



# Contemporary Accounting Case Studies

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Vol. 2, No. 2, September 2023

Article 12

## IMPLEMENTING KEY AUDIT MATTERS COMMUNICATION IN THE INDEPENDENT AUDITOR'S REPORT OF THE FINANCIAL STATEMENTS OF PT XYZ

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# **IMPLEMENTATION OF KEY AUDIT MATTERS COMMUNICATION IN THE INDEPENDENT AUDITOR'S REPORT OF THE FINANCIAL STATEMENTS OF PT XYZ**

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## **ABSTRACT**

The implementation of key audit matters (“KAM”) communication in the independent auditor’s report of issuers in Indonesia for financial statements periods beginning on or after January 1, 2022 will significantly affect the audit environment in Indonesia. This paper investigates the implementation process of KAM communication in the independent auditor’s report of PT XYZ, the challenges encountered, and the necessary critical success factors to facilitate the KAM communication implementation effectively. PT XYZ is an issuer in Indonesia and the U.S.A engaged in the telecommunication industry. This research used a qualitative analysis by circulating questionnaires to the Head of Internal Audit (the representative of those charged with governance) and the independent auditor. This research found that there are important steps in identifying, filtering, and determining KAM, the challenges encountered during its implementation, and certain critical success factors that would facilitate the KAM communication implementation effectively. This research concludes that the KAM communication implementation process is challenging and continuous and requires additional time and resources. This research focuses on the KAM communication implementation only from the perspectives of the Internal Audit and the independent auditor, and not other stakeholders. Future research may be required to study the impact of KAM communication to other stakeholders.

Keywords: independent auditor’s report, key audit matters, those charged with governance

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## 1. INTRODUCTION

In 2021 the Indonesian Institute of Certified Public Accountants (“**IICPA**”) issued revised and new auditing standards, which include the new Standard on Auditing 701, “*Communicating Key Audit Matters in the Independent Auditor’s Report*” (“**SA 701**”). SA 701 is effective for audits of the periods of a complete set of general-purpose financial statements of issuers in Indonesia beginning on or after January 1, 2022. The implementation of SA 701 for non-issuers is optional. SA 701 may also be applicable when the independent auditor is required by law or regulation to communicate “key audit matters” (“**KAM**”) in the audit report. SA 701 is adopted from International Standard on Auditing 701, “*Communicating Key Audit Matters in the Independent Auditor’s Report*”, issued by the International Auditing and Assurance Standards Board (“**IAASB**”) (“**ISA 701**”), which had been implemented for audits of a complete set of general-purpose financial statements of issuers ending on or after December 15, 2016. Besides ISA 701, the equivalent requirements like those contained in SA 701 in the United States of America (“**U.S.**”) are also included in Auditing Standard 3101, “*The Auditor’s Report on an Audit of Financial Statements when the Auditor Expresses an Unqualified Opinion*”, issued by the U.S. Public Company Accounting Oversight Board (“**PCAOB**”) (“**AS 3101**”). In AS 3101, the terminology of “critical audit matters” (“**CAM**”) is used instead of KAM. AS 3101 is applicable for audits of issuers with fiscal years ending on or after December 15, 2017, except for the requirements related to CAM. The requirements related to CAM are effective for audits of fiscal years ending on or after June 30, 2019 for large accelerated filers (“**LAF**”), while fiscal years ending on or after December 15, 2020 for all other companies to which the requirements apply.

SA 701, which governs an extended independent auditor reporting, requires independent auditor to communicate KAM in its audit report. KAM are defined as those matters that, in the independent auditor’s professional judgment, were of most significance in the audit of the financial statements of the current period. KAM are selected from matters communicated to those charged with governance (“**TCWG**”). The purposes of communicating KAM are: (i) to enhance the communicative value of the independent auditor’s report by providing greater transparency about the audit that was performed. Communicating KAM provides additional information to the intended users of the financial statements and the related independent auditor’s report (the “**intended users**”) to assist them in understanding those matters that, in the

independent auditor's professional judgment, were of most significance in the audit of the financial statements of the current period, (ii) to assist the intended users in understanding the entity and areas of significant management judgment in the financial statements, and (iii) to provide the intended users a basis to further engage with management and TCWG about certain matters relating to the entity, the financial statements, and/or the audit that was performed.

The KAM communication requirement was introduced to respond to the demand by the intended users of greater transparency in the audit process and clarity in the independent auditor's report (IAASB, 2015). The old form and contents of the independent auditor's report, which only provides a "pass/fail" type of statement is no longer considered sufficient to provide better understanding of the intended users about the financial statements. Accordingly, an extended form and contents of the independent auditor's report is required and fulfilled through the issuance of ISA 701.

The communication of KAM in the independent auditor's report is expected to provide the following benefits: (i) improving the transparency and communicative value of the financial statements and the related independent auditor's report to the intended users, (ii) stimulating better corporate governance as a result of better communication between the independent auditor and TCWG, (iii) supporting better audit quality as a result of better professional skepticism applied to those matters identified and communicated as KAM, and (iv) encouraging better financial reporting practice.

PT XYZ, the entity on which we conducted our research on the implementation of KAM communication, is an Indonesian issuer engaged in telecommunication sector whose equity securities are registered and listed in Indonesia and U.S. Accordingly, as a large accelerated filer in the U.S., PT XYZ has already implemented CAM communication since the audit of its 2019 financial statements, while the equivalent KAM communication will be implemented for the audit of its 2022 financial statements. Accordingly, it becomes relevant and educational to research the process of implementing KAM communication in the independent auditor's report of the financial statements of PT XYZ, so that we have better understanding of the related challenges encountered by its independent auditor and TCWG and the critical success factors that must be present to facilitate an effective implementation of KAM communication. For research purposes, the phrases "KAM" and "CAM" in this paper are used interchangeably. This research is expected to provide a better understanding of the processes involved in implementing the KAM

communication and the related challenges, and the critical success factors required to facilitate an effective implementation of KAM communication.

## **2. LITERATURE REVIEW**

### **2.1. SOURCE CREDIBILITY THEORY**

The source credibility theory is an essential and foundation theory in the research of the impact of communicating KAM in the independent auditor's report of the financial statements of issuers to the intended users. This theory becomes more important as one of the purposes of communicating KAM to the intended users is to improve the transparency and communicative value of the financial statements. Source credibility is a term used to indicate the positive characteristics of communicators that can increase the value of the information communicated in a message, and therefore have an effect on the reception of such message (Hovland et al., 1953; Ohanian, 1990). Source credibility is the consumers' perception of the extent to which the source of information they receive online (Chaiken, 1979) is trustworthy and competent (Coursaris & Van Osch, 2016). Source credibility is also defined as a peripheral cue or route in consumer information processing (Petty & Cacioppo, 1986). Peripheral routes are variables that allow a person to arrive at an assessment of an argument without processing the message argument itself (Petty & Cacioppo, 1986). In this context, peripheral routes are elements in messages that are not directly related to product benefit information and usually require little effort to process (Cheung & Thadani, 2012). According to the source credibility theory proposed by (Hovland et al., 1953), it assumes that information originating from credible sources can influence the attitudes, opinions, and behavior of the receiver. The source credibility is determined by the following two dimensions: (i) expertise, and (ii) trustworthiness. However, according to the source attractiveness models (McGuire, 1985), the credibility of the information source is also determined by the attractiveness of the sender. An important factor that can influence the quality of attractiveness is the similarity or social homophily between the recipient and the sender (McGuire, 1985). Conducted a study in combining the two models, where the results of his research showed that source expertise, trustworthiness, and source homophily were important factors in determining source credibility (Ohanian, 1990). Furthermore, (Ismagilova et al., 2020) stated that the characteristics of source credibility are source expertise, trustworthiness, and homophily. Based on the source credibility models, source expertise and source trustworthiness are dimensions that

determine source credibility (Alan et al., 2019).

Source expertise shows the extent to which the source or sender is considered capable of providing correct information (Hovland et al., 1953). According to Ohanian (1990), source reliability is defined as the degree to which a person is considered to have knowledge, skills, or experience, and thus is considered to provide accurate information. Receivers of information will consider the information accurate if the sender (source) is considered to have high expertise regarding the product. Further, high source expertise will provide quality information (Lis, 2013). According to Ohanian (1990), the indicator of source expertise is having knowledge, skills, and experience that enables the provision of accurate information. Source expertise refers to the extent to which sources are considered to possess knowledge, skills, and experience that enables the provision of accurate information. Source expertise has a significant impact on receivers of information (Lis, 2013). With their extensive experience and knowledge, the sender's skill level can create more persuasive information (Wangenheim, 2004).

Based on the source credibility theory, source trustworthiness is also a determinant of source credibility. Source trustworthiness is defined as the trust level of the recipient of information about the source's intention in communicating his/her statement (Hovland et al., 1953). Source trustworthiness refers to consumer perceptions of how reliable, unbiased, and honest sources of information (Ohanian, 1990). When sources can be trusted, the information will not be doubted by receivers of information because they are considered to have credible sources (Sparkman and Locander, 1980 in Ismagilova et al., 2020). Receivers of messages will find the information useful when the information comes from reliable sources (Ismagilova et al., 2020).

## **2.2. SA 701 AND ITS REQUIREMENTS**

SA 701 governs that communicating KAM in the independent auditor's report is in the context of the independent auditor having formed an opinion on the financial statements taken as a whole, and not on component parts thereon. Further, communicating KAM in the independent auditor's report is not: (i) a substitute for disclosures in the financial statements that the applicable financial reporting framework requires management to make or that are otherwise necessary to achieve fair presentation of the financial statements, (ii) a substitute for the independent auditor expressing a modified audit opinion when required by the circumstances of a specific audit engagement in accordance with Standard on Auditing 705, "*Modifications to the Opinion in the Independent*

*Auditor's Report*", issued by the IICPA ("SA 705"), (iii) a substitute for reporting in accordance with Standard on Auditing 570, "Going Concern", issued by the IICPA ("SA 570") when a material uncertainty exists relating to events or conditions that may cast significant doubt on an entity's ability to continue as a going concern, or (iv) a separate opinion on individual matters of the financial statements.

SA 701 requires that the independent auditor should determine, from the matters communicated with TCWG, those matters that required significant auditor attention in performing the audit of the financial statements. In making such determination, the independent auditor should consider the following factors: (i) areas of higher assessed risk of material misstatement or significant risks identified in accordance with Standard on Auditing 315, "Identifying and Assessing the Risks of Material Misstatement", issued by the IICPA ("SA 315"), (ii) significant auditor judgments relating to areas in the financial statements that involved significant management judgment, including accounting estimates that have been identified as having high estimation uncertainty, and (iii) the effect on the audit of significant events or transactions that occurred during the period. The independent auditor should determine which of the matters determined above are of most significance in the audit of the financial statements of the current period, which therefore become KAM.

Further, SA 701 requires that the description of each KAM in the "Key Audit Matters" section of the independent auditor's report should include a reference to the related disclosure, if any, in the financial statements and should address: (i) the reason the matter was considered to be one of most significance in the audit and accordingly, determined to be a KAM; and (ii) the audit procedures implemented to address the reported KAM. Moreover, SA 701 governs that the independent auditor should describe each KAM in the independent auditor's report unless: (i) law or regulation precludes public disclosure about the matter, or (ii) in extremely rare circumstances, the independent auditor determines that the matter should not be communicated in the independent auditor's report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication. However, such requirement is not applicable if the entity has publicly disclosed information about the matter previously.

SA 701 requires the independent auditor to communicate the following matters to TCWG: (i) those matters that the independent auditor has determined to be KAM, or (ii) when applicable, depending on the facts and circumstances of the entity and the audit of the financial statements, the independent auditor's

determination that there is no KAM to communicate in the independent auditor's report.

When documenting KAM, SA 701 requires that the independent auditor includes the following matters in the audit documentation: (i) the matters that required significant auditor attention and the rationale for the independent auditor's determination as to whether or not each of such matters is a KAM, (ii) when applicable, the rationale for the independent auditor's determination that there are no KAM to communicate in the independent auditor's report or that the only KAM to communicate are those matters reported in accordance with SA 705 or SA 570, and (iii) where applicable, the rationale for the independent auditor's determination not to communicate in the independent auditor's report a matter determined to be a KAM.

### **2.3. AS 3101 AND ITS REQUIREMENTS**

AS 3101 requires the independent auditor to determine whether there are any CAM in the audit of the financial statements of the current period. A CAM is defined as any matter arising from the audit of the financial statements that was communicated or required to be communicated to the TCWG and that: (i) relates to accounts or disclosures that are material to the financial statements, and (ii) involved especially challenging, subjective, or complex auditor judgment. CAM are not a substitute for the independent auditor's departure from an unmodified audit opinion (i.e., a qualified audit opinion, adverse audit opinion, or disclaimer of audit opinion on the financial statements as governed under Auditing Standard 3105, "*Departures from Unqualified Opinions and Other Reporting Circumstances*", issued by the PCAOB ("AS 3105").

Further, AS 3101 requires that in determining whether a matter involved especially challenging, subjective, or complex auditor judgment, the independent auditor should take into account, alone or in combination, the following factors, as well as other factors specific to the audit of the financial statements: (i) the independent auditor's assessment of the risks of material misstatement, including significant risks, (ii) the degree of auditor judgment related to areas in the financial statements that involved the application of significant judgment or estimation by management, including estimates with significant measurement uncertainty, (iii) the nature and timing of significant unusual transactions and the extent of audit effort and judgment related to such transactions, (iv) the degree of auditor subjectivity in applying audit procedures to address the matter or in evaluating the results of such procedures, (v) the nature and extent of audit effort required to address the matter, including the



extent of specialized skill or knowledge needed or the nature of consultations outside the engagement team regarding the matter, and (vi) the nature of audit evidence obtained regarding the matter. It is expected that, in most audits conducted under AS 3101, the independent auditor should determine that at least one CAM involved especially challenging, subjective, or complex auditor judgment.

AS 3101 governs that the independent auditor should communicate in the auditor's report CAM relating to the audit of the financial statements of the current period or state that the independent auditor determined that there are no CAM to report. When the financial statements of the current period are presented on a comparative basis with those of one or more prior periods, the independent auditor may communicate CAM relating to a prior period in a situation when, for example: (i) the financial statements of the prior period are made public for the first time, such as in an initial public offering, or (ii) issuing an independent auditor's report on the financial statements of the prior period because the previously issued independent auditor's report could no longer be relied upon.

Further, AS 3101 requires that for each CAM communicated in the independent auditor's report, the independent auditor must: (i) identify the CAM, (ii) describe the principal considerations that led the independent auditor to determine that the matter is a CAM, (iii) describe how the CAM was addressed in the audit of the financial statements, and (iv) refer to the relevant financial statement accounts or disclosures that relate to the CAM. In describing how the CAM was addressed in the audit of the financial statements, the independent auditor may describe: (i) the independent auditor's response or approach that was most relevant to the matter, (ii) a brief overview of the audit procedures performed, (iii) an indication of the outcome of the audit procedures, and (iv) key observations with respect to the matter, or some combination of these elements. Further, language that could be viewed as disclaiming, qualifying, restricting, or minimizing the independent auditor's responsibility for CAM or the independent auditor's opinion on the financial statements is not appropriate and may not be used. The language used to communicate a CAM should not imply that the independent auditor is providing a separate opinion on CAM or on the accounts or disclosures to which they relate. In addition, when describing CAM in the independent auditor's report, the independent auditor is not expected to provide information about the entity being audited that has not been made publicly available by such entity unless such information is necessary to describe the principal considerations that led the independent

auditor to determine that a matter is a CAM or how the matter was addressed in the audit of the financial statements.

## **2.4. COMPARISON BETWEEN SA 701 AND AS 3101**

It is important to compare the requirements of KAM/CAM communication under SA 701 and AS 3101 considering that, in its form, PT XYZ has not implemented SA 701, but has only experienced in implementing AS 3101. By making such a comparison, we are able to see the link between the experience of PT XYZ and its independent auditors in implementing AS 3101 and the upcoming experience in implementing SA 701 when the audit of its 2022 financial statements takes place.

The following five factors may be considered when making comparison between SA 701 and AS 3101: (i) determining whether a matter is a KAM/CAM, (ii) considerations in determining whether a matter is a KAM/CAM, (iii) KAM/CAM documentation, (iv) communication of KAM/CAM, and (v) descriptions of KAM/CAM in the independent auditor's report.

### **2.4.1. DETERMINING WHETHER A MATTER IS A KAM/CAM**

Under SA 701, the independent auditors of issuers are required to communicate KAM in their audit reports. Law, regulation, or auditing standards in a particular jurisdiction may extend the requirement to communicate KAM to entities other than issuer, such as public interest entities (“**PIE**”), public sector entities, entities in a particular industry, or all entities. SA 701 also allows independent auditors to communicate KAM on a voluntary basis for entities other than issuers in the absence of a requirement to do so. Under AS 3101, the independent auditors are required to communicate CAM in their audit reports for audits conducted under PCAOB standards, except for: (i) audits of brokers and dealers reporting under Rule 17a-5 of the U.S. Securities Exchange Act of 1934 (the “**Securities Act**”), (ii) investment companies registered under the Investment Company Act of 1940 (other than business development companies), (iii) employee stock purchase, savings, and similar plans, and (iv) emerging growth companies as defined in Section 3(a)(80) of the Securities Act.

#### **2.4.2. CONSIDERATIONS IN DETERMINING WHETHER A MATTER IS A KAM/CAM**

Under SA 701, KAM should be specific to the entity and the audit of the financial statements to provide relevant and meaningful information to the intended users. Accordingly, SA 701 provides a two-step process using a judgment-based decision-making framework to help independent auditors to determine which matters, from those communicated with TCWG, are KAM. Such decision-making framework was developed to focus the independent auditors on areas of the financial statements that involved the most significant or complex judgments by management and areas of auditor focus in accordance with the risk-based approach in the Standards on Auditing established by the IICPA. Under AS 3101, the framework for determining CAM is similar to SA 701 and starts with those matters communicated or required to be communicated to TCWG. As defined, a CAM also relates to accounts or disclosures that are material to the financial statements.

Further, although the form of the definition of KAM under SA 701 and the one under AS 3101 is not identical, both definitions contain a similar substance. Unlike AS 3101 where the definition of CAM includes an emphasis on the materiality of the financial statements, although not included in the definition of KAM under SA 701, paragraph A29 of its Application and Other Explanatory Materials provides for the consideration of materiality by noting that the importance of the matter to the understanding of the financial statements taken as a whole of the intended users and, in particular, its materiality to the financial statements, may be relevant to determining the relative significance of a matter communicated with TCWG and whether such a matter is a KAM.

Although the requirements and considerations in determining whether a matter is a KAM under SA 701 and a CAM under AS 3101 are not identical, for the most part, the substance of the specific factors and other considerations underlying the independent auditor's determination of which matters are KAM/CAM are similar under both auditing standards. In addition, SA 701 provides a substantial amount of guidance to support the independent auditor's decision-making process through its Application and Other Explanatory Materials contained therein.

### **2.4.3. KAM/CAM DOCUMENTATION**

Because the determination of KAM / CAM is linked to principles-based requirements and relies on auditor judgment, both SA 701 and AS 3101 have set out specific requirements to assist the independent auditors in documenting those important judgments. However, these requirements slightly differ in terms of the matters for which such documentation is required. SA 701 requires documentation of the matters that required significant auditor attention and the rationale for the independent auditor's determination as to whether or not each of such matters is a KAM. While under AS 3101, for each matter arising from the audit of the financial statements that was communicated to TCWG and relates to accounts or disclosures that are material to the financial statements, the independent auditor must document whether or not the matter was determined to be a CAM and the basis for such determination.

### **2.4.4. COMMUNICATION OF KAM/CAM**

The number of KAM/CAM that will be communicated in the independent auditor's report may be affected by the complexity of the entity, the nature of the entity's business and environment, and the facts and circumstances of the audit engagement. Under both SA 701 and AS 3101, it is generally expected that there will be at least one KAM/CAM communicated by the independent auditor in the independent auditor's report, although both auditing standards acknowledge that there may be circumstances where there is no KAM/CAM at all to report, where in such situation, both SA 701 and AS 3101 require inclusion of a statement to indicate so in the independent auditor's report.

Further, although both SA 701 and AS 3101 require the communication of KAM/CAM only for the audit of the financial statements of the current period, SA 701 indicates that it nevertheless may be useful for the independent auditor to consider whether a KAM in the prior period continues to be a KAM in the audit of financial statements of the current period, while AS 3101 acknowledges that the independent auditor may communicate CAM relating to a prior period and includes examples of circumstances as to when this may be appropriate.

Moreover, SA 701 acknowledges that, in extremely rare circumstances, the independent auditor may decide that a matter determined to be a KAM should not be communicated, while AS 3101 acknowledges that the independent auditor is not expected to provide information about the entity that has not been made publicly available by the entity unless such information is necessary to

describe the principal considerations that led the independent auditor to determine that the matter is a CAM or how it was addressed in the audit of the financial statements.

Lastly, both auditing standards preclude the communication of KAM/CAM when the independent auditor disclaims an opinion on the financial statements. AS 3101 does not permit the communication of CAM when the independent auditor expresses an adverse opinion, while SA 701 may require otherwise subject to certain considerations as governed in the Application and Other Explanatory Materials contained therein.

#### **2.4.5. DESCRIPTIONS OF KAM/CAM IN THE INDEPENDENT AUDITOR'S REPORT**

Under both SA 701 and AS 3101, the description of a KAM/CAM is intended to provide a succinct and balanced explanation about the matter that is tailored to the audit of the financial statements with the objective to prevent the use of standardized language and to reflect the specific circumstances of the matter, while limiting the use of highly technical accounting and auditing terms. SA 701 indicates that the level of detail in the description of each KAM is a matter of professional judgment and may vary depending on the specific facts and circumstances encountered in the particular engagement, while AS 3101 acknowledges that the description of a CAM should be at a level that the intended users would understand and further notes that the objective is to provide a useful summary and not to detail every aspect of how the CAM was addressed. Both auditing standards are of the view that flexibility in describing KAM/CAM is important to enable the independent auditors to be as entity-specific and audit-specific as possible to mitigate concerns from the intended users that communication of KAM/CAM could quickly result in more standardized or "boilerplate" communications.

### **3. RESEARCH METHODS**

This research analyzed the implementation of KAM communication in the independent auditor's report of the financial statements of PT XYZ (an issuer engaged in the telecommunication sector) by focusing on the processes involved, the related challenges encountered during the implementation, and the critical success factors required to facilitate an effective implementation of KAM communication. It used an in-depth analysis using qualitative or a case

study method. The use of the qualitative method was chosen because this method has several advantages that are fact-based and allows a more in-depth and centralized analysis (Raco, 2010).

This research used a case-study method by circulating questionnaires to, and interviewed with, the Head of Internal Audit Department of PT XYZ (as the representative of those charged with governance and the counter-party to the independent auditor in the context of the audit of the financial statements of PT XYZ) and the Audit Engagement Partner (as the representative of the independent auditor who audited the financial statements of PT XYZ) during May 2-9, 2022, and read relevant documents. These respondents were selected for interviews as they were selected as their roles and responsibilities are directly related to the implementation of KAM communication.

The interviews with the respondents were conducted using a semi-structure format and open ending questions, which covered 16 questions for each respondents. Matters asked during the interviews, as contained in the respective questionnaires, included the respondents' views, observations, and understanding about matters related to the implementation of KAM in the independent auditor's report, the challenges identified during the implementation process, and the critical success factors that were considered essential and important to facilitate an effective and efficient implementation of KAM communication in the independent auditor's report. This research used both quantitative and qualitative data. The quantitative data used were sourced from the annual reports and Form 20-Fs (including the audited financial statements) of PT XYZ for 2019-2021, while the qualitative data used were non-financial information nature sourced from the results of the interviews with the respondents. The source data used in this research were both primary and secondary data. The primary data are data and information that were obtained directly from the respondents (PT XYZ and its independent auditor), including those obtained during the interview sessions. The secondary data are data and information that were obtained from secondary/indirect sources, such as annual reports and Form-20Fs issued by PT XYZ for U.S. financial reporting purposes.

Considerations used by the independent auditors when identifying, filtering, and determining a matter as KAM, and the related factors and environment governed by SA 701 become the basis and framework for conducting an analysis on the processes involved in implementing KAM, and the related challenges encountered during the implementation, and the critical success factors required to facilitate an effective implementation of KAM communication. This means that to what extent, the description in the

independent auditor's report refers to the main considerations that guide the auditor, in the audit conditions to determine a matter as one of the most significant matters.

#### 4. ORGANIZATION PROFILE

PT XYZ, the entity on which this research was conducted, is an Indonesian issuer engaged in telecommunication sector whose equity securities are registered and listed in Indonesia and U.S. Accordingly, as a LAF, PT XYZ has already implemented CAM communication reporting since the audit of its 2019 financial statements, while the equivalent KAM communication will only be implemented for the audit of its 2022 financial statements.

Below is the summary of CAM communicated in the independent auditor's reports of the financial statements of PT XYZ for 2019-2021:

Description	2019	2020	2021
Type of audit opinion expressed	Unmodified audit opinion	Unmodified audit opinion	Unmodified audit opinion
Number of communicated CAM	2	1	1
Description of communicated CAM	<ul style="list-style-type: none"> <li>• Estimated useful lives of fixed assets</li> <li>• Implementatoin of the new accounting standard for leases</li> </ul>	<ul style="list-style-type: none"> <li>• Estimated useful lives of fixed assets</li> </ul>	<ul style="list-style-type: none"> <li>• Estimated useful lives of fixed assets</li> </ul>

#### 5. RESULTS AND DISCUSSION

##### 5.1. PROCESSES IN IMPLEMENTING CAM COMMUNICATION

The initial implementation of CAM communication in the independent auditor's report of the financial statements of PT XYZ was during the audit of its 2019 financial statements, which was the first year implementation of AS 3101 for issuers with LAF classification in the U.S. The following discussions

were presented based on the results of the interview sessions with the respondents and reading of the secondary data used in the research.

During the audit of the 2019 financial statements of PT XYZ, the independent auditor considered the following areas when determining matters to be included in their communication to TCWG, since they were related to the financial statements of the entity, based on the principles and guidance provided by AS 3101: (i) critical accounting estimates, (ii) significant unusual transactions, (iii) related party relationships and transactions, (iv) significant deficiencies and material weaknesses in internal control over financial reporting, (v) corrected and uncorrected misstatements, (vi) communications related to interim review, (vii) new accounting pronouncements, (viii) difficult or contentious matters subject to consultation outside of the audit engagement team, (ix) significant difficulties encountered in performing the audit (including any difficulties in dealing with management), (x) fraud and non compliance with laws and regulations, (xi) disagreement with management, (xii) findings regarding external communications, (xiii) accuracy of management's disclosures about changes in internal control that require modification, (xiv) designation of engagement as "close-monitoring" (including the risk factors that led or contributed to the "close-monitoring" designation and the audit engagement team's plan to address them, including any changes thereto), (xv) overall audit strategy, timing of the audit, and significant risks identified (and any changes thereto), (xvi) material alternative accounting treatments discussed with management, (xvii) management's consultations with other accountants, (xviii) other material written communications with management, (xix) significant issues discussed with management in connection with the initial appointment or recurring retention of the independent auditor, (xx) responsibility of the independent auditor, any procedures performed and the results relating to other information in documents containing audited financial statements, (xxi) representations that the independent auditor requested from management, (xxii) fees and related SEC required disclosures, (xxiii) terms of the audit engagement, including the objective of the audit, the auditor's responsibilities under PCAOB standards, and management's responsibilities, (xxiv) independence matters, (xxv) all relationships between the independent auditor and the entity (additional communications required by stock exchange rules), (xxvi) pre-approval of services by TCWG, (xxvii) draft of the independent auditor's report and the related evaluation of the financial statements and related disclosures, (xxviii) additional information included in management's report on internal control over financial reporting, (xxix)



American Institute of Certified Public Accountants' ethics ruling regarding third-party service providers, (xxx) other matters arising from the audit that are significant to the oversight of the entity's financial reporting process, including complaints or concerns regarding accounting or auditing matters, and (xxxii) any other matters communicated to TCWG related to the audit other than those listed above.

When evaluating matters to be included in their communication to TCWG from the 31 factors mentioned above, the independent auditor considered the nature of each matter being communicated and the related accounts or disclosures in the financial statements of the matters being communicated. For purposes of CAM evaluation, the nature of the matters being communicated to TCWG consists of: (i) matters that relate to material accounts or disclosures in the financial statements, (ii) matters that by themselves do not relate to material accounts or disclosures in the financial statements, but could contribute toward another matter being a CAM, and (iii) matters that do not relate to material accounts or disclosures in the financial statements and do not contribute toward another matter being a CAM.

Based on the above-mentioned factors evaluated during the preliminary CAM identification, the following matters were identified as preliminary: (i) the allowance for doubtful receivables, (ii) the estimated useful lives of fixed assets, (iii) the accounting for acquisition of telecommunication towers, (iv) the accounting for leases, and (v) the implementation of new information technology systems that affected revenue recognition. The first four CAM items were classified as "matters that relate to material accounts or disclosures in the financial statements", and accordingly, met the CAM definition; while the fifth CAM item was classified as "a matter that by itself does not relate to material accounts or disclosures in the financial statements, but could contribute toward another matter being a CAM" it had significant impact on the business process and internal controls for revenue.

The preliminary identified five CAM items were further evaluated as part of the filtration and determination of final CAM. For each of those five CAM items, the independent auditor evaluated the following factors and provided the related rationales for determining such matters as CAM: (i) the assessment of the risks of material misstatements to the financial statements, (ii) the nature and extent of audit effort required to address the matter, including the extent of specialized skill or knowledge needed or the nature of consultations outside the audit engagement team regarding the matter, (iii) the degree of auditor judgment related to areas in the financial statements that involved the application of

significant judgment or estimation by management, including estimates with significant estimation uncertainty, (iv) the nature and timing of significant unusual transactions and the extent of audit effort and judgments related to these transactions, (v) the degree of auditor subjectivity in applying audit procedures to address the matter or in evaluating the results of those procedures, (vi) the nature of audit evidence obtained regarding the matter, and (vii) other audit-or-entity-specific considerations.

Based on the above-mentioned further evaluation, the independent auditor determined that only two out of the five preliminary CAM items were eventually determined as final CAM, being the estimated useful lives of fixed assets and the accounting for leases, as they were matters arising from the current period (i.e. 2019) audit of the financial statements that were communicated or required to be communicated to TCWG and that related to accounts or disclosures that were material to the financial statements and involved especially challenging, subjective, or complex auditor judgments. The independent auditor performed certain audit procedures that were responsive to the audit risks associated with those CAM items.

The approaches for identifying, evaluating, and determining CAM in the audits of the 2020 and 2021 financial statements of PT XYZ were consistent with those used in the audit of the 2019 financial statements, which resulted in the identification of the following matters as preliminary CAM during those audits: (i) the allowance for doubtful receivables, (ii) revenue recognition, (iii) valuation of an investment in securities, and (iv) the estimated useful lives of fixed assets. The accounting for leases and the recovery of plan assets of defined benefit pension plan were identified as preliminary CAM in the audit of the 2020 financial statements, but were not in 2021 because they did not meet the CAM definition in the the audit of the 2021 financial statements. For both the audits of the 2020 and 2021 financial statements, the estimated useful lives of fixed assets was the only CAM evaluated and determined as a final CAM.

Below is the summary of CAM items identified as preliminary CAM and their subsequent evaluation and determination as final CAM during the audits of the financial statements of PT XYZ during 2019-2021:

No.	Description	2019		2020		2021	
		Preliminary CAM	Final CAM	Preliminary CAM	Final CAM	Preliminary CAM	Final CAM
1.	Allowance for doubtful receivables	Yes	No	Yes	No	Yes	No

2.	Acquisition of telecommunication towers	Yes	No	No	No	No	No
3.	Revenue recognition	Yes	No	Yes	No	Yes	No
4.	Accounting for leases	Yes	Yes	Yes	No	No	No
5.	Estimated useful lives of fixed assets	Yes	Yes	Yes	Yes	Yes	Yes
6.	Valuation of an investment in securities	Not applicable	Not applicable	Yes	No	Yes	No
7.	Recovery of plan assets of defined benefit pension plan	Not applicable	Not applicable	Yes	No	No	No

The implementation of KAM communication in the independent auditor's report reflects the applicability of the source credibility theory, which requires the elements of source expertise and source trustworthiness when messages are expected to be communicated effectively to the audience. The independent auditor, who is the source of messages in this context, is considered capable of providing accurate information due to their expertise based on their qualification, training, experience, and professionalism. Further, they are also perceived as trustworthy due to their high professional and ethical standards, including independence requirements. Accordingly, the intended users, who are the receivers of messages in this context, are expected to find the information contained in the independent auditor's report accurate, reliable, relevant, and useful, so that the KAM communication improves the integrity, credibility, transparency, and communicative value of the audited financial statements.

## **5.2. CHALLENGES ENCOUNTERED AND THE RELATED CRITICAL SUCCESS FACTORS IN IMPLEMENTING KAM/CAM**

During the implementation of CAM, the independent auditor and PT XYZ encountered several challenges, such as additional time, cost, and effort required, especially by the independent auditor, as both the independent auditor and TCWG required additional time and resources to learn and explore further on their understanding about KAM/CAM and the risks of materi material misstatement and significant management judgments/estimates contained in the financial statements. Further, additional time were also required by both parties

to be engaged and discussed potential CAM topics as they were developed, especially in the first year of KAM implementation, and aligned their perspectives about what constituted to be final CAM that would be communicated in the independent auditor's report. The positive action that was conducted was to implement a dry run session for CAM implementation using the 2018 audited financial statements as the basis prior to the commencement of the audit of the 2019 financial statements, so that management and TCWG would obtain a perspective on how the CAM communication would look like had CAM communication been implemented in the audit of the 2018 financial statements.

Based on this research, it was noted that the following critical success factors are important and essential to facilitate an effective implementation of KAM: (i) having sufficient knowledge and understanding about KAM and the risks of material misstatement and significant management judgments/estimates contained in financial statements, (ii) maintaining continuous dialog between the independent auditor and TCWG during the audit process as KAM topics are developed, (iii) ensuring the alignment of the objective, process, and benefits of KAM communication, and (iv) conducting a timely executed dry run on KAM communication implementation.

## **6. CONCLUSION AND RECOMMENDATION**

This research concludes that the implementation process of KAM communication is an ongoing process, challenging, and requires additional time and resources, and that certain critical success factors are essential to facilitate an effective implementation of KAM communication. Certain recommendations were also provided to TCWG and the independent auditor to improve their existing process for KAM implementation, which include improving their understanding and competencies about KAM, maintaining continuous and timely communications during the audit, and improving professional skepticism of the independent auditors. This research focuses on the KAM communication implementation from the perspective of independent auditor and TCWG and does not cover other stakeholders. Future research may be required to investigate the impact of KAM communication to other stakeholders.

### **ACKNOWLEDGEMENT**

I would like to express my most gratitude to the Almighty God who has blessed us with every spiritual blessing in the heavenly places and given us life. I also would like to thank Agung Nugroho Soedibyo, M.Ak., Dr. Ancella Anitawati Hermawan, CA, and Nureni Wijayati, Ph.D., CA who provided their views, comments, expertise, and wisdom that greatly improved the manuscript of this research. Lastly, I would like to thank dr. Margareth J. Widiastuti, M.Gizi, my beloved wife, who provided her support and encouragement that has made the completion of this research possible. This research was self-funded.

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