part, the audit report is the only contact an investor, lender, or other stakeholder have with the auditor (Pound, 1981), and it is thereby seen as an important communication tool between the auditor and the users of the audit report (Libby, 1979).

ISA 200 manages the independent auditor’s general obligations when performing an audit according to ISA (200.1). The objective of auditing is to improve the confidence of investors, lenders, and other stakeholders interested in a company’s financial statements. To improve the confidence, the auditor conducts an audit report where an audit opinion is expressed. The audit opinion articulates whether the corporate financial statements are arranged in accordance with a general purpose framework and are free from material misstatements. Namely, the audit opinion in the audit report should express whether the financial statements provide a true and fair view of a company’s financial position, according to the framework (ISA 200.3).

ISA 200 demands the auditor’s opinion to be based on reasonable assurance that the financial statements are free from material misstatements. The term reasonable assurance signifies a high, but not an absolute, level of assurance. That is because there are inherent restraints that emerge mainly from the nature of financial reporting and auditing, making the opinion of the auditor more persuasive than conclusive. A reasonable assurance level
is required when the auditor has gathered sufficient audit evidence to reduce audit risk to a tolerably low level (ISA 200.5).

Another concept communicated by ISA 200 is materiality and material misstatements, and it is used both when the auditor is preparing the audit and when the auditor is carrying out the audit. Materiality can be seen as a tool for evaluating and determining the impact of recognised misstatements, if they are not corrected, on the financial statements and the audit. Misstatements are believed to be material if they in a legitimate way can be predicted to affect decisions that are based on the financial statements. Decisions about materiality are based on the prevailing conditions and are influenced by the size and nature of the misstatements, or the auditor’s understanding of the financial information needs of the investors and other stakeholders, or a mixture of both. The auditor is not accountable for the discovery of misstatements which are not material to the overall financial statements, since the opinion of the auditor concerns the financial statements as a whole (ISA 200.6).

ISA 700 manages the auditor’s obligation to form an audit opinion on the financial statements (ISA 700.1 Revised) and should be interpreted in combination with ISA 200. As a consequence of the still existing expectation gap between auditors and different stakeholders, and since research show that ISA 700 is not fulfilling its purpose to close the gap (e.g., Mock et al., 2013), IAASB has issued a revised version of ISA 700. The rewriting of ISA 700 is intended to, in a more effective way, narrow the gap between stakeholders’ expectations and auditors’ actual accountabilities. This by enhancing the reliability of audited financial information and stakeholders’ comprehension of auditors’ obligations (Gold, Gronewold, & Pott, 2012). Audited financial statements for periods closing on or after December 15, 2016, are required to comply with the revised version of ISA 700.

According to ISA 700, an auditor should, based on the acquired audit information, construct an audit opinion on a company’s financial statements, and evidently present that audit opinion in a written audit report. The audit report should also express the fundamentals for that audit opinion (ISA 700.6 Revised). Similar to ISA 200, ISA 700
points out that the work of an auditor includes forming an opinion on the financial statements’ compliance with the relevant financial reporting framework (ISA 700.10 Revised) and in order to do that, acquire reasonable assurance that the financial statements do not include material misstatements (ISA 700.11 Revised).

To provide the users of the audit report with more transparency about the performed audit, and to improve the communicative value of the audit report, IAASB has issued ISA 701. ISA 701 concerns KAM, and except for generating transparency and communicative value, the intention with KAM is to provide further information to investors and stakeholders to help them understand the matters which, according to the auditor, are of most significance in the financial statements (ISA 701.2). KAM may also contribute as a base for users of the audit report to further involvement with management, and others charged with governance, about particular elements relating to the entity (ISA 701.3). To clarify the aspects which brought the auditor to establish whether a specific matter is of high importance and need more attention is often of interest for the user of the audit report. Further, the description of KAM in an audit report is intended to bring knowledge about why the matter is determined to be of high importance (ISA 701.A42). To hinder KAM of becoming overly standardised, IAASB articulates that assigning matters directly to a particular situation of the entity may help minimise this risk (ISA 701.A44).

2.2. Expectation Gap and the Extended Audit Report

Agency theory is extensively used within the research area of auditing (Quick, Sattler, & Wiemann, 2013; Sharma, Boo, & Sharma, 2008) since the need for auditing arises due to the agency problem. The agency problem occurs, given that the ownership and control are separate, when a manager of a corporation (the agent) has more information than the stockholders (the principals). This leads to information asymmetries between the two parties. If the principal and the agent are both utility maximisers it is possible that the agent has motives to act in a way that is not always in the best interest of the principal, in which agency costs will occur. Agency costs are defined as the sum of monitoring expenditures by the principle, bonding expenditures by the agent, and the residual loss. The residual loss is the experienced difference between the decisions which the agent took and the decisions that had been preferred by the principal. In the agency theory, the
auditor can operate as an intermediary between the principal and the agent, and additionally, as a control function (Jensen & Meckling, 1976).

As defined earlier, the auditor works as an intermediary between the users of the audit report and the audited companies, where the function of the auditor is to provide confidence to users of the report that the financial information given display a true and fair view (ISA 200.3) of the financial performance and position of the audited company. The confidence users have in the audit report is threatened by the fact that the expectations the users of the audit report have on the financial statement and auditing are different from what the audit actually provides. This difference is referred to as an expectation gap (IAASB, 2012; Porter, 1993), and is a recurring issue for auditors (Gold et al., 2012).

Further, previous auditing research shows that an expectation gap exists between investors and the society (Humphrey et al., 1992; Innes, Brown, & Hatherly, 1997) and that it has been a reappearing matter of discussion (Chandler & Edwards, 1996). The gap is an issue for auditors since it decreases the credibility of the audit and damages the prestige of the audit profession. The gap does not only affect auditors but the public, investors, and politicians as well. The mechanism of wealth creation and political strength within the capitalist economy relies a lot upon the confidence in the processes of accountability in which the audit report is an important part (Sikka, Puxty, Willmott, & Cooper, 1998).

One of the early studies regarding the expectation gap was conducted in the United States by Libby (1979). He examined bankers’ and auditors’ perceptions of the message communicated by the audit report. Libby concluded that the perceptions of the message communicated were rather similar in the two groups. Further, McEnroe and Martens (2001) studied and compared auditors’ and investors’ perceptions of auditors’ responsibilities in various aspects. They found that an expectation gap exists and that investors have higher expectations then the auditor on different aspects of the audit. In the United Kingdom, Humphrey, Moizer and Turley (1993) showed that an audit expectation gap exists on an array of elements of the audit function and the perceived performance. These findings are further supported in both Australia and New Zealand.
(Gay, Schelluch, & Reid, 1997; Gay, Schelluch, & Baines, 1998; Porter, 1993). In Sweden, Öhman et al. (2006) studied the thought patterns of Swedish auditors. They concluded that auditors dedicate a respective amount of time and effort to objects which can be adequately verified, but not to objects which they distinguish as being of fundamental importance to stakeholders. Further, they state that this inconsistency in thought patterns of auditors is similar to the expectation gap.

As an effort to narrow the expectation gap, institutional changes have been implemented throughout the years. Nevertheless, the gap still exists and is a constantly recurring concern for auditors (Gold et al., 2012). In 2010, the European Commission published the Green Paper Audit Policy: Lessons from the Crisis. A Green Paper is a document published by the European Commission which aims to spark discussion on given topics at the European level (Eur-Lex, n.d.). In this Green Paper, the Commission urge the need for an extensive debate on what needs to be done in order to guarantee that audits of financial statements and audit reports are appropriate for its intended use, which is to provide assurance to users of the audit report that the audited company has prepared its financial statements in line with the financial reporting frameworks. According to the Green Paper, the audit is a key element in re-establishing the trust and market confidence which were lost during the financial crisis.

For many years, auditors have been blamed for their weaknesses in recognising situations in which financial statements are not arranged in accordance with the relevant financial reporting framework (Church, Davis, & McCracken, 2008; ISA 700.16 Revised, 700.17 Revised). In connection with the financial crisis beginning in 2007, a large number of financial organisations went bankrupt without any prior notice from their auditors (Sikka, 2009). This generated even more concerns regarding auditors and their responsibilities of detecting and reporting audit risks. However, some researchers have argued that the prevailing accounting and audit standards restrained auditors from presenting any warnings, despite the fact that audit risks were discovered (Doogar, Rowe, & Sivadasan, 2015). Also, the audit report has been criticised for its resemblance with a pass or fail report (Church et al., 2008). The standardised construction of the audit report makes it clear for users to tell the difference between an unmodified and a modified opinion.
However, further than the pass or fail opinion, the communicative value of the audit report is hard to interpret (Smieliauskas, Craig, & Amernic, 2008).

As stated earlier, the financial crisis gave rise to severe issues concerning the present practices of financial reporting and auditing. The trust in financial reports declined (Kelton & Montague, 2018) and a discussion regarding the structure, substance, and informative value of the audit report began (Bédard, Coram, Espahbodi, & Mock, 2016). The crisis generated a great demand for transparency in audits and audit reports, and as a consequence, standard setters such as IAASB (2015a, 2015b) issued new and revised standards (Bédard et al., 2016; Kelton & Montague, 2018). Mainly, the altered audit standards demand extended information in the audit report that points out items that are crucial for users’ comprehension of the audited financial statements (Bédard et al., 2016).

A study by Mock et al. (2013) clearly expresses the prevailing expectation gap, and the troubles auditors face in situations of corporate failures. The study examined what information users of financial statements wish to receive and how the information that is currently being communicated is perceived. The results of the study show that stakeholders request more entity-specific information, such as information regarding risks and accounting policies. Except for more entity-specific information, stakeholders also demand more audit-specific information, such as level of assurance, materiality level, audit judgements, and audit process. Additionally, the findings reveal that the current audit report is seen as too standardised to be interesting for users of the financial information and that by providing additional audit-specific information in the audit report, the audit report will become more valuable.

Kelton and Montague (2018) conducted a study concerning the unintended effects of the emphasis of matter paragraph (ISA 706.1 Revised) in the audit report, motivated by the high regulatory interest in raising stakeholders’ capabilities to identify ambiguities in audited financial statements. The authors express that up-to-date investigation is needed to find out how uncertainty disclosures influence stakeholders’ perceptions and reactions. The results of the study are closely connected to the criticism of an extended audit report and point out that the audit report is not the most convenient location for information
about the level of assurance and materiality. However, the research by Kelton and Montague (2018) was conducted on nonprofessional investors, and the results could have been different with professional investors in focus.

Gold et al. (2012) examined the revised ISA 700 and the performance of its administered explanations in the audit report. The study compared stakeholders’ impressions of audit reports including explanations, as mandated by the revised ISA 700, with stakeholders’ impressions of audit reports only including the audit opinion. The results of the comparison show that the thorough explanations mandated by the revised ISA 700 are failing in closing the expectation gap between auditors and users of the audited financial statements. Gold et al. (2012) articulate that these findings signify either a demand for more extensive explanations in the audit report or the fact that stakeholders’ impressions of the quality of the audit report are not affected by supplementary explanations. Nevertheless, the findings and their implications can only be seen as speculations, and further investigation is needed.

2.3. Assurance Level

Audit risk is a fundamental notion of auditing and an important concept throughout the different audit procedures, and extensively, throughout the entire audit process (Krishansing & Quick, 2016). Audit risk can also be interpreted as level of assurance. ISA 200.5 demands the auditor’s opinion to be based on reasonable assurance that the financial statements are free from material misstatements, with reasonable assurance signifying a high, but not an absolute, level of assurance (ISA 200.5). However, a study by Epstein and Geiger (1994) revealed that almost half of the participating investors expected an absolute assurance that material misstatements would be discovered and disclosed by auditors. Another study by Backof, Bowlin and Goodson (2018) examined how a more precise explanation of reasonable assurance influence jurors’ evaluation of the responsibility of auditors. The results of the experiment exhibit that by pointing out the restraints of reasonable assurance, the probability that jurors consider auditors as careless declines. Asare and Wright (2012) declare that divided expectations easily lead to misunderstandings, which in turn can lead to inappropriate allocations of resources, unintended investments, and decreased confidence in auditors and audit reports.
Peecher, Solomon and Trotman (2013) conducted a study that investigated the auditor’s judgement process and the verifiability of the auditor’s judgements. The authors advocate a test of the reasonableness of the auditor’s judgements by a clarification of the current circumstances and the given evidence at the time of the audit. The test of reasonableness is closely associated with the level of assurance, and Peecher et al. (2013) argue that the prevailing audit standards constrain auditors from disclosing diverse assurance levels of the audited financial statements.

Another study related to the auditor’s judgements, encouraged by financial accidents and the expectation gap, is one by Wright and Wright (2014). They investigated the effect of revealing the auditor’s judgement process concerning the level of assurance, this in order to diminish damaging accusations of an auditor after the happening of an unfavourable event. The findings from this study show that the disclosure of the auditor’s decision process possibly can reduce negative auditor attention. The findings also suggest that a disclosure of the judgement process increase investors’ perceptions of auditor expertise and diligence, and decrease investors’ beliefs that actions by auditors can be connected with investment failures.

In a study by Hasan, Roebuck and Simnett (2003), different forms of assurance reports were examined. However, none of the examined forms contained the suggestion of a quantification of the level of assurance. Krishansing and Quick (2016) stress that a quantification of reasonable assurance (ISA 200.5) possibly could impact the perceptions of the audit report and its quality. Nevertheless, they also emphasise the existing expectation gap and the fact that many users of the audit reports expect absolute assurance. Thus, a quantification of the level of assurance could perhaps affect the perceived audit quality in a negative way. If users of audited financial statements explicitly become aware of the risk that reasonable assurance cannot be given that material misstatements are identified and declared, the trust in the audit function and the audited financial statements can be argued to decrease (Krishansing & Quick, 2016). However, Krishansing & Quick (2016) came to the conclusion that the disclosure of the level of assurance increased bank directors’ probability to grant credit. These diverse ways of reasoning enlighten the issue of the expectation gap and stakeholders’
expectations of absolute assurance, and in turn, points out a call for further research in this area.

2.4. Materiality Level

The principle of materiality is practiced throughout the entire audit process. That is, in the planning of the audit, the performing of the audit, the evaluation of the impact of detected and not altered misstatements on the audit and the financial statements, and in the forming of the auditor’s opinion (ISA 320.5). As stated earlier, materiality can be seen as a tool for estimating and determining the effect of recognised misstatements, if they are not corrected, on the financial statements and the audit (ISA 200.6). Materiality can be argued to be a central function of the audit process (Krishansing & Quick, 2016), and Mock et al. (2013) declare that information about the applied level of materiality should be communicated to stakeholders through the audit report.

A study by De Martinis and Burrowes (2007) examined the effect of the disclosed level of materiality on the audit expectation gap. The results suggest that the publication of the materiality level may improve stakeholders’ impressions of the audit quality as well as the comprehension of the audit report. Another study by Houghton, Jubb and Kend (2011) investigated the problem of materiality judgements and the demand for disclosures of the level of materiality. The findings of the study reveal that stakeholders find the principle of materiality and its educational purpose hard to understand. The findings also tell that there are diverse opinions regarding whether the disclosed materiality level, in other words, the level of acceptable misstatements, is increasing or decreasing stakeholders’ perceptions of audit quality. Additionally, the authors argue that if the level of materiality is disclosed, the companies being audited can purposely commit fraud by taking advantage of the revealed materiality levels. Houghton et al. (2011) refers to the agency theory and point out that audited companies with that kind of self-interest only would present particular items in the financial statements. Krishansing and Quick (2016) also question the usefulness of the disclosure of the level of materiality and whether it is able to narrow the existing expectation gap. They express that theoretically, supplementary information is beneficial. In contrast, they question the capability of the disclosed materiality level to enhance stakeholders’ understanding of its function in the audit.
process. Further, the findings of Krishansing & Quick (2016) show that the disclosure of the materiality level has no influence on bank directors’ probability to grant credit.

In a study by Ruhnke, Pronobis and Michel (2018), the impact of materiality disclosures on credit lending decisions was examined. The study came to the conclusion that materiality disclosures generate the prerequisite needed for adequate credit lending decisions, namely the acknowledgment of possible bias and inaccuracies in the audited financial statements. Thereby, disclosures of materiality assist in creating profitable credit contracts. Ruhnke et al. (2018) also express that the disclosure of the level of materiality can serve as a tool to communicate the level of acceptable misstatements, and thus, to meet the criteria of stakeholders’ information needs (ISA 320.2).

2.5. Key Audit Matters

In the past few years, there have been a number of experimental studies on how KAM, or Critical Audit Matters (CAM), which is the equivalent to KAM in the Public Company Accounting Oversight Board (PCAOB) in the United States, influence users’ perceptions of entities and auditor liabilities. The studies have focused on how KAM directly affect the decision making of users’ of the audit report (Christensen, Glover & Wolfe, 2014; Sirois, Bédard, & Bera, 2018), and also, how KAM may have a second-order effect on decision making (Brasel, Doxey, Grenier, & Reffett, 2016; Gimbar, Hansen, & Ozlanski, 2016; Li, Hay, & Lau, 2019).

A recent study conducted in New Zealand by Li et al. (2019), investigated if the disclosure of KAM have an impact on audit quality and audit cost (audit fees). The results show that the audit quality increases with the extended audit report, however, so does the audit fees. Nevertheless, the desired objective to improve the audit quality is met by the enhanced audit reports.

Sirois et al. (2018) used eye-tracking technology to examine whether and how the additional paragraphs of KAM affect the information search and attention of users of the audit report. In this study, the users of the audit report were graduate business students. The findings suggest that the participants of the study capture disclosures of KAM faster and pay more attention to them when communicated in the report, meaning that KAM
have an attention-directing impact. However, the participants devoted less attention to other parts of the financial statements if they were given an audit report with several KAM.

Another experiment on the reaction of business students towards KAM was done by Christensen et al. (2014). They examined how users react to the KAM paragraph which is centered on the audit of fair value estimates. They found that the participants who received a KAM paragraph were more likely to alter their investment decisions than the ones who got a standard audit report or received the same KAM paragraph in the management’s footnotes. Further, they also concluded that the impact of a KAM paragraph is weakened if it is followed by a paragraph offering an answer to the KAM.

Brasel et al. (2016) investigated the concern that the disclosure of KAM would increase jurors’ auditor liability judgements when the auditor failed to notice misstatements. However, they found that the disclosure of KAM could, under certain circumstances, actually reduce auditor liability judgements as the members of the jury perceive that undiscovered fraudulent misstatements were more predictable to the plaintiff (i.e., the user of the financial statement suing the auditor). Further, they found that the disclosure of KAM only reduces the auditor liability for undiscovered misstatements that, without the disclosure of KAM, are somewhat challenging to find.

Gimbar et al. (2016) investigated how jurors’ understanding of auditor liability is influenced by KAM, accounting standard precision, as well as the interaction between accounting standard precisions and KAM. They concluded that the auditor liability was greater with any kind of KAM disclosures in a rules-based setting, for example, GAAP in the United States. However, this was not the case in a principles-based setting, like IFRS in the European Union. This could, according to Gimbar et al. (2016), imply that the effect of KAM may change in different jurisdictions and the impact of KAM on auditor liability might even be smaller in countries who use IFRS and IAS. Further, Krishansing and Quick (2016) found that the disclosure of KAM had no influence on the granting of credit.
2.6. Lending Decisions by Banks

Published accounts are one of the most important sources of information for bankers (Bartlett & Chandler, 1997; Berry & Robertson, 2006). Bank directors often use accounting information to determine the financial health of the credit applicant as an element of the loan evaluation. This information is usually followed by audits to give a form of assurance on the information (Schneider, 2018). Firth (1979), as well as Bamber and Stratton (1997), found that the information which the auditor provides influence the loan decisions made by bankers. In contrast to this, Estes and Reimer (1977) and Libby (1979) did not find the information to affect lending decisions significantly.

Berry and Robertson (2006) investigated the information used by bankers and how the usage of this information has changed from 1985 to 2001. The findings suggest that in 2001 more attention was given to liquidity, than to profitability. Regarding the more detailed ratios, findings show that cash flow indicators have become more valuable. Although, the balance sheet, and the profit and loss based ratios, are still applied (Berry & Robertson, 2006). In the study, there is evidence of a decline in the importance of audit reports during the years 1985 to 2001. One explanation for this decline could be that lenders use and depend on the material they find understandable and less simple to change to suit the desires of the loan applicants (Berry & Robertson, 2006).

In a study by Miller and Smith (2002), different assurance levels in the financial statements and their effects on bank loan decisions were examined. The findings propose that the assurance level does not have an impact on the lending decisions by bank directors. However, the findings also suggest, yet without statistical significance, that the number of non-allowed credits increased as the level of assurance decreased. Krishansing and Quick (2016) found that disclosing the applied assurance level increased the probability of granting a credit, while the disclosure of applied materiality levels and KAM had no influence on the granting of credit. Nevertheless, Trpeska, Atanasovski and Lazarevska (2017) concluded that the information in the extended audit report is recognised as of great importance.
3. Method

3.1. Sampling

The study uses a non-probabilistic sampling technique (Saunders, Lewis, & Thornhill, 2015) since the study requires subjects with the necessary knowledge of granting credits to companies. The population of the study is bank directors in Sweden, where the definition of a bank director is an employee at a bank that is either a chief, company advisor, or business advisor. The names, roles, and emails of bank directors in Sweden are hand collected from the websites of the banks, and compiled in an excel-sheet. The banks addressed are Avanza, Länsförsäkringar, SBAB, SEB, SHB, Skandia, and Swedbank, due to their accessible contact information online. By conducting a database, and thereby a sampling frame, the risk of obtaining incomplete, inaccurate, and out of date data is reduced. Nonetheless, by doing so, the sample only consists of Swedish bank directors with their emails provided online.

The sampling frame consists of 3,060 Swedish bank directors. However, out of those, 1,545 bank directors operate within the private banking sector and are therefore excluded from the sample. Thereby, the final sample consists of 1,515 bank directors who have knowledge, and operate, within the corporate banking sector. These 1,515 bank directors are divided into eight groups, one group per case and questionnaire.

Table 1 displays the demographic information of the participants of the study. The participants, on average, have more than 14 years of experience in banking (YEARS; mean = 14.47) and have been part in credit-granting of 870 firms (NR_FIRMS; mean = 870.35). The average age of the participants is 41 (AGE; mean = 41.48), and the majority of the participants are males.
Table 1. Demographic Information

<table>
<thead>
<tr>
<th>Variable</th>
<th>N</th>
<th>Mean</th>
<th>Std Dev</th>
<th>Min</th>
<th>Max</th>
<th>Median</th>
</tr>
</thead>
<tbody>
<tr>
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<td>14.47</td>
<td>8.59</td>
<td>1</td>
<td>42</td>
<td>13</td>
</tr>
<tr>
<td>NR_FIRMS</td>
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<td>825.53</td>
<td>0</td>
<td>5 000</td>
<td>660.5</td>
</tr>
<tr>
<td>AGE</td>
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<td>9.67</td>
<td>23</td>
<td>63</td>
<td>40</td>
</tr>
<tr>
<td>GENDER</td>
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<td>1.35</td>
<td>0.48</td>
<td>1</td>
<td>2</td>
<td>1</td>
</tr>
<tr>
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<td>3</td>
<td>7</td>
<td>5</td>
</tr>
<tr>
<td>AUD_EXPERT</td>
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<td>1.23</td>
<td>1</td>
<td>7</td>
<td>5</td>
</tr>
<tr>
<td>RISK</td>
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<td>1.02</td>
<td>2</td>
<td>7</td>
<td>5</td>
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<tr>
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<td>7</td>
<td>5</td>
</tr>
<tr>
<td>TRUST_MGMT</td>
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<td>0.92</td>
<td>3</td>
<td>7</td>
<td>5</td>
</tr>
<tr>
<td>TRUST_BM</td>
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<td>4.76</td>
<td>0.91</td>
<td>2</td>
<td>7</td>
<td>5</td>
</tr>
<tr>
<td>TRUST_AUD</td>
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<td>5.13</td>
<td>0.99</td>
<td>3</td>
<td>7</td>
<td>5</td>
</tr>
<tr>
<td>OVERSIGHT</td>
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<td>4.91</td>
<td>0.96</td>
<td>2</td>
<td>7</td>
<td>5</td>
</tr>
<tr>
<td>SANCT</td>
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<td>4.67</td>
<td>1.05</td>
<td>1</td>
<td>7</td>
<td>5</td>
</tr>
<tr>
<td>CONTACT</td>
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<td>1.58</td>
<td>0.50</td>
<td>1</td>
<td>2</td>
<td>2</td>
</tr>
</tbody>
</table>

YEARS: Number of years the participant has worked in banking. NR_FIRMS: Number of firms the participant took part in the decision with regard to granting a credit. AGE: Age of participant. GENDER: Male=1/Female=2. ACC_EXPERT: Self-assessment of financial accounting expertise on a 7-point Likert scale. AUD_EXPERT: Self-assessment of auditing expertise on a 7-point Likert scale. RISK: Self-assessment of risk attitude on a 7-point Likert scale. TRUST_REPORT: Self-assessment of trust in annual reports on a 7-point Likert scale. TRUST_MGMT: Self-assessment of trust in corporate management on a 7-point Likert scale. TRUST_BM: Self-assessment of trust in board members on a 7-point Likert scale. TRUST_AUD: Self-assessment of trust in auditors on a 7-point Likert scale. OVERSIGHT: Perception of adequacy of oversight on auditors on a 7-point Likert scale. SANCT: Perception of adequacy of disciplinary sanctions on auditors. CONTACT: Private contact with auditors (Yes=1/No=2).

3.2. Data Collection

Primary data is collected via online questionnaires which are sent out together with the cases through emails to 1,515 Swedish bank directors. Since this study comprises of eight different cases and questionnaires, it is important that the right questionnaire goes with the correct case. For example, case 1 needs to be sent out together with questionnaire 1, case 2 together with questionnaire 2, and so on. The different cases and questionnaires are explained in detail in section 3.3.2.

By using emails, the likelihood that the targeted, i.e., correct, persons answer is high, and the likelihood of distortion of the responses is low. Emails also allow a large and highly distributed geographic sample, compared to, for example, interviews and focus groups. However, the response rate for emails is often low, and it is not unusual with a response rate of 11% or lower. Nevertheless, with a large sample, a low response rate can still
generate a satisfactory amount of answers (Saunders et al., 2015). To motivate the bank directors to participate in the research, they got offered to take part in a lottery to win two cinema tickets. By sending reminding emails to subjects that have not answered after a given time, the response rate can also be improved (Bryman, 2012). Reminding emails were sent out to the sample after two weeks, which generated more responses. In total, the questionnaire received 124 responses. However, out of these, two responses included incomplete answers. Thereby, the complete responses amounted up to 122, and thereby a final response rate of 8.05% is attained.

The emails consist of a short introduction about the study, a link to the accurate questionnaire, and an attachment with the accurate case as a PDF. For the case to be useful, a number of questions need to be answered. To make the answers easy to distribute and analyse, eight different questionnaires are constructed in an online survey software.

3.3. Research Design

This explanatory study has a quantitative research strategy with a deductive approach. Further, to answer the research questions, the study has an experimental design with one control group and seven experimental groups. The control group and the experimental groups are identical concerning all elements connected to the research. However, seven different manipulations are applied to the seven experimental groups, one manipulation per group. The variables used in this study are based on prior research by Krishansing and Quick (2016), who conducted a similar study based in Germany.

3.3.1. Dependent Variables

The questionnaire required the participants to assess their confidence (CONF) in the financial statements of the audited company, i.e., the case company, on a scale from 0% to 100%, with steps of 10%. It also asked them to judge the quality of the performed audit (AQ) and the value of information in the report (AR), which are measured on a 7-point Likert scale. The 7-point Likert method consists of several statements which the respondents are requested to express their level of agreement with. Normally, the scale to the statements goes from strongly disagree (1) to strongly agree (7) (Bryman, 2012), however, in this study the scale goes from a low awareness (1) to a high awareness (7). Finally, the participants are asked to assess the probability of granting a credit (CREDIT)
to the case company. This is measured on a scale from 0% to 100%, with steps of 10%. The complete set of questions in the questionnaire can be seen in Appendix 1.

3.3.2. Experiment and Independent Variables

The experiment is designed as a case study with one standard version of the case and seven altered versions of the case. The case, which can be seen in Appendix 2, is based on a case designed by Krishansing and Quick (2016) in a German research setting. Since the German and Swedish markets and regulations are not identical, the case is altered to fit a Swedish setting. For example, the board and the supervisory board has been replaced by a single board. The standard version of the case, i.e., the case without manipulations, is constructed as a description of a fictive company, Beer Brewery AB. The information provided in the case concerns the general business position, corporate governance, stock exchange listing, the audit and audit fee, as well as the audit report. More detailed information about the company’s income statement, balance sheet, and free cash flow is provided in the general business situation section.

The manipulated versions of the case differ from the standard case in the audit report paragraph. In the manipulated versions, the audit report is extended in various ways related to the independent variables assurance level (AL), materiality level (ML), and KAM (KAM). The cases and their different combinations of extensions can be seen in Table 2.

<table>
<thead>
<tr>
<th>Experimental condition</th>
<th>AL</th>
<th>ML</th>
<th>KAM</th>
<th>Number of participants</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>17</td>
</tr>
<tr>
<td>2</td>
<td>Yes</td>
<td>Yes</td>
<td>No</td>
<td>17</td>
</tr>
<tr>
<td>3</td>
<td>Yes</td>
<td>No</td>
<td>Yes</td>
<td>15</td>
</tr>
<tr>
<td>4</td>
<td>Yes</td>
<td>No</td>
<td>No</td>
<td>13</td>
</tr>
<tr>
<td>5</td>
<td>No</td>
<td>Yes</td>
<td>Yes</td>
<td>16</td>
</tr>
<tr>
<td>6</td>
<td>No</td>
<td>Yes</td>
<td>No</td>
<td>17</td>
</tr>
<tr>
<td>7</td>
<td>No</td>
<td>No</td>
<td>Yes</td>
<td>14</td>
</tr>
<tr>
<td>8</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>17</td>
</tr>
</tbody>
</table>

Case 1 includes an extension concerning all three independent variables and case 8, which is the standard version, consists of no extension concerning any of the three independent
variables. The manipulation regarding the assurance level is included in the audit report with the sentence *We applied a level of assurance of 95%, i.e., the probability that our opinion is correct is 95%*. A rule of thumb is that total misstatements of more than 5% of profit cause financial statements to be materially misstated (Eilifsen, Messier, Glover, & Prawitt, 2014). The manipulation regarding the materiality level is included in the audit report by the sentence *To perform the statutory audit we applied a materiality level of €250,000, which is the maximum total amount of misstatements we tolerate*. Lastly, the manipulation concerning KAM includes the information *We highlight the following matters that are, in our judgement, likely to be most important to users’ understanding of the audited financial statements or our audit:*

- The company is exposed to various claims and contingencies in the normal course of business. We draw attention to the uncertainty related to an environmental claim regarding an industrial accident which happened in 2017.
- Due to the significant measurement uncertainty associated with the company’s structured financial instruments, we determined that there was a high risk of material misstatements in the financial statements related to their valuation. As part of our response to this risk, we developed an independent range to evaluate the reasonableness of management’s fair value estimate. Management’s recorded amount fell within our range.

To examine the bank directors’ perceptions of extended information in the audit report, they receive a questionnaire about the dependent variables; perceived confidence in the audit report (CONF), audit quality (AQ), value of information (AR), and probability to grant Beer Brewery AB a credit (CREDIT). The eight cases have one questionnaire each with questions formulated to fit the different manipulations. To control for the awareness of the additional information, specific manipulation check questions were asked in those cases where additional information was provided. The question regarding the manipulation of the assurance level is *To what degree did you notice that the auditor reported the level of assurance?*. The question regarding the manipulation of the materiality level is *To what degree did you notice that the auditor reported the applied materiality level?*. Finally, the question regarding the manipulation of KAM is *To what degree did you notice that the auditor reported on matters that are important to users’ understanding of the audited financial statements?*. All of the manipulation checks are
measured with a 7-point Likert scale, and the mean results of the awareness of the additional information for each independent variable can be seen in Table 3. Except for the specific manipulation questions, the questionnaires consist of a number of questions regarding the dependent variables and the demographics that are similar for every case.

<table>
<thead>
<tr>
<th></th>
<th>N</th>
<th>Mean</th>
<th>Std Dev</th>
</tr>
</thead>
<tbody>
<tr>
<td>AL</td>
<td>65</td>
<td>4.95</td>
<td>1.11</td>
</tr>
<tr>
<td>ML</td>
<td>70</td>
<td>4.61</td>
<td>1.11</td>
</tr>
<tr>
<td>KAM</td>
<td>66</td>
<td>4.88</td>
<td>1.06</td>
</tr>
</tbody>
</table>

Means of the awareness of the additional information regarding AL, ML and KAM measured on a 7-point Likert scale.

A threat to the reliability of the study is subject error, which concerns the fact that different answers can be given by the same person depending on at what time of the day the questionnaire is answered (Saunders et al., 2015). Since the cases and the questionnaires are sent out by email to the Swedish bank directors, the time and place for their answers cannot be controlled. One thing which can be affected is the timing of the sending of the emails. However, this does not indicate that the questionnaires are being answered at the time the emails are received. Nevertheless, since the questions in the questionnaire are relatively fact related, subject error might not impact the answers to a substantial degree.

Another threat to reliability is subject bias, which relates to the problem of a subject expressing what he or she thinks is expected (Saunders et al., 2015). The bank directors may believe that the identification of additional information in the audit report is expected of them, and thus, subject bias may occur. However, subject bias is challenging to conquer and can be argued to exist in most research settings.

In order to meet the principle of informed consent (Saunders et al., 2015), the introduction of the questionnaire includes a paragraph expressing information about the study and its purpose, how long time the completion of the case and the questionnaire is estimated to
take, that the participation is voluntary, as well as that the answers are anonymous unless they decide to take part in the lottery.

3.4. Data Analysis

The data collected from the questionnaires are compiled into one dataset from which the demographic information is analysed by using descriptive statistics. Further, the means of the dependent variables according to independent variables, the means of the dependent variables according to experimental conditions, and the means of the two-way interactions are analysed.

An analysis of covariance (ANCOVA) is performed to test the research questions. First, to see which demographic variables are of primary interest, a Pearson’s correlation coefficients test is performed between the demographic variables and each of the dependent variables. The demographic variables which have a significant value, and do not have a significant correlation with each other, will be used as covariates. The ANCOVA shows whether there are any significant differences between the independent variables on the dependent variable, while also controlling for the included covariates and the interactions between the independent variables. In this study, a confidence interval of 95% is applied, meaning that p-values less than 0.05 are significant.

Further, the significant interactions between the independent variables are controlled by conducting a Bonferroni test. The Bonferroni test is a post-hoc test performed to reduce the risk that variables appear to be significant when they are not, this by lowering the alpha value.
4. Empirical Findings and Analysis

The empirical findings are presented together with the analysis with the aim to answer the research questions. Table 4 consists of the means for the dependent variables according to the independent variables. Regarding the disclosure of the applied assurance level, the means are higher for the dependent variables when this information is provided. The results for the means are similar regarding the disclosure of KAM. However, for the disclosure of the applied materiality level, there is a reverse effect on AQ. Nevertheless, the results for the other dependent variables are in line with the results of the assurance level and KAM.

Table 4. Means of the Dependent Variables According to Independent Variables

<table>
<thead>
<tr>
<th></th>
<th>Scale 0% - 100%</th>
<th>7-point Likert scale</th>
<th>7-point Likert scale</th>
<th>Scale 0% - 100%</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Mean</td>
<td>Std Dev</td>
<td>Mean</td>
<td>Std Dev</td>
</tr>
<tr>
<td>AL</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Yes</td>
<td>76.77%</td>
<td>15.02%</td>
<td>5.48</td>
<td>1.04</td>
</tr>
<tr>
<td>No</td>
<td>65.16%</td>
<td>17.91%</td>
<td>4.34</td>
<td>1.25</td>
</tr>
<tr>
<td>ML</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Yes</td>
<td>71.79%</td>
<td>18.25%</td>
<td>4.90</td>
<td>1.33</td>
</tr>
<tr>
<td>No</td>
<td>69.83%</td>
<td>16.66%</td>
<td>4.92</td>
<td>1.24</td>
</tr>
<tr>
<td>KAM</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Yes</td>
<td>71.29%</td>
<td>17.03%</td>
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<td>1.21</td>
</tr>
<tr>
<td>No</td>
<td>70.47%</td>
<td>18.03%</td>
<td>4.67</td>
<td>1.31</td>
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</tbody>
</table>

Table 5 consists of the means for the dependent variables according to the eight different experimental conditions. Condition 2, which includes an applied assurance level and materiality level, but not KAM, has the highest mean for CONF (84.12%), and high, but not the highest, means for the rest of the dependent variables. Condition 6, which includes a disclosed materiality level but not assurance level and KAM, has the lowest mean for all the dependent variables, except for CREDIT. Condition 8, which does not include any additional information, has the lowest mean for CREDIT. However, condition 8 does not contain the lowest means for the other dependent variables.
Table 5. Means of the Dependent Variables According to Experimental Conditions

<table>
<thead>
<tr>
<th>Experimental condition*</th>
<th>Scale 0% - 100%</th>
<th>7-point Likert scale</th>
<th>7-point Likert scale</th>
<th>Scale 0% - 100%</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Mean</td>
<td>Std Dev</td>
<td>Mean</td>
<td>Std Dev</td>
</tr>
<tr>
<td>1</td>
<td>74.71%</td>
<td>10.07%</td>
<td>5.59</td>
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</tr>
<tr>
<td>2</td>
<td>84.12%</td>
<td>13.26%</td>
<td>5.47</td>
<td>0.94</td>
</tr>
<tr>
<td>3</td>
<td>73.33%</td>
<td>18.77%</td>
<td>5.40</td>
<td>1.35</td>
</tr>
<tr>
<td>4</td>
<td>73.85%</td>
<td>16.09%</td>
<td>5.46</td>
<td>1.13</td>
</tr>
<tr>
<td>5</td>
<td>69.38%</td>
<td>23.23%</td>
<td>4.88</td>
<td>1.54</td>
</tr>
<tr>
<td>6</td>
<td>58.82%</td>
<td>15.36%</td>
<td>3.65</td>
<td>1.00</td>
</tr>
<tr>
<td>7</td>
<td>67.14%</td>
<td>13.83%</td>
<td>4.64</td>
<td>0.84</td>
</tr>
<tr>
<td>8</td>
<td>65.88%</td>
<td>17.34%</td>
<td>4.29</td>
<td>1.21</td>
</tr>
</tbody>
</table>

* The experimental conditions related to this numbering are defined in Table 2.

Table 6 includes the means of the two-way interactions and shows the participating bank directors’ self-assessment of confidence (CONF), audit quality (AQ), value of the information in the audit report (AR), and probability to grant credit (CREDIT).

Table 6. Means of the Two-Way Interactions

<table>
<thead>
<tr>
<th>Interaction</th>
<th>Scale 0% - 100%</th>
<th>7-point Likert scale</th>
<th>7-point Likert scale</th>
<th>Scale 0% - 100%</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Mean</td>
<td>Std Dev</td>
<td>Mean</td>
<td>Std Dev</td>
</tr>
<tr>
<td>AL * ML</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>No No</td>
<td>66.45%</td>
<td>15.61%</td>
<td>4.45</td>
<td>1.06</td>
</tr>
<tr>
<td>Yes No</td>
<td>63.94%</td>
<td>19.99%</td>
<td>4.24</td>
<td>1.42</td>
</tr>
<tr>
<td>Yes Yes</td>
<td>73.57%</td>
<td>17.26%</td>
<td>5.43</td>
<td>1.23</td>
</tr>
<tr>
<td>AL * KAM</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>No No</td>
<td>62.35%</td>
<td>16.53%</td>
<td>3.97</td>
<td>1.14</td>
</tr>
<tr>
<td>Yes Yes</td>
<td>79.41%</td>
<td>12.54%</td>
<td>5.53</td>
<td>0.86</td>
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<tr>
<td>ML * KAM</td>
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<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>No No</td>
<td>69.33%</td>
<td>17.01%</td>
<td>4.80</td>
<td>1.30</td>
</tr>
<tr>
<td>Yes Yes</td>
<td>70.34%</td>
<td>16.58%</td>
<td>5.03</td>
<td>1.18</td>
</tr>
<tr>
<td>Yes Yes</td>
<td>71.47%</td>
<td>15.09%</td>
<td>4.56</td>
<td>1.33</td>
</tr>
<tr>
<td>Yes Yes</td>
<td>72.12%</td>
<td>17.63%</td>
<td>5.24</td>
<td>1.25</td>
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</tbody>
</table>

4.1. Extended Audit Report and Confidence

To investigate RQ1a, concerning if extended audit reports affect confidence in the financial statements, the bank directors had to make a decision about their confidence on a scale from 0% to 100%, with steps of 10%. The question asked was How is your degree of confidence in the financial statements of the audited company?, as can be seen in Appendix 1.
To administer the effect of demographic variables that are not essential, Pearson’s correlation coefficients are calculated between CONF and the demographic variables. For CONF, only the demographic variable ACC_EXPERT showed a significant effect ($p = 0.018$). Thereby, ACC_EXPERT is included as a covariate in the ANCOVA. The ANCOVA estimate the perceptions of bank directors’ confidence in the financial statements, where AL, ML, and KAM are the independent variables. The ANCOVA can be seen in Panel A of Table 7 and shows that AL is significant, and that ML and KAM are not. The significance of AL signifies that the disclosed assurance level has a meaningful positive impact on bank directors’ confidence in financial statements (76.77% vs. 65.16%, see Table 4). The findings also show that there is an interaction between AL and KAM that is significant ($p = 0.044$, see Panel A of Table 7). In Table 6 it can be seen that the mean for when AL is disclosed and KAM is not disclosed (79.67%) is higher than the mean for when both AL and KAM are disclosed (74.06%). Thereby, the disclosure of KAM diminishes the effect of the disclosure of the assurance level. However, when testing the significance with a Bonferroni test (Panel B of Table 7), there is no longer a significant effect between AL and KAM ($p = 0.185$). Further, the covariate ACC_EXPERT demonstrates that the confidence in the financial statements increases with the bank directors’ self-assessment of accounting expertise.

The significance of AL is in line with prior research by Krishansing and Quick (2016). The significance shows that the disclosure of assurance level in the audit report has a positive impact on the confidence in the financial statements of Swedish bank directors. Further, the applied level of assurance of 95%, implies that the financial statements provide a true and fair view of the audited company, as requested by ISA 200.3. The positive impact of the 95% assurance level also suggests that the bank directors are satisfied with reasonable assurance, meaning that bank directors do not require an absolute assurance level, which is in line with the requirements of ISA 200.5. The results of the study by Epstein and Geiger (1994) showed that many investors demand absolute assurance, which is then in contrast to the results of this study. However, another study by Backof et al. (2018) concluded that a more explicit explanation of the reasonable assurance level impacts investors’ positive perceptions of auditors and their work. Nevertheless, the additional information regarding the assurance level in this study only
concerns the percentage level of assurance. Still, the results of the increased confidence in the financial statements by the disclosed assurance level can be argued to go hand in hand with the results by Backof et al. (2018).

The findings suggest that the disclosure of the materiality level and KAM does not have an impact on the confidence in financial statements of Swedish bank directors. This is in line with the research of Krishansing and Quick (2016). Also, since the experimental conditions 1 to 4, which includes information about the assurance level, have higher means for confidence than the experimental conditions 5 to 8, which does not include information about the assurance level, the assurance level can be argued to have an impact on confidence. Both together with and without the disclosure of the materiality level and KAM.

Further, the results demonstrate an interaction between AL and KAM \( (p = 0.044, \text{ see Panel A of Table 7}) \), meaning the disclosure of KAM reduces the effect of the disclosure of the assurance level. Thus, by revealing an assurance level of 95%, investors and other stakeholders can be assumed to no longer have the same interest in KAM. One explanation can be that they choose to have trust in the auditors’ work and the applied level of assurance and thereby no longer identify a need for more explicit information about entity-specific matters. That is, with an applied level of assurance of 95%, investors have confidence in the audited financial statements to give a true and fair view (ISA 200.3) of the audited company, without additional information about KAM. However, the interaction between AL and KAM is not supported by the Bonferroni test \( (p = 0.185, \text{ see Panel B of Table 7}) \). By assuming that there may not be an interaction between AL and KAM, it can still be seen in Table 6 that there is a difference in the confidence for AL when KAM is disclosed (74.06%) and not disclosed (79.67%). However, as the difference is not substantial, a significant interaction may not exist, which is then in line with the Bonferroni test.
4.2. Extended Audit Report and Perceived Quality

To investigate RQ1b, concerning if extended audit reports affect the perceived quality of the audit report, the bank directors had to make a decision about their perception of the quality of the audit on a 7-point Likert scale, where 1 signifies low quality and 7 signifies high quality. The question asked was *How would you assess the quality of the audit performed?*, as can be seen in Appendix 1. To administer the effect of demographic variables that are not essential, Pearson’s correlation coefficients are calculated between AQ and the demographic variables. For AQ, the demographic variables ACC_EXPERT (p = 0.018), TRUST_MGMT (p = 0.011), TRUST_AUD (p = 0.024), OVERSIGHT (p = 0.004), and SANCT (p = 0.022) shows a significant correlation. There is a high correlation between TRUST_AUD and TRUST_MGMT, OVERSIGHT, and SANCT. Due to this, TRUST_AUD and ACC_EXPERT are used as covariates in the estimated ANCOVA.

### Table 7. Analysis Regarding Confidence in Financial Reporting

| Dependent variable: CONF: Participants confidence in financial reporting (scale from 0% to 100%). Independent variables: AL: Assurance Level was provided by the auditor (Yes=1/No=0). ML: Materiality Level was provided by the auditor (Yes=1/No=0). KAM: Key Audit Matters were provided by the auditor (Yes=1/No=0). ACC_EXPERT: Self-assessment of financial accounting expertise. |

<table>
<thead>
<tr>
<th>Panel A: Analysis of covariance (ANCOVA)</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>df</strong></td>
<td>F</td>
</tr>
<tr>
<td>Corrected model</td>
<td>8</td>
</tr>
<tr>
<td>AL</td>
<td>1</td>
</tr>
<tr>
<td>ML</td>
<td>1</td>
</tr>
<tr>
<td>KAM</td>
<td>1</td>
</tr>
<tr>
<td><strong>Covariates:</strong></td>
<td></td>
</tr>
<tr>
<td>ACC_EXPERT</td>
<td>1</td>
</tr>
<tr>
<td>AL*ML</td>
<td>1</td>
</tr>
<tr>
<td>AL*KAM</td>
<td>1</td>
</tr>
<tr>
<td>ML*KAM</td>
<td>1</td>
</tr>
<tr>
<td>AL<em>ML</em>KAM</td>
<td>1</td>
</tr>
<tr>
<td>Error</td>
<td>113</td>
</tr>
<tr>
<td>N</td>
<td>122</td>
</tr>
</tbody>
</table>

**Panel B: Bonferroni test for AL*KAM**

<table>
<thead>
<tr>
<th>AL</th>
<th>KAM</th>
<th>Mean difference (Yes-No)</th>
<th>Std Error</th>
<th>p</th>
</tr>
</thead>
<tbody>
<tr>
<td>No</td>
<td>Yes</td>
<td>5.980</td>
<td>4.457</td>
<td>0.185</td>
</tr>
<tr>
<td>Yes</td>
<td>Yes</td>
<td>5.604</td>
<td>3.779</td>
<td>0.143</td>
</tr>
</tbody>
</table>
The findings of the ANCOVA, as can be seen in Panel A of Table 8, show that AL has a significant effect, and that ML and KAM have not. However, KAM is somewhat close to having a significant effect (p = 0.054). The significance of AL signifies that the disclosed assurance level has a meaningful positive impact on bank directors’ perceived audit quality (5.48 vs. 4.34, see Table 4). The findings also show an interaction between AL and KAM that is significant (p = 0.043, see Panel A of Table 8). However, in Table 6 it can be seen that the mean for when AL is disclosed (5.47) is similar to the mean for when both AL and KAM are disclosed (5.50). Thereby, the disclosure of KAM to a minimal degree increases the effect of the disclosure of the assurance level. However, when testing the significance with a Bonferroni test, there is a significant effect (p = 0.010, see Panel B of Table 8). The Bonferroni test shows that the disclosure of KAM will only be significant for the perceived audit quality when the assurance level is not disclosed.

The significance of AL, meaning that additional information improves the perceived audit quality, can be connected to the results of the study by Wright and Wright (2014) which showed that a disclosure of the auditor’s judgement process, i.e., the assurance level, increases stakeholders’ perceptions of auditor expertise and diligence.

By looking at Table 4, it can be seen that the mean for audit quality when AL is disclosed (5.48) is higher than the mean for when AL is not disclosed (4.34). The significance of AL can also be interpreted together with what Peecher et al. (2013) suggest about a test of reasonableness, which is related to a disclosed level of assurance. Peecher et al. (2013) claim that the current audit standards restrain auditors from disclosing diverse assurance levels, and by looking at the results of this study it can be seen that a publication of the applied assurance level increases the perceived quality of the audit performed. The idea of improving auditors’ ability to disclose diverse levels of assurance is hereby ratified.

The ANCOVA suggests that there is a significant interaction between AL and KAM (p = 0.043, see Panel A of Table 8), which the Bonferroni test confirms (p = 0.010, see Panel B of Table 8). Since the results in Table 6 show that KAM to a very small degree increases the effect of AL, but the results in Panel B of Table 8 show that KAM is only significant when AL is not disclosed, the small positive effect by KAM can be suggested to be
without value. This can be connected with the findings by Krishansing and Quick (2016) which revealed that the disclosure of the assurance level increases bank directors’ probability to grant credit. Since bank directors use the audit report as a base for their lending decisions (Schneider, 2018), credit can be presumed only to be given to companies with high-quality audit reports. Therefore, the increased probability to grant credit can signify an increase in the perceived quality of the audit report as well.

Even if KAM is only significant when AL is not disclosed, Table 6 reveals that the perceived audit quality is higher when AL is disclosed, regardless of if KAM is disclosed together with AL or not. This can be an implication of the disclosure of the assurance level as a mean for achieving higher perceived audit quality. If the results regarding the disclosure of KAM is seen as different from each other (5.47 vs. 5.50, see Table 6), and not without value as suggested above, the disclosure of AL together with KAM can be seen as a mean for achieving even higher perceived audit quality. The additional information about entity-specific matters thereby strengthens the effectiveness of the disclosed assurance level, i.e., investors and other stakeholders perceive the applied level of assurance as more reliable when they can read more specific information about the firm and its KAM. This reasoning follows the findings by Li et al. (2019) which claim that the new audit requirements regarding KAM have accomplished the intended objective of improving the quality of audit reports. Brasel et al. (2016) found that the disclosure of KAM only reduces the auditor liability for undiscovered misstatements that are difficult to find without a disclosure of KAM, which further enhances the assumption that KAM together with a disclosed assurance level produces an even higher perceived audit quality. However, since the assumption requires that the audit matters that are disclosed are challenging to find without a clarification of them in the audit report, it may not be suitable for other audit settings.

The ANCOVA in this study does not show a significant effect for ML on perceived audit quality (p = 0.898, see Panel A of Table 8), which is further supported by Table 4, where the mean for when ML is provided (4.90) is only slightly lower than when ML is not provided (4.92). This means that the materiality level does not have a significant impact on perceived audit quality by bank directors. Contrasting to this, De Martinis and
Burrowes (2007) concluded that the disclosure of the materiality level may improve stakeholders’ perceptions of the audit quality of the audit report. The diverse findings between the studies support the argument by Houghton et al. (2011) concerning the ambiguous effect of a disclosed materiality level on the perceptions of audit quality of stakeholders. However, the various findings of the studies may suggest that the disclosure of the materiality level has a minor impact on the perceptions of audit quality in certain situations.

### Table 8. Analysis Regarding Perceived Audit Quality

#### Panel A: Analysis of covariance (ANCOVA)

<table>
<thead>
<tr>
<th>Source of Variation</th>
<th>df</th>
<th>F</th>
<th>p</th>
</tr>
</thead>
<tbody>
<tr>
<td>Corrected model</td>
<td>9</td>
<td>5.658</td>
<td>0.000</td>
</tr>
<tr>
<td>AL</td>
<td>1</td>
<td>28.701</td>
<td>0.000</td>
</tr>
<tr>
<td>ML</td>
<td>1</td>
<td>0.017</td>
<td>0.898</td>
</tr>
<tr>
<td>KAM</td>
<td>1</td>
<td>3.795</td>
<td>0.054</td>
</tr>
<tr>
<td>Covariates:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>ACC_EXPERT</td>
<td>1</td>
<td>3.361</td>
<td>0.069</td>
</tr>
<tr>
<td>TRUST_AUD</td>
<td>1</td>
<td>1.236</td>
<td>0.269</td>
</tr>
<tr>
<td>AL*ML</td>
<td>1</td>
<td>0.609</td>
<td>0.437</td>
</tr>
<tr>
<td>AL*KAM</td>
<td>1</td>
<td>4.208</td>
<td>0.043</td>
</tr>
<tr>
<td>ML*KAM</td>
<td>1</td>
<td>1.998</td>
<td>0.160</td>
</tr>
<tr>
<td>AL<em>ML</em>KAM</td>
<td>1</td>
<td>0.098</td>
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</tr>
<tr>
<td>Error</td>
<td>112</td>
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<td></td>
</tr>
<tr>
<td>N</td>
<td>122</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Dependent variable: AQ: Participants’ assessment of the quality of the audit performed measured on a 7-point Likert scale from 1 (low) to 7 (high). Independent variables: AL: Assurance Level was provided by the auditor (Yes=1/No=0). ML: Materiality Level was provided by the auditor (Yes=1/No=0). KAM: Key Audit Matters were provided by the auditor (Yes=1/No=0). ACC_EXPERT: Self-assessment of financial accounting expertise. TRUST_AUD: Self-assessment of trust in auditors.

#### Panel B: Bonferroni test for AL*KAM

<table>
<thead>
<tr>
<th>AL</th>
<th>KAM</th>
<th>Mean difference (Yes-No)</th>
<th>Std Error</th>
<th>p</th>
</tr>
</thead>
<tbody>
<tr>
<td>No</td>
<td>Yes - No</td>
<td>0.796</td>
<td>0.299</td>
<td>0.010</td>
</tr>
<tr>
<td>Yes</td>
<td>Yes - No</td>
<td>0.033</td>
<td>0.265</td>
<td>0.900</td>
</tr>
</tbody>
</table>

### 4.3. Extended Audit Report and Perceived Value

To investigate RQ1e, concerning if extended audit reports affect the perceived value of the information, the bank directors had to make a decision about their perception of the value of the information on a 7-point Likert scale, where 1 signifies low value and 7 signifies high value. The question asked was How would you assess the value of the
information in the audit report?, as can be seen in Appendix 1. To administer the effect of demographic variables which are not essential, Pearson’s correlation coefficients are calculated between AR and the demographic variables. For AR, the demographic variables ACC_EXPERT (p = 0.035), TRUST_MGMT (p = 0.030), TRUST_AUD (p = 0.024), OVERSIGHT (p = 0.048), and SANCT (p = 0.030) show a significant correlation. There is a high correlation between TRUST_AUD and TRUST_MGMT, OVERSIGHT, and SANCT. Due to this, TRUST_AUD and ACC_EXPERT are used as covariates in the estimated ANCOVA.

The findings in Table 9 show that both AL and KAM have a significant effect (p = 0.000; p = 0.002), but ML does not (p = 0.376). The significance of AL shows that the disclosed assurance level has a positive impact on the perceived value of the information in the audit report (5.35 vs. 4.36, see Table 4). The significant effect of KAM also signifies that the disclosure of KAM has a significant impact on the perceived value of information (5.18 vs. 4.53, see Table 4). The results of the ANCOVA does not disclose a significant interaction between the independent variables or a significant effect of the covariates.

The significance of AL (p = 0.000, see Table 9), meaning that the disclosure of the assurance level increases the perceived informational value of the audit report, can be related to the study by Mock et al. (2013) which concluded that more audit-specific information in the audit report enhances the value of the information communicated by the audit report. Mock et al. (2013) also express that the audit report becomes more valuable with more entity-specific information, which can be connected to KAM and their significance. The significant positive impact of KAM is also in line with the intentions of IAASB. Namely, to enhance the communicative value of the report (ISA 701.2) and to bring further knowledge to users of the audit (ISA 701.A42). The communicative value can be connected to Sirois et al. (2018) who examined whether the paragraphs of KAM affect the information search and attention of users of the audit report. They concluded that the KAM paragraphs got more attention and were captured faster in the report. This could be a reason for the positive impact of KAM on the value of the information in the audit report, since more attention can imply that the additional information is valuable.
The significance of KAM regarding the perceived value of the information in the audit report can also be examined in connection with the findings by Gimbar et al. (2016), which state that the impact of KAM is smaller in contexts under IFRS than in contexts under GAAP. The significance of KAM implies that the disclosure of KAM increases the perceived informational value of the audit report and that the impact of KAM can be argued to be substantial, and thus, conflicting to the study by Gimbar et al. (2016). However, since this study is only conducted in a setting under IFRS, it is not possible to know the impact of the disclosure of KAM in comparison to the disclosure of KAM in a setting under GAAP. Nevertheless, since Gimbar et al. (2016) express that the impact of KAM under IFRS is smaller than under GAAP, it is still implied that an impact exists. Thereby, the findings of this study may not be contradictory at all.

The independent variable ML does not appear to have a significant effect on the perceived informational value of the audit report (p = 0.376, see Table 9). Thereby, the results of this study is not congruent with the results of the study by Ruhnke et al. (2018), which declared that the disclosure of the level of materiality can serve as a tool to communicate the level of acceptable misstatements, and thus, to meet the criteria of stakeholders’ information needs (ISA 320.2). Nevertheless, Houghton et al. (2011) suggest that users of the audit report find the concept of materiality difficult to comprehend and that it is uncertain whether a disclosed level of applied materiality increases or decreases the perceived quality of the audit report. Since a high-quality audit report can be argued to also be of high informational value, the results of this study advocate that a disclosure of the materiality level does not increase the informational value of the audit report. However, by looking at Table 4, it can be seen that when ML is disclosed the mean is higher (4.91) than the mean when ML is not disclosed (4.78), which may imply that the disclosure of the materiality level still has a small positive impact on the perceived informational value of the audit report. Either way, the findings by Houghton et al. (2011) concerning the doubtful impact of a disclosed materiality level can be endorsed.

The ANCOVA does not show a significant correlation between any of the independent variables. This suggests that the disclosure of one independent variable does not affect the impact of the other disclosed independent variables, meaning that the variables
operate on their own. In contrast to this, Table 6 shows that there is a slight difference between the means for when two of the independent variables are disclosed, for example, the disclosure of ML but not KAM result in a mean of 4.50, and a disclosure of both ML and KAM yield a mean of 5.33. This could imply that the disclosure of more information has a positive impact on the perceived value of the information in the audit report, which then supports the aim of the extended audit report required by IAASB.

Table 9. Analysis of Covariance (ANCOVA) Regarding Perceived Value

<table>
<thead>
<tr>
<th></th>
<th>df</th>
<th>F</th>
<th>p</th>
</tr>
</thead>
<tbody>
<tr>
<td>Corrected model</td>
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<td>0.000</td>
</tr>
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<td>23.268</td>
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</tr>
<tr>
<td>ML</td>
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</tr>
<tr>
<td>KAM</td>
<td>1</td>
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<td>0.002</td>
</tr>
</tbody>
</table>

Covariates:

<table>
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<th>Covariate</th>
<th>df</th>
<th>F</th>
<th>p</th>
</tr>
</thead>
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<td>1.085</td>
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</tr>
<tr>
<td>TRUST_AUD</td>
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</tr>
<tr>
<td>AL*ML</td>
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</tr>
<tr>
<td>AL*KAM</td>
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<td>2.391</td>
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</tr>
<tr>
<td>ML*KAM</td>
<td>1</td>
<td>1.500</td>
<td>0.223</td>
</tr>
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<td>AL<em>ML</em>KAM</td>
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<td>0.668</td>
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<td>Error</td>
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<tr>
<td>N</td>
<td>122</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Dependent variable: AR: Participants' assessment of the value of information in the audit report measured on a 7-point Likert scale from 1 (low) to 7 (high). Independent variables: AL: Assurance Level was provided by the auditor (Yes=1/No=0). ML: Materiality Level was provided by the auditor (Yes=1/No=0). KAM: Key Audit Matters were provided by the auditor (Yes=1/No=0). ACC_EXPERT: Self-assessment of financial accounting expertise. TRUST_AUD: Self-assessment of trust in auditors.

4.4. Extended Audit Report and the Granting of Credit

Besides investigating the effect of extended audit reports on the perceptions of bank directors, the effect on credit lending is also examined. To investigate RQ2, concerning if extended audit reports affect the probability of granting a credit, the participants got to state the probability that they would allow credit to the client, i.e., the case company, on a scale from 0% to 100%, with steps of 10%. The question asked was *What is the probability that you will grant a credit to the company?*, as can be seen in Appendix 1. In this case, there is a significant correlation between the dependent variable CREDIT and the demographic variable AUD_EXPERT (p = 0.017). Thereby, AUD_EXPERT is included as a covariate in the ANCOVA. The results of the ANCOVA, as can be seen in
Table 10, show that AL has a significant effect ($p = 0.001$). This means that the disclosed assurance level has a significant positive impact on the probability that the audited client will receive a credit (65.32% vs. 53.28%, see Table 4). There is a significant effect for the covariate AUD_EXPERT ($p = 0.004$, see Table 10), which demonstrates that the probability of granting a credit increases with the bank directors’ self-assessment of auditing expertise. Further, there is no significant effect for the interaction between the independent variables.

The significance of AL, meaning that the disclosure of additional information improves the probability of a credit being granted, is contradicting to the findings by Miller and Smith (2002) which showed that the assurance level does not have an impact on lending decisions by bank directors. Nevertheless, since the findings by Miller and Smith (2002) also express that the number of non-allowed credits increased as the level of assurance decreased, but without significant impact, the assurance level can be argued to still have some effect on the granting of credit. The significance of AL is in line with the findings by Krishansing and Quick (2016), which demonstrate that a disclosure of the assurance level increases bank directors’ probability to grant a credit. However, this study does not investigate the size of the bank loans. Thereby, one possible explanation for the increase in the number of credits being granted is that a greater number of smaller loans are being approved, loans that without a disclosed assurance level would not have been granted at all. Nonetheless, since this study does not consider the size of the potential bank loans, further research is needed for a reliable conclusion to be drawn.

There is no significant relationship between the probability of granting a credit and KAM. This can be contrasted to the study by Christensen et al. (2014), which found that participants who received a KAM paragraph tended to change their investment decision when compared to participants who got a standard audit report. This implies that KAM works as an informative tool to users of the audit report in their investment decisions. However, in this study, there is not a significance, which suggests that KAM does not have a meaningful impact on bank directors when they grant credit to companies. The opposing views of the two studies may exist due to the fact that different studies have different types of participants, i.e., bank directors vs. business school graduates.
In a study by Ruhnke et al. (2018), it was concluded that the disclosure of materiality generates the prerequisite needed for adequate credit lending decisions, which means that the materiality assists in forming profitable credit contracts between a creditor and a debtor. In this study, ML does not have a significant impact on the probability of granting a loan (p = 0.116, see Table 10), which implies that the disclosure of materiality does not assist in the lending decisions. However, when looking at Table 4, it can be seen that there is a difference between the means of granting a credit when ML is disclosed (62.39%) and when ML is not disclosed (55.59%), which suggests that the materiality level may have an impact on the granting of credit. Nevertheless, the impact of the materiality level can be argued to be minor, and the findings in this study are thereby not in line with those of Ruhnke et al. (2018).

Table 10. Analysis of Covariance (ANCOVA) Regarding Bank Loan

<table>
<thead>
<tr>
<th></th>
<th>df</th>
<th>F</th>
<th>p</th>
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<tbody>
<tr>
<td>Corrected model</td>
<td>8</td>
<td>3.356</td>
<td>0.002</td>
</tr>
<tr>
<td>AL</td>
<td>1</td>
<td>12.535</td>
<td>0.001</td>
</tr>
<tr>
<td>ML</td>
<td>1</td>
<td>2.504</td>
<td>0.116</td>
</tr>
<tr>
<td>KAM</td>
<td>1</td>
<td>0.885</td>
<td>0.349</td>
</tr>
<tr>
<td>Covariates:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>AUD_EXPERT</td>
<td>1</td>
<td>8.425</td>
<td>0.004</td>
</tr>
<tr>
<td>AL*ML</td>
<td>1</td>
<td>1.626</td>
<td>0.205</td>
</tr>
<tr>
<td>AL*KAM</td>
<td>1</td>
<td>1.599</td>
<td>0.209</td>
</tr>
<tr>
<td>ML*KAM</td>
<td>1</td>
<td>0.942</td>
<td>0.334</td>
</tr>
<tr>
<td>AL<em>ML</em>KAM</td>
<td>1</td>
<td>0.074</td>
<td>0.786</td>
</tr>
<tr>
<td>Error</td>
<td>113</td>
<td></td>
<td></td>
</tr>
<tr>
<td>N</td>
<td>122</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Dependent variable: CREDIT: Participants assessed probability for granting a credit to the company (scale from 0% to 100%). Independent variables: AL: Assurance Level was provided by the auditor (Yes=1/No=0). ML: Materiality Level was provided by the auditor (Yes=1/No=0). KAM: Key Audit Matters were provided by the auditor (Yes=1/No=0). AUD_EXPERT: Self-assessment of auditing expertise.
5. Conclusion

Audited financial statements are the most substantial source of information concerning bank loan decisions (Berry & Robertson, 2006) and investors mainly base their investment decisions on the financial statements in combination with the audit report (Schneider, 2018). However, in the aftermath of the financial crisis of 2008, attention was given to the existing expectation gap between auditors and stakeholders. IAASB tries to narrow the gap by requiring additional information in the audit report (IAASB, 2015a, 2015b). The purpose of this study is to investigate how the extended audit report is perceived by Swedish bank directors. To conduct this investigation, two research questions are established. The first question concerns bank directors’ perceptions of additional information in the audit report, and the second question deals with how the extended audit report affects the probability that credit will be granted by bank directors.

The additional information provided in this experimental study concerns the assurance level, the materiality level, and KAM. The findings suggest that the disclosure of the assurance level is significant for all dependent variables, implying that the assurance level has a positive impact on bank directors’ confidence in the financial statements, perceived quality of the audit report, perceived value of the information the audit report contains, as well as the probability of granting a credit. The positive impact of the applied assurance level of 95% indicates that bank directors are pleased with a reasonable assurance, which supports the requirements of IAASB (ISA 200.5). The results also indicate a significance for KAM regarding the perceived value of information, meaning that the disclosure of KAM improves bank directors’ perceptions of the informational value the audit report contains. This is in line with the intentions of enhancing the value of the audit report (ISA 701.2). The disclosure of the materiality level did not appear to have a significant impact on any of the dependent variables, which can imply that a disclosure of the applied materiality level may not be of relevance for bank directors.

To summarise, additional information in the audit report affects the perceptions of bank directors to some extent. However, the practice of including additional information in the audit report may not solely increase its value, the additional information needs to serve a
purpose. Also, since the findings suggest that the disclosure of KAM reduces the effect of the disclosure of the assurance level for bank directors’ confidence in the financial statements, and that KAM is only significant for the perceived audit quality when the assurance level is not disclosed, the interactions between different types of additional information have to be taken into account. Thereby, standard setters should consider the interaction effects between different expansions when deciding on which additional information should be included in the audit report.

Some limitations of this research need to be specified. First, experiments as a research approach comprise of intrinsic limitations. For instance, the bank directors willing to participate in this study are not representative for the whole sample. Also, the case and the associated questionnaire are fictive, and their outcome may not provide a credible view of bank directors’ perceptions in a real market setting. Regarding the study, the case company is a brewery, and there may be a difference between the perceptions and outcomes of the extended audit report in other industries. Further, the case examines three distinct approaches of additional information. Other extensions of the audit report may generate alternative impacts on bank directors’ perceptions. In addition, as the study is conducted in Sweden on Swedish bank directors, the results may not be generalisable and applicable in other market settings. The outcome may vary if the study takes place elsewhere. Another limitation regards KAM and their content. KAM in this study concern risks and uncertainties and thereby the impact of the disclosure may relate to risk perceptions and not the additional information per se. Other information provided as KAM may produce a different fallout. Finally, the response rate of 8.05% can be considered to be somewhat low and thereby decrease the reliability of the results.

The mentioned limitations create opportunities for further research. Future studies can investigate bank directors’ perceptions in different countries as well as the perceptions of other users of the audit report. Also, a larger sample could increase the reliability and display a more accurate picture of the examined perceptions. Additionally, other extensions and independent variables can be examined. For example, a different assurance level than 95%, and a different materiality level than €250,000, can be applied. Also, as mentioned above, the disclosed KAM can consist of other information than risks
and uncertainties. Further, the size of potential bank loans can be considered to investigate the effect additional information has on the amount the creditor is willing, or not willing, to approve.
References


International Standard on Auditing (ISA) 320. *Materiality in Planning and Performing an Audit*.


International Standard on Auditing (ISA) 700 (Revised). *Forming an Opinion and Reporting on Financial Statements*.


Appendix

Appendix 1. Questionnaire

Questions regarding the dependent variables

- How is your degree of confidence in the financial statements of the audited company?
  0%-100%, steps of 10%
- How would you assess the quality of the audit performed?
  7-point Likert scale
- How would you assess the value of information in the audit report?
  7-point Likert scale
- What is the probability that you will grant a credit to the company?
  0%-100%, steps of 10%

Questions regarding the manipulations

- To what degree did you notice that the auditor reported the level of assurance?
  7-point Likert scale
- To what degree did you notice that the auditor reported the applied materiality level?
  7-point Likert scale
- To what degree did you notice that the auditor reported on matters that are important to users’ understanding of the audited financial statements?
  7-point Likert scale

Questions regarding the demographic information

- How many years have you worked in banking?
- For how many firms have you been part of the decision regarding granting a credit?
- How old are you?
- What gender do you identify yourself with?
- What is your self-assessment of financial accounting expertise?
- What is your self-assessment of auditing expertise?
• What is your self-assessment of risk attitude?
• What is your self-assessment of trust in annual reports?
• What is your self-assessment of trust in corporate management?
• What is your self-assessment of trust in board members?
• What is your self-assessment of trust in auditors?
• What is your perception of adequacy of oversight of auditors?
• What is your perception of adequacy of disciplinary sanctions on auditors?
• Do you have any private connections to auditors?
Appendix 2. The Experimental Case

Beer Brewery AB

General
The brewery, ‘Beer Brewery AB’ is a specialist in beverages and located in Jönköping. It produces a broad range of beverages with a focus on beer and beer mixed drinks. Since 2015 it also produces alcohol-free beverages. In the last few years, ‘Beer Brewery AB’ has become more and more successful in selling not only to local clients but also to beverage wholesalers all over Sweden. The company is planning to obtain material sale revenues from abroad in the future. First relationships to business partners in Australia, Japan, China, South Korea, Vietnam, Thailand, and India have been built up.

‘Beer Brewery AB’ has 512 employees (including part-time employees). The labour agreement from March 2017 will end on 30 April 2019.

Business Situation
Despite the economic crisis and the problematic situation of the Swedish beer market, ‘Beer Brewery AB’ managed to increase sales from €71.2m in 2016 to €75.5m in 2017. The net income slightly increased from €4.87m to €5.01m. Cost of materials increased by 9.8 % to €35.2m due to a higher output but also to increased prices for malt. In contrast, labour costs remained stable at €19.0m. Heightened salaries were balanced by a slight reduction in the number of employees.

In comparison to last year, balance sheet total has marginally decreased by €0.8m, i.e. reduced to €66.8m. Figures A and B provide further balance sheet information. In 2017, a positive free cash flow of €3.1m was generated (2016: €0.8m).

Corporate Governance
The board of ‘Beer Brewery AB’ consists of eight members: one chairman, one vice chairman, and six other members, where two of these represent employees. Furthermore, in December the board annually determines a performance-related compensation based
on existing contracts. All members of the board receive a fixed payment at year end and a reimbursement of expenses.

**Figure A. Structure of Assets**

![Figure A](image)

**Figure B. Structure of Capital**

![Figure B](image)

**Listing**

Stocks of ‘Beer Brewery AB’ are listed on Nasdaq OMX Stockholm. Since 2014, the company has been listed on Small Cap.
**Auditing**

Since 2013, the audit firm KPSE has been responsible for the statutory audit. KPSE is one of the Big 4 audit firms which operate in the German audit market. During these 5 years KPSE has always provided an unmodified audit opinion. There has been no dissent between ‘Beer Brewery AB’ and KPSE on accounting principles, the financial statements, the scope of the audit or the type of audit procedures.

KPSE performs the statutory audit in accordance with the auditing requirements of the Swedish Commercial Legislation and the auditing standards of the Swedish Association of Auditors, FAR.

**Audit Fee**

The audit fee paid to KPSE for the statutory audit of the financial statements 2017 is €260,000. This audit fee is not materially different from prior years. The board of ‘Beer Brewery AB’ monitors the performance of the audit to the required extent. The board would agree to changes to the terms of contract and the audit fee which are caused by, for example, changes in the scope of the audit or changes in the structure of the corporation, if necessary.

**Auditor’s Report**

We have audited the Consolidated Financial Statements prepared by XYZ AB, Jönköping, Sweden, comprising the statement of income, statement of income and expense recognized in equity, balance sheet, statement of cash flows, statement of equity and the notes to the Consolidated Financial Statements, together with the Management’s Analysis for the business year from January 1 to December 31, 2017. The preparation of the Consolidated Financial Statements and the Management’s Analysis in accordance with IFRSs as adopted by the European Union, and the Annual Accounts Act, are the responsibility of the parent company’s management. Our responsibility is to express an opinion on the Consolidated Financial Statements and on the Management’s Analysis based on our audit. In addition, we have been instructed to express an opinion as to whether the Consolidated Financial Statements comply with full IFRS.
We conducted our audit of the Consolidated Financial Statements in accordance with International Standards on Auditing (ISA) and generally accepted auditing standards in Sweden.

Those standards require that we plan and perform the audit such that misstatements materially affecting the presentation of the net assets, financial position and results of operations in the Consolidated Financial Statements in accordance with the applicable financial reporting framework and in the Management’s Analysis are detected with reasonable assurance. **We applied a level of assurance of 95 %, i.e. the probability that our opinion is correct is 95%**. Knowledge of the business activities and the economic and legal environment of the Group and expectations as to possible misstatements are taken into account in the determination of audit procedures. The effectiveness of the accounting-related internal control system and the evidence supporting the disclosures in the Consolidated Financial Statements and the Management’s Analysis are examined primarily on a test basis within the framework of the audit. The audit includes assessing the annual financial statements of those entities included in consolidation, the determination of entities to be included in consolidation, the accounting and consolidation principles used and significant estimates made by management, as well as evaluating the overall presentation of the Consolidated Financial Statements and the Management’s Analysis. We believe that our audit provides a reasonable basis for our opinion. Our audit has not led to any reservations. **To perform the statutory audit we applied a materiality level of €250,000, which is the maximum total amount of misstatement we tolerate.**

We highlight the following matters that are, in our judgement, likely to be most important to users’ understanding of the audited financial statements or our audit:

- The company is exposed to various claims and contingencies in the normal course of business. We draw attention to the uncertainty related to an environmental claim regarding an industrial accident which happened in 2017.
- Due to the significant measurement uncertainty associated with the company’s structured financial instruments, we determined that there was a
high risk of material misstatements in the financial statements related to their valuation. As part of our response to this risk, we developed an independent range to evaluate the reasonableness of management’s fair value estimate. Management’s recorded amount fell within our range.

In our opinion, based on the findings of our audit, the Consolidated Financial Statements comply with IFRSs as adopted by the EU, and the additional requirements of the Annual Accounts Act, give a true and fair view of the net assets, financial position and results of operations of the Group in accordance with these requirements. The Management’s Analysis is consistent with the Consolidated Financial Statements and as a whole provides a suitable view of the Group’s position and suitably presents the opportunities and risks of future development.