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A Literature Review on Critical Audit Matters in Relation to Audit Quality

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Abstract: *The focus of this study is on a review of literatures on Critical Audit Matters CAMs in relation to Audit Quality and to x-ray as many as all the past available works on the Critical Audit Matters CAMs in relation to CAMs, CAMs procedures, investors' views, auditors' liability and audit reporting quality as found in the literatures and the gap in knowledge for further research. We provide a review of twenty one studies from 2014 to 2020 that anchored on CAMs disclosures procedures, audit reporting quality, investors' expectations, risks and auditors' liability. We find that there are evidences that collectively suggest that CAMs disclosure improves and also reduces the aforementioned. Finally, we find mixed evidences in some of these observations that demand for future research. Further, these observations shows there are several other substantive differences among these studies that give place for additional researches and more works on CAMs and effects on CAMs disclosures. Our study contribute on CAMs procedures, auditor reporting quality and have implications for the debate regarding CAMs, especially, managers, accountants, auditors and regulators and present important insights regarding various literatures on CAMs disclosure. We recommend that CAMs disclosure suggest to be informative to investors, analysts, protects auditors; improves audit reporting quality; but CAMs disclosures still suggests a potential unintended consequence and thus warrants further considerations.*

Keywords: Critical Audit Matters CAMs, Disclosures, Audit Quality,

Introduction

From the early 1990s, the global business environment has become so dynamic and competitive up-to these recent years. These developments have met with several tragedies such as fraudulent activities, dubious financial schemes, falsification of corporate data, fraudulent financial reporting not just in Nigeria but globally, (Enron scandal of 2001; Parmalat in 2003; Cadbury Nigeria Plc in 2006 and Afribank Nigeria Plc in 2009; Ajani, 2012; Miettinen, 2011). The devastations have affected the work of the external financial statement auditors (Coram, Ferguson & Moroney, 2011); and the consequent loss of confidence on auditing professions (Brandon & Mueller, 2006; Lys & Walts, 1994; Palmrose, 1997; Pacini, Hillison & Sinason, 2000). Above all, after the high profile scandal and the emergency of Statement of Auditing Standard SAS No. 99, there seemed to be an increase in liabilities of the auditors, (Ashbaughshaife, Collins, Kinney & Lafond, 2008; Krashnan & Z'hang, 2005; Raphuandan & Rama, 2007); loss of investors' and stakeholders' confidence in auditors unqualified financial reports, (Hamilton & Gabriel, 2012; Defond & Zhang, 2014) and; the unqualified audit report purpose has no value if the public has no confidence in it (Maijoor & Vanstraelen, 2012). Thus, the provision of financial statements and the auditing of the same are considered as a monitoring mechanism that helps narrow information gap between the owners and the management and assure shareholders that the financial statements prepared by management and unqualified by the external auditors are free from material misstatements (Ugwu, I. V. 2020; Watts & Zimmerman, 1986), hence they are trustworthy for investment decisions purposes for all and sundries. But, the audit report has long been criticized for its form, content, and value to investors (Carson et al. 2013; Church, Davis, & McCracken 2008; Cohen Commission 1978; Geiger 1993; Mock et al. 2013; Smieliauskas, Craig, and Amernic 2008). However, in US the standard setters have been addressing criticisms about the audit report's value proposition, as evidenced by the audit report revisions suggested by the PCAOB (2011, 2013b) and the IAASB (2011b, 2012, 2013) in the form of Critical Audit Matters CAMs.

Statement of Problem of the Study

Failure of the unqualified audit reports prepared by the management but having some sort of hidden short falls have made stakeholders to lose confidence in financial reports, which by management obligations should represent the state of their investments. These scenarios have contributed to spark the past enormous losses to investors in the firms whose financial statements and reports appeared robust until the very day they collapsed or were declared bankrupt, (Flaherty & Maki, 2004; Harbour, 2013; Wolf, 2013). The unqualified financial report failures has piloted awareness, concerns and attention of all the corporate governance on business sustainability and the return on their investment portfolio becomes more intensely increasing, (PWC, 2010; Ernest & Young, 2010; Wolf, 2013; Senal, Atilla & Ates, 2012). The stakeholders interests has resulted to a series of high-level enquiries into the role and effectiveness of audit, (ACCA, 2011) and the subsequent promulgations of new accounting and auditing laws, regulations and standards, (Ayodele & Lasun, 2015; PWC, 2010). In these contexts, there still exist a vacuum in the expectation of the stakeholders as to the credibility of the reported financial statements based on the existing principles or rules, (Bray, 2003). This cause has pushed the U.S. Public Company Accounting Oversight Board (PCAOB) to expand the auditor's reporting model by requiring auditors to disclose "critical audit matters" (CAMs), hereby defined as "matters that involved the most difficult, subjective, or complex auditor judgments or posed the most difficulty to the auditor in obtaining sufficient appropriate audit evidence or forming an opinion on the financial statements" (PCAOB, 2013). However, (Zietsman, Burns, Pruitt, and Simer, 2013) stated that auditing facilitates the efficient flow of resources in capital markets, changes to the auditor's primary communication vehicle have potentially significant capital market implications. Therefore, financial statement users could potentially benefit from information about CAMs, but concerns have been raised that CAM disclosures could be misinterpreted to imply "piecemeal" assurance, meaning different levels of assurance in different areas of the financial statements (Ernst & Young, 2013; KPMG, 2013).

Focus and Objective of the Study

The main focus of this study is to carry out a review of literatures on Critical Audit Matters CAMs in relation to Audit Quality; while the specific objectives are to x-ray as many as all the past available works on the Critical Audit Matters CAMs in relation to audit quality: informative to investors, analysts and auditors' liability. Further, to provide the current position of CAMs in relation to audit quality to meet the expectations of the stakeholders and the gap in knowledge for further research.

Literature Reviews

Concept of Critical Audit Matters

Requirements for auditors to communicate critical audit matters (CAMs) in the auditor's report was stated to phase in starting in 2019, based on the PCAOB's new standard, AS 3101, the Auditor's Report on an Audit of Financial Statements when the Auditor expresses an Unqualified Opinion. The determination of CAMs is principles-based and depends on the facts and circumstances of each audit. The Board adopted these changes to inform investors and other financial statement users about significant matters in the audit and how they were addressed. This document provides a high-level overview of the CAMs requirements based on PCAOB Release (PCAOB Standards, 2017). A critical audit matters, or CAMs, is any matter communicated or required to be communicated to the audit committee and that both relates to material accounts or disclosures that are material to the financial statements and involves "especially challenging, subjective, or complex auditor judgment" (CAQ, Report, 2018). Critical audit matters are the backbone of PCAOB Auditing Standard 3101, The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion. Under the new standard, a critical audit matter that arises from the financial statement audit, is required to be communicated to the audit committee, and: Relates to accounts or disclosures that are material to the financial statements, and Involved especially challenging, subjective, or complex auditor judgment. For auditors, addressing CAMs must be approached in three phases: Determine the critical audit matters. Communicate these matters in the auditor's report. Document each matter (Tysiac, 2018). Vinson, Robertson and Cockrell, (2019) studied CAMs and the removal of CAMs and found that subsequent removal of a CAM increases auditor liability and other several recent academic studies have investigated the potential effect of CAMs on auditor liability (Backof, Bowlin, and Goodson 2014; Brasel, Doxey, Grenier, and Reffett 2016; Brown, Majors, and Peecher 2015; Gimbar, Hansen, and Ozlanski 2016; Kachelmeier, Schmidt, and Valentine 2014). Ozlanski (2019) found that nonprofessional investors provide insights about the interaction between CAMs and accounting standards. Christensen, Glover and Wolfe, (2014) said that the effect of a CAM paragraph is reduced when it is followed by a paragraph offering resolution of the critical audit matter. Bentley, Lambert and Wang, (2020) are of the opinions that CAMs disclosure decreases managers' risk-decreasing activities more than managers' risk-increasing activities and disclosing a CAM reduces nonprofessional investors' investment intentions (Rapley, Robertson, & Smith, 2018). Julia, Joshua, Duo and Kate (2020) documented that market reactions are more negative for firms with more CAMs disclosures.

Audit Quality

Although there is no universally recognized definition of audit quality, yet CPA Canada referred to it as a quality external audit service that would include a rigorous audit, with an appropriate degree of professional skepticism, conducted in compliance with the applicable standards. They continued that other essential elements of audit quality might include depth of industry knowledge, the nature and extent of valuable insights and observations arising from the audit process or the ability to effectively coordinate services from many locations around the world, (KPMG, 2016). On the other hand, Christensen, Glover, Omer and Shelley (2015) found that investors' definitions of audit quality focus more on inputs to the audit process than do auditors', and that investors view the number of PCAOB deficiencies as an indicator of overall firm quality and that auditor characteristics may be the most important determinants of audit quality, and that restatements may be the most readily available signal of low audit quality. Sulaiman and Fatimah Mat-yasin, (2018) identify three main perspectives (academic research, professional and regulatory) related to audit quality that could add to the understanding of the concepts and factors affecting audit quality in practice. Their result identifies: multifaceted concepts of audit quality and the various academic research approaches that have been carried out to assess audit quality; audit quality in practice is not only affected by various internal factors within the accounting firms but is also influenced by various contextual factors in which the accounting firms operate and that the prior research employs an archival approach that potentially provides limited information about the effect of the contextual setting in actual audit practices, which is important to enhance the understanding of audit quality. Krishnan and Schauer, (2001) define audit quality as conformance to the auditing standards during audit performance. Some studies have been carried out on the perceptions of the users and preparers of financial statements on audit quality (Schroeder, Solomon, & Vickrey, 1986; Carcello, Hermanson, & McGrath, 1992; Duff, 2009;

Daniels & Booker, 2011; Fontaine, Khemakhem, & Herda, 2016; Sulaiman, Yasin & Muhamad, 2018). There have been concerns about audit quality and the consequences of audit quality failures (Enron scandal of 2001; Parmalat in 2003; Cadbury Nigeria Plc in 2006 and Afribank Nigeria Plc in 2009; Ajani, 2012; Miettinen, 2011). Some studies have shown that audit quality has an impact on the financial performance of an organization (Beasley, 1996; Heil, 2012; Miettinen, 2011). Chen Xinyuan & Xia Lijun (2006) found the relationship between auditor tenure and audit quality is inverse “U” shape. But, when auditor tenure is less than 6 years, the increase of tenure has positive effects on audit quality, but when auditor tenure is more than 6 years, it has negative effects on audit quality. Fan and Yang (2019) found a positive association between CAMs disclosure and the audited information quality. Li, X. (2020) stated that informational value of CAMs was more significant in companies with high informational asymmetry and companies audited by relatively less professional audit firms. Rapley, Robertson and Smith, (2018) found investors’ cognitive processes that CAMs disclosure negatively impacts perceptions of management’s influence on financial reporting quality and also found that CAMs disclosure also has an indirect effect on investment intentions through its positive effect on perceptions of the auditor’s influence on financial reporting quality. In other words, some literatures have found CAMs to have some influence on audit quality (Da Wu, 2020; Wu, Fan & Yangs, 2019; Rapley, Robertson and Smith, 2018).

Empirical Reviews

Vinson, Robertson and Cockrell (2019) investigate the effects of CAMs removal and duration on jurors' assessments of auditor negligence when there is a subsequent material misstatement due to fraud in the account related to the CAMs. The study used the Culpable Control Model, to predict whether jurors will assess higher auditor negligence when a CAM is removed than when a CAM is reported and when a CAM is reported for multiple years than for one year. Their study results showed two experiments support in the authors expectations, although their results vary depended on complexity of the misstated account. Finally, the overall findings highlight a quandary for audit firms, where subsequent removal of a CAM increases auditor liability.

Ozlanski, (2019 studied the bright lines vs. blurred lines: when do critical audit matters influence investors' perceptions of management's reporting credibility? The study envisaged that PCAOB will soon require auditors to disclose critical audit matters (CAMs) to highlight areas of financial statements which are subject to a higher risk of material misstatement in agreement with FASB and the International Accounting Standards Board IASB that has continued their efforts to converge both sets of accounting standards, and the newly converged revenue recognition standard contains a relatively limited amount of implementation guidance. In this the author hypothesize and find that CAMs lower investors' perceptions of management's reporting credibility when the financial statement area discussed by CAMs is governed by precise, but not an imprecise, accounting standards. Thus, the result emphasis of risks via CAMs is incongruent with investors' expectations about the ability of precise standards to reduce financial reporting risks. Finally, the result from this experiment shows that nonprofessional investors provide insights about the interaction between CAMs and accounting standards.

Christensen, Glover and Wolfe, (2014) examined how nonprofessional investors react to an audit report's CAMs paragraph that is centered on the audit of fair value estimates. The authors performed an experiment with nonprofessional investors who are business school graduates who invest in individual stocks and analyze company financial data. Their experiment found that investors who receive a CAM paragraph are more likely to change their investment decision than are investors who receive a standard audit report (an information effect) or investors who receive the same CAM paragraph information in management's footnotes (a source credibility effect). Finally they found that the effect of a CAM paragraph is reduced when it is followed by a paragraph offering resolution of the critical audit matter.

JuKang, (2019) examined the joint effect of investor sophistication and the prospect of critical audit matter (CAM) disclosure on experienced audit committee members' propensity to ask challenging questions about management's significant accounting estimates. This study applied the theory of helping behavior and social responsibility norm. The author predicts that audit committee members will ask more challenging questions given a more unsophisticated investor base, particularly when there is a prospect of additional CAMs disclosures in the audit report. This study tested hypotheses using highly experienced audit committee members in an experimental setting. At the end the results are supportive of the study hypotheses. The additional analysis indicates the results are driven by audit committee members perceiving greater oversight duty in the presence of a more unsophisticated investor base and when there is the prospect of additional CAMs disclosures. Finally the overall findings shed light on factors that affect audit committee members' questioning behavior in the oversight process and are likely of interest to regulators and standard setters given their traditional emphasis on protecting unsophisticated investors as well as the current move towards expanding the audit report to include CAMs.

Rapley, Robertson and Smith, (2018) investigated the (PCAOB) recently adopted sweeping changes to the audit report, requiring the audit firm to disclose whether or not it identified a critical audit matters (CAMs), and its tenure with the client. They provided experimental evidence on the effects of a CAM disclosure or an explicit statement that the auditor did not identify a CAM on investor judgments, and examined whether auditor tenure disclosure influences investors’ judgments. They found that relative to disclosing that no CAMs were identified, disclosing a CAM reduces nonprofessional investors’ investment intentions. On the contrary, they found investors' cognitive processes CAMs disclosure negatively impacts perceptions of management's influence on financial reporting quality, which mediates the relationship between CAMs disclosure and investment intentions. Again, CAMs disclosure also has an indirect effect on investment intentions through its positive effect on perceptions of the auditor's influence on financial reporting quality. The result did not find a significant effect of tenure disclosure on investment intentions.

More, Bentley, Tamara and Elaine (Ying), (2019) looked at the effect of increased audit disclosure on managers' real operating decisions: evidence from disclosing critical audit matters. The study sort whether and how a "critical audit matter" (CAM) disclosure affects managers' real operating decisions in two contexts (issuing a loan that decreases versus increases the average risk profile of loan portfolios, or choosing to hedge versus speculate on commodity risk). They expected a CAM disclosure increases disclosure costs and implies expanded auditor support for both types of activities; but expect implied auditor support to be valued more highly for risk-increasing than for risk-decreasing activities. As a result the authors predict that a CAM disclosure decreases managers' risk-decreasing activities (due to increased disclosure costs) more than managers' risk-increasing activities (as the implied auditor support counteracts the increased disclosure costs). The study found evidence consistent with the prediction across multiple experiments. Finally, the study sheds light on unintended consequences of a CAM disclosure and provides insight to relevant parties as the new standard goes into effect.

More so, Todd and Brad, (2017) investigated the nonprofessional investors' reactions to the PCAOB's proposed changes to the standard audit report. The proposal met with approval from investor groups, while preparers have suggested the new disclosures could negatively affect the quality of the audit and the informational content of the audit report. In their study, Todd and Brad examined how the proposed standard influences experienced, nonprofessional investors' perception of the readability of the audit report, their valuation judgments, and their evaluations of management's credibility. The result found that the disclosure of CAMs negatively impacts the readability of the audit report, but does not, either directly or through its effect on readability, incrementally inform investors' valuation judgments. Instead, investors focused on earnings benchmark performance when making valuation judgments. The disclosure of a CAM does, however, lower investors' perceptions of management's credibility when earnings just meet expectations. Finally the results suggest that the PCAOB's proposed standard will have a significant, negative effect on the readability of the audit report but only a limited impact on the informational content of the audit report for investors.

Cody, (2019) examined Critical audit matters CAMs: improving disclosure through auditor insight. The author indicated that despite being relatively unchanged for nearly 80 years, starting in 2019 the Independent Auditor's Report will undergo a major update with the addition of critical audit matters CAMs. He continued that the update improves disclosure, while providing something new to investors - auditor insight and knowledge that was always saved for the Company and the Audit Committee.

Da Wu, (2020) examined the impact of the critical audit matters (CAMs) requirements on audit fees. The study specifically studied the changes of audit fees in the years prior to or during the implementation of the CAMs requirements, for fiscal years from 2016 – 2019, for public companies in the U.S. The result were that audit fees for companies that are subject to the CAM requirements increased in 2017 and 2018 and these increases are not attributed to the CAMs requirements. Finally the analyses help to alleviate the concern that the CAMs requirement would add unnecessary costs for businesses and accounting firms.

Wu, Fan & Yangs (2019) carried out a study to know "whether critical audit matters signal higher quality of audited financial information using asset impairment". Their study considered the Chinese auditing standards that mandate the disclosure of critical audit matters (CAMs) in audit reports for all listed companies since 2017. However, in Chinese risk-oriented auditing requires auditors to assess material misstatement risks and provide reasonable assurance on financial statements that should reflect the firm's underlying economics, regardless whether a CAM is disclosed. But, given a material misstatement risk, if some auditors effectively identify it as a CAM while others do not, the financial information with a CAM would exhibit higher quality than that without a CAM, leading to a positive association between CAM disclosure and the audited information quality. The authors applying asset impairment-related CAMs, showed the relation between asset impairment and worsened economics to be notably stronger for companies with an impairment-related CAM than those without any and this association is more pronounced in smaller audit firms. Finally they found inadequate implementation of risk-oriented auditing, particularly in audit firms with greater resource constraints.

Hollie and Dana (2020) investigated Early Evidence on the AS 3101 Critical Audit Matters Disclosure. The study objective was on how the fiscal year-end large accelerated filers have already met the deadline with reported CAMs, and provides some insights to companies still looking ahead toward this part of the audit process. They used firms that have reported between one to four CAMs each with the average disclosure consisting of 1.74 CAMs, with 100% of the firms disclosing at least one CAM. The study found that 48% of the CAMs that were reported for these firms were related to (1) revenue recognition and, (2) the assessment & impairment of intangibles. And, 57% of the CAMs categorized as acquisition-related issues were related to assessing intangibles as part of an acquisition. Additionally, 84.5% of the firms fall within the manufacturing (51.7%) and services (32.8%) industries.

Klevak, Livnat, Pei and Suslava (2020), investigated whether Critical Audit Matters Are Informative? The study used Natural Language Processing (NLP) techniques and examined the types of CAMs disclosed by auditors and the typical audit procedures used to address them. They also explored whether CAMs are informative to investors and security analysts. The findings are consistent with greater amounts of CAM disclosures as indicators of greater uncertainty. The study document that market reactions are more negative for firms with more CAMs disclosures and that analysts reduce their earnings forecasts to a larger extent for such firms; stock prices become more volatile; and the dispersion of analyst forecasts are greater for firms with more CAM disclosures. Their further findings are that many issues related to CAMs are raised in earnings conference calls with analysts during the immediately subsequent quarter. It is true that the authors' findings indicate that CAMs are informative to investors and analysts, but their effects are concentrated around the time of disclosure. The study did not find evidence of a drift in returns after the initial disclosures.

Li, X., (2020) reviewed, the Informational Value in Critical Audit Matters—Evidence from Institutional Investors in Shanghai Stock Market. Results showed that, current CAMs are quantitatively small, accurately and specifically poor and they mostly come in statements rather than in forms, and institutional investors withdrew more investment as the number and accuracy of CAMs went up. Further studies, showed that the informational value of CAMs was more significant in companies with high informational asymmetry and companies audited by relatively less professional audit firms (neither international big 4 nor national big 10 audit firms).

Kleyverson, Renan, Vagner and Elizeu, (2020) analyze the relationship between Critical Audit Matters (CAMs) and earnings management practices among Brazilian companies. Study sample was composed of 96 companies listed in IBRX 100, data of which were collected from the Securities and Exchange Commission (CVM) and COMDINHEIRO database in 2016 and 2017, using descriptive statistics and panel data regression analysis. Their result found that the most predominant types of CAMs were: Assets Recovery, Contingencies, and Recognition of Revenues, which together accounted for 58% and 66% of CAMs reported in 2016 and 2017, respectively. A positive and significant association was found between the number of CAMs and accruals and discretionary revenues while a negative and significant association was found between the number of CAMs and earnings management proxy by operations through discretionary expenses.

Pinello, Puschaver, Volkans (2020) researched the relationship between critical accounting estimates and critical audit matters CAMs. The authors in order to gain insight concerning the estimates that are considered critical to the preparation of financial statements and might potentially be reported as critical audit matters, the disclosures in the 2017 Form 10-K filings for the Dow Jones 30 Industrials were reviewed. The potential linkage between management's disclosures of critical accounting estimates and the newly required auditor reporting of critical audit matters was analyzed resulting to three major predictions, that: 1) critical audit matters will most likely reflect items already identified by management as critical accounting estimates; 2) future Public Company Oversight Board inspections will be inclined to note shortcomings in critical audit matters reporting and generate controversy; and 3) management discussion and analysis will address, as critical accounting estimates, any matter raised by auditors as a critical audit matter.

Drake, Goldman, Lusch and Schmidt, (2020) studied whether critical audit matter disclosures indirectly benefitted investors by constraining earnings management: evidence from tax accounts. The focus was to investigate whether tax-related CAMs disclosures indirectly benefit investors by constraining tax-related earnings management. They found that tax-related CAMs disclosures are associated with: a lower likelihood that the audited company uses tax expense to meet analysts' consensus forecasts, and increases in the reported reserve for prior-period uncertain tax benefits (UTBs).

Backof, Bowlin, and Goodsons (2014) investigate the effects of CAMs and the inclusion of language that clarifies the term "reasonable assurance" in the audit report. CAMs are considered at three levels: no CAM, a CAM that specifically relates to the litigated issue (related CAM), or a related CAM that also describes the audit procedures performed in response to the disclosed risks. Participants are undergraduate business students, who are often used as proxies for jurors . Relying on the Culpable Control Model of blame attribution, the authors hypothesize and find that the presence of a related CAM that includes a discussion of audit procedures performed increases jurors' assessments of the foreseeability of the misstatement, which, in turn, increases auditor liability assessments. This effect decreases, however, with clarification of the term "reasonable assurance," suggesting that such clarification mitigates perceived auditor liability.

Similarly, Kachelmeier, Schmidt, and Valentine, (2014) used the Culpable Control Model to consider the effects on auditor liability of CAMs that include or exclude a description of the procedures performed to respond to the identified risks. The authors ask M.B.A. students, who serve the dual role of proxies for both nonprofessional investors and informed jurors, to consider the effects of four levels of CAM disclosure: the current audit reporting model, a related CAM, a CAM that discusses a high-risk accounting issue that is different from the accounting issue identified in subsequent litigation (unrelated CAM), or a statement that

CAMs are required but that none were present. The authors find that auditor liability is significantly lower when a related CAM is disclosed relative to the disclosure of an unrelated CAM. They attribute this result to a related CAM serving as a warning to financial statement users and therefore as a "disclaimer" of auditor liability for the identified high-risk areas. Liability assessments in either of the no CAM conditions are observed in a range that is between the related and unrelated CAM conditions.

Brasel, Doxey, Grenier, and Reffett, (2016) present CAMs disclosures at the four levels and they find that certain related CAMs can reduce auditor liability. The authors recruit jury-eligible individuals via Amazon Mechanical Turk and ask them to evaluate auditor liability for a misstatement that was caused by either an overstatement of inventory or an understatement of an environmental restoration liability. They, observed "disclaimer" effect and utilize Decision Affect Theory to predict that related CAMs will serve as notice or as a "forewarning" to users that an issue may be present in the financial statements, which leads to lower liability. However, they find that this is only true when the potential for a misstatement related to the accounting issue addressed by the CAM is not foreseeable in the absence of a CAM (e.g., an accounting issue perceived as "easy to audit"). The authors find no significant differences in assessed liability between the current reporting model and the inclusion of an unrelated CAM. However, the results indicate that liability assessments are highest when the auditor explicitly states that no CAMs were identified.

Also, Brown, Majors and Peecher (2015) apply the Story Model of juror decision making and also find that related CAMs disclosures may act as a warning to investors and, in turn, reduce auditor liability. They present participants either with both a related and an unrelated CAM, or with neither. In addition, their study manipulates the presence or absence of a "judgment rule" that would require auditors to be evaluated based on the reasonableness of their judgments. Further, the authors compare responses received from lay juror proxies recruited from Amazon Mechanical Turk and law students who serve as proxies for legal experts. The results suggest that related CAMs reduce legal liability when compared to the current reporting model. In addition, the authors find that lay jurors, but not legal experts, provide lower auditor liability assessments with the implementation of an auditor judgment rule, regardless of the presence or absence of CAM disclosures.

Finally, Gimbar et al. (2016), manipulate both the level of CAMs disclosure (related, unrelated, or the current reporting model) and accounting standard precision (precise or imprecise). Using students as proxies for lay jurors, the authors also use the Culpable Control Model to hypothesize that CAM disclosures increase perceptions of auditor control over financial reporting outcomes in a setting where the client's accounting technically complies with a precise accounting standard. Supporting this argument, they present evidence that auditor liability increases with either a related or an unrelated CAM when the accounting issue is governed by a precise accounting standard and the client's accounting treatment meets the "letter of the law." However, they find that neither type of CAM has an incremental impact on auditor liability in an imprecise accounting standard environment. They argue this result holds because the auditor's perceived control, and hence liability, are already elevated in an imprecise environment.

Discussions of the Empirical Reviews

According to (PCAOB 2013b), critical audit matters are those matters addressed during the audit that (1) involve the most difficult, subjective, or complex auditor judgments; and/or (2) pose the most difficulty to the auditor in obtaining sufficient appropriate audit evidence; and/or (3) pose the most difficulty to the auditor in forming an opinion on the financial statements. The purpose of including a CAM paragraph in the audit report is to communicate auditor insights to investors about difficult audit issues, (Christensen, Glover, and Wolfe, 2014). This study reviewed twenty one published journals on CAMs from 2014 to 2020 and an important aspect of these studies is the relation to the CAMs, CAMs procedures, investors' views; auditors' liability and audit report quality.

In the reviews, Oslanski, (2019), hypothesize and found that CAMs lower investors' perceptions of management's reporting credibility when the financial statement area discussed by CAMs and is governed by precise, but not an imprecise, accounting standards. According to the result, emphasis of risks via CAMs is incongruent with investors' expectations about the ability of precise standards to reduce financial reporting risks, (Bently et al., 2020). The results from (Oslanski, 2019) experiment, further shows that nonprofessional investors provide insights about the interaction between CAMs and accounting standards, (Rapley et al., 2018). On the other hand, Christensen et al., (2014) who also performed an experiment with nonprofessional investors using business school graduates that invest in individual stocks and analyze company financial data found that investors who receive a CAMs paragraph are more likely to change their investment decision than are investors who receive a standard audit report (an information effect) or investors who receive the same CAMs paragraph information in management's footnotes (a source credibility effect), (Oslanski, 2020); and the effect of a CAMs paragraph is reduced when it is followed by a paragraph offering resolution of the critical audit matter. Rapley et al., (2018) provide experimental evidence on the effects of a CAMs disclosure and found that relative to disclosing, that no CAMs were identified, disclosing a CAMs reduces nonprofessional investors' investment intentions and that investors' cognitive processes CAMs disclosure, negatively impacts perceptions of management's influence on financial reporting quality, which mediates the relationship between CAMs disclosure and investment intentions. They also stated that CAMs disclosure has an indirect effect on investment intentions through its positive effect on perceptions of the auditor's influence on financial reporting quality. The study of Bently et al., (2020) predicted that a CAM disclosure decreases managers' risk-decreasing activities (due to increased disclosure costs) more than managers' risk-increasing activities (as the implied auditor support counteracts the increased disclosure costs) and the found evidence was consistent with their prediction across multiple experiments. While Bently et al., (2020) found that CAMs disclosure decreases managers' risk decreasing activities; Tod and Brad, (2017) found that the disclosure of CAMs negatively impacts the readability of the audit report, but does not, either directly or through its effect on readability, incrementally inform investors' valuation judgments. Instead, investors focused on earnings benchmark performance when making valuation judgments. The disclosure of CAMs does, however, lower investors' perceptions of management's credibility when earnings just meet expectations. But, Cody, (2019) found that CAMs improves disclosure and audit quality (Todd & Brad, 2017) and improves audit committee report, (Jukay, 2019). Wu et al., (2019) stated that given a material misstatement risk, if some auditors effectively identify it as a CAM, while others do not, the financial information with CAMs would exhibit higher quality than that without a CAM, leading to a positive association between CAMs disclosure and the audited information quality. But, the authors applying asset impairment-related CAMs, found the relation between asset impairment and worsened economics to be notably stronger for companies with an impairment-related CAM (Wu, Fan & Yang, 2019), than those without any and this association is more pronounced in smaller audit firms, (Hollie & Dana, 2020). On impairment and revenue recognition (Hollie & Dana, 2020) found that 48% of the CAMs disclosure that were reported for firms were related to revenue recognition and the assessment & impairment of intangibles and, 57% of the CAMs categorized as acquisition-related issues were related to assessing intangibles as part of an acquisition. In agreement to CAMs disclosure on revenue recognition, Kleyverson et al., (2020) result found that the most predominant types of CAM were: Assets Recovery, Contingencies, and Recognition of Revenues, which together accounted for 58% and 66% of CAMs reported in 2016 and 2017, respectively. There was a positive and significant association between the number of CAMs and accruals and discretionary revenues while a negative and significant association was found between the number of CAMs and earnings management proxy by operations through discretionary expenses (Kleyverson et al., 2020). Then, Da and Wu, (2020) found that audit fees for companies that are subject to the CAMs requirements increased in 2017 and 2018 and these increases are not attributed to the CAMs requirements. Klevak et al., (2020) document that market reactions are more negative for firms with more CAMs disclosures and that analysts reduce their earnings forecasts to a larger extent for such firms; stock prices become more volatile; and the dispersion of analyst forecasts are greater for firms with more CAMs disclosures. More so, Pinello et al., 2020) found three major predictions, that: 1) CAMs will most likely reflect items already identified by management as critical accounting estimates; 2) PCOB inspections will be inclined to note shortcomings in CAMs reporting and generate controversy; and 3) management discussion and analysis will address, as critical accounting estimates, any matter raised by auditors as CAMs. Drake et al., (2020) found that tax-related CAMs disclosures are associated with: a lower likelihood that the audited company uses tax expense to meet analysts' consensus forecasts, and increases in the reported reserve for prior-period uncertain tax benefits. Li X., (2020) found that CAMs are quantitatively small, accurately and specifically poor and they mostly come in statements rather than in forms, and institutional investors withdrew more investment as the number and accuracy of CAMs went up and further, that the informational value of CAMs was more significant in companies with high informational asymmetry and companies audited by relatively less professional audit firms.

Furthermore, Backof et al. (2014) investigate the effects of CAMs and the inclusion of language that clarifies the term "reasonable assurance" in the audit report, relying on the Culpable Control Model (CCM) of blame attribution, find that the presence of a related CAMs that includes a discussion of audit procedures performed increases jurors' assessments of the foresee ability of the misstatement, which, in turn, increases auditor liability assessments. This effect decreases, however, with clarification of the term "reasonable assurance," suggesting that such clarification mitigates perceived auditor liability. In the same manner, Kachelmeier et al. (2014) applied the Culpable Control Model CCM, (Vinson et al., 2019; Backof et al. (2014), to consider the effects on auditor liability of CAMs that include or exclude a description of the procedures performed to respond to the identified risks also find that auditor liability is significantly lower when a related CAMs is disclosed relative to the disclosure of an unrelated CAMs. Kachelmeier et al., (2014) attribute their finding to a related CAMs serving as a warning to financial statement users and serves as a "disclaimer" of auditor liability for the identified high-risk areas. But, Brasel et al. (2016) present CAM disclosures applying four levels as Kachelmeier et al. (2014); find that certain related CAMs can also reduce auditor liability. Brasel et al. (2016) utilize Decision Affect Theory to predict that related CAMs will serve as notice or as a "forewarning" to users that an issue may be present in the financial statements, which leads to lower liability discovered that this is only true when the potential for a misstatement related to the accounting issue addressed by the CAMs is not foreseeable in the absence of a CAMs. But, they find no significant differences in assessed liability between the current reporting model and the inclusion of unrelated CAMs. Nevertheless, their findings indicate that liability assessments are highest when the auditor explicitly states that no CAMs were identified. In the study of Brown et al. (2015), they apply the Story Model of juror decision making and find that related CAMs disclosures may act as a warning to investors and, in turn, reduce auditor liability. Their results suggested that related CAMs reduce legal liability when compared to the current reporting model. In addition, the authors find that lay jurors, but not legal experts, provide lower auditor liability assessments with the implementation of an auditor judgment rule, regardless of the presence or absence of CAMs disclosures. Further, Gimbar et al. (2016), used both the level of CAMs disclosure (related, unrelated, or the current reporting model) and accounting standard precision (precise or imprecise), also use the Culpable Control Model CCM like ((Vinson et al., 2019; Kachelmeier et al., 2014; Backof et al., (2014) to hypothesize that CAMs disclosures increase perceptions of auditor control over financial reporting outcomes in a setting where the client's accounting technically complies with a precise accounting standard. Ultimately, they find that neither type of CAMs has an incremental impact on auditor liability in an imprecise accounting standard environment. Finally, Vinson et al., (2019) investigate the effects of CAMs removal and duration on jurors' assessments of auditor negligence when there is a subsequent material misstatement due to fraud in the account related to the CAMs. They, also manipulated the Culpable Control Model CCM like (Kachelmeier et al., 2014; Backof et al., 2014), to predict whether jurors will assess higher auditor negligence when CAMs is removed than when CAMs is reported and when CAMs is reported for multiple years than for one year. Eventually, their results showed two experiments support in the authors expectations, although their results vary depended on complexity of the misstated account. However, their overall findings highlight a quandary for audit firms, where subsequent removal of CAMs increases auditor liability.

Conclusion, Recommendations, Further Study and Contributions

The main focus of this study is to carry out a review of literatures on Critical Audit Matters CAMs in relation to Audit Quality and to x-ray as many as all the past available works on the Critical Audit Matters CAMs in relation to CAMs, CAMs procedures, investors' views; auditors' liability and audit report quality as found in the literatures and the gap in knowledge for further research. We provide a review of twenty one studies that anchored on CAMs disclosures procedures, audit quality, investors' expectations and auditor liability. We find that there are evidences that collectively suggests that CAMs disclosures: 1) improves disclosures, improves audit reporting and audit quality; 2) Improves revenue recognition, accruals, discretionary revenues, impairment of intangibles assets, while some opinion says it worsen asset impairment; 3) Decreases managers risk decreasing activities, reduce financial risk; 4) Market expectations are more negative with CAMs, Increase investors expectations while others say it lowers investors perception on management credibility; 5) increase audit fees; 6) CAMs reduces auditors' liability, while the removal increases liability ie related to subsequent litigation either reduce or do not influence auditor liability; and, we note that related CAMs may increase liability when accounting standards are precise or when the auditor discloses additional procedures performed in response to higher risks associated with the CAMs; and finally there are mixed evidences in some of these observations that demand for future research. Further, these observations shows there are several other substantive differences among these studies that give place for additional researches and more works on CAMs disclosures and effects on CAMs disclosures.

We recommend that CAMs disclosure suggest to be informative to investors, analysts, protects auditors, improves audit reporting and quality; but CAMs disclosures still suggests a potential unintended consequence and thus warrants further considerations.

Our study contribute and have implications for the debate regarding CAMs, especially, managers, accountants, auditors and regulators and present important insights regarding various literatures on CAMs disclosure.

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