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## **REPORTING ON KEY AUDIT MATTERS: THE CASE OF BOSNIA AND HERZEGOVINA**

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### **Abstract**

*This paper investigates the application of International Standard on Auditing 701 (Communication of Key Audit Matters in the Independent Audit Report) in Bosnia and Herzegovina. The objective of the research is to determine the scope and content of key audit matter (KAM) disclosures in audit reports of listed companies in Bosnia and Herzegovina in 2022 and 2023. The research is designed to answer how many KAMs auditors disclose on average in audit reports of listed companies in Bosnia and Herzegovina, which areas auditors most often identify as KAMs, whether there are differences in the scope and content of KAMs depending on the industry sector, the type of audit firm performing the audit or the type of audit opinion, whether auditors report the same KAMs in two consecutive years, and whether they use identical or modified disclosures related to audit procedures when reporting on the same KAMs in two consecutive years. The research was conducted on a sample of audit reports of companies whose securities are listed on stock exchanges in Bosnia and Herzegovina. The final sample consists of 228 companies and 456 audit reports. The data required to achieve the research objective and to answer the research questions were collected from individual audit reports that make up the sample and processed using descriptive statistics and non-parametric tests (Kruskal-Wallis test and Mann–Whitney test).*

*The research results show that auditors disclose an average of 0.7 KAMs per audit report. In the majority of audit reports, auditors disclosed one or no KAMs, while in a relatively small number of audit reports, 2 or 3 KAMs were disclosed. The results show that in all industry sectors, auditors disclose a small number of KAMs on average and that there is no statistically significant difference between*

*the number of KAMs in most industry sectors. A statistically significant difference is present between the finance and insurance sector and most other industry sectors. The Big 4 audit firms disclose a larger number of KAMs on average than audit firms that do not belong to this group. Auditors disclose a larger number of KAMs when they issue an unmodified audit opinion. Within the KAMs, auditors most often point out the risks associated with revenue recognition, loan impairment and valuation of fixed assets. In 94% of cases, auditors disclosed the same KAMs in two consecutive years, most often with the same or slightly modified text.*

**Keywords:** *Key audit matter, audit report, industry sector, audit firm, audit opinion*

**JEL:** M41, M42

## 1. INTRODUCTION

Over the past decades, the traditional audit report has been widely criticised. Users perceived it as overly standardised, focused more on the audit process than on the audited entity, and lacking sufficient informational value for financial statement users (Church et al., 2008; Abdullatif & Al-Rahahleh, 2020). It has been pointed out that the minimal information content offered by the traditional audit report can lead to wrong investment decisions, improper capital allocation, unnecessary litigation, and loss of trust among financial statements users in the audit and auditors (Asare & Wright, 2012). In response to users' demands for more information in the audit report, the International Auditing and Assurance Standards Board issued six revised standards and one new standard related to audit reporting in 2015 (IAASB, 2015a). The most significant change is the introduction of International Standard on Auditing (ISA) 701: Communicating Key Audit Matters in the Independent Audit Report. Under this standard, auditors of publicly traded companies are required to disclose key audit matters in audit reports (IAASB, 2015b).

Key audit matters (KAMs) are matters that, in the auditor's professional judgment, were of most significance in the audit of financial statements (IAASB, 2015b). Auditors select KAMs from matters that required significant attention during the audit, posed the highest audit risk, and were communicated to those charged with governance. These are areas where there are significant risks of material misstatement, where there are significant management estimates, where the effect of transactions is material, where the auditor encountered significant difficulties during the audit, and where significant modifications to the auditor's planned approach to the audit were required (IAASB, 2015b). Auditors must describe each KAM in the audit report, explain why it was significant to the audit, and indicate how it was addressed. They are also required to refer to the related

disclosures in the financial statements. Disclosing KAMs introduces entity-specific information into the audit report. In order to allow for the specifics of the audited entity to be reflected in the audit report, auditors are given a certain degree of freedom in terms of the formulation of the content related to KAMs. Including this information is expected to increase the transparency of the conducted audit and the information and communication value of the audit report and help users of financial statements to focus on the segments of the financial statements that the auditor considers to be most challenging (IAASB, 2015a, PCAOB, 2013).

Despite the potential benefits of including KAMs in the audit report, there are concerns that including this information could have unintended consequences in terms of abuse of auditor discretion, possible standardisation of KAM reporting, and increased risk of breach of confidentiality between the auditor and the audited entity (Segal, 2017). ISA 701 does not define precisely what is considered KAM and what should be disclosed about it. Auditors are left to assess what was critical to the audit, but are given the option to determine that there were no KAMs or that it was not appropriate to disclose KAMs because the potential negative consequences of disclosure outweigh the benefits (IAASB, 2015b). They may use the discretion they have gained to avoid disclosing KAMs in order to avoid conflict with the audited entity and legal liability for breach of confidentiality (Köhler et al., 2016). For the same reasons, they may tend to make KAM reporting standardised to the point that a significant portion of the expected informational and communication value is lost. Also, there is concern that under KAM disclosure conditions, auditors may be more likely to issue an unmodified audit opinion because they can inform the users of financial statements about potential risks through KAM disclosures (Segal, 2017).

If authors from developed countries expect that KAM disclosures will not bring the expected benefits, the problems in applying ISA 701 in developing countries could be even more pronounced. Hopper et al. (2017) believe that the application of International Accounting Standards and International Auditing Standards in developing countries may be inappropriate because their application implies an efficient capital market, investor sophistication and an efficient legal system, which are not the characteristics of developing countries. Developing countries are characterised by underdeveloped capital markets, high concentration of ownership, lack of shareholder activism, prevalence of family businesses, underdeveloped legal framework, weak enforcement of regulations, etc. (Khan et al., 2015). In such an environment, it can be expected that compliance with auditing standards, especially those that include a certain level of auditor discretion, will be relatively limited (Abdullatif & Al-Rahahleh, 2020).

This paper investigates the application of ISA 701 in Bosnia and Herzegovina. The aim of the research is to determine the scope and content of KAM disclosures in the audit reports of listed companies in Bosnia and Herzegovina in 2022 and 2023. This is not the first study of KAM reporting on a sample of companies from Bosnia and Herzegovina. Hladika et al. (2021) investigated the application of ISA 701 in Bosnia and Herzegovina in the first two years after the implementation of

this standard (2018 and 2019). This research has shown that auditors in Bosnia and Herzegovina, on average, disclose a significantly smaller number of KAMs than in other countries. This motivated the present study to examine whether there have been any changes in KAM reporting in Bosnia and Herzegovina four or five years after the implementation of the Standard, as well as whether there are differences in reporting depending on the industry sector to which the companies belong, the type of audit firm performing the audit, or the type of audit opinion. By investigating KAM reporting in two consecutive years, this study will provide evidence on whether auditors report the same KAMs year after year and whether they use the same or different disclosures related to audit procedures when reporting the same KAM in two consecutive years.

This paper can contribute to the existing literature and practice in several ways. The results of this research can contribute to completing the picture of the scope and content of KAM reporting worldwide. The paper summarises the content of KAMs related to companies listed on stock exchanges in Bosnia and Herzegovina. Based on this, regulators, analysts, auditors, managers and investors can identify the most common risks that occur in financial statements. The results of this paper can be useful for regulators and policymakers in Bosnia and Herzegovina to assess auditors' compliance with the requirements defined in ISA 701 and assess whether certain interventions are needed to improve compliance.

The rest of the paper is structured as follows. Section 2 provides an overview of previous research on the topic of KAM reporting. In Section 3, the data and research methodology are presented. Section 4 presents the results of the research. Discussion and concluding remarks are provided in Section 5.

## **2. LITERATURE REVIEW**

The KAM disclosures in audit reports have attracted considerable attention from both the academic and professional communities worldwide. Numerous studies and debates have addressed this topic. Research on KAM reporting has evolved along several distinct lines. On the one hand, efforts are being made to determine the scope and content of KAM reporting and the factors that influence KAM disclosures (Abdullatif & Al-Rahahleh, 2020; Ferreira & Morais, 2019; Kend & Nguyen, 2020; Li, 2020; Tušek & Ježovita, 2018; Pinto & Morais, 2019; Sierra-García et al., 2019; Wuttichindanon & Issarawornrawanich, 2020; Zeng et al., 2021). On the other hand, researchers are trying to determine whether the inclusion of KAMs has improved the information and communication value of the audit reports, i.e. whether and how KAM disclosures affect the behaviour of investors and lenders (Altawalbeh & Alhajaya, 2019; Boonyanet & Promsen, 2018; Köhler et al., 2020; Lennox et al., 2018; Moroney et al., 2021; Rapley et al., 2021; Velte & Issa, 2019). Furthermore, the efforts have been made to determine whether the obligation to disclose KAMs affects the quality of financial reporting

and audit quality (Al-mulla & Bradbury, 2022; Asbahr & Ruhnke, 2019; Gold et al., 2020; Kitiwong & Sarapaivanich, 2020; Ratzinger-Sakel & Theis, 2019; Reid et al., 2019).

An important aspect of KAM reporting concerns the number of KAMs that should be disclosed in the audit report. ISA 701 states that the number of KAMs to be disclosed in the audit report is a matter of the auditor's professional judgment and that the number of KAMs may be influenced by the size and complexity of the audited entity, the nature of its business and environment, and the facts and circumstances of the audit engagement (IAASB, 2015b). Cordos and Fülöpa (2015) argue that two to seven KAMs should be included in the audit report. Sirosis et al. (2018) argue that including a larger number of KAMs may create confusion and reduce their informative value, noting that the prominence and user attention given to each additional KAM diminish with its inclusion. They point out that the prominence of individual KAMs and the attention and importance that users of the audit report give to them decrease with the inclusion of each additional KAM.

Prior research shows substantial variation in the number of KAMs disclosed across countries. The average number of KAMs disclosed in the UK is 4.1 (ACCA, 2018a). In the audit reports of banks in the European Union, an average of 4 KAMs are disclosed, and the number of KAMs in individual audit reports varies from 1 to 8 (Accountancy Europe, 2018). Pinto and Morais (2019) found that auditors in France, the Netherlands and the UK disclosed an average of 3.8 KAMs, and the number of KAMs in individual audit reports ranges from 0 to 9. Auditors in Spain most often disclose 2 to 4 KAMs (Pérez et al., 2021). Research has shown that in a number of countries, such as France and Cyprus (ACCA, 2018a), Turkey (Özcan, 2021), Australia (Kend & Nguyen, 2020), New Zealand (XRB, 2020), Malaysia (ACCA, 2018b), Singapore (PWC, 2017) and Thailand (Kitiwong & Sarapaivanich, 2020; Suttipun, 2020; Wuttichindanon & Issarawornrawanich, 2020), auditors disclose an average of about 2 KAMs per audit report. Zeng et al. (2021), as well as Li (2020) found that in most cases, auditors in China also disclose 2 KAMs. In Poland, the Czech Republic, Romania and Turkey, the majority of audit reports contain 1 to 3 KAMs (Čiğer et al., 2019). Research conducted by Burke et al. (2023) shows that auditors in the US disclose an average of 1.7 KAMs per audit report. Tušek & Ježovita (2018) found that in the largest number of audit reports in Croatia, 1 or 2 KAMs were disclosed, and based on the research conducted by Hladika et al. (2021), it was determined that the audit reports in Croatia contain an average of 1.4 KAMs. Hladika et al. (2021) also report that auditors in Bosnia and Herzegovina disclose an average of 0.7 KAMs per audit report, with half of the analysed audit reports containing no KAMs.

Prior studies show that the number of KAMs disclosed is influenced by characteristics of the audited entity, such as size, complexity, profitability, and liquidity. The size and complexity of the audited entity positively affect the number of KAMs that will be disclosed (Mah'd & Mardini, 2022; Özcan, 2021;

Pinto & Morais, 2019; Suttipun, 2020). These characteristics increase audit risk. Özcan (2021) argues that when auditors audit the financial statements of large and complex companies, they may feel greater pressure to disclose KAMs in order to ensure their independence and reduce audit risk. On the other hand, profitability and liquidity negatively affect the number of KAMs because they indicate the financial stability of the audited entity, which leads to a decrease in inherent risk and audit risk (Suttipun, 2020; Wuttichindanon & Issarawornrawanich, 2020).

When it comes to the impact of auditor characteristics and audit engagement on the number of disclosed KAMs, research results show that the amount of audit fee and the type of audit firm influence the number of KAMs in the audit report (Ferreira & Morais, 2019, Mah'd, & Mardini, 2022, Özcan, 2021; Pinto & Morais, 2019; Wuttichindanon & Issarawornrawanich, 2020). Since audit fees are associated with audit risk, auditors may disclose a greater number of KAMs to mitigate litigation exposure (Pinto & Morais, 2019). Abdullatif and Al-Rahahleh (2020) argue that this outcome is expected that the Big 4 audit firms disclose a greater number of KAMs because it is more likely that auditors in these audit firms undergo training and follow unique procedures related to KAM reporting defined by their international firms. Researchers have not found evidence of the impact of the type of audit opinion on the number of KAMs disclosed (Özcan, 2021; Pérez et al., 2021), although it has been hypothesized that auditors are more likely to disclose KAMs in the audit reports of audited entities who receive a modified audit opinion in order to protect their reputation and minimize the litigation risk (Özcan, 2021).

Auditors most frequently disclose KAMs related to revenue recognition, receivables allowance, asset valuation, impairment of goodwill and other intangible assets, inventory write-offs, impairment of property, plant and equipment, provisions, fraud, internal controls, information technology, litigation, etc. (Zeng et al., 2021; Kend & Nguyen, 2020; Suttipun, 2020; Altawalbeh & Alhajaya, 2019; Min & Kee, 2019; Özcan, 2021; Abdullatif & Al-Rahahleh, 2020; Pinto & Morais, 2019; Accountancy Europe, 2018; ACCA, 2018a). The content of KAMs varies across industries, taking into account the specificities of individual industry sectors. The financial sector is predominantly focused on determining the fair value of financial assets, impairment of financial assets, and provisions for credit losses (Li, 2017). In capital-intensive industry sectors, such as construction and energy, the main risks concern fixed assets (Pérez et al., 2021). Zeng et al. (2021) found that risks associated with revenue recognition are inherent to most industry sectors, that risks associated with the accounts receivable allowance are characteristic of the manufacturing sectors, that KAMs containing inventory write-offs are predominantly contained in audit reports of agricultural and manufacturing companies, and that KAMs related to goodwill impairment are primarily contained in audit reports of companies belonging to the education, healthcare, culture, and arts sectors. Abdullatif & Al-Rahahleh (2020) argue that the content of KAMs also depends on the level of

economic development of the country. In developing countries, auditors recognise asset valuation as a significant risk area because there is a lack of information and active markets for most assets, which are necessary to determine the value of the assets (Abdullatif & Al-Rahahleh, 2020). Auditors in developed countries also recognise asset valuation as an area of risk, but to a lesser extent than in developing countries. Research shows that auditors in developed countries disclose topics such as KAM that are not at all represented in the audit reports in developing countries, such as fraud, internal controls, information technology, litigation, taxes, and pension accounting (Accountancy Europe, 2018; ACCA, 2018a).

### 3. DATA AND METHODOLOGY

This paper investigates KAM disclosure practices in audit reports of listed companies in Bosnia and Herzegovina. The research aims to determine how many KAMs auditors disclose on average, which areas are most frequently identified as KAMs, whether differences exist in the scope and content of KAMs across industry sectors, audit firm types or audit opinions, whether auditors report the same KAMs in two consecutive years, and whether the wording of those disclosures remains identical or undergoes modification.

The research was conducted on a sample of audit reports of companies whose securities are listed on the Banja Luka Stock Exchange and the Sarajevo Stock Exchange. The analysis covers audit reports issued for the financial years 2022 and 2023. The audit reports were obtained from the official websites of the Banja Luka and Sarajevo Stock Exchanges. The initial sample included all companies whose securities are listed on these two stock exchanges. At the time of data collection, a total of 426 companies were listed on the Banja Luka Stock Exchange, while 192 companies were listed on the Sarajevo Stock Exchange. Companies whose audit reports for one or both years were not publicly available were excluded from the initial sample. The final sample consists of 228 companies and 456 audit reports. The structure of the final sample by industry sector and audit firm type is presented in Table 1 and Table 2.

**Table 1.** Sample structure by industry sectors

Industry sectors	No. of companies	% of companies
Finance and insurance	47	20,6
Water supply and sewerage	40	17,6
Manufacturing	35	15,3
Real estate	19	8,3
Wholesale and retail trade	17	7,5

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Industry sectors	No. of companies	% of companies
Electricity generation and supply	15	6,6
Transportation and storage	12	5,3
Professional, scientific and technical activities	12	5,3
Agriculture, forestry and fishing	11	4,8
Construction	8	3,5
Information and communication	4	1,8
Mining and quarrying	3	1,3
Hospitality industry	3	1,3
Health care and social work	1	0,4
Arts, entertainment and recreation	1	0,4
Total	228	100,0

Source: Author's calculation

**Table 2.** Sample structure by type of audit firm that performed the audit

Audit firms	No. of auditor's engagements (reports)			% of auditor's engagements (reports)
	2022	2023	Total	
Big 4	22	22	44	9.6
Non Big 4	206	206	412	90.4
Total	228	228	456	100.0

Source: Author's calculation

As can be seen from Table 1, the sample is dominated by companies belonging to the finance and insurance sector, followed by the water and sewage sector and the manufacturing sector. They make up slightly more than half of the sample. Table 2 shows that the sample contains a relatively small number of audit reports prepared by some of the audit firms belonging to the Big 4 audit firm type. The dominant share, at 90%, is held by the audit reports of audit firms that do not belong to this type.

The data used to address the research objectives were collected directly from the audit reports in the sample. The data were analysed using descriptive statistics and non-parametric tests.

#### 4. RESULTS

Table 3 presents the number of KAMs disclosed in audit reports issued for 2022 and 2023. The number of disclosed KAMs per audit report ranges from zero to

three. The average number of KAMs disclosed per audit report is 0.7. Most audit reports contain either zero or one KAM, while only a small proportion include two or three.

**Table 3.** Number of KAMs in audit reports

No. of KAMs	Audit reports					
	2022		2023		Total	
	No.	%	No.	%	No.	%
0	98	43,0	99	43,4	197	43,2
1	108	47,4	110	48,3	218	47,8
2	17	7,4	14	6,1	31	6,8
3	5	2,2	5	2,2	10	2,2
Total	228	100,0	228	100,0	456	100,0

*Source: Author's calculation*

A more detailed analysis of audit reports in which no KAMs were disclosed revealed that, in 57% of these reports, auditors explicitly stated that, after performing the audit, they concluded that there were no KAMs requiring separate communication. In 34% of audit reports, auditors stated that KAMs were considered in the context of the audit of the financial statements as a whole and in forming the audit opinion, but no KAMs were disclosed, nor was it indicated that none existed, requiring separate communication. In the remaining 9% of audit reports, the KAM paragraph was missing altogether.

The results indicate that, on average, auditors disclose a limited number of KAMs across all industry sectors (Table 4). In order to determine whether the difference in the number of KAMs between individual industry sectors is statistically significant, a non-parametric analysis using the Kruskal–Wallis test was conducted. The Kruskal–Wallis test was applied due to unmet assumptions of normality and homogeneity of variances (Šošić, 2004, pp. 280-283). The results of the conducted analysis indicate the existence of statistically significant differences in the number of KAMs between industry sectors ( $p < 0,05$ ).

**Table 4.** Descriptive statistics and Kruskal-Wallis test for the number of disclosed KAMs by industry sectors

Industry sectors	No. of KAMs				
	Min	Max	Median	Mean	Std. deviation
Finance and insurance	0	2	1	0,97	0,253
Water supply and sewerage	0	3	0	0,59	0,807
Manufacturing	0	2	0	0,57	0,693
Real estate	0	2	0	0,34	0,582

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Industry sectors	No. of KAMs				
	Min	Max	Median	Mean	Std. deviation
Wholesale and retail trade	0	2	0	0,53	0,615
Electricity generation and supply	0	2	1	0,93	0,450
Transportation and storage	0	3	1	0,83	0,868
Professional, scientific and technical activities	0	3	0	0,58	0,974
Agriculture, forestry and fishing	0	3	0	0,59	0,854
Construction	0	1	0	0,25	0,447
Information and communication	0	3	0,50	1,13	1,356
Mining and quarrying	0	1	0	0,33	0,516
Hospitality industry	0	1	0	0,33	0,516
Health care and social work	1	1	1	1,00	0,000
Arts, entertainment and recreation	1	1	1	1,00	0,000
<b>Kruskal-Wallis Test</b>					
Kruskal–Wallis H	82,854				
Degrees of freedom (df)	14				
Asymptotic significance (p)	0,000				

*Source: Author's calculation*

Since the Kruskal–Wallis test does not identify which specific groups have statistically significant differences, a post hoc Dunn’s analysis was performed using Mann–Whitney tests with Bonferroni correction (Gibbons & Chakraborti, 2011, pp. 353-356). The sample companies were classified into fifteen industry sectors. This analysis implies that each industry sector is compared with each other, so that there are a large number of pairs for comparison. Therefore, only those results of Dunn’s post hoc analysis that were found to be statistically significant (adjusted p-value < 0,05) are presented in Table 5.

The analysis shows that no statistically significant differences exist between the number of KAMs in most industry sectors. A statistically significant difference is present between the finance and insurance sector and most other industry sectors. These findings suggest that audits of entities in the finance and insurance sector require greater professional judgment and involve higher complexity, resulting in a somewhat higher number of disclosed KAMs. Such a difference may be a consequence of regulatory requirements, the systemic importance of

these business entities and the inherent risk associated with their operations (IAASB, 2015b). Also, a statistically significant difference in the number of KAMs disclosed in the audit reports is present between the electricity generation and supply sector, on the one hand, and the construction and real estate sector, on the other hand.

**Table 5.** Significant results of Dunn's post hoc analysis with Bonferroni correction

<b>Industry sector 1</b>	<b>Industry sector 2</b>	<b>Z value</b>	<b>p value</b>	<b>Bonferroni p value</b>
Finance and insurance	Manufacturing	-4,694	0,000000	0,000001
Finance and insurance	Mining and quarrying	2,700	0,000000	0,000024
Finance and insurance	Wholesale and retail trade	4,057	0,000000	0,000001
Finance and insurance	Water supply and sewerage	5,085	0,000000	0,000000
Finance and insurance	Agriculture, forestry and fishing	3,289	0,000001	0,000155
Finance and insurance	Real estate	5,835	0,000000	0,000000
Finance and insurance	Hospitality industry	2,700	0,000000	0,000024
Finance and insurance	Professional, scientific and technical activities	3,717	0,000000	0,000029
Finance and insurance	Construction	4,714	0,000000	0,000000
Electricity production and supply	Real estate	3,878	0,000013	0,001404
Electricity production and supply	Construction	3,506	0,000045	0,004686

*Source: Author's calculation*

The results of this study also show that Big 4 audit firms, on average, disclose a slightly higher number of KAMs than Non-Big 4 audit firms (Table 6). Big 4

audit firms disclosed one KAM in almost all audit engagements, except one. Interestingly, in no audit engagement did they assess that two or more KAMs should be disclosed. It is also interesting that among Non-Big 4 audit firms, there are several audit firms that have performed a larger number of audit engagements included in the sample, without disclosing a single KAM in any audit report.

**Table 6.** Descriptive statistics and Mann–Whitney U test results for the number of disclosed KAMs by audit firm category

Audit firm	No. of KAMs				
	Min	Max	Median	Mean	Std. deviation
Big 4	0	1	1	0,98	0,151
Non Big 4	0	3	1	0,65	0,725
<b>Mann-Whitney U Test</b>					
Mann-Whitney U	5839,500				
Wilcoxon W	90917,500				
z-value	-4,313				
Asymptotic significance (2-tailed)	0,000				

*Source: Author's calculation*

In order to determine whether there is a statistically significant difference in the number of disclosed KAMs between audit firms belonging to the Big 4 group and those that do not belong to this group, the Mann–Whitney U test was applied. This non-parametric test was applied due to unmet assumptions of normality and homogeneity of variances (Sheskin, 2000). The test results indicate a statistically significant difference between the groups, which implies that auditors from Big 4 firms disclose a larger number of KAMs in their audit reports. This can be explained by the fact that Big 4 firms usually audit the financial statements of larger and more complex audited entities, which requires a higher degree of professional judgment. Also, these firms operate in a stricter regulatory environment and are subject to greater public scrutiny, which further affects the quality and scope of reporting (Francis, 2004). The findings support previous research that has shown that Big 4 audit firms consistently demonstrate higher audit quality and more detailed reporting in accordance with international auditing standards (Che et al., 2020).

Although prior literature suggests that auditors are more likely to disclose a higher number of KAMs in the audit reports of audited entities that receive a modified audit opinion (Özcan, 2021), the results of this study show that auditors disclose a slightly higher number of KAMs when they issue an unmodified audit opinion. The results of the Mann–Whitney U test showed that there is a statistically significant difference in the number of KAMs between these two groups of audit reports. One possible explanation is that auditors, in cases where

they express an unmodified opinion, feel a greater obligation to explain complex issues and key risks in order to further increase user confidence in the audit report. On the other hand, in situations where auditors issue a modified audit opinion, their focus may be directed more at identified material misstatements than at explaining KAMs.

**Table 7.** Descriptive statistics and Mann-Whitney U test results for the number of disclosed KAMs by type of audit opinion

Audit opinion	No. of KAMs				
	Min	Max	Median	Mean	Std. deviation
Unmodified audit opinion	0	3	1	0,74	0,709
Modified audit opinion	0	1	0	0,30	0,462
<b>Mann-Whitney U Test</b>					
Mann-Whitney U	7845,00				
Wilcoxon W	9675,00				
Z-value	-4,71				
Asymptotic significance (2-tailed)	0,00				

*Source: Author's calculation*

Table 8 summarises the topics most frequently identified as KAMs. As can be seen in Table 8, in 40% of cases, auditors identify revenue recognition as KAM. Auditors most often state in their audit reports that they chose revenue recognition as KAM because there is a risk to the accuracy of recognized revenue arising from the complexity of information systems, a large number of customers or fragmentation of sales outlets, the risk that revenue recognition is made in different periods compared to the date when the service was provided and the risk that management intentionally overstated revenue in order to achieve sales targets or the reason for choosing revenue recognition as KAM is that revenue is an important parameter by which business performance is assessed.

**Table 8.** Content of KAMs

KAMs Area	No. of KAMs	% of KAMs
Revenue recognition	126	40,7
Impairment of loans	48	15,5
Valuation of fixed assets	45	14,5
Valuation of liabilities and provisions	27	8,7
Valuation of financial investments	24	7,7
Valuation of receivables	18	5,8
Valuation of inventories	14	4,5

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Other	8	2,6
Total	310	100,0

*Source: Author's calculation*

In the audit reports of financial institutions, the impairment of loans is most often cited as a KAM. Auditors choose this issue as a KAM due to the complexity of calculating expected credit losses, the uncertainty of the estimate arising from unstable economic conditions, increased inflationary pressure and interest rate increases, and exposure to subjective judgment by management, which leads to a significant risk of material misstatement in relation to the calculation and recording of the allowance for potential credit losses, as well as the fair presentation of receivables based on loans granted.

Auditors often cite the valuation of fixed assets as a KAM. The reasons why auditors cite this issue as a KAM are related to the use of significant management estimates when capitalising investment costs in software and property, plant and equipment, determining the useful life of fixed assets, subsequently measuring the recoverable value of these assets, determining their fair value, etc.

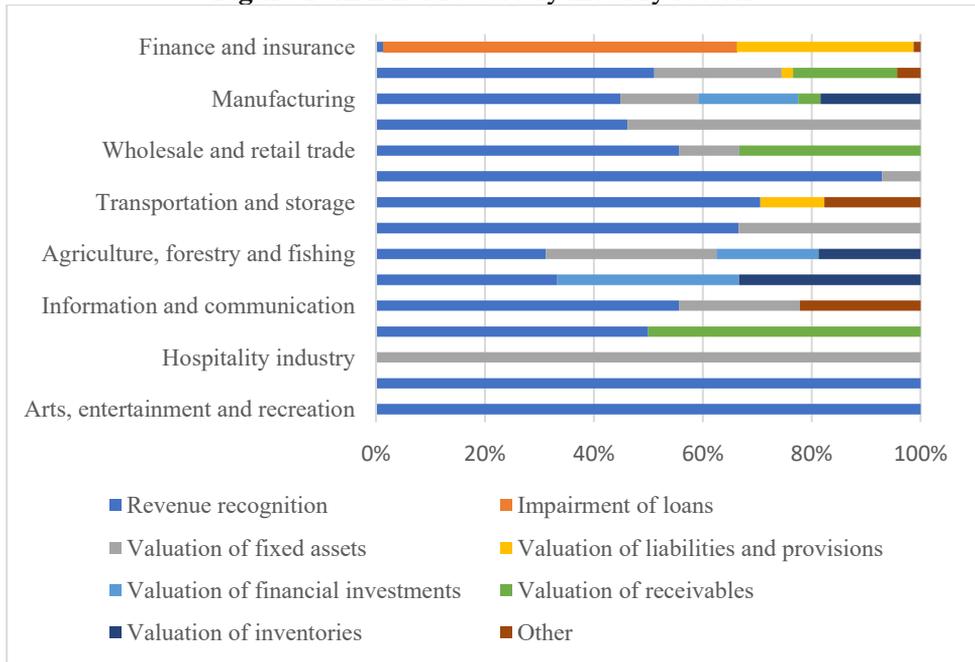
When it comes to the valuation of liabilities and provisions, the largest part of these KAMs relates to the valuation of insurance technical reserves reported in the audit reports of insurance companies. Auditors choose this issue as a KAM because their valuation involves significant judgment regarding uncertain future outcomes as well as the use of complex actuarial methodology, which is why there is a significant risk that management has not adequately calculated provisions for incurred unreported claims, as well as for other claims for which provisions are made. In a smaller number of cases, auditors indicate the existence of a significant amount of liabilities based on loans, issued bonds and deferred tax liabilities.

The reasons why auditors report the valuation of financial investments as KAM are related to the materiality of these assets and the existence of a risk that the fair value of financial investments will not be properly determined, given the nature of the judgment that management makes when determining this value. When auditors report the valuation of receivables as KAM, they indicate the size of the gross value, value adjustments and net present value of these assets. The valuation of inventories is also reported as KAM because of the materiality of inventories, which represent the most significant part of current assets, as well as because it involves significant management estimates related to reducing inventories to their net recoverable value, if it is lower than the purchase price or cost price of inventories.

Figure 1 illustrates the distribution of KAMs across industry sectors. Lennox et al. (2019) and Zeng et al. (2021) argue that if a KAM topic appears in more than 50 percent of audit reports of companies belonging to the same industry sector, that type of KAM is more indicative of the specificities of a particular industry sector than of the specificities of the audited entity. This research shows that revenue recognition is a KAM that is specific to numerous industry sectors, such

as electricity supply and generation, manufacturing, water supply and sewage, transportation and storage, wholesale and retail trade, etc. Valuation of fixed assets is a KAM that is specific to the real estate and hospitality sector, while impairment of loans is a KAM that is specific to the finance and insurance sector. An analysis of the text of the paragraph related to KAMs has shown that auditors who audit multiple audited entities belonging to the same industry sector, if they mention the same issue as KAM in the audit report, often also mention almost identical text for the description of KAM. This confirms that auditors do not provide information in the audit reports that is specific to the audited entity but to the industry sector to which the audited entity belongs.

**Figure 1.** KAMs structure by industry sectors



Source: Author's creation

The findings further reveal that auditors disclosed the same KAMs in 94% of cases in two consecutive years, which is significantly higher than, for example, in Hong Kong, where auditors disclosed the same KAMs in 46% of cases in two consecutive years (HKICPA, 2018) or Australia, where this occurred in 70% of cases (Kend & Nguyen, 2020). When auditors in Bosnia and Herzegovina disclose the same KAMs in two consecutive years, in 80% of cases, the text of the KAM description contains no or minor changes. In only 20% of cases, the auditors significantly changed the description of KAM in the audit report for 2023 compared to the audit report for 2022, even though they disclosed the same

KAMs in those two years. Auditors in other countries act in a similar way (HKICPA, 2018).

## 5. DISCUSSION AND CONCLUSION

The results of this research show that auditors in Bosnia and Herzegovina disclose, on average, significantly fewer KAMs compared to auditors in other countries. While in most countries auditors typically disclose between two and three KAMs per audit report (Pérez et al., 2021; Özcan, 2021; Kend & Nguyen, 2020; Kitiwong & Sarapaivanich, 2020), and in some jurisdictions even more than four (ACCA, 2018a), the average number in Bosnia and Herzegovina is below one (0.7). In more than 40% of audit engagements, auditors did not disclose any KAMs. Although financial and insurance companies exhibit somewhat higher KAM disclosure levels, these values remain well below the averages reported in the European Union. (Accountancy Europe, 2018). The reason why the average number of KAMs disclosed in the audit reports of financial and insurance companies is higher than in other industry sectors is not the disclosure of a larger number of KAMs in individual audit reports, but the lower share of audit reports in which no KAMs are disclosed. While in the audit reports of banks in the European Union, the number of KAMs in individual audit reports ranges from one to eight (Accountancy Europe, 2018), in audit reports of financial and insurance companies in Bosnia and Herzegovina, this number ranges from zero to one.

Despite the formal implementation of ISA 701, the low number of disclosed KAMs in Bosnia and Herzegovina carries several important implications. Although the business environment is characterised by many small and medium-sized enterprises with relatively simple operational models, the low volume of KAM disclosures cannot be attributed solely to the lack of complexity. Bosnia and Herzegovina is a developing country characterised by an unstable economic and political environment, limited efficiency of the legal system, an underdeveloped capital market, and other structural constraints (World Bank, 2021). These conditions create an unfavourable business environment, increase uncertainty, and affect the reliability of financial reporting. Such factors elevate audit risk, particularly in areas related to the collectability of receivables, the determination of recoverable and fair values of assets and liabilities, and the potential for financial statement fraud. Under these circumstances, one would expect the average number of disclosed KAMs to be higher than the reported figures. However, the institutional oversight of the application of international standards and auditor behaviour in Bosnia and Herzegovina is weaker compared to developed countries (IFAC, 2022). Furthermore, investors and other users place limited pressure on auditors to provide detailed disclosures about risks. Consequently, auditors are not subject to strong market incentives to explain key areas of audit focus in more detail. The presence of similar reporting patterns

across industry sectors suggests that auditors may apply a narrow interpretation of what constitutes matters of most significance in the audit of financial statements. The uniformity of KAM descriptions indicates a standardised, template-oriented reporting approach in which auditors prioritise meeting ISA 701 requirements over enhancing the communicative value of the audit report. At the same time, conservative reporting behaviour may serve to reduce exposure to risk or avoid conflict with management. Taken together, these factors suggest that the low number of KAM disclosures reflects the structural characteristics of the Bosnian-Herzegovinian audit environment rather than the nature of audited entities. A comparison with Hladika et al. (2021) shows that, since the introduction of ISA 701 in Bosnia and Herzegovina, the average number of disclosed KAMs per audit report has not increased. Given these findings, it is difficult to expect significant growth in future periods.

The results of this study indicate the absence of statistically significant differences in the number of disclosed KAMs across most non-financial industry sectors, which supports the conclusion that KAM reporting practices do not sufficiently reflect sector-specific risks. Instead, the uniformity of disclosures suggests that auditors tend to apply a standardised approach to reporting KAMs across different industry sectors. This pattern indicates that auditors fulfil the formal requirement to consider KAMs but do not fully utilise the flexibility offered by ISA 701 to reflect the specific characteristics of individual audited entities arising from their industry affiliation. As a result, KAM disclosures do not always capture all operational and accounting risks inherent to particular industry sectors, thereby reducing the informational value that such disclosures could provide to users of financial statements.

This study found that Big 4 audit firms disclose more KAMs than non-Big 4 firms. However, the higher average number of disclosed KAMs is attributable solely to the consistent practice of reporting only one KAM, rather than to the provision of broader or more detailed insights into audit risks specific to individual audited entities. Such behaviour reflects a strategy of minimal compliance rather than a genuine risk-responsive reporting model. By consistently providing a single KAM, regardless of the complexity of the audited entity, Big 4 audit firms reduce their exposure to litigation and reputational risk and avoid potential conflicts with management, while simultaneously adhering to the procedural requirements set out in ISA 701. This pattern questions the commonly held belief that Big 4 audit firms deliver higher-quality and more information-rich audit reports compared to their non-Big 4 counterparts.

Regarding the content of KAMs, the results of this study are entirely expected. Auditors most frequently identify risks related to revenue recognition and the valuation of certain types of assets. Revenue has a direct impact on financial performance, meaning that even minor errors in its recognition can significantly alter the financial position of an entity. In certain industry sectors, determining when and in what amount revenue should be recognised involves significant judgement. Moreover, many asset categories require valuation estimates based

on assumptions related to discount rates, future cash flows, useful life, and similar inputs. The absence of active markets and the unreliability of market indicators further complicate the use of fair value. An inefficient legal system and underdeveloped corporate governance structures enable managers to engage in aggressive accounting practices aimed at increasing reported revenue, overstating assets, and delaying the recognition of asset impairments. Consequently, auditors consider revenue recognition and asset valuation to be particularly high-risk areas and include them as KAMs.

Although the intention of the standard setters was for KAM disclosures to provide information specific to the audited entity (IAASB, 2015b), this study shows that auditors more frequently include information specific to the industry sector in which the audited entity operates rather than to the audited entity itself. For audited entities belonging to the same industry sector, auditors often identify the same areas as KAMs, which is understandable given that sectoral characteristics influence the types of assets held, the nature of transactions performed, and the risks present in financial statements. However, auditors frequently also provide almost identical wording in their KAM descriptions for such audited entities, which indicates that they do not seek to include information that is specific to the individual audited entity. This practice reduces the informational value of KAM disclosures, even though formal compliance with ISA 701 is achieved. Moreover, this study shows that auditors most frequently report the same KAMs in two consecutive years, using almost identical descriptions. This indicates the persistence of business processes and accounting estimates, and therefore the stability of significant risks in business operations, as well as consistency in the application of audit procedures. At the same time, it also points to the use of a template-based approach to audit reporting.

The results of this study have several implications for regulators and the audit profession in Bosnia and Herzegovina. The persistently low number of disclosed KAMs, the similarity of their content, and the dominance of template-based reporting indicate that the intended communicative value of the audit report has not been fully achieved. Regulators may need to consider strengthening oversight mechanisms related to the application of ISA 701 and providing clearer guidance on how to identify matters of most significance in the audit of financial statements, particularly in industry sectors characterised by complex business transactions and subjective accounting estimates. Enhanced supervisory activities could help reduce the use of template-based KAM disclosures and ensure that KAMs reflect the specific characteristics of the audited entity. For the audit profession, the results highlight the need to improve the exercise of professional judgement and invest in auditor training focused on identifying and articulating risks specific to the audited entity. Increasing the quality and specificity of KAM disclosures could enhance the transparency of the audit process and improve user confidence in the audit report.

Although this study makes a significant contribution to understanding KAM disclosure practices in Bosnia and Herzegovina, certain limitations must be

acknowledged, as they may affect the interpretation and generalisation of the findings. The research sample consists solely of publicly available audit reports. While this sampling choice is justified for practical reasons, it introduces potential sample bias. Audited entities whose audit reports are not publicly available may differ from those included in the sample in terms of risk exposure or auditor selection, which limits the generalisability of the results. It is also important to note that publicly available information does not allow for the determination of the total number of entities subject to statutory audit in Bosnia and Herzegovina. Consequently, the exact proportion of listed companies within the overall population of audit-obliged entities cannot be estimated precisely, which should be considered when assessing the representativeness of the sample. Furthermore, the findings relate specifically to Bosnia and Herzegovina, whose legal, economic, and market environment may limit the applicability of the results to other countries or regions. The classification of areas most frequently identified as KAMs and the assessment of disclosure similarities may involve a certain degree of researcher subjectivity, despite the use of predefined categories. The application of descriptive statistics and non-parametric tests provides insight into patterns and differences between groups, but does not allow for the examination of causal relationships between variables. Finally, the analysed period covers only two consecutive years, which may be insufficient to capture long-term changes in KAM disclosure practices.

In light of these limitations, future research should extend the time horizon analysed in order to track trends and changes in KAM disclosure practices. Comparative studies involving multiple countries are also recommended. Furthermore, qualitative research that includes interviews with auditors would be valuable for gaining deeper insight into the reasons behind the selection of particular KAMs and the approaches used in formulating their descriptions.

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## IZVJEŠTAVANJE O KLJUČNIM REVIZIJSKIM PITANJIMA: SLUČAJ BOSNE I HERCEGOVINE

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*Prethodno priopćenje*

### Sažetak

*Ovaj rad istražuje primjenu Međunarodnog standarda revizije 701 (Komuniciranje ključnih revizijskih pitanja u izvješću neovisnog revizora) u Bosni i Hercegovini. Cilj istraživanja je utvrditi opseg i sadržaj objavljenih ključnih revizijskih pitanja (KRP) u revizorskim izvješćima društava koja kotiraju na burzi u Bosni i Hercegovini u 2022. i 2023. godini. Istraživanje je osmišljeno kako bi odgovorilo na pitanja koliko KRP u prosjeku objavljuju revizori u revizorskim izvješćima društava koja kotiraju na burzi u Bosni i Hercegovini, koja područja revizori najčešće identificiraju kao KRP, postoje li razlike u opsegu i sadržaju KRP ovisno o industrijskom sektoru, vrsti revizorske tvrtke koja provodi reviziju ili vrsti revizorskog mišljenja, izvješćuju li revizori o istim KRP u dvije uzastopne godine i koriste li iste ili različite objave vezane uz revizijske postupke kada izvješćuju o istim KRP u dvije uzastopne godine. Istraživanje je provedeno na uzorku revizorskih izvješća tvrtki čiji su vrijednosni papiri uvršteni na Banjalučku burzu i Sarajevsku burzu. Konačni uzorak sastoji se od 228 tvrtki, odnosno 456 revizorskih izvješća. Podaci potrebni za postizanje cilja istraživanja i odgovor na istraživačka pitanja prikupljeni su iz pojedinačnih revizorskih izvješća koja čine uzorak te obrađeni su korištenjem deskriptivne statistike i neparametrijskih testova (Kruskal-Wallis test i Mann-Whitneyjev test).*

*Rezultati istraživanja pokazuju da revizori u prosjeku otkrivaju 0,7 KRP po revizorskom izvješću. U većini revizorskih izvješća revizori su otkrili jedno ili nijedno KRP, dok su u relativno malom broju revizorskih izvješća objavljena 2 ili 3 KRP. Rezultati pokazuju da u svim sektorima revizori u prosjeku objavljuju mali broj KRP te da ne postoji statistički značajna razlika između broja KRP kod većine sektora. Statistički značajna razlika prisutna je između sektora financija i osiguranja i većine ostalih sektora. Revizorske tvrtke koje pripadaju skupini*

*„Velike četvorke“ u prosjeku otkrivaju veći broj KRP od revizorskih tvrtki koje ne pripadaju ovoj skupini. Revizori otkrivaju veći broj KRP kada izdaju nemodificirano revizorsko mišljenje. U okviru KRP, revizori najčešće ističu rizike povezane s priznavanjem prihoda, umanjnjem vrijednosti kredita i vrednovanjem dugotrajne imovine. U 94% slučajeva revizori su objavili ista KRP u dvije uzastopne godine, najčešće s istim ili neznatno izmijenjenim tekstom.*

**Ključne riječi:** *Ključno revizijsko pitanje, Revizorovo izvješće, Industrijski sektor, Revizorska tvrtka, Revizorsko mišljenje*

**JEL:** M41, M42