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The Impact of Company Financial Performance and Audit Fees on the Disclosure of Key Audit Matters (KAM)

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ABSTRACT

Key Audit Matters (KAM), recently mandated by ISA 701, aim to enhance audit transparency by addressing critical audit areas. This study provides empirical evidence on the impact of financial performance and audit fees on KAM disclosures. Furthermore, it categorizes KAM into two risk levels: Entity-Level Risk (ELRKAM) and Account-Level Risk (ALRKAM). The data analyzed consist of 1,080 firm observations listed on the Indonesia Stock Exchange (IDX) for the period 2022-2023. The researchers conducted panel data regression analysis using EViews 12.0. The findings reveal that financial performance has no significant impact on the overall KAM or ELRKAM disclosures but does affect ALRKAM. This indicates that auditors focus more on specific risk areas rather than on overall financial performance. On the other hand, we find that audit fees positively influence the disclosure of overall KAM and ELRKAM, but they have no effect on ALRKAM. These results suggest that higher audit fees contribute to enhanced transparency regarding overall risks but do not necessarily affect the disclosure of specific account-level risks.

Keywords: Financial performance; audit fee; key audit matter.

INTRODUCTION

An audit report serves as a crucial source of information for investors [62] and other external stakeholders [23]. It represents the auditors' final output, reflecting their responsibility to disclose matters deemed significant in the company's financial statements [38] and to be accountable for any consequences arising from these reports [50]. However, the traditional audit report format has proven insufficient and often inadequate, as it provides limited valuable information [8, 23, 52]. In response to these shortcomings, the company has expanded the audit report format to encompass significant aspects of its financial reporting. This expansion aims to improve transparency [30], reduce information gaps [54], and improve the quality and relevance of audit reports [60], thereby meeting public demands for more meaningful and detailed information [39].

International Standard on Auditing (ISA) 701, issued by the IAASB in 2015, emphasizes the auditor's responsibility to communicate Key Audit Matters (KAM) [23]. Indonesia recently adopted ISA 701, which became effective on January 1, 2022, through SA 701 [35]. This new audit report format was introduced to respond to criticisms regarding the homogeneity of audit reports, which often lack specific information about the opinions and assessments of the audited company [3, 6, 12, 13]. The disclosure of KAM allows financial statement users to gain a more comprehensive understanding of audit-related issues [50] and access relevant information [33, 35]. Additionally, the implementation of KAM aims to improve the audit quality [7, 49] and provide greater transparency for financial statement users [25]. This transparency helps users better understand the company's inherent risks [62] and the significant considerations made by management [39].

From the auditor's perspective, KAM can enhance their understanding of the audited company, as well as their accountability and professional skepticism [6, 23, 42], while also helping to reduce the audit expectation gap [36, 50]. Furthermore, the disclosure of KAM prompts auditors to devote additional attention to key audit risks [22] and may increase their responsibility by requiring the disclosure of more detailed information [30].

A study by [52] analyzed the determinants of various types of KAM reported based on their risk characteristics, specifically entity-level risk key audit matters (ELRKAM) and account-level risk key audit matters (ALRKAM). The findings indicate that companies paying higher audit fees tend to have more ELRKAM and fewer ALRKAM [52]. Audit fees are often associated with higher client risk [43] and reflect the time and resources required to perform an audit. As client risk and the complexity of the audited company increase,

auditors must invest more effort, resources, and time to complete the audit and issue the audit report. This results in higher audit fees for the company [8, 30]. Consequently, auditors may perform more extensive procedures and apply greater scrutiny, which can lead to increased reporting of KAM.

In addition to audit fees, financial performance is another factor influencing the extent of KAM disclosure. Financial performance is often associated with a company's profitability, which is typically linked to its going concern. Lower profitability increases the likelihood of the company receiving a going concern opinion [15]. Larger companies with strong liquidity, high profitability, or significant losses during the year tend to disclose more ELRKAM [52]. Auditors of less profitable companies with greater operational risks may face increased pressure to disclose KAM to maintain their independence [15]. Furthermore, companies with lower profitability face a higher risk of failure, leading auditors to expand the scope of their work and disclose more KAM [43]. However, a study by [55] suggests that financial performance does not significantly influence KAM disclosure.

This study seeks to address whether the level of audit fees paid by a company and its financial performance will influence the number and type of KAM disclosed by the auditor. This study is unique because it looks at how audit fees and financial performance affect the disclosure of KAM, specifically divided into ELRKAM and ALRKAM, in Indonesia. While the use of KAM in audit reports has been adopted in several countries, Indonesia only implemented KAM after the Indonesian Institute of Certified Public Accountants (IAPI) issued SA 701, titled "Communicating Key Audit Matters in Independent Auditor Reports," on July 13, 2021. This standard became effective for audits conducted on or after January 1, 2022. The relatively recent implementation of KAM in Indonesia has resulted in limited research on this topic, particularly concerning the factors influencing KAM disclosure. To fill this gap, this study looks at how audit fees and financial performance might affect KAM disclosure, especially focusing on the differences between ELRKAM and ALRKAM in Indonesia.

Literature Review

ISA 701 Implementation in Indonesian Context

The implementation of ISA 701 in Indonesia marks the beginning of a new direction that has the potential to add value for issuers, enhance investor confidence in the financial reporting process, and meet regulatory expectations. According to a study by [26], the first-year implementation of ISA 701 can be regarded as notably successful. This is evident from the fact that 98.4% of firms have included KAM paragraph in their annual report, and 99% of firms have communicated KAM in compliance with ISA 701. Reports also indicate that the number of KAM disclosures varies from zero to six, with an average of 1.3. This figure is comparable to that of Thailand, where the number of KAM disclosed ranges from zero to five, with a mean of 1.92. [45]

[26] examined the first-year implementation of ISA 701 and noted several important points from discussions with stakeholders, auditors, and audit committees. Surveys and interviews with different stakeholders showed that there has been better communication between auditors and those in charge of governance (TCWG), especially the audit committee, about risk areas and the audit steps taken to address them.

From stakeholders' standpoint, although they acknowledge the benefits of KAM in assisting with the identification of company risks during the initial stage, they do not rely solely on it as a tool for making comprehensive assessments. Instead, KAM facilitates the risk identification process, accelerates the assessment, and serves as a point of comparison for previous assessments. Next, the readability of the KAM is a concern, particularly during the first year, due to the complexity of the language used, which may result in difficulties in understanding it. Stakeholders expect that language used in communicating KAM can be simplified, as not all stakeholders possess an accounting background. This finding is consistent with the work of [2], which highlights that selecting the appropriate language for communicating and discussing the determination of KAM presents a challenge for auditors.

The auditors acknowledge that the KAM disclosure increases audit time due to the additional attention and effort required. Auditors encounter several challenges, including selecting the most significant audit issues to be included in the KAM, educating and reassuring clients about the importance of communicating KAM for both the company and financial statement users, and persuading management to accept the KAM disclosed by the auditors. This aligns with the findings of [2], which emphasizes the importance of aligning perceptions between auditors and those charged with governance (TCWG). Lastly, the majority of audit committee respondents believe that the KAM disclosure adds value for financial statement users in their decision-making processes, and the benefits of disclosing KAM outweigh the associated costs for the company.

Agency Theory

Agency theory, first introduced by [27], addresses conflicts of interest between agents (management) and principals (shareholders), which can result in an expectation gap [4]. It defines the agency relationship as a contract in which principals delegate decision-making authority to agents. However, due to information asymmetry and differing motives between management and shareholders, aligning their interests becomes necessary. Typically, incentives and monitoring costs achieve this alignment [27]. One form of monitoring costs is the engagement of external auditors to ensure that management acts in accordance with the principals' interests.

The purpose of audits is to mitigate conflicts between principals and agents. However, the expectation gap can compromise their effectiveness, leading to dissatisfaction with the audit process. As defined by [44], the expectation gap arises from differences between what financial statement users expect from auditors and what auditors can reasonably provide. This gap is categorized into two types: the reasonableness gap, which reflects unrealistic public expectations, and the performance gap, which occurs when auditors fail to meet expected standards [33, 43]. The performance gap is further divided into two subcategories: the deficient standards gap, which refers to discrepancies between auditors' responsibilities as defined by regulations and social expectations, and the deficient performance gap, which refers to differences between actual auditor performance and societal expectations [34, 44].

The disclosure of KAM aims to reduce the expectation gap by enhancing transparency regarding the scope and limitations of external audits, allowing stakeholders to better understand the company's inherent risks and key management considerations [23, 59]. KAM also makes audit reports less generic and more customized to each company, thereby improving stakeholder trust [17]. However, the disclosure of KAM may lead to higher audit fees due to the increased responsibilities and complexities involved [18]. Additionally, auditors of higher-risk and less profitable companies may feel pressured to disclose more KAM to uphold their independence [17].

Key Audit Matters (KAM)

According to SA 701 (2021), KAM refers to issues identified through audit findings that have been communicated to those charged with governance. These issues are selected based on the auditor's professional judgment and are deemed the most significant in the audit of the current period's financial statements. SA 701 (2021) outlines key factors auditors must evaluate when determining the most significant matters in an audit. These factors include areas that are more likely to have important errors, important auditor thoughts about management decisions, and the effects of major events or transactions that happened during the audit period.

The disclosure of KAM increases the auditor's responsibilities, requiring enhanced professional skepticism and experience to make sound professional judgments [5, 19]. KAM can represent risks at both the entity and account levels, categorized into ELRKAM and ALRKAM [29]. ELRKAM addresses issues that affect the entire company, such as tax risks or regulatory litigation, while ALRKAM focuses on risks related to specific accounts, such as revenues or asset impairments [52]. ELRKAM provides a broader perspective on the company's financial health, whereas ALRKAM highlights risks tied to individual accounts [10].

Financial Performance

Profitability, liquidity, and solvency (leverage) ratios are crucial indicators of a company's financial health [10]. A company is deemed financially healthy when it demonstrates high profitability and liquidity ratios alongside low solvency (leverage) ratios. Liquidity ratios assess a company's ability to meet its short-term obligations. A high liquidity ratio indicates that the company possesses sufficient current assets to cover its short-term debts. However, an excess of current assets can reduce profitability, while insufficient assets may lead to financial difficulties [37]. Therefore, effective management of current assets and short-term liabilities is critical to minimizing the risk of default [37].

Solvency (leverage) ratios assess the extent to which a company's assets are financed through debt, particularly long-term debt, and significantly influence the company's financial performance [1]. A higher leverage ratio indicates a greater reliance on debt to finance investments, which increases financial risk. From an auditor's perspective, highly leveraged companies are deemed riskier and are more likely to receive a going-concern modification in their audit opinion prior to a potential failure [61].

Financial performance is often linked to a company's profitability, with Return on Assets (ROA) serving as a key measure. ROA evaluates a company's ability to generate net income from its total assets [58, 63]. It is commonly used by management to assess how effectively and efficiently

the company utilizes its resources. A higher ROA signifies greater efficiency, indicating that the company generates more profit from the same amount of resources. We calculate ROA by comparing the company's net profit after tax to its total assets.

Audit Fees

Audit fees, or compensation, refer to the payments received by public accountants from their clients for audit services rendered [24]. These fees represent the economic costs or expenses incurred by auditors in performing their duties efficiently [53]. Higher audit fees are often associated with higher-quality audit reports, as companies tend to prefer audit firms known for high-quality reporting [53].

Several factors influence audit fees, including company size, the complexity of business operations, company risk, and other characteristics of the audited entity [20, 53]. These factors act as supply-side variables for audit fees, reflecting the costs and effort involved in the audit process [20]. Auditors aim to minimize total costs by balancing the resources required for additional audit work and the potential risks of future legal liability [11]. However, excessively low audit fees can create conflicts of interest and lead to non-compliance with professional ethics, highlighting the need for adequate fees to ensure proper audit procedures [24].

As organizational performance deteriorates, audit risk increases, resulting in higher expected audit fees [20]. Additionally, audit effort, measured by the time auditors spend performing their duties, significantly impacts audit fees [38]. When a company's financial risk increases, auditors typically conduct more thorough reviews, increasing effort and associated costs [40].

Financial Performance and Key Audit Matters (KAM)

Profitability, liquidity, and solvency (leverage) ratios are key indicators of a company's financial health [10]. Profitability, in particular, is often associated with the company's long-term viability [10, 17]. Negative profitability ratios are a key indicator of financial distress and low profitability ratio signal financial difficulties [31]. Auditors must remain vigilant to the potential for company failure, providing additional attention to high-risk matters by identifying and disclosing KAM in the audit report [17, 43]. For companies with high financial risk, auditors tend to disclose more KAM to mitigate liability and protect their professional reputation [43]. Moreover, large companies with high profitability levels disclose more KAM due to the complexity of their business operations [21]. In contrast, a study by [52] found that companies with high profitability levels typically issue fewer KAM [52, 62]. Based on these findings, the following hypothesis is proposed to test the relationship between financial performance and the disclosure of KAM:

H_1a: Financial performance influences the disclosure of KAM.

The disclosure of KAM based on risk type offers valuable insights into a company's financial difficulties. When auditors issue audit reports aligned with the company's risk level, factors reflecting material misstatement risks disclosed as KAM can inform users about elements contributing to the assessment of the client's financial challenges. Consequently, KAM disclosures highlight risks that impact the financial statements as a whole (ELRKAM) or those related to specific accounts (ALRKAM) [12]. ELRKAM tends to have a strong association with higher levels of financial difficulty [10], serving as an indicator of an increased likelihood of a company's bankruptcy [18]. Based on these findings, the following hypothesis is proposed to test the relationship between financial performance and the disclosure of ELRKAM:

H_1b: Financial performance influences the disclosure of ELRKAM.

ALRKAM is associated with a company's profitability and solvency [10]. At the account level, key areas frequently disclosed include revenue recognition, as it directly impacts profitability. Auditors focus on this area to ensure that the reported revenue and profitability accurately represent the company's economic reality. Conversely, when profitability declines, the company may face increased scrutiny regarding asset valuation and impairment assessment. This often leads auditors to flag such areas as KAM due to the heightened risk of impairment. Moreover, ALRKAM is particularly effective in detecting risks that directly affect components of the company's financial viability [10]. Based on these findings, the following hypothesis is proposed to examine the relationship between financial performance and the disclosure of Account-Level Risk Key Audit Matters (ALRKAM):

H_1c: Financial performance influences the disclosure of ALRKAM.

Audit Fees and Key Audit Matters (KAM)

The disclosure of KAM, introduced as part of a new audit report format, enhances transparency in

audits [25, 30]. Additionally, KAM disclosure encourages auditors to focus more closely on key audit risks [22], thereby increasing their responsibility [19], accountability, and professional skepticism [5, 31, 42]. This practice also helps reduce conflicts of interest and information asymmetry [60], while narrowing the reasonableness gap by providing stakeholders with better insights into the scope and limitations of external audits [59]. Prior research by [43] and [30] suggests a positive relationship between audit fees and the number of KAM disclosures. Companies paying higher audit fees may have more areas requiring auditor attention, leading to increased KAM disclosure. Furthermore, companies with higher audit fees are more likely to disclose a greater number of ELRKAM and fewer ALRKAM [52].

According to [52], larger, riskier, or more complex companies generally incur higher audit fees, although their business complexity may be concentrated in a few accounts within the financial statements. This is because entity-level risks tend to be broader and more impactful, encompassing governance issues, financial distress, and technological disruption, which affect the organization as a whole. In contrast, account-level risks pertain to specific financial items. Notably, ELRKAM disclosures are often more complex than ALRKAM due to the inherently broader scope of entity-level risks [16].

Similarly, auditors dedicate considerable attention to risks associated with various accounts, particularly those prone to misstatement. This often necessitates extensive audit procedures, including detailed testing of accounting estimation and the involvement of specialists. Based on these findings, the following hypotheses are proposed to explore the effect of audit fees on KAM disclosures, divided into three parts: overall KAM, ELRKAM, and ALRKAM:

H_2a: Audit fees have a positive influence on the disclosure of KAM.

H_2b: Audit fees have a positive influence on the disclosure of ELRKAM.

H_2c: Audit fees have a positive influence on the disclosure of ALRKAM.

RESEARCH METHOD

Data and Sample

KAM was effectively implemented for companies listed on the Indonesia Stock Exchange (IDX) starting January 1, 2022. Therefore, this study utilized annual reports from companies listed on the IDX for the years 2022-2023. The research data, as summarized in Table 1, includes companies that met the specific criteria for testing. The total number of company-years listed on the IDX during this period is 1,742. After applying purposive sampling, we obtained a final sample of 540 companies per year, or 1,080 company-years. A total of 95 companies were excluded from the sample because they did not publish annual reports and were under special monitoring by the Stock Exchange.

Table 1. Description of the Research Sample

Sample Criteria	2022	2023	Firm-Year
Firms listed on the IDX	840	902	1742
Firms that did not publish annual reports	(33)	(62)	(95)
Missing Data	(267)	(300)	(567)
Final observations	540	540	1080

Source: www.idx.co.id

Table 2 presents the total number of KAM disclosures by sector for the 2022-2023 period. The findings reveal significant variation in KAM disclosures across sectors, suggesting that the complexity and perceived risks inherent to different industries influence the extent of KAM reporting. The financial sector comprises the largest number of firms (162) and has the highest total KAM disclosures (228). This dominance likely reflects the complex regulatory and risk environment of financial institutions, which require more detailed disclosures. Conversely, the technology sector disclosed only 50 KAM across 42 firms, with minimal ERL KAM (2). This could reflect simpler reporting structures or underestimation of risks within the sector.

Table 2. Number of KAM Disclosures by Sector

Sector	Firms	ERL KAM	ALR KAM	KAM
Financials	162	25	203	228
Consumer non-cyclicals	160	9	178	187
Consumer Cyclicals	156	11	189	200
Basic Materials	126	13	154	167
Properties and Real Estate	108	4	123	127
Energy	96	19	109	127
Infrastructures	86	29	99	128
Industrials	48	6	75	81
Healthcare	48	3	73	76
Transportation and Logistic	48	7	59	66
Technology	42	2	48	50
Total	**1080**	**127**	**1310**	**1437**

Table 3 further illustrates that firms within the same sector do not necessarily disclose the same number of KAM. The number of KAM disclosures within a single industry range from 0 to 6, a pattern consistent with international contexts such as Thailand in their first-year KAM implementation

(45). This variability highlights the role of auditors' professional judgment in determining KAM disclosures, suggesting that the identification of significant risks is not solely industry-specific but also influenced by firm-specific factors, similar to a study of (45).

Table 3. Average Number of KAM Disclosures by Sector

Sector	Avg. Number of KAM/Firms	Highest Number of KAM	Lowest Number of KAM
Industrials	1.69	5	0
Healthcare	1.58	6	1
Infrastructures	1.49	4	0
Financials	1.41	4	1
Transportation and Logistic	1.38	4	1
Basic Materials	1.33	4	0
Energy	1.32	5	0
Consumer Cyclicals	1.28	4	0
Properties and Real Estate	1.18	4	0
Consumer non-cyclicals	1.17	4	0
Technology	1.19	3	0
Total	**1.33**	**6**	**0**

From the 1,080 observations, the total number of KAM disclosures during 2022-2023 amounted to 1,437, reflecting a 2.11% increase from 711 in 2022 to 726 in 2023, as shown in Table 4. Furthermore, the table indicates that ALRKAM is the most frequently disclosed type of KAM in this study, comprising 91.16% of cases, compared to ELRKAM, which accounts for only 8.84%.

The most frequently reported ALRKAM categories include assets and receivables (28.60%), revenue recognition (19.97%), and property, plant, and equipment along with related impairment issues (13.08%). Among these, assets and receivables constitute the most commonly reported account-level risk by auditors. This prominence is closely associated with the implementation of PSAK 71 in 2020, which introduced the Expected Credit Loss (ECL) model for financial assets, including financing receivables. The high reporting frequency of this category is particularly evident within the financial sector, reflecting the significant impact of PSAK 71 on risk assessments and disclosures.

Other areas, revenue recognition, and property, plant, and equipment-related impairment issues are also closely linked to management judgment and are considered high-risk [46], requiring special attention from auditors. This finding aligns with the notion that income-smoothing practices are often executed through discretionary accounting changes (DAC), such as changes in capitalization or expensing policies, modifications in depreciation or amortization methods, revisions to the estimated useful lives of property, plant, and equipment, and changes in income recognition methods [56]. Meanwhile, information and technology (1.88%), tax (1.74%), acquisition and merger (1.53%), and provision (1.74%) are the most frequently reported of ELRKAM categories.

Table 4. KAM Classification and Disclosures

KAM Classification	Number of KAM Disclosures			
	2022	2023	Total	%
ELRKAM				
Information and Technology (IT)	13	14	27	1.88
Tax	17	8	25	1.74
Acquisition and Merger	14	8	22	1.53
Provision	11	11	22	1.53
Business Combination	5	8	13	0.90
Accounting for Non-Controlling Interest	3	1	4	0.28
Going Concern	2	2	4	0.28
Change in Currency	2	0	2	0.14
Dilution of Investment in Subsidiary	2	0	2	0.14
Financial Instrument Measurement	1	1	2	0.14
Litigation	1	0	1	0.07
Internal Control	0	1	1	0.07
Sale of Shares	1	0	1	0.07
Ownership of Subsidiary				
Distribution of Bonus Share	0	1	1	0.07
Subtotal	**72**	**55**	**127**	
ELRKAM	**5.01%**	**3.83%**	**8.84%**	
ALRKAM				
Asset and Receivable	196	215	411	28.6
Revenue Recognition	132	155	287	19.9
Property, Plant, and Equipment and Related Impairment Issues	100	88	188	13.0
Inventory	79	87	166	11.5
Intangibles and Related Impairment Issues	44	41	85	5.92
Liabilities	25	26	51	3.55
Investments and Related Impairment Issues	22	28	50	3.48
Leases and Long-Term Debt	23	19	42	2.92
Accrual, Deferral, and Management Estimates	15	11	26	1.81
Expense Recognition	2	0	2	0.14
Supplier Rebates	0	1	1	0.07
Pension and Defined Benefit Plan Accounting	1	0	1	0.07
Subtotal	**639**	**671**	**1310**	
ALRKAM	**44.47%**	**46.69%**	**91.16%**	
Total KAM	**711**	**726**	**1437**	
	49.48%	**50.52%**	**100%**	

Source: www.idx.co.id; data processed by authors

Variables Measurement

Independent Variable

Financial Performance (ROA)

In this study, we measure the variable of financial performance with Return on Assets (ROA). ROA assesses a company's profitability, which refers to its ability to generate net income from its total assets [58, 63], and helps evaluate the overall financial health of the company [14]. One can formulate ROA in the following way:

$$ROA = \frac{Net\ Income}{Total\ Asset}$$

Audit Fees (FEE)

Audit fees refer to the compensation received by public accountants from their client entities for the audit services provided [24]. We include this variable because the disclosure of KAM, as a new audit report format, increases auditors' efforts. Therefore, we expect companies that pay higher audit fees to disclose more KAM [52]. Audit fees are measured using the natural logarithm (Ln) of the audit fees reported in the company's annual report [6, 20].

Dependent Variable

Key Audit Matters (KAM)

KAM refers to the total number of items disclosed in the KAM section of the audit report [51]. [51] classified KAM based on their risk levels into two categories: 1) ELRKAM includes the total number of KAM related to overall company risks, such as taxes, litigation/regulatory provisions, acquisitions, changes in accounting standards, internal controls, IT, and other entity-level risks; and 2) ALRKAM includes the total number of KAM related to risks associated with specific accounts in the financial statements, such as revenue, intangible assets, asset impairment, inventory, pension costs, and other account-level risks. We measure this variable by counting the number of ELRKAM, ALRKAM, and the total KAM disclosed in the audit report.

Control Variable

Public Accounting Firm Size (BIG4)

We classify public accounting firms into Big 4 and non-Big 4 firms. The Big 4 accounting firms include PwC, EY, Deloitte, and KPMG. Big 4 firms tend to pay more attention to litigation risk and disclose more KAM compared to non-Big 4 audit firms [56, 63]. We measure this variable using a dummy variable: 1 for companies audited by Big 4 firms and 0 for companies audited by non-Big 4 firms.

Auditor Gender (GENDER)

Females are generally considered more sensitive to risk and tend to make lower-risk decisions [9]. Female auditors are more likely to comply with rules and regulations and are known to possess higher moral values and ethical standards compared to their male counterparts [28]. Female audit partners tend to allocate more resources and effort to audits compared to their male peers [9]. Additionally, female auditors are more likely to disclose more KAM [62], and they disclose more ALRKAM and fewer ELRKAM compared to male audit partners [9]. We measure this variable using a dummy variable: 1 for female auditors and 0 for male auditors.

Firm Size (SIZE)

Company size is a key characteristic that influences audit fees [20, 53]. Larger companies, particularly those operating internationally or with subsidiaries, typically incur higher audit fees [30]. The more complex the company being audited, the greater the effort, resources, and time required by auditors to issue the audit report [52]. Larger, more complex, and higher-risk companies generally result in auditors disclosing more KAM [9]. Specifically, auditors tend to disclose more ELRKAM for larger companies and more ALRKAM for complex companies [9]. We measure company size using the natural logarithm (Ln) of the company's total assets.

Research Model

We formulate the following multiple linear regression equations to test how financial performance (ROA) and audit fee (FEE) impact the disclosure of KAM and the types of KAM based on their risk categories, as outlined in hypotheses 1 and 2.

$$KAM_{i,t} = \alpha + \beta_1 ROA_{i,t} + \beta_2 FEE_{i,t} + \beta_3 BIG4_{i,t} + \beta_4 GENDER_{i,t} + \beta_5 SIZE_{i,t} + e_1 \quad (1a)$$

$$ELRKAM_{i,t} = \alpha + \beta_1 ROA_{i,t} + \beta_2 FEE_{i,t} + \beta_3 BIG4_{i,t} + \beta_4 GENDER_{i,t} + \beta_5 SIZE_{i,t} + e_2 \quad (1b)$$

$$ALRKAM_{i,t} = \alpha + \beta_1 ROA_{i,t} + \beta_2 FEE_{i,t} + \beta_3 BIG4_{i,t} + \beta GENDER_{i,t} + \beta_5 SIZE_{i,t} + e_3 \quad (1c)$$

In this study, we use three regression model to test overall KAM (1a), ELRKAM (1b), and ALRKAM (1c).

RESULTS AND DISCUSSION

Descriptive Statistics

Descriptive statistics provide information on the maximum, minimum, mean, and standard deviation (SD) of each variable in this study. Table 5 presents the results as follows:

Table 5. Descriptive Statistics

	N	Min.	Max.	Mean	SD
ROA	1080	1.67	3612.43	3.3921	109.92149
FEE	1080	7.77	25.51	20.2686	1.33396
KAM	1080	0.00	6.00	1.3306	0.71330
ELRKAM	1080	0.00	3.00	0.1176	0.35249
ALRKAM	1080	0.00	6.00	1.2130	0.67870
SIZE	1080	7.98	35.32	28.6935	2.17084
BIG4	1080	0.00	1.00	0.3120	0.46354
GENDER	1080	0.00	1.00	0.1269	0.33296

The average ROA was 3.3921, with a standard deviation of 109.92149. The range of ROA is from 1.67 to 3612.43. The mean FEE was 20.2686, with a standard deviation of 1.33396, and the range was from 7.77 to 25.51. This suggests that most of the companies in the sample incurred relatively high audit fees.

Furthermore, the average number of KAM, ELRKAM, and ALRKAM disclosures were relatively small (1.3306, 0.1176, 1.2130, respectively), which implies that the overall number of KAM disclosures remains low. The range of KAM, ELRKAM, and ALRKAM disclosure varied from 0 to 6, indicating that some companies did not disclose any KAM, while others disclosed up to six items.

The average firm size (SIZE) was 28.6935, with a standard deviation of 2.17084, and they range from 17.98 to 35.32. This indicates that the sample predominantly consisted of small and medium-size companies. Additionally, the mean of public accounting firm size (BIG4) was 0.3120, with a standard deviation of 0.46354, showing that most companies were audited by non-Big4 firms. The mean of auditor gender (GENDER) was 0.1269, with a standard deviation of 0.33296, suggesting that male auditor partners were predominant.

Estimated Results of the Panel Data Regression Model

Chow Test

The Chow test was used to determine the best approach between the Common Effect Model (CEM) and the Fixed Effect Model (FEM) for estimating panel data. The Chow test results are shown in Table 4 below:

Table 6. Chow Test Results

Research Model	X^2	Selected Model
Model 1a	0.0000	FEM
Model 1b	0.0000	FEM
Model 1c	0.0000	FEM

Based on Table 6, the chi-square probability values (X^2) for models 1a (0.0000), 1b (0.0000), and 1c (0.0000) were all less than 0.05, indicating that the FEM is preferred over the CEM. Therefore, the Hausman test will be conducted for models 1a, 1b, and 1c.

Hausman Test

We use the Hausman test to identify the most suitable approach between FEM and the Random Effects Model (REM) for panel data estimation. Table 7 presents the results of the Hausman test.

Table 7. Hausman Test Results

Research Model	X^2	Selected Model
Model 1a	0.7922	REM
Model 1b	0.0128	FEM
Model 1c	0.3484	REM

Based on Table 7, the X^2 values for models 1a (0.7922) and 1c (0.3484) are greater than 0.05, which indicates that the REM is more suitable than FEM for these models. Therefore, we will conduct the Lagrange Multiplier test for models 1a and 1c. However, for model 1b (0.0128), since the value is less than 0.05, it can be concluded that the FEM is better than the REM. Therefore, model 1b will use the FEM for the panel data estimation.

Lagrange Multiplier Test

We use the Lagrange Multiplier test to determine the best approach between REM and CEM for estimating panel data. Table 8 presents he Lagrange Multiplier test results as follows:

Table 8. Lagrange Multiplier Test Results

Research Model	X^2	Selected Model
Model 1a	0.0000	REM
Model 1c	0. 0000	REM

Based on Table 8, the p-values for the chi-square tests of Models 1a (0.0000) and 1c (0.0000) are both less than 0.05, indicating that the REM is preferred over the CEM. Therefore, Models 1a and 1c will use the REM for estimating the panel data.

Results of Panel Data Regression Model Selection

Table 9 listed the models for panel data regression based on earlier tests like the Chow test, Hausman test, and Lagrange Multiplier test.

Table 9. Panel Data Regression Model Selection Results

Research Model	Selected Model
Model 1a	REM
Model 1b	FEM
Model 1c	REM

Panel Data Regression

Before conducting the panel data regression tests, multicollinearity and heteroscedasticity tests were performed. The results of the multicollinearity test for models 1a, 1b, and 1c indicate that all three models passed the test, as the coefficient values between independent variables were less than 0.85. Furthermore, the results of the heteroscedasticity test for Models 1a, 1b, and 1c showed that the leftover data points stayed between 5.00 and -5.00, which means the variation in the data is stable. Therefore, we can conclude that models 1a, 1b, and 1c do not exhibit any signs of heteroscedasticity.

Table 10. F-test Results

Research Model	F-value	P-value
Model 1a	6.171425	0.000012
Model 1b	3.536826	0.000000
Model 1c	2.841971	0.014766

Table 11. Research Model 1a Regression Results

Dependent Variable: KAM				
Variable	Coefficient	Std. Error	t-value	P-value
C	-1.393202	0.51191	-2.72155	0.0066
ROA	0.000143	0.00016	0.89019	0.3736
FEE	0.108201	0.03126	3.46113	0.0006
SIZE	0.020573	0.01712	1.20158	0.2298
BIG4	-0.227668	0.07281	-3.12683	0.0018
GENDER	0.086140	0.06894	1.24944	0.2118

Table 12. Research Model 1b Regression Results

Dependent Variable: ELRKAM				
Variable	Coefficient	Std. Error	t-value	P-value
C	-5.085089	1.530534	-3.322429	0.0010
ROA	-1.934640	0.000139	-0.139267	0.8893
FEE	0.100448	0.034180	2.938772	0.0034
SIZE	0.109947	0.046790	2.349813	0.0191
BIG4	0.011795	0.034614	0.340769	0.7334
GENDER	0.070369	0.057564	1.222443	0.2221

According to Table 10, the F-test results for models 1a, 1b, and 1c have p-values below 0.05, which means that the independent variables (ROA and FEE) and the control variables (SIZE, BIG4, and GENDER) have a significant impact on the dependent variables (KAM, ELRKAM, and ALRKAM) at the same time.

Tables 11, 12, and 13 present the regression results for models 1a, 1b, and 1c.

Table 13. Research Model 1ac Regression Result

Dependent Variable: ALRKAM				
Variable	Coefficient	Std. Error	t-value	P-value
C	0.123948	0.405781	0.305455	0.7601
ROA	0.000318	0.000154	2.059479	0.0397
FEE	0.016148	0.013444	1.201117	0.2300
SIZE	0.027730	0.013242	2.094040	0.0365
BIG4	-0.116662	0.043300	-2.694288	0.0072
GENDER	0.028410	0.066626	0.426409	0.6699

The Impact of Financial Performance on KAM, ELRKAM, and ALRKAM Disclosure

Table 11 shows the regression results for research model 1a, indicating that the financial performance does not affect the disclosure of KAM ($p > 0.05$). These results go against the studies by [43], [62], and [10], which say that there is a link between financial performance and KAM disclosure, where more profitable companies usually disclose fewer KAM. However, [10, 58, 62] argue that higher financial distress leads to more KAM disclosure. This study aligns with the findings of [55], which show that a company's financial performance does not influence overall KAM disclosure.

Table 12 presents the regression results for research model 1b, revealing that financial performance does not affect the disclosure of ELRKAM ($p > 0.05$). In contrast, Table 13 presents the regression results for research model 1c, showing that financial performance positively impacts the disclosure of ALRKAM ($p < 0.05$). This result suggests that the better a company's financial performance, the more ALRKAM disclosures are made. One argument suggests that auditors prioritize areas of significant risk over a company's financial performance alone. ALRKAM is linked to a company's profitability and solvency [10]. In this present study, we found that the highly profitable companies tend to disclose more ALRKAM, particularly related to revenue recognition.

As shown in Table 4, one of the most frequently reported ALRKAM relates to revenue recognition. This aligns with the notion that revenue recognition impacts earnings quality and reflects a company's true profitability [46, 48], as accurate revenue recognition provides reliable information [32]. Auditors focus on this area to ensure that the reported revenue and profitability accurately represent the economic reality and to help stakeholders understand key areas without

being misled by financial outcomes. In Indonesia, where governance practices vary widely across firms and industries, accurate revenue recognition is essential for ensuring the integrity of financial reports. High profitability might incentivize management to engage in earnings management to sustain positive results, increasing the importance of detailed ALRKAM disclosures. Auditors mitigate information asymmetry by providing stakeholders with reliable insights into revenue streams and profitability, consistent with agency theory's goal of reducing principal-agent conflicts.

The findings indicate that financial performance plays a critical role in shaping the communicative value of KAM disclosure in enhancing audit report quality. Auditors should prioritize transparency when disclosing KAM related to financial performance. This involves providing stakeholders with sufficient detail about the nature of the issue, the audit procedures performed, and the rationale behind the auditor's conclusions. For companies facing challenges related to financial performance, such as declining profitability or liquidity constraints, auditors can use KAM disclosures to provide greater insight into these issues. This may involve discussing the steps management has taken to address these challenges and how these actions were assessed during the audit.

The Impact of Audit Fees on KAM, ELRKAM, and ALRKAM Disclosure

Table 11 shows the regression results for research model 1a, finding that audit fees positively affect KAM disclosure ($p<0.05$). This suggests that the higher the audit fee, the more KAM are disclosed. This aligns with agency theory, which posits that higher monitoring costs, such as audit fees, reflect the increased efforts required to align management's actions with shareholders' interests. In Indonesia, where many firms have complex ownership structures, such as family ownership or government-linked companies, these monitoring costs can be higher to ensure transparency and accountability. These results are consistent with studies by [52], [43], and [30], which suggest that audit fees influence KAM disclosure. However, this contradicts the findings of [5], [8], [15], [19], and [49], which argue that audit fees do not significantly affect KAM disclosure.

The research also shows that audit fees do not fully influence the type of KAM disclosed based on their risk. Table 10 shows that audit fees positively affect the disclosure of ELRKAM ($p<0.05$), while Table 13 indicates that audit fees do not significantly affect the disclosure of ALRKAM ($p>0.05$). Put differently, a higher audit fee leads to a greater disclosure of ELRKAM, while audit fees do not influence the disclosure of ALRKAM. This is consistent with [52], which found that companies paying higher fees tend to disclose more ELRKAM. Larger, riskier, or more complex companies typically pay higher audit fees [52], as entity-level risks usually involve more extensive information about the company, such as governance and operational risk, unlike risks related to individual accounts in the financial statements.

High audit fees are often associated with higher-quality audit reports. A key indicator of a high-quality audit report is adherence to auditing standards, such as SA 701, which requires auditors to include KAM paragraphs. Additionally, auditors must provide clear and transparent disclosures to offer a fair presentation of the company's financial position and performance. The inclusion of KAM in the new audit report format results in longer and more detailed audit reports due to increased risk disclosure. This leads to higher audit efforts and fees because auditors have to disclose more information. Stakeholders may use this information to assess whether the audit fees reflect the company's risk profile, especially at the entity level, which could impact long-term sustainability.

The findings indicate that higher audit fees are associated with increased disclosure of ELRKAM but not ALRKAM. This suggests that auditors should prioritize a comprehensive assessment of entity-level risks, especially for larger or more complex companies. Auditors can improve report quality by ensuring that ELRKAM disclosures reflect the company's governance, operational, and strategic risks, offering stakeholders a more holistic view of the company's risk profile. Companies can use this relationship to justify audit fees to stakeholders, emphasizing how the additional resources contribute to higher-quality audit reports.

The Impact of Firm Size on KAM, ELRKAM, and ALRKAM Disclosure

Table 11 shows that firm size does not affect the disclosure of KAM ($p>0.05$). However, as seen in Table 12 and Table 13, the results show that company size positively affects the disclosure of both ELRKAM ($p<0.05$) and ALRKAM ($p<0.05$). This implies that larger and more complex companies disclose more ELRKAM and ALRKAM. This is consistent with the study by [9], which suggests that auditors disclose more ELRKAM for large companies and more ALRKAM for complex companies. Larger companies typically face higher risks, with more reportable segments and more complex operations,

making them more exposed to risks than smaller firms. As a result, auditors disclose more ELRKAM and ALRKAM according to the company's risk level.

The disclosure of KAM, ELRKAM, and ALRKAM is often associated with large companies. However, since the sample in this study spans from small to medium size, these factors also apply to small companies. While small firms may have simpler operations than large firms, they still face risks that can significantly impact their financial statements. Limited resources and technology in small companies can increase the risk of financial reporting errors. Thus, auditors may need to adjust their audit approach based on company size. For larger firms, auditors focus more on entity-level risks, such as governance, operational, and compliance risks, while for smaller firms, auditors pay special attention to specific account-level risks, such as inventory valuation or receivables management, as smaller firms may lack robust internal controls, increasing their susceptibility to account-specific risks.

The Effect of Public Accounting Firm Size on KAM, ELRKAM, and ALRKAM Disclosure

Table 11 shows that the size of a public accounting firm negatively affects KAM disclosure ($p<0.05$). This means that companies audited by Big 4 firms disclose fewer KAM than those audited by non-Big 4 firms. These findings contradict [56] and [61], which suggest that Big 4 firms disclose more KAM due to concerns about litigation risks. However, this study supports [41], which indicates that companies audited by non-Big 4 firms disclose more KAM. This could occur because non-Big 4 auditors disclose more KAM to enhance their credibility and avoid potential litigation costs. According to [47], there is a difference in the perceived importance of clients between Big 4 and non-Big 4 firms. Non-Big 4 auditors tend to invest more effort in key clients, possibly due to fewer clients and greater competition among firms. Table 14 reveals that non-Big 4 firms audit the majority of sample firms, accounting for 68.80%.

Additionally, Table 14 shows that the size of the public accounting firm does not significantly affect ELRKAM disclosure ($p>0.05$). However, Table 13 indicates that Big 4 firms positively affect ALRKAM disclosure ($p<0.05$). These results indicate that Big 4 firms place more emphasis on risks related to specific accounts, leading to more ALRKAM disclosures. This contrasts with [9], which found that non-Big 4 firms disclose more ALRKAM than ELRKAM.

From an agency theory perspective, the findings show that Big 4 and non-Big 4 auditors have different approaches to their responsibilities. Big 4 auditors, with established reputations and large client bases, focus on managing client expectations and minimizing risks, emphasizing account-level risks. In contrast, non-Big 4 auditors, seeking to build credibility, provide broader disclosures covering both entity-level and account-level risks. This highlights the role of auditors in addressing the agency problem. Non-Big 4 auditors, through detailed KAM disclosures, may better align the interests of management and shareholders in Indonesia.

The differing findings between Big 4 and non-Big 4 firms underscore the need to promote a balanced approach to risk coverage in audit practices. The limited emphasis on ELRKAM by Big 4 firms highlights a potential gap in their risk reporting. To address this, it is recommended that Big 4 firms adopt a more comprehensive approach that integrates both entity-level and account-level risks, ensuring that broader operational and governance issues are adequately addressed. Conversely, non-Big 4 firms should maintain their focus on ELRKAM while also ensuring that significant ALRKAM are appropriately disclosed, thereby providing a well-rounded perspective of the company's risk profile.

The Effect of Auditor Gender on KAM, ELRKAM, and ALRKAM Disclosure

Based on Tables 11, 12, and 13, the results of this study show that auditor gender does not influence the disclosure of KAM, ELRKAM, and ALRKAM. This is inconsistent with [9], which found that female auditors disclose more ALRKAM and fewer ELRKAM than male auditors. However, the findings align with [47], which suggests that female auditors are more skeptical and avoid disclosing negative information, leading to fewer KAM disclosures. It is also worth noting that, in this study, the majority of auditors (87.31%) were male, as shown in Table 14.

Table 14. Public Accountant Firm Classification by Auditor Gender

Audit Firm	Gender	2022	2023	Total	%
Big 4	Female	30	33	63	5.83
	Male	138	136	274	25.37
	Subtotal	**168**	**169**	**337**	
		15.56%	**15.65%**	**31.20%**	
Non-Big 4	Female	37	37	74	6.85
	Male	335	334	669	61.94
	Subtotal	**372**	**371**	**743**	
		34.44%	**34.35%**	**68.80%**	
	Subtotal Female	**67**	**70**	**137**	
		12.41%	**12.96%**	**12.69%**	

Audit Firm	Gender	2022	2023	Total	%
	Subtotal				
	Male	473	470	943	
		87.59%	87.04%	87.31%	
	Total	540	540	1080	

Source: www.idx.co.id; data processed by authors

The dominance of male auditors in this study (87.31%) suggests that the gender composition of audit teams, rather than gender itself, could explain the lack of significant findings. This raises an important point: professional competence, rather than gender, should be the primary consideration in audit practices. Auditors play a key role in resolving conflicts between management and shareholders by improving transparency and aligning their interests. The findings suggest that auditors' professional skills and judgment are more important than gender in addressing the agency problem. Their main responsibility, regardless of gender, is to reduce information asymmetry and protect shareholders' interests.

Nevertheless, fostering diversity within audit teams remains important for promoting varied perspectives and balanced decision-making. Given that 87.31% of the auditors in this study were male, the findings may reflect the composition of the audit teams rather than inherent gender traits. Audit firms should reevaluate team structures to ensure they include a diverse range of perspectives. This could improve the identification and communication of key risks, leading to more effective audit outcomes and better alignment of interests between management and shareholders.

CONCLUSION

This study provides empirical evidence regarding the impact of financial performance and audit fees on KAM disclosure for companies listed on the IDX during 2022-2023. The findings indicate that financial performance does not affect KAM disclosure in general, nor does it influence ELRKAM disclosure. However, it does impact ALRKAM disclosure. This indicates that auditors focus more on specific risk areas rather than overall financial performance. The researchers suggest that auditors may allocate resources more effectively when considering profitability. For example, for high-profitability companies, auditors may shift their focus to risks related to earnings management. Furthermore, the study found that audit fees positively impact the overall disclosure of KAM and ELRKAM but do not affect the disclosure of ALRKAM. This implies that auditors focus more on broader risk, which typically requires more resources.

The present study also found that company size does not affect the disclosure of KAM but positively influences the disclosure of both ELRKAM and ALRKAM. Additionally, the size of the public accounting firm negatively influences KAM disclosure, while it has a positive effect on the disclosure of ALRKAM and does not impact ELRKAM disclosure. This divergence reflects differences in audit approaches, with non-Big 4 firms focusing on enhancing credibility through broader disclosures, while Big 4 firms leverage their reputational capital to emphasize account-specific risks. Lastly, the study found that auditor gender does not affect the disclosure of KAM, ELRKAM, or ALRKAM. This suggests that professional judgment and expertise are more critical than gender in determining audit outcomes. However, the dominance of male auditors in the sample highlights the importance of fostering diversity within audit teams to enhance decision-making and risk assess-ment.

These findings underscore the importance of contextual and firm-specific factors in shaping KAM disclosures. Auditors should prioritize transparency and provide detailed information about significant risks to enhance the communicative value of audit reports. Companies, in turn, can leverage these disclosures to demonstrate their commitment to accountability and effective risk management.

This study examined the recent implementation of KAM disclosure in Indonesia, leading to several key implications. During the audit process, auditors may refine their risk assessment procedures by concentrating on the risks of earnings manipulation or specific accounts vulnerable to misstatements. Additionally, auditors must ensure an efficient audit approach by prioritizing critical areas at the entity level that require significant attention.

It is important to acknowledge the limitations of this study. First, as this study examined the recent implementation of KAM, the two-year period may not fully capture the long-term effects of profitability on KAM. Second, the short study period also may be prone to bias or variations in KAM disclosure as auditors and companies continue to adapt to the new standard. Future research could extend the study period, explore differences in KAM disclosures between Big 4 and non-Big 4 firms, and integrate quantitative analysis with qualitative methods, such as interviews or surveys. This would provide deeper understanding from the perspective of stakeholders and auditors on how profitability, audit fees, and other variables considered in the audit process impact KAM disclosure, particularly regarding why certain risks are prioritized at both the entity and account levels.

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