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IMPLEMENTATION READINESS OF KEY AUDIT MATTERS AT KAP ABC

Rahcoyoning Widianingrum
Master of Accounting Program, Faculty of Economics and Business, Universitas Indonesia
rwidianing@gmail.com

Nureni Wijayati, Ph.D., C.A.
Master of Accounting Program, Faculty of Economics and Business, Universitas Indonesia
nureniwijayati@ui.ac.id

IMPLEMENTATION READINESS FOR KEY AUDIT MATTERS AT DIVISION X KAP ABC

Rahcoyoning Widianingrum* *, *Nureni Wijayati
Master of Accounting Program, Faculty of Economics and Business, Universitas Indonesia

ABSTRACT

Audit reports, which are thought to be of no informational value, may lead to higher expectations among the users of financial statements. The inclusion of essential information in the audit report will determine how it can be used, reflecting how the “expectations gap”—the difference between what users expect and what the auditing profession believes—has risen dramatically over time. This study aimed to analyse the readiness to implement Audit Standard SA 701 Key Audit Matters (KAM) at Division X KAP ABC (an Indonesian audit firm) and the auditors’ understanding of KAM, including potential doubts regarding the classification of KAM with other reporting standards such as SA 706 Emphasis of Matter and SA 570 Going Concern. The data were collected via a questionnaire and semi-structured interviews with the external auditors in charge at Division X KAP ABC. The questionnaire statements were taken from previous research by Hegazy and Kamareldawla (2021) based on paragraphs from SA 701, SA 706, and SA 570, which consist of 26 statements. The results of the analysis conclude that the auditors understand the explanation of SA 701. However, the potential for doubt exists when classifying matters as Emphasis of Matter and Going Concern. Concerning the implementation readiness of KAM SA 701 in 2022, Division X KAP ABC has communicated and interacted more with its clients and conducted training and sharing sessions.

Keywords: Key Audit Matters, SA 701, SA 706, SA 570, auditor's report

* Corresponding Author’s Email: rwidianing@gmail.com

1. INTRODUCTION

Researchers have long debated the usefulness of audit reports for the users of financial statements (Hegazy & Kamareldawla, 2021). Previous researchers found that audit reports have no informational value and can increase the expectations gap among users of financial statements (Bédard, Gonthier-Besacier, & Schatt, 2019).

The "expectations gap" between what users anticipate and what the auditing profession believes has grown significantly over time, including pertinent information in the audit report that determines how it can be used.

Users anticipate receiving information that will make financial statements easier to interpret and enable them to evaluate the impact of fundamental problems, such as serious misstatements, on the company's operations and financial condition (Heilmann & Pott, 2018). However, auditors frequently provide the bare minimum of information to reduce the threat of litigation while continuing to satisfy the parameters set by auditing standards.

The International Auditing and Assurance Standards Board (IAASB) developed an improved audit reporting model in response to concerns about the openness of audit reporting (International Auditing and Assurance Standards Board, 2015a). The most significant changes discussed in the IAASB revisions were the addition of Key Audit Matters (KAM) (International Auditing and Assurance Standards Board, 2015a) and the establishment of new disclosure requirements, which call for the provision of information regarding critical problems found by auditors during audits (International Auditing and Assurance Standards Board, 2013).

Australia, New Zealand, the UK, most European countries (Nguyen & Kend, 2022), and China have added SA 701 since the 2016 financial year (Wu, Fan, & Yang, 2019). Malaysia (Min & Kee, 2019), the Philippines (Auditing and Assurance Standards Council, 2017), Thailand (Kitiwong & Sarapaivanich, 2020), and Singapore adopted SA 701 for the 2016 audit (Accounting and Corporate Regulatory Authority et al., 2017). SA 701 (2021) was established by the Indonesian Institute of Certified Public Accountants (IAPI) and approved on 13 July 2021. SA 701 (2021) applies to the audits of issuers for periods beginning on or after 1 January 2022.

KAP ABC faces a challenge in implementing KAM as while SA 701 provides auditors with guidance on identifying KAM, the standard explanatory material is deemed too general. It will therefore lead to concern among auditors regarding the correct classification of KAM. SA 701 also limits the auditor's ability to avoid disclosing all information about the entity during the audit process by communicating with those charged with corporate governance and selecting the most significant matters based on the auditor's judgement.

The ability to accurately classify KAM has an additional influence on the activities taken and judgements made during an audit. During this time, issues will be raised for discussion, including the primary audit matter that will be addressed in the auditor's report. The auditor must be able to classify KAM into the appropriate category; as such, they must have a thorough understanding of this new standard. They also need to be able to eliminate any uncertainty regarding other reporting standards, such as SA 706 (2021), which addresses Emphasis of Matter (EOM) or other paragraphs, and SA 570 (2014), which addresses going concern (GC).

External auditors are required by SA 706 (2021) to report items critical to the users' understanding of the financial statements, such as significant future occurrences or material uncertainty about future outcomes. Important future events and material uncertainty are included in this category. The new version of SA 706 (2021) requires the auditor to explain that EOM is distinct from KAM and that EOM has not been classified as a key audit matter. Concerns about significant risk should be defined as KAM, while the EOM paragraph should be used to communicate any additional audit planning or scope-related concerns.

When KAM is disclosed in the audit report, the objective of the EOM paragraph is to provide users with financial statement-related information that is not KAM (International Auditing and Assurance Standards Board, 2015b). The EOM portion of the audit report may thus be included after the KAM section.

Based on the background described above, the following research questions are posed:

1) How is the auditor's capability in classifying KAM from various matters identified during the audit?

2) Is there any potential doubt when classifying an issue; that is, whether as a KAM, EOM, or GC?

3) How prepared is KAP ABC to implement KAM?

The objectives of this study are to determine the auditor's ability to implement KAM and the potential for doubt in the opinion of EOM and GC, as well as to determine the readiness to implement KAM in Division X KAP ABC.

2. LITERATURE REVIEW

2.1. CREDIBILITY THEORY

The Credibility (reliability) theory explains that the ability of information to influence users depends on the reliability of the information. Information sources with high credibility will be more influential than those with low credibility. Information reliability derives from the technical skills of compiling information and users' trust in the financial information based on the level of technical skills with which the financial information was compiled. Technical skills are described as a source of power to organise information into accurate statements.

2.2. SA 701

KAM are matters which, in the auditor's professional judgement, are most significant in the audit of the current period's financial statements. This relates to the auditor's responsibility to communicate key audit issues in the auditor's report. The communication of key audit issues in the auditor's report can also enable the users of financial statements to engage more deeply with management relating to the entity and the financial statements being audited. KAM covers several focus areas, including important points regarding communication with those charged with governance (TCWG), matters that require significant auditor attention in carrying out the audit, and matters that are most important to the audit.

KAM should be identified from matters communicated with TCWG. These may include, among other things, the auditor's responsibilities concerning the audit of the financial statements and the significant findings of the audit. Matters requiring significant auditor attention are identified from the matters communicated to TCWG. This is especially the case with matters that pose a challenge for the auditor in terms of forming an opinion or obtaining evidence that, in his judgement, is sufficient and appropriate in the circumstances.

An auditor needs to determine which of the matters identified are most significant in the audit of the current period's financial statements. It is a matter of professional judgement to determine which, and how many, of the matters requiring the auditor's attention in the audit are the most significant. Furthermore, the number of KAM to be included in the auditor's report may be affected by the size and complexity of the entity, the nature of the business and its environment, and the facts and circumstances of the audit.

In carrying out the audit, matters that require significant auditor attention include areas with a higher assessed risk of material misstatement or identified significant risks. The auditor's significant judgements therefore relate to areas of the financial statements that involve significant management judgement, including accounting estimates that have been identified as areas of high estimation uncertainty, followed by the effect on the audit of significant events or transactions that occurred during the period. For example, matters that have a significant effect on the financial statements or audits and economic, accounting, regulatory, industrial, or other significant developments that have an impact on management's assumptions and judgements.

SA 701 provides a narrowed approach to determining the items to report as KAM in the auditor's report. According to this approach, when determining KAM in SA 701, certain factors can be considered when identifying the most significant matters. For example, in areas where the auditor has had a more in-depth, frequent, or strong interaction with TCWG on more difficult or complex matters; when there have been significant delays in management providing the necessary information; where management has shown reluctance to make or extend its assessment of the entity's ability to continue as a GC when requested, and based on the severity of the control deficiency.

There is no limit on the number of KAM that the auditor may need to communicate. Different entities in the same industry may have different KAM because their identification depends on the auditor's risk assessment process and the entity's specific circumstances. Similarly, KAM can vary across years; however, they cannot be completely different.

2.2. SA 706

In the agency theory of corporate governance, auditors are expected to represent the shareholders of a particular company and the best interests of the owners of financial statements and other users regardless of the interests of any party.

The introduction of KAM and changes to reporting requirements in the audit reports submitted to shareholders and other stakeholders will help to reduce any existing principal–agent problems and improve the company's corporate governance.

Previous research has emphasised the importance of communicating EOM paragraphs in new audit reports to increase the value of information to investors. Therefore, these various audit matters need to be properly identified and categorised in the audit report. For example, if KAM are mentioned in an EOM paragraph, the investor may not be able to secure an investment in the company because of the risks associated with the entity's future viability.

Any potential doubts between KAM and EOM will reduce audit quality. It can also send the wrong signal to stakeholders when analysing the matters presented in the auditor's report. Results from previous research have demonstrated the usefulness and impact of expanded audit report standards. Standard setters and regulators need to take into account the specific areas and circumstances in the supplementary paragraph of SA 701 to effectively communicate matters as KAM (Bédard et al., 2019).

2.3 SA 570

Auditing Standard "SA" 570 describes the assumption that an entity should be considered a GC to remain in business for the future, and this assumption can be projected. The preparation of financial statements therefore requires management to assess the entity's ability to continue as a GC. This assessment involves a judgement, at any given time, about the outcome of future events or conditions that are inherently uncertain.

The auditor's objective, in this case, is to obtain sufficient appropriate audit evidence concerning the appropriateness of the management's use of the GC assumption in the preparation of the financial statements, and to then conclude, based on that audit evidence, that material uncertainty exists related to events or conditions that may cast significant doubt on the entity's ability to continue as a GC, which determines the impact on the auditor's report.

The auditor must be able to evaluate the management's assessment of the entity's ability to continue as a GC. In conducting such evaluations the auditor shall cover the same period used by management to perform the assessment as required by the applicable financial reporting framework. If the management's assessment of the entity's ability to continue as a GC covers a period of fewer than 12 months from the date of the financial statements as defined in SA 560, the auditor shall request management to extend the assessment period to a minimum of 12 months from that date.

In accordance with the stipulation and ratification of SA 701 (2021) by the Governing Council of the Indonesian Institute of Certified Public Accountants (IAPI) with the aim of transparency in the audited financial statements, the audit report regarding the main matters in the audit process is disclosed in a new format. This implementation will affect the decision of the auditor's report and its relation to other standards, namely SA 706 and SA 570. In understanding the new SA 701, there is the potential for doubt concerning the classifications that it includes, which also affects the readiness to implement KAM.

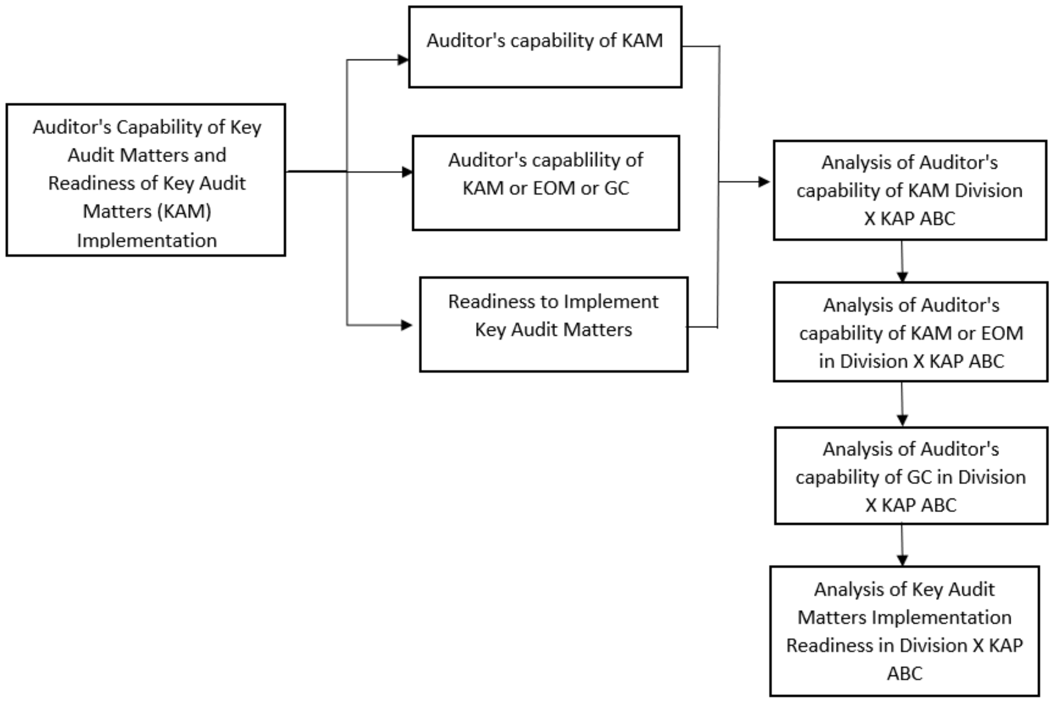

Figure 1 Research Framework

3. RESEARCH METHODS

This study seeks to examine the readiness of auditors in Division X KAP ABC to implement KAM. It uses a descriptive method, which describes the object studied in deep, comprehensive detail. To determine the auditor's understanding of KAM and the difference between EOM and GC, the auditor was asked to answer several questions via a questionnaire. Semi-structured interviews were conducted with engagement partners on the subject of preparing for the implementation of KAM in Division X KAP ABC.

The questionnaires on the capability of KAP ABC Division X auditors on KAM, EOM, and GC were distributed using Google Forms between 10 May 2022 and 9 June 2022. The questions comprised 26 statements related to SA 701 (2021), 706 (2021), and 570 (2014), where the respondents were asked to select the correct answer to statements that included KAM, EOM, and GC. The 26 statements were adapted from previous research by Hegazy and Kamareldawla (2021).

The respondents comprised 40 auditors in charge at Division X KAP ABC, the identities of whom were guaranteed to remain confidential (Anonymous). In completing the questionnaire, the respondents were not informed about the 26 statements contained in the explanations of SA 701 (2021), SA 706 (2021), and SA 570 (2014).

The assessment for each statement was carried out using two dummy variables, with a value of “0” indicating the wrong classification and “1” indicating the correct category. Furthermore, the researcher conducted online interviews with engagement partners regarding the readiness of Division X at KAP ABC to implement KAM. These were held on 22 May 2022, using Google Meet, and on 10 June 2022, using WhatsApp. Data from the questionnaire results were then analysed by calculating the average value for each audit standards statement and sorting them from the highest value.

4. ORGANISATION PROFILE

KAP ABC was established in July 2003 and is registered with the Financial Services Authority and Bank Indonesia. KAP ABC obtained a business licence on 5 August 2003.

KAP ABC has expanded its association network in Indonesia and at the same time has become part of or one of the affiliate members of KAP International, which provides two types of services, namely audit services and non-audit services.

KAP ABC has five auditing and assurance divisions. One of these is Division X, which has 101 audit staff and four audit engagement partners. Division X KAP ABC has a total of 268 clients (audit clients), with 45 publicly listed companies.

KAP ABC is a company engaged in accounting and financial services. To operate its business in the field of auditing services, KAP ABC is led by a Managing Partner and a Partner from each service sector to conduct its operational activities in the sector concerned.

5. RESULTS AND DISCUSSION

Of the 40 questionnaires distributed, 35 were returned, giving a response rate of 77.5%.

5.1 Demographic profile

The respondents consisted of Audit Engagement Partners (3) (8.57%), Managers (6) (17.14%), Supervisors (6) (17.14%), and Senior Auditors (20) (57.14%). The majority were aged under 30 years, which comprised the senior auditors. The dominant length of tenure was 5–10 years, while the average auditor in charge in Division X KAP ABC did not yet hold a CPA degree.

5.2 The auditor's capability in classifying KAM from various matters identified during the audit

The statements in the questionnaire contained 11 individual statements based on previous research by Hegazy and Kamareldawla (2021) in the explanations of SA 701 (2021). The correctness of the answers was determined by calculating each statement's average (mean) value against the correct choice of classification answer from SA 701.

Table 5.1 KAM classification statements with the highest rank

Rank	Statement in the Questionnaire	No. in Questionnaire	Average (mean)
1	Identified material risks or issues needing significant auditor judgement in financial statement preparation.	Q1	85.7%
2	Whether the auditor needed written statements from management to verify audit material. Written representations include plans or intentions that may affect carrying value or asset classification.	Q19	77.1%
3	Accounting policies or areas of complexity in financial reporting that are unique to a particular industry.	Q12	71.4%
4	There were many different auditing factors to examine, all of which were interconnected. Revenue recognition, litigation, and other contingencies, as well as other accounting estimations, may all need special attention from auditors when dealing with long-term contracts.	Q14	68.6%
5	Accounting policies that are new or changing, such as entity- or industry-specific issues, for which the engagement team contacted organisation members to measure, present, or disclose transactions.	Q9	65.7%
6	Some economic factors, like markets that are not liquid for certain financial instruments, can make it harder for an auditor to obtain audit evidence.	Q17	60.0%
7	Significant risks identified specifically in the context of the entity, rather than those identified solely because they are presumed to be significant risks in the SAs. Fraud, for example, is a significant risk.	Q18	60.0%
8	Recent significant economic, accounting, regulatory, or other developments may have an impact on management's assumptions, judgements, or audit approach.	Q4	57.1%
9	Changes to a company's business plan or strategy have a big effect on its financial statements.	Q6	48.4%
10	Circumstances that prompted a large adjustment to the auditor's audit process, such as a serious internal control weakness.	Q8	48.4%
11	Accounting estimates with high estimation uncertainty are of interest to financial statement users.	Q2	45.7%

As Table 5.1 shows, in the previous study by Hegazy and Kamareldawla (2021), eight statements were correctly classified as KAM, which are also defined in SA 701 paragraph 9 as “areas identified as significant risk”. (Q1): In line with previous research, this statement received the highest average percentage in the classification of correct KAM. SA 701 (2021) paragraph 21 defines “the statement regarding significant modifications to audit planning related to deficiencies in internal control”. (Q8): This result was not in line with previous research because the statement (Q8) in this study had the second-highest error in the classification of KAM.

Statements regarding accounting estimates with high estimation uncertainty (Q2) were not in line with previous research. In this study, (Q2) had the highest error percentage in the classification of KAM.

The statements regarding matters that involve separate but related auditors’ concerns, such as revenue recognition, litigation, or other contingencies that may affect other accounting estimates (Q14), were in line with previous research. In terms of fraud in an entity, (Q18) was in line with previous research, where this statement had an average true percentage score of 60.0% and was ranked seventh.

Based on the answers to the questionnaire above, it can be concluded that Division X KAP ABC has only general knowledge related to SA 701. In the initial implementation of SA 701, in general, from the 11 questionnaire statements, a total of eight were classified as true, and thus as KAM, by most of the respondents in this study, namely (Q1, Q19, Q12, Q14, Q9, Q17, Q18, and Q4). This demonstrates that the auditors do not fully understand the concept of KAM, thereby signalling the need for further guidelines for use as a reference in audit reports.

5.3 Potential for auditor doubt in classifying the problem as KAM, EOM, or GC

5.3.1 Potential for auditor doubt in classifying the problem as KAM or EOM

The questionnaire contained 10 individual statements based on previous research by Hegazy and Kamareldawla (2021) in the explanations of SA 706 (2021). The correctness of the answers was determined by calculating each statement’s average (mean) value against the correct choice of classification answer from SA 706.

Table 5.2 EOM classification statements with the highest rank

Rank	Statement in the Questionnaire	No. in Questionnaire	Average (mean)
1	Between the time of the financial statements and the date of the auditor's report, a significant event occurs.	Q11	51.4%
2	To inform users that the financial statements used a special framework.	Q3	45.7%
3	When a law or regulation requires a financial reporting system that would not be acceptable if it were not required.	Q16	40.0%
4	A new accounting standard is not yet in effect, but it will affect financial statements.	Q20	40.0%
5	Potential future judicial or regulatory action that raises significant doubts about the case's outcome.	Q5	37.1%
6	A matter properly provided or disclosed in the financial statements that, in the auditor's opinion, is so important to the users' understanding of the financial statements that it cannot be omitted.	Q7	37.1%
7	Undisclosed information relevant to understanding the audit, the auditor's responsibilities, or the auditor's report.	Q13	34.2%
8	A major disaster that has significantly affected the entity's finances.	Q10	25.7%
9	The same entity prepared financial statements using a different general-purpose framework, and the auditor issued a report.	Q15	20.0%
10	Audit planning and scoping communication (e.g. the planned scope of the audit or the application of materiality in the context of the audit).	Q21	6.0%

Table 5.2 contains the EOM classification statements from the highest to the lowest ranking. Hegazy and Kamareldawla (2021) reported that three statements were correctly classified as EOM, which is also described in SA 706 paragraph A4 about "significant subsequent events". (Q11), in line with previous research, received the highest average percentage in the correct EOM classification. The statement "the financial statements are prepared in accordance with the special purpose framework" (Q3) is also explained in SA 706 A9, and the results were in line with previous research; this is also explained in SA 706 A14 as "the financial statements are prepared with other general-purpose frameworks". The results for (Q15) were not in line with previous research, indicating the potential for doubt concerning the intended meaning.

In general, of the 10 questionnaire statements, only one was classified as true, and therefore as EOM, by most of the respondents. This indicates the need for further guidance in audit report standards related to SA 706 (2021) and also for training and sharing seasons.

5.3 Potential for auditor doubt in classifying the problem as KAM or GC

The questionnaire contained five individual statements based on previous research by Hegazy and Kamareldawla (2021) in the explanations of SA 570. The correctness of the answers was determined by calculating the average (mean) value of each statement against the correct choice of classification answer from SA 570.

Table 5.3 GC classification statements with the highest rank

Rank	Statement in the Questionnaire	No. in Questionnaire	Average (mean)
1	Loss of a major market, an important client franchise licence, or an important primary supplier. A sufficient amount of information regarding this matter has been disclosed.	Q25	48.6%
2	Borrowings with fixed maturities that are approaching maturity with no realistic chance of renewal or repayment, or excessive reliance on short-term borrowings to finance long-term investments. This topic has been sufficiently disclosed.	Q24	37.1%
3	Inability to comply with the requirements of loan agreements. There is adequate disclosure of this subject in the financial statements.	Q23	31.4%
4	Historical and forecast financial statements reflect negative cash flows from operations. There is sufficient disclosure of this subject.	Q26	31.4%
5	Law, regulation, or government policy changes could hurt the company. Financial statements disclose this adequately.	Q22	25.7%

Table 5.3 shows that in general, when it comes to the understanding of GC, most auditors experience potential doubts when classifying matters as GC in line with SA 701, paragraph 4 of which states “Communication of major audit matters in the auditor’s report is in the context of the auditor having formulated an opinion on the financial statements as a whole”. Paragraph 15 outlines the major audit matters that should be communicated in the auditor’s report: “Principal audit matters include anything that raises material uncertainty about the entity’s ability to continue as a GC

after SA 570 (Revised 2021). This will not be explained in the main audit. Instead, the auditor must report these issues based on applicable SAs and Qualified Opinion."

5.4 The readiness to implement KAM at KAP ABC

KAP ABC's readiness to implement KAM was evaluated through semi-structured interviews with the audit partners.

5.4.1 Changes in Auditor Reports and Audit Practices

Responding to changes in audit practice, with the increase in audit reports, audit quality reviews, and the need for more complete and standardised audit documentation, it is natural for the auditor's workload to increase (Aobdia, 2018). This study aligns with previous research as, based on the interview results, the need for risk-based implementation will result in a more in-depth audit, which in turn will affect the series of audit procedures carried out. These will include the more complete and standardised documentation of audit evidence, which will also increase the workload of the auditor.

"The deep application of risk-based audit, as well as changes in the way auditors communicate with stakeholders, especially regarding the significant risks found during the audit and the steps (audit procedures) that the auditors take in dealing with these risks" (JW, June 10, 2022).

"In terms of work planning strategy, it will not have a significant effect, but it will be more significant in the preparation of financial statements and decisions on the auditor's report because it is possible that in the application of Key Audit Matters, there can be misclassification of things including Key Audit Matters that will be included in the auditor's report" (SF, May 22, 2022).

5.4.2 Audit Quality Improvement from Changes in Independent Auditor's Report

Regarding the effect of the implementation of KAM on improving audit quality and the impact of changes to new standards on auditor reports, Mihret, Kansal, Muttakin, and Rana (2022) explained that the application of KAM improves the quality of work through this additional level of audit and documentation review. This led to auditors re-examining and ensuring good consistency across their working papers and audit files, which was a positive aspect of the audit report change.

"KAM disclosure can improve audit quality, especially in terms of the auditor's interaction with relevant stakeholders, and communicate significant issues or deficiencies that exist through the independent auditor's report (LAI/auditor's opinion). In addition, it is hoped that with further disclosure of information related to

significant risks, the audit opinion can also provide added value for its readers and for client management" (JW,June 10, 2022).

5.4.3 Key Audit Matter Scope and Auditor–Client Relations

The literature at the time that the new reporting standards were made available for public comment raised concerns around the (later) impact of the proposed new reporting on the audit environment, particularly on engagements between auditors and their clients (Segal, 2019). In accordance with the respondents' opinions regarding the relationship between the auditors, users, and preparers of financial statements, the implementation of KAM emphasises more general and non-specific aspects that may impact the preparers and users of financial statements.

"Discussions during the preparation and inclusion of KAM by the audit team can encourage the preparers of financial statements (management) to increase transparency, especially providing information about the assumptions used in relation to accounting estimates and management's considerations on certain accounting practices to increase public trust and report users" (JW, June 10, 2022)

In general, the disclosure of KAM has been defined as a discussion of the most significant audit concerns, and KAM have been described as a useful reference point that can even help to bridge audit expectations. The audit expectation gap is the discrepancy between stakeholder assumptions concerning the purpose and scope of the audit and its actual purpose and scope (Velte & Issa, 2019). KAM disclosures may thus assist investors in comprehending the auditor's job and the intricacies of financial statements.

"Additional paragraphs regarding important audit matters must also be communicated to the client because this is a new thing, when the client sees a new paragraph of possible responses, whether this paragraph will affect the decisions of the client's financial statement readers" (SF, May 22, 2022).

5.4.4 Readiness to Implement KAM at Division X KAP ABC

In terms of the readiness to implement KAM at Division X, KAP ABC is affiliated with a foreign KAP where it had previously been applied.

"Resources from foreign KAPs affiliated with us are generally in the form of guides and seminars, such as video recordings of ACCA Global presentations and from our affiliated KAP Heads of Audit, to help us better understand the new SA and its implementation" (JW, June 10, 2022).

Strategies can take various forms, including collaboration, and must be prepared to implement KAM. Using a collaborative approach, they can manage the divergent interests of various parties and adjust or construct a logic acceptable to those parties (Gray, 2000; Narayan, Northcott, & Parker, 2017).

"Increasing socialisation and training both internally and from IAI and IAPI to all levels of the audit team (especially for senior, manager, and partner levels), completion of sample opinion guides for the first year of KAM implementation, preparation of strategies and audit procedures to accommodate the inclusion of KAM in auditor's opinion, socialisation to issuer clients and their stakeholders regarding the implementation of KAM" (JW, June 10, 2022).

5.4.5 Possibility of no KAM in an Entity

In cases where it is possible that no KAM are present in an entity, or the audit client thinks that what the auditor has determined as KAM are not KAM, then the following explanatory paragraph in SA 701 (2021) applies:

"It may occur when the auditor determines that there is no key audit matter in an entity to be disclosed in the independent auditor's report, but it may be rare that the auditor auditing the issuer's financial statements is unable to determine at least one major audit matter from a number of matters communicated to the issuer. parties responsible for governance (board of commissioners) in the auditor's report, but this may occur in certain limited conditions such as the business activities of the issuer which is very limited" (JW, June 10, 2022).

If the auditor finds a major audit issue, but the client does not, SA 701 (2021) explains: "When a principal audit matter is not communicated in the auditor's report, the auditor must explain each audit matter in the auditor's report except where (Ref. Para. A53-A56):

1) The law prohibits public disclosure; or (Ref: Para. A52); and
2) In very rare cases, the auditor determines that communicating such matters would be detrimental to the public interest. This does not apply if the entity has publicly disclosed information about it."

6. CONCLUSION AND RECOMMENDATION

Conclusion

Based on the results of the research above, to determine the auditor's understanding in correctly classifying a matter as KAM, the author uses 11 questions taken from paragraph SA 701. From these statements, an auditor in Division X KAP ABC can correctly classify KAM during the audit of 8 statements regarding areas of significant risk, industry complexity, and certain accounting estimates.

The potential was identified for doubt to exist in the correct classification of matters as EOM; most of the answers that should have been classified as EOM were instead categorised as KAM. This indicates that the explanatory paragraph of SA 701 is too general to assist the auditor in determining what should be classified as KAM.

This study also raised doubts when classifying things as GC since most of the participants chose the wrong GC classification. It also highlighted the auditor's insufficient level of understanding concerning the application of SA 701.

Credibility theory explains that technical knowledge of accounting, auditing, taxation, and the ability to absorb information on each audited client's business can influence the decision on how to classify matters, including KAM. This was also found to affect the reliability of the audited financial statements in terms of increasing the level of confidence in all of the financial information contained in the financial statements and management performance.

Concerning the readiness to apply SA 701 in audit report decisions, from the interviews conducted with the audit engagement partners, they were generally aware of the implementation of the main audit matter paragraph. However, their knowledge remained general and it is still a new auditing standard. In terms of preparation, the auditor must understand SA 701, especially the supervisor, manager, and audit partner levels, then share knowledge about the latest standards and conduct training.

The work planning strategy was not found to have a significant effect. However, the auditor's ability to make decisions on matters to be included in KAM must continue to develop through experience and communication with TCWG.

Regarding work planning, the auditor must be able to determine the risks so that the audit process complies with auditing standards. Significant matters can arise when preparing financial statements, as errors can occur in the correct classification of KAM. However, the new report format positively impacts the transparency of audit reports. The addition of this paragraph will also impact the client because it will affect the decisions of the readers of the financial statements; initial communication and discussion must therefore take place regarding the disclosure of KAM to the client (audit company).

Auditing standard 701 explains that in only very rare cases will an entity have no KAM. However, such a situation may arise under certain limited conditions (for example, an issuer with very limited business activities).

Meanwhile, situations can arise in which the auditor considers matters to be KAM but the client (the audit firm) does not consider them as matters that should be disclosed in the audit report. This may occur with the following limitations: (1) the laws and regulations prohibit disclosure of the matters to the public, and (2) if the detrimental effect of disclosing the matters to the public outweighs the benefit of doing so.

Recommendation

This research has implications and benefits for the following interested parties. Practitioners are expected to set the benchmark concerning the application of KAM in reporting audit decisions. The company (audit client) can provide additional information regarding the implementation of KAM and the impact on the users of its financial statements. Academics may wish to add insight through additional literature or other research materials on related topics. Standard setters are expected to be able to provide more practical guidelines specific to KAM requirements. Lastly, further studies can expand the object of research, both regarding companies and the implications for audit quality.

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