

Key Audit Matters and Earnings Management: Evidence from Indonesian Manufacturing Firms

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Abstract

This study examines the effect of Key Audit Matter (KAM) disclosures on earnings management (EM) among manufacturing firms listed on the Indonesia Stock Exchange (IDX) from 2022 to 2024. Motivated by concerns over the standardized and less informative nature of KAM reporting, the study explores whether disclosure quantity, length, and specificity content of KAM disclosure are associated with EM behavior. Using 227 firm-year observations, the findings reveal that the number and length of KAMs do not significantly affect EM, while greater entity-specific disclosure is negatively associated with earnings management. These findings highlight the importance of enhancing the *quality* rather than the *quantity* of KAM disclosures. Practically, the study suggests that regulators and auditors should prioritize the contextual richness of KAM narratives to improve audit transparency and strengthen financial reporting credibility in emerging markets.

Keywords: Key Audit Matters, Disclosure Quality, Earnings Management, Audit Transparency,

Abstrak

Penelitian ini mengkaji pengaruh pengungkapan *Key Audit Matter* (KAM) terhadap manajemen laba (EM) pada perusahaan manufaktur yang terdaftar di Bursa Efek Indonesia (BEI) selama 2022–2024. Penelitian ini dilatarbelakangi kekhawatiran bahwa pengungkapan KAM dapat menjadi bersifat standar dan kurang informatif. Penelitian ini menguji apakah kuantitas, panjang, dan tingkat kekhususan isi pengungkapan KAM berhubungan dengan perilaku manajemen laba. Dengan menggunakan 227 observasi perusahaan, hasil penelitian menunjukkan bahwa jumlah dan panjang KAM tidak berpengaruh signifikan terhadap manajemen laba, sementara KAM yang lebih spesifik terhadap entitas berhubungan negatif dengan praktik manajemen laba. Temuan ini menegaskan pentingnya peningkatan kualitas dibandingkan kuantitas pengungkapan KAM. Secara praktis, penelitian ini menyarankan agar regulator dan auditor lebih menekankan kekayaan konteks dalam narasi KAM guna meningkatkan transparansi audit dan memperkuat kredibilitas pelaporan keuangan di pasar negara berkembang.

Kata Kunci: Key Audit Matters, Kualitas Pengungkapan, Manajemen Laba, Transparansi Audit

1. INTRODUCTION

Earnings management (EM) remains a persistent challenge that undermines the reliability of financial reporting and the credibility of corporate governance, particularly in emerging markets such as Indonesia Auliana et al. (2023), Itan et al. (2024) and Mappadang et al. (2024). EM refers to managerial discretion in manipulating accounting figures to influence reported earnings, thereby affecting investors and stakeholders' decisions Healy & Wahlen (1998). This practice can reduce the usefulness of financial statements for evaluating firm performance and lead to inefficiencies in capital allocation. This issue is particularly relevant in Indonesia, where weak enforcement and concentrated ownership structures often create opportunities for managerial discretion Sri Murni et al. (2023).

In response to these concerns, the International Auditing and Assurance Standards Board (IAASB) issued ISA 701 Communicating Key Audit Matters (KAM) to enhance the transparency of audit reports by requiring auditors to disclose matters that were of most significance during the audit. Indonesia formally adopted this standard through SA 701: "Pengkomunikasian Hal Audit Utama dalam Laporan Auditor Independen", which was issued by Institut Akuntan Publik Indonesia (IAPI) on 13 July 2021 and became effective for audits of financial statements for periods beginning on or after 1 January 2022 IAPI (2021). The objectives of KAM disclosure are twofold: first, to provide additional insight for report users about areas involving significant auditor judgment, and second, to enhance auditor accountability by clarifying where auditors concentrated their attention, both of which are expected to strengthen external monitoring and reduce information asymmetry between management and shareholders Ma et al. (2024).

However, the implementation of SA 701 in Indonesia has not always translated into improved financial reporting quality during the 2022–2024 period Lauren & Mita (2023), Novita & Fatima (2024). Recent evidence indicates that earnings management (EM) practices persist across various manufacturing-related sectors despite the full adoption of KAM reporting. For instance, Paramastri et al. (2023) found that firms in the chemical, pharmaceutical, and telecommunications industries continued to engage in earnings management during the early years following the adoption of SA 701, suggesting that audit transparency had yet to meaningfully constrain managerial discretion. Since SA 701 became effective for audits beginning in 2022 IAPI (2021), the 2022–2024 period marks the initial phase of its implementation in Indonesia. Several recent studies focusing on this period Fakhri (2024), Gita Rhamadhani & Heriyati (2025) reveal that although KAM disclosures have increased, earnings management practices persist, particularly in manufacturing firms. These findings underscore that the mere presence of KAM disclosures does not necessarily deter opportunistic reporting behavior, implying that SA 701 compliance may remain largely procedural rather than substantive. Consequently, this raises an important question as to whether KAM disclosures function as a genuine monitoring mechanism capable of constraining EM in Indonesia's manufacturing sector, or if they primarily serve as a symbolic compliance tool.

Empirical findings across countries have shown mixed results regarding the effectiveness of KAM disclosures. Studies in developed economies such as the UK and Australia indicate that while KAM improves users' understanding of audit focus areas, its impact on earnings quality remains inconsistent Gutierrez et al. (2018), Sirois et al. (2018). Further, recent

evidence shows that the *nature* of KAM matters more than its number. Narrative depth, specificity, and client-tailored disclosures are associated with lower earnings management, while standardized or boilerplate disclosures that is, generic and repetitive audit statements copied across clients without reflecting their unique risks offer little incremental value Camacho-Miñano et al. (2024). In contrast, research from emerging markets shows context-dependent results. For instance, in a Middle Eastern context, Matta & Feghali (2021) found that KAM disclosures significantly improved information quality and reduced information asymmetry; however, in China (Liu, 2025) observed that while KAM disclosures increased, their impact on earnings management was weak or non-significant, likely because many disclosures remained generic and lacked client-specific depth. Such inconsistencies suggest that institutional context, audit enforcement, and corporate governance strength may moderate the effectiveness of KAM disclosures.

In Indonesia, empirical research on KAM remains relatively limited and inconclusive. While a few studies have examined its association with earnings management Batara et al. (2024), Herlina & Lastanti (2025) most prior works have focused on its relationship with audit fees and audit report lag Rahaman & Bhuiyan (2025), Yulianto et al. (2025). Moreover, KAM disclosure practices in Indonesia tend to be relatively uniform. Firms typically disclose two to three KAMs focusing on similar issues such as revenue recognition, receivables, and inventory valuation. This pattern suggests possible standardization, which may reduce the informational content and monitoring value of the disclosures. Despite the regulatory mandate, it remains unclear whether such standardized KAM disclosures hold substantive monitoring value or merely fulfill formal compliance requirements. Therefore, it is essential to assess whether KAM characteristics particularly their number and narrative richness play a meaningful role in constraining earnings management in the Indonesian context.

Theoretically, this study is grounded in agency theory and signaling theory. According to agency theory, effective monitoring mechanisms such as informative auditor reporting should reduce managerial discretion in financial reporting Soras et al. (2025). Meanwhile, signaling theory suggests that auditors' disclosures serve as signals of audit quality and diligence, provided that such disclosures are credible and client-specific. When KAM narratives are detailed and entity-focused, they convey auditor effort and independence, potentially discouraging managers from engaging in opportunistic earnings management. Accordingly, this study empirically tests whether the characteristics of KAM disclosures align with these theoretical expectations.

Therefore, the research question addressed in this study is whether the characteristics of Key Audit Matter (KAM) disclosures constrain earnings management among manufacturing firms listed on the Indonesia Stock Exchange during 2022–2024. KAM characteristics are operationalized through three dimensions: the number of KAMs (NKAM), the word count of KAM disclosures (WKAM), and the proportion of entity-specific KAMs (PKAM). The study employs a firm fixed-effects panel regression model and estimates discretionary accruals using the Modified Jones approach to capture accrual-based earnings management. Recent Indonesian studies have begun to explore the link between KAM disclosures and earnings management, suggesting that the implementation of KAMs may enhance audit transparency and discourage opportunistic reporting behavior Batara et al. (2024), Herlina & Lastanti (2025). However, the consistency of these effects remains underexplored across different sectors,

especially in manufacturing firms, which tend to have greater complexity of operations, significant physical assets and more intricate accounting estimates and audit risks Rachman & Astri (2024), Saleh et al. (2025).

The findings are expected to provide insights into whether KAM disclosures under SA 701 function as a genuine transparency mechanism or merely a formal compliance requirement, thereby offering empirical evidence that contributes to both the theoretical understanding and practical evaluation of audit reporting quality in emerging markets. Furthermore, considering that SA 701 has only been effectively implemented in Indonesia since 2022, existing studies have provided preliminary insights but have yet to offer a comprehensive understanding of its effectiveness in reducing audit expectation gaps and improving financial reporting credibility Kumaunang et al. (2024). Hence, this study offers novelty by examining the quality dimensions of KAM disclosures, which remain underexplored in Indonesian research contexts.

2. LITERATURE REVIEW AND HYPOTHESES FORMULATION

Agency Theory

The relationship between principals (shareholders) and agents (managers) describes a condition in which managers are authorized to make decisions on behalf of shareholders. However, because managers are often driven by personal interests, they do not always act in the best interest of shareholders. This condition creates agency conflict, which commonly arises due to information asymmetry, where managers have greater access to internal company information than shareholders. When managers possess superior information, they can engage in opportunistic behavior, including manipulating accounting figures to achieve certain goals such as maximizing bonuses, avoiding debt covenant violations, or meeting market expectations Eisenhardt (1989), Sri Utaminingsih et al. (2022). This relationship is explained by agency theory Jensen & Meckling (1976).

In this context, auditing serves as a crucial monitoring mechanism to reduce agency conflict. Auditors, as independent third parties, are expected to ensure that the information presented in financial statements reflects the company's actual condition. The introduction of Key Audit Matters (KAMs) strengthens this monitoring function by requiring auditors to disclose significant audit areas involving high judgment or potential material misstatements Fattahaulia Qadrina & Raharja (2024). By revealing critical audit areas, KAM disclosures reduce information asymmetry and limit managerial latitude, thereby operationalizing the agency monitoring function. Under agency theory, transparent and informative KAM disclosures are therefore expected to improve external monitoring and restrict managerial discretion in financial reporting.

Signaling Theory

Signaling theory Spence (1973), complements agency theory by emphasizing how information disclosure acts as a signal of underlying quality or credibility. In the auditing context, KAMs serve as signals of audit quality and auditor diligence Li et al. (2024). Audit-related disclosures convey credible signals when they are verifiable and costly to imitate. When auditors disclose detailed, entity-specific KAMs, users of financial statements may perceive that the auditor has performed a thorough and independent examination, thereby enhancing the

credibility of the audit report. Conversely, standardized or boilerplate KAMs may convey weak signals and reduce users' confidence Al Qahtani et al. (2025).

Accordingly, signaling theory suggests that the quality of KAM disclosure reflected in its specificity, narrative depth, and contextual relevance plays an essential role in communicating auditor competence and integrity. When KAMs are informative, they not only reduce information asymmetry but also enhance market trust, leading to improved perceptions of financial reporting quality and audit credibility Ariadi et al. (2023).

Key Audit Matters and Earnings Management

Key Audit Matters (KAMs) are disclosures made by auditors regarding areas that required significant professional judgment during the audit process. As regulated under ISA 701 and its Indonesian equivalent SA 701, these disclosures are intended to improve the transparency and communicative value of audit reports Kumaunang et al. (2024). Through KAMs, auditors communicate to users which aspects of the audit involved the highest levels of risk, complexity, or estimation uncertainty.

Empirical studies in developed markets show mixed evidence regarding the impact of KAM disclosures on earnings management (EM). Sirois et al. (2018) and Gutierrez et al. (2018) found that the implementation of KAMs in the UK improved investors' understanding of audit focus areas but did not significantly reduce accrual-based EM. Similarly, Reid et al. (2018) observed that while KAMs increased audit effort and cost, they did not meaningfully alter EM behavior. These findings suggest that enhanced audit communication alone may not be sufficient to influence managerial discretion.

In contrast, evidence from emerging and developing contexts presents more varied results. Studies from Middle Eastern settings indicate that longer and more narrative KAMs are negatively associated with EM, implying that disclosure depth matters more than mere quantity. Camacho-Miñano et al. (2024) found in Spain that firms adjusted their EM strategies after KAM adoption, shifting from accrual-based to real earnings management. Li et al. (2024) reported that in China, the quality of KAMs measured by specificity and contextual richness had a stronger negative association with EM than the count of KAMs disclosed. Taken together, these findings suggest that KAMs influence earnings management not only through disclosure quantity but also through their credibility and informativeness, consistent with both agency and signaling perspectives.

In Indonesia, empirical research on KAMs remains limited but has started to emerge in recent years. For example, Batara et al. (2024) documented that KAM disclosures contribute to improved audit transparency and may discourage earnings management practices, while Herlina & Lastanti (2025) found that the effectiveness of KAMs in constraining EM depends on the auditor's professional skepticism and the client's governance strength. Meanwhile, Kumaunang et al. (2024) emphasized that although SA 701 has been implemented, auditors often rely on standardized KAM templates, reducing the informational value of disclosures. However, Yulianto et al. (2025) reported that KAM disclosure did not significantly affect EM among manufacturing firms, implying that auditors may still treat SA 701 as a formal compliance exercise. Domestic audit reports also show a lack of variation in KAM topics, which typically revolve around receivables, inventory, and revenue recognition Batara et al. (2024). Given Indonesia's developing audit environment and standardized disclosure patterns,

it remains uncertain whether the signaling role of KAMs effectively constrains opportunistic reporting behavior. Therefore, it is necessary to examine whether specific characteristics of KAMs such as their number, narrative length, and entity-specific content are associated with reduced EM among Indonesian firms.

Prior research across various countries presents mixed results regarding the effect of Key Audit Matters (KAMs) on earnings management. In developed economies, Gutierrez et al. (2018) analyzed audit reports in the United Kingdom and found that KAM implementation increased users' understanding of audit focus areas but had no significant impact on reducing accrual-based earnings management. Similarly, Sirois et al. (2018) examined the French and UK settings and concluded that while KAMs improved audit transparency, they primarily enhanced *perceived audit quality* rather than actual reporting quality. In contrast, evidence from emerging markets offers more optimistic insights. Aljerd & Abazeed (2025) investigated listed firms in Jordan and found that detailed and entity-specific KAM disclosures significantly constrained discretionary accruals, suggesting that narrative quality enhances auditor monitoring. Likewise, Li et al. (2024) demonstrated in the Chinese context that longer and more client-tailored KAM narratives were associated with lower real earnings management, indicating that qualitative disclosure characteristics matter. However, studies in Indonesia show more limited progress. Yulianto et al. (2025) found that auditors tend to view KAMs as a formal compliance requirement rather than as a substantive communication mechanism, which weakens their potential to mitigate opportunistic reporting practices.

This variation highlights the need to further examine the characteristics of KAM disclosure including number, length, and specificity as determinants of earnings management behavior in Indonesian firms.

Hypotheses Development

Based on agency theory, KAM disclosures strengthen external monitoring and limit managerial discretion by increasing the transparency of audit focus areas and revealing the specific accounting estimates or judgments that auditors consider most significant. When such sensitive areas are publicly disclosed, managers become more cautious in manipulating earnings because their decisions are subject to greater scrutiny by investors, regulators, and audit committees. Consequently, higher disclosure transparency reduces information asymmetry and deters opportunistic behavior, thereby lowering the likelihood of earnings manipulation Herlina & Lastanti (2025). Meanwhile, signaling theory suggests that the informativeness and specificity of KAM narratives communicate audit quality and credibility to users, thereby discouraging managers from engaging in opportunistic reporting practices. When auditors disclose detailed and client-specific KAMs, the signal sent to external stakeholders is one of heightened auditor diligence and stronger oversight. This increased scrutiny raises the reputational and detection risk for managers, making aggressive accounting choices or earnings manipulation less attractive Junior & Galdi (2020), Wee GOH et al. (2024).

Based on the theoretical framework of agency theory and signaling theory, the characteristics of Key Audit Matter (KAM) disclosures are expected to influence the extent of earnings management in audited firms. KAMs serve as an essential communication channel that reflects the auditor's professional judgment and attention to areas of significant risk. The following hypotheses are developed to test these relationships.

A greater number of KAM disclosures reflects broader auditor attention to multiple areas of financial statement risk, which signals higher audit diligence and enhances external monitoring. When auditors identify and report several key issues, managers are aware that their financial reporting behavior is under closer scrutiny, thereby discouraging opportunistic earnings management. Prior evidence suggests that extensive KAM disclosure improves transparency and reduces accrual manipulation by limiting managerial discretion Herlina & Lastanti (2025), Li et al. (2024).

H1a: The number of Key Audit Matters (NKAM) is negatively associated with earnings management.

The narrative length of KAM disclosures indicates the depth of explanation and audit reasoning provided by auditors. Longer KAM texts reflect greater transparency and information content, enabling stakeholders to better understand auditor focus and professional skepticism. This detailed communication increases perceived audit quality, reduces information asymmetry, and constrains opportunistic managerial behavior (Camacho-Miñano et al., 2024; Li et al., 2024; GOH et al., 2024).

H1b: The length of Key Audit Matter (WKAM) disclosures is negatively associated with earnings management.

Entity-specific KAMs provide client-tailored insights into risks unique to each firm, thereby demonstrating auditor independence and in-depth understanding of the client's operations. Such disclosures enhance the credibility of audit reports and strengthen the signaling effect of audit quality. Prior studies show that entity-specific KAMs carry higher informational value and help curb discretionary reporting practices Aljerd & Abazeed (2025), Herlina & Lastanti (2025), Wee GOH et al. (2024).

H1c: The proportion of entity-specific Key Audit Matters (PKAM) is negatively associated with earnings management.

3. RESEARCH METHODS

Population and Sample

This study uses annual reports of manufacturing firms listed on the Indonesia Stock Exchange (IDX) for the 2022–2024 period. The sample focuses on manufacturing firms because this sector involves complex accounting estimates and higher audit risk, making it an appropriate context to assess the effectiveness of Key Audit Matter (KAM) disclosures in constraining earnings management. Annual reports were obtained from the official IDX website (www.idx.co.id), while financial variables were collected from the Refinitiv Eikon database, a global financial data platform that provides standardized and audited firm-level information, ensuring accuracy, consistency, and comparability across firms and reporting years. A purposive sampling technique was employed because it enables the selection of samples that meet specific research criteria. The criteria include: (1) consistent disclosure of Key Audit Matters (KAMs) and (2) availability of complete financial and audit data. Firms with incomplete or restated reports are excluded. Specifically, 183 firms were removed due to missing financial or audit information across the 2022–2024 period, such as unavailable annual reports or incomplete financial variables in the Refinitiv Eikon database. In addition, 122 firms

were excluded because they did not consistently disclose KAMs in their auditor’s reports for all observed years. Consistent KAM disclosure is essential to ensure the comparability of KAM characteristics namely, the number, narrative length, and entity-specific content over time. The final sample consists of 227 manufacturing firms, producing 681 firm-year observations, as presented in Table 1.

Table 1. Sample Selection

No.	Description	Sample Size
1	Manufacturing sector companies listed on the IDX from 2022 to 2024	532
2	Companies without complete financial or audit data for the period 2022–2024	(183)
3	Companies that did not consistently disclose Key Audit Matters (KAMs)	(122)
Total sample companies		227
Final balanced data used in this study observation years (3 years)		681

Variable Measurement

The operational definitions and measurements of variables are summarized in Table 2.

Table 2. Variable Measurement

Variable	Measurement Indicator	Scale	Source	Supporting Literature
NKAM	The NKAM is obtained by counting the total distinct KAM items identified by the auditor in each report.	Ratio	Auditor Report (IDX)	Aljerd & Abazeed (2025), Rahaman & Bhuiyan (2025)
WKAM	WKAM is calculated by counting all words contained in the narrative explanation of each KAM using a word-count tool in Microsoft Word.	Ratio	Auditor Report (IDX)	Aljerd & Abazeed (2025), Li et al. (2024)
PKAM	PKAM is calculated as: (Number of entity-specific KAMs / Total KAMs) × 100%.	Ratio	Auditor Report (IDX)	Aljerd & Abazeed (2025)
EM	Earnings management measured by discretionary accruals estimated through an accrual-based from equation 3	Ratio	Financial Statements	Dechow et al. (1994)
SIZE	Natural logarithm of total assets	Ratio	Financial Statements	Gul et al. (2001)
LEV	Measured as total debt divided by total assets	Ratio	Financial Statements	DeFond & Jiambalvo (1994)
ROA	Net income divided by total assets	Ratio	Financial Statements	Jere & Yu (2009)

The study’s dependent variable is Earnings Management (EM), which captures accrual-based manipulation through discretionary accruals. The independent variable is Key Audit Matter (KAM), measured by its number, length, and specificity. Control variables include firm size (SIZE), leverage (DAR), and profitability (ROA) are included to control firm-specific

characteristics that may affect earnings management. Larger, more leveraged, or more profitable firms tend to differ in managerial incentives, so including these variables helps isolate the true association between KAM disclosures and EM DeFond & Jiambalvo (1994), Gul et al. (2001).

Earnings Management

Accrual-based earnings management (AEM) is measured using the Modified Jones Model developed by Dechow et al. (1994), which is widely recognized for its robustness in detecting discretionary accruals. This model adjusts for changes in credit sales to isolate non-discretionary components of accruals. First, total accruals (TA) are computed as:

$$TA_{i,t} = NI_{i,t} - CFO_{i,t} \quad (1)$$

Where, $NI_{i,t}$ = net income for firm i in year t , $CFO_{i,t}$ = operating cash flow.

Total accruals are then scaled by lagged total assets ($A_{i,t-1}$):

$$\frac{TA_{i,t}}{A_{i,t-1}} = \alpha_1 + \beta_1 \left(\frac{1}{A_{i,t-1}} \right) + \beta_2 \left(\frac{\Delta REV_{i,t} - \Delta REC_{i,t}}{A_{i,t-1}} \right) + \beta_3 \left(\frac{PPE_{i,t}}{A_{i,t-1}} \right) + \varepsilon_{DA-MDJONES} \quad (2)$$

Where, ΔREV is change in revenue. ΔREC change in receivables. PPE gross property, plant, and equipment.

The fitted values (NDA) represent Non-Discretionary Accruals, while the residuals ($\varepsilon_{DA-MDJONES}$) represent Discretionary Accruals (DA), the proxy for earnings management:

$$DA_{i,t} = \frac{TA_{i,t}}{A_{i,t-1}} - NDA_{i,t} \quad (3)$$

A higher absolute value of DA indicates greater earnings management.

Key Audit Matters (KAM)

The characteristics of Key Audit Matters (KAMs) in this study are captured through three indicators: NKAM, WKAM, and PKAM. The variable NKAM represents the total number of distinct KAMs disclosed in the auditor's report, reflecting the breadth of audit focus areas communicated to stakeholders. WKAM measures the total number of words contained in the KAM section, serving as an indicator of disclosure depth and narrative richness. Meanwhile, PKAM denotes the proportion of entity-specific KAMs to the total number of KAMs disclosed, which captures the contextual and firm-specific nature of the auditor's communication. Collectively, these three indicators represent the overall quality of KAM disclosure, encompassing its quantity, depth, and contextual relevance in enhancing the transparency and informativeness of audit reporting.

Research Model

To test the hypotheses, the study employs panel data regression using the Fixed Effects Model (FEM), which controls for unobserved firm-specific heterogeneity. The model is chosen based on the Hausman test, indicating that FEM is more appropriate than Random Effects ($p < 0.05$). Three regression models are estimated as follows:

Model 1:

$$EM_{it} = \alpha_i + \beta_1 NKAM_{i,t} + \beta_2 SIZE_{i,t} + \beta_3 LEV_{i,t} + \beta_4 ROA_{i,t} + \varepsilon_{i,t} \tag{4}$$

Model 2:

$$EM_{it} = \alpha_i + \beta_1 WKAM_{i,t} + \beta_2 SIZE_{i,t} + \beta_3 LEV_{i,t} + \beta_4 ROA_{i,t} + \varepsilon_{i,t} \tag{5}$$

Model 3:

$$EM_{it} = \alpha_i + \beta_1 PKAM_{i,t} + \beta_2 SIZE_{i,t} + \beta_3 LEV_{i,t} + \beta_4 ROA_{i,t} + \varepsilon_{i,t} \tag{6}$$

where:

EM = Discretionary accruals of firm *i* in year *t*

NKAM = number of KAMs disclosed

WKAM = total words in KAM section

PKAM = proportion of entity-specific KAMs

SIZE = firm size (log of total assets)

LEV = total liabilities/total assets

ROA = return on assets

α_i = firm-specific fixed effect

ε = error term;

Each model isolates one KAM characteristic to determine whether disclosure quantity, narrative length, or contextual specificity has a stronger effect in constraining earnings management.

4. RESULTS AND DISCUSSION

Descriptive Statistics

This study uses a balanced panel of 681 firm-year observations from 227 manufacturing firms listed on the Indonesia Stock Exchange (IDX) during 2022–2024. Table 3 summarizes the descriptive statistics of all variables.

Table 3. Descriptive Statistics

Description	DA	NKAM	WKAM	PKAM	SIZE	DAR	ROA
Mean	0.2022	1.4596	138.81	0.0362	28.188	1.1239	-0.0025
Median	0.1092	1.0000	98.000	0.0000	28.213	0.3957	0.0360
Maximum	4.7812	5.0000	2039.0	1.0000	33.790	111.45	4.6933
Minimum	0.0001	1.0000	0.0000	0.0000	22.879	0.0026	-9.9300
Std. Dev.	0.4029	0.8516	179.18	0.1717	1.7955	7.4910	0.6421

The mean value of discretionary accruals (DA) of 0.2022 indicates a moderate level of earnings management among Indonesian manufacturing firms. This interpretation follows prior studies, where DA values between 0.10 and 0.25 are considered indicative of moderate accrual manipulation, while values above 0.30 reflect aggressive earnings management practices Herlina & Lastanti (2025), Rahaman & Bhuiyan (2025). On average, auditors disclose about one to two Key Audit Matters (NKAM), showing that most audit reports focus on a limited number of significant issues. The average KAM word count (WKAM) of 139 words suggests concise reporting, considering that prior studies classify KAM narratives below 150 words as

brief or boilerplate in nature Camacho-Miñano et al. (2024), Li et al. (2024). Meanwhile, the mean proportion of entity-specific KAMs (PKAM) of 3.6% reflects that most disclosures remain generic and lack firm-specific depth, as prior literature indicates that a PKAM value below 10% generally represents standardized disclosures with limited informational content Aljerd & Abazeed (2025).

The average firm size (SIZE = 28.18) shows wide variation across firms, while the mean debt-to-asset ratio (DAR = 1.12) suggests relatively high leverage in the sample. The mean ROA (-0.0025) indicates that some firms experienced negative profitability during the observation period, possibly reflecting the effects of post-pandemic recovery in the manufacturing sector.

Model Selection

Before estimating the regression model, a model selection test was performed using the Chow and Hausman tests.

Table 4. Model Selection

Model 1 Specification	Effects Test	Statistic	Prob.
Chow Test	Cross-section F	2.421662	0.0000
Hausman Test	Cross-section random	66.558721	0.0000
Model 2 Specification	Effects Test	Statistic	Prob.
Chow Test	Cross-section F	2.412785	0.0000
Hausman Test	Cross-section random	66.237408	0.0000
Model 3 Specification	Effects Test	Statistic	Prob.
Chow Test	Cross-section F	2.510437	0.0000
Hausman Test	Cross-section random	80.792070	0.0000

The results consistently indicate that the Fixed Effect Model (FEM) is the most appropriate specification for all three models, confirming the presence of firm-specific heterogeneity.

Hypothesis Testing

Panel data regression analysis was conducted using the Fixed Effect Model (FEM) with clustered robust standard errors to examine the effect of Key Audit Matter characteristics on earnings management (DA). Three separate models were estimated to test the effect of (1) the number of KAMs (NKAM), (2) KAM length (WKAM), and (3) the proportion of entity-specific KAMs (PKAM) on earnings management.

Table 5. Hypothesis Testing

Variable	Coefficient (β)	Std. Error	t-Statistic	Prob.
Constant	-16.460	2.0804	-7.9120	0.0000
NKAM	0.0279	0.0341	0.8874	0.3753
WKAM	-0.0000	0.0001	-0.1371	0.8910
PKAM	-0.2872	0.0919	-3.1236	0.0019
SIZE	0.5823	0.0736	7.9076	0.0000
DAR	0.0170	0.0181	0.9390	0.3482
ROA	0.7421	0.0511	14.508	0.0000

The FEM results reveal that the number (NKAM) and length (WKAM) of KAM disclosures are not statistically associated with earnings management, as indicated by their high p-values (0.3753 and 0.8910, respectively). However, the proportion of entity-specific KAMs (PKAM) shows a negative and statistically significant coefficient ($\beta = -0.2872$, $p = 0.0019$), suggesting that firms receiving more tailored and specific KAM disclosures tend to engage less in earnings management.

Among control variables, firm size (SIZE) and profitability (ROA) exhibit positive and significant relationships with discretionary accruals, indicating that larger and more profitable firms may still engage in some earnings adjustments, possibly to meet market expectations. Leverage (DAR) shows a positive but insignificant effect.

The coefficient of determination ($R^2 = 0.8141$; Adjusted $R^2 = 0.7179$) indicates that the model explains approximately 71.8% of the variation in earnings management, reflecting high explanatory power. The overall F-statistic (Prob. F = 0.0000) confirms that all independent variables jointly influence earnings management. The Durbin-Watson statistic (2.9119) suggests no autocorrelation problem, indicating the regression model is valid and reliable for inference.

Discussion

The Number of Key Audit Matters (NKAM)

Referring to Table 5, the results show that the number of Key Audit Matters (NKAM) are not statistically associated with discretionary accruals (DA), as indicated by a probability value of 0.3753, which exceeds the 0.05 significance level. Thus, hypothesis H1a is not supported. This finding suggests that the mere quantity of KAMs disclosed by auditors does not effectively constrain earnings management practices among Indonesian manufacturing firms.

From the perspective of agency theory Jensen & Meckling (1976), KAM disclosures are expected to enhance monitoring by increasing audit transparency. However, when auditors disclose KAMs only to meet regulatory requirements rather than to provide informative communication, the intended monitoring role becomes less effective. The lack of variation in NKAM across firms where most audit reports include only one or two KAMs indicates a standardized and formulaic disclosure pattern, consistent with prior Indonesian evidence (Yulianto et al., 2025).

This finding aligns with Gutierrez et al. (2018) and Reid et al. (2019), who also found that the introduction of KAMs did not significantly reduce earnings management in the UK. Conversely, it contrasts with Aljerd and Abazeed (2025), who found that in emerging markets, more detailed and context-rich audit reporting may reduce earnings manipulation. Thus, the evidence indicates that in Indonesia, the number of KAMs alone does not reflect audit quality or constraint on opportunistic reporting behavior. This may occur because KAM disclosure in Indonesia is still largely compliance-oriented, with auditors disclosing a minimum number of matters to fulfill regulatory requirements rather than to communicate substantive audit insights. Moreover, the limited differentiation of KAM topics across firms reduces the informational value of disclosure quantity, making the number of KAMs an inadequate proxy for audit quality in constraining earnings management.

The Length of Key Audit Matter

Referring to Table 5, the results show that KAM word count (WKAM) has no significant effect on discretionary accruals (DA), with a probability value of 0.8910 (> 0.05). Therefore, hypothesis H1b is not supported. Although WKAM theoretically reflects disclosure depth and the auditor's narrative effort, longer wording in KAM sections does not necessarily equate to substantive information or stricter monitoring.

This result implies that verbosity without contextual relevance fails to reduce information asymmetry between auditors and stakeholders. In Indonesia, auditors often use standardized and cautious language when drafting KAM disclosures to comply formally with SA 701 while avoiding potential legal or reputational risks. Consequently, higher word counts may merely represent descriptive elaboration rather than genuine auditor insight or client-specific discussion. This institutional tendency toward "compliance-oriented disclosure" weakens the ability of narrative length to serve as an indicator of audit quality or to constrain managerial opportunism.

This finding is consistent with Sirois et al. (2018) and Camacho-Miñano et al. (2024), who suggest that increasing disclosure volume does not automatically improve audit transparency or earnings quality. However, it diverges from Li et al. (2024), who demonstrated that narrative richness when contextually specific can reduce earnings management in Chinese firms. Hence, in the Indonesian setting, lengthy but generic disclosures lack the informational value needed to influence managerial reporting behavior.

The Entity-Specific Key Audit Matters

Referring to Table 5, the results show that the proportion of entity-specific KAMs (PKAM) has a negative and significant effect on discretionary accruals ($\beta = -0.2872$, $p = 0.0019 < 0.05$). Thus, hypothesis H1c is supported. This finding indicates that KAMs tailored to firm-specific conditions play a meaningful role in reducing earnings management, supporting the argument that contextualized audit communication strengthens audit quality and transparency.

Under signaling theory Spence (1973), detailed and entity-specific KAMs act as credible signals of auditor diligence and independence. When auditors explicitly describe risks unique to a company rather than using generic templates users perceive higher audit credibility, which may discourage managers from manipulating earnings. This finding aligns with Li et al. (2024) and Aljerd & Abazeed (2025), who emphasize that the quality and specificity of KAMs are more important than their quantity in constraining opportunistic financial reporting.

In the Indonesian context, where enforcement remains relatively weak, this result underscores the importance of substance over form in implementing SA 701. Entity-specific KAMs appear to strengthen the monitoring function of audits, enhancing accountability and reducing information asymmetry between managers and shareholders.

5. CONCLUSIONS AND SUGGESTIONS

This study investigates whether the disclosure of Key Audit Matters (KAMs), as mandated by SA 701, effectively constrains earnings management (EM) among manufacturing firms listed on the Indonesia Stock Exchange (IDX) during 2022–2024. Using three KAM disclosure proxies the number of KAMs (NKAM), word count (WKAM), and the proportion

of entity-specific KAMs (PKAM) the findings reveal that none of these characteristics exert a statistically significant direct effect on earnings management. However, the significant overall model observed in the PKAM regression suggests that the qualitative dimension of KAM disclosures may still influence managerial reporting behavior.

These results imply that the practical implementation of SA 701 in Indonesia remains largely procedural and standardized, with auditors disclosing KAMs primarily to meet compliance requirements rather than to convey substantive, firm-specific insights. Although SA 701 aims to enhance audit transparency and accountability, its actual contribution to constraining opportunistic financial reporting appears limited.

From a regulatory perspective, the findings underscore the need for stronger oversight by the Financial Services Authority (OJK) and the Indonesian Institute of Certified Public Accountants (IAPI). Regulators are encouraged to refine KAM-related guidance by emphasizing narrative quality, contextual relevance, and industry differentiation, supported by periodic reviews of KAM disclosure practices. For practitioners and investors, the results highlight the importance of evaluating the substance and specificity of KAM disclosures rather than their quantity alone, as entity-specific discussions more accurately reflect genuine auditor engagement and provide higher informational value.

This study contributes to the limited body of Indonesian research on KAMs but also acknowledges several limitations. First, the analysis focuses solely on manufacturing firms, which may restrict generalization to other sectors. Future studies could expand to financial, mining, or service industries to improve external validity. Second, earnings management is measured only through accrual-based models; incorporating real earnings management proxies could yield a more comprehensive picture of managerial discretion. Third, this study captures only the quantitative dimensions of KAMs number, length, and specificity without assessing the linguistic quality of auditor narratives. Future research using textual analysis (e.g., readability, tone, or sentiment) is recommended to enrich the understanding of KAM quality.

Additionally, since the 2022–2024 period coincides with Indonesia's post-pandemic recovery phase, economic fluctuations may have influenced firm performance and auditor judgment. Extending the study to a longer horizon could reveal long-term shifts in disclosure behavior. Future research may also explore moderating factors such as auditor independence, ownership structure, or audit committee effectiveness to better explain how institutional factors shape the effectiveness of KAM disclosures.

In conclusion, while KAM disclosure under SA 701 represents an important regulatory innovation to enhance audit transparency in Indonesia, its potential as an effective governance mechanism remains underutilized. Strengthening disclosure quality, improving enforcement consistency, and reinforcing professional accountability are essential to transform SA 701 from a procedural compliance requirement into a substantive instrument of audit credibility and financial reporting integrity.

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