

Key Audit Matters in Independent Audit Reports in Azerbaijan

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Abstract. *This study examines the application, legal framework, and practical significance of Key Audit Matters (KAM) in independent audit reports in Azerbaijan. KAMs refer to areas in the financial statements where, according to the auditor's professional judgment, the risk of material misstatement is high and requires special attention during the audit process. In the first stage of the research, the place of the KAM concept in international standards (ISA 701), selection criteria, presentation formats in reports, and communication function are theoretically evaluated. Subsequently, the level of reflection of KAMs in reports is analyzed by examining Azerbaijani legislation, Azerbaijan Accounting Standards (AMS), IFRS compliance, and the practices of audit firms operating in the country. In the study, sample independent audit reports from different sectors are compared; types of KAMs concentrated especially in the banking, insurance, oil and gas, and manufacturing sectors are identified. The findings indicate that Key Audit Matters (KAM) implementation in Azerbaijan is generally compliant with international requirements, but needs improvement in terms of the depth of disclosure, risk justification, and user-oriented information presentation. The research offers recommendations for increasing transparency in the country's audit practice, strengthening auditor-stakeholder communication, and deepening international integration.*

Keywords: *independent audit, Key Audit Matters (KAM), audit reports, ISA 701, financial reporting, Azerbaijan audit system*

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Azərbaycanda müstəqil audit hesabatlarında əsas audit məsələləri

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Xülasə. *Bu tədqiqatda Əsas Audit Məsələlərinin (KAM) Azərbaycanadakı müstəqil audit hesabatlarında tətbiqi, hüquqi çərçivəsi və praktik əhəmiyyəti araşdırılır. KAM-lar maliyyə hesabatlarında auditorun peşəkar mühakiməsinə görə, əhəmiyyətli səhvlərin riskinin yüksək olduğu və audit prosesi zamanı xüsusi diqqət tələb etdiyi sahələrə aiddir. Tədqiqatın birinci mərhələsində KAM konsepsiyasının beynəlxalq standartlarda (ISA 701) yeri, seçim meyarları, hesabatlarda təqdimat formatları və kommunikasiya funksiyası nəzəri olaraq qiymətləndirilir. Daha sonra, KAM-ların hesabatlarda əks olunma səviyyəsi Azərbaycan qanunvericiliyi, Azərbaycan Mühəsibat Uçotu Standartları (AMS), BMHS uyğunluğu və ölkədə fəaliyyət göstərən audit firmalarının təcrübələri araşdırılaraq təhlil edilir. Tədqiqatda müxtəlif sektorlardan nümunə müstəqil audit hesabatları müqayisə edilir; xüsusilə bank, sığorta, neft və qaz və istehsal sektorlarında cəmləşmiş KAM-ların*

növləri müəyyən edilir. Nəticələr göstərir ki, Azərbaycanda Əsas Audit Məsələlərinin (KAM) tətbiqi ümumilikdə beynəlxalq tələblərə uyğundur, lakin açıqlama dərinliyi, risklərin əsaslandırılması və istifadəçi yönümlü məlumatların təqdimatı baxımından təkmilləşdirməyə ehtiyac var. Tədqiqat ölkənin audit təcrübəsində şəffaflığın artırılması, auditor-maraqlı tərəflər arasında ünsiyyətin gücləndirilməsi və beynəlxalq integrasiyanın dərinləşdirilməsi üçün tövsiyələr təqdim edir.

Açar sözlər: *Müstəqil audit, Əsas Audit Məsələləri (KAM), audit hesabatları, ISA 701, maliyyə hesabatı, Azərbaycan audit sistemi*

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Introduction

The rapid development of global capital markets has significantly increased the expectation of transparency and accountability in corporate operations (Bozan, 2017). In particular, the need for accurate, reliable, and comparable financial information by investors, creditors, regulatory bodies, and other stakeholders has made independent auditing an integral part of the modern economic system (Mirzayeva, 2019). The main purpose of independent auditing is to provide reasonable assurance that financial statements have been prepared in accordance with international accounting standards and to increase the reliability of financial information (Alshdaifat, 2023). However, one of the fundamental requirements of today's corporate governance understanding is that the audit report should not be merely a short document "reported at the meeting," but rather a more informative, detailed, and user-oriented structure (Alshdaifat, 2023).

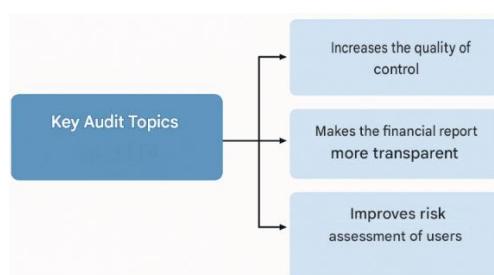
In this context, ISA 701 - Reporting of Key Audit Matters, published by the International Auditing Standards Board (IAASB), has initiated a new communication phase in audit reports. Key Audit Matters (KAM) refer to areas in the audit process that require the most attention, carry a high risk of material misrepresentation, and are critical to users of financial statements as a result of the auditor's professional judgment (IFAC, 2017). Through KAM implementation, audit reports have become more transparent, information asymmetry between auditors and users of financial statements has decreased, and trust in the financial reporting process has increased. In this context, KAM is not only an indicator of audit quality but also an integral part of a good governance mechanism (Dogan Bozan, 2017).

Methods

This study aims to reveal how and to what extent MCs (Certified Audit Reports) are applied in independent audit reports in Azerbaijan, to what extent the selection criteria comply with international standards, and to what extent the presentation formats meet the needs of users. Furthermore, it aims to provide a more objective assessment of the current state of the country's audit system through the analysis of MC types in different sectors and their comparison with international examples (Bozan, 2017). The results of this study offer practical and theoretical recommendations that will contribute to increasing audit transparency, improving audit quality, and strengthening integration with international practices in Azerbaijan (Mirzayeva, 2019).

Results

In today's environment, where global capital markets are active and investor behavior is based on more rational information, independent auditing has become one of the fundamental elements of trust in the economic system (Chamber of Auditors of the Republic of Azerbaijan, 2022). As the need for transparency, accuracy, and comparability in financial reporting processes has increased, the scope of audit reports has also changed, moving beyond the traditional "auditor's opinion" structure (Mirzayeva, 2019). In this context, ISA 701 – Reporting of Key Audit Matters (KAM), published by the International Auditing Standards Board (IAASB), has made audit reports more information-oriented and user-focused (Bozan, 2017). Thanks to the KAM application, the auditor is obliged to disclose the areas they consider most important in the audit process and the areas where the risk of material error is high; this improves the quality of the audit process and allows users of financial statements to assess risks more accurately (World Bank, 2019). International studies show that the KAM application improves audit quality, makes financial reporting more transparent, and enhances the level of information for investors (SGC Azerbaijan, 2020).



Scheme 1

The effects of key audit matters on the audit process

Source: Compiled by the author.

In Azerbaijan, the legal basis for independent auditing activities is established by various normative regulations (Azercosmos, 2025). In this context, the Law "On Auditing Activities" constitutes the basic legal framework ensuring that audit processes are conducted in accordance with professional standards (Bozan, 2017). Furthermore, the mandatory application of Azerbaijan Accounting Standards (AMS), which form the basis for financial reporting in the country, and IFRS, which strengthens international harmonization, are of great importance in terms of the transparency and comparability of financial information (Azergold, 2024). In addition, the adoption of International Auditing Standards (ISA) by auditing firms ensures the consistent use of global methodologies and practices in auditing processes (Auditing Committee Effectiveness and Key Audit Matters, 2020).

Table 1
Most Frequently Reported Key Audit Issues (KAM) by Sector in Azerbaijan)

Sector	Key Audit Matters (KAM)	Description
Banking	- Impairment of loan portfolio (IFRS 9) – Classification of non-performing loans – Risk-weighted asset calculations – Recognition of interest income – Discounting calculations	Due to the risk-focused nature of the banking sector, calculations are highly forward-looking and sensitive to economic variables, making KAM disclosures the most frequent in this sector.
Insurance	- Technical provisions calculations – Estimation of claim files – Accuracy of actuarial assumptions – Financial effects of reinsurance transactions	In this sector, where estimation models are extensive, actuarial calculations require significant professional judgment, leading to a high intensity of KAM.
Oil & Gas	- Asset impairment tests – Accuracy of reserve estimates – Accounting for production-sharing agreements – Financial share calculations in joint operations	Due to oil price fluctuations, reserve estimations, and complex agreements, this sector is strategically important regarding KAM.
Manufacturing & Industry	- Inventory valuation – Cost calculation methods – Depreciation policies – Impact of raw material price fluctuations	Since cost calculations and inventory valuations directly affect financial performance, these matters are frequently reported as KAM.

Source: Compiled by the author.

When identifying Key Audit Matters (KAMs), the internationally accepted ISA 701 standard serves as a guide. According to this standard, areas that carry a significant risk of material misstatement, are based on complex estimation processes, and require intensive discussion between management and the auditor should be identified as KAMs. While compliance with these criteria is generally observed in Azerbaijani practices, the disclosures appear to be more limited compared to international examples. In particular, there are shortcomings in the justification of risks and the detailing of audit procedures. The lack of explanation of technical terms used in audit reports, the failure to fully provide user-focused information, and the superficial expression of auditor procedures reduce the effectiveness of the reports. These shortcomings highlight areas for improvement in KAM reporting in Azerbaijan (Alshdaifat, 2023).

Compared to international practices, the depth of KAM disclosures in Azerbaijan, the clear expression of risks, the scope of auditor procedures, the level of transparency, and user-focused aspects show room for improvement. In developed countries, in particular, KAM disclosures not only indicate risk areas but also detail the procedures followed by the auditor, the findings obtained, and the management's views. This approach makes audit reports much more useful for investors. In Azerbaijan, however, most KAM disclosures still consist of standard statements and are limited in terms of detail.

Discussion and Conclusion

This study systematically assessed the state of Key Audit Matters (KAM) application in independent audit reports in the context of Azerbaijan. The analysis revealed that KAM application is widely adopted and implemented in the country, particularly by large companies and the Big 4 audit firms operating in accordance with international standards. The main KAM focus areas were identified in

the banking, insurance, oil and gas, and manufacturing sectors, indicating their relevance to the risk profiles of these sectors. In the banking sector, impairment of loan portfolios, classification of non-performing loans, and accounting for interest income; in the insurance sector, actuarial calculations and technical payments; in the oil and gas sector, accurate valuation of reserves and accounting rules for production sharing agreements; and in the manufacturing and industrial sectors, inventory valuation and depreciation policies emerged as the most common KAM areas.

The study shows that Azerbaijan generally complies with the ISA 701 standard in KAM application, but that some areas require improvement. In particular, there is a lag compared to international practices in the areas of detailed risk disclosure, interpretation of auditor procedures, and user-oriented information presentation. International comparisons show that in developed countries, KAMs are not limited to merely stating risk areas, but also include the procedures applied by the auditor, the results obtained, and the management positions. This is an important indicator for making KAM disclosures more useful and informative in the Azerbaijani context.

The results of the study show that further development of KAMs in the Azerbaijani audit system can provide the following advantages:

Information asymmetry between auditors and users of financial statements will be reduced;

Transparency regarding companies' risk management and internal control mechanisms will be increased;

Compliance and integration with international standards will be strengthened;

Audit reports will be made user-oriented, clear, and practically usable.

Therefore, although Azerbaijan has made significant progress in terms of KAM implementation, the depth of reports containing detailed risk disclosures and procedural explanations should be increased.

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