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THE INFLUENCE OF EARNINGS MANAGEMENT ON KEY AUDIT MATTERS (KAMs) DISCLOSURE

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ABSTRACT

The study was conducted to examine the influence of earnings management on Key Audit Matters (KAMs) disclosure. The independent variable in this study is earnings management, measured using the Modified Jones Model. The dependent variable is the disclosure of Key Audit Matters (KAMs), measured by three indicators the number of Key Audit Matters (KAMs) accounts, the word count of Key Audit Matters (KAMs) disclosure, and the reason for Key Audit Matters (KAMs) disclosure. There are three control variables in this study company size, profitability, and leverage.

The population of this study consists of companies listed on the Indonesia Stock Exchange (IDX) during 2022 and 2023. The sample was selected using purposive sampling method, resulting in a total sample of 1080 companies. The research data were analyzed using logistic regression and linear regression analysis with Eviews-12.

The test results show that the earnings management variable has a positive and significant inlfuence on the disclosure of Key Audit Matters (KAMs) as measured by the number of accounts. However, earnings management does not have a significant influence on the disclosure of Key Audit Matters (KAMs) when measure by the word count and reason for disclosing Key Audit Matters (KAMs).

Keywords: earnings management, Key Audit Matters (KAMs), profitability, and leverage.

INTRODUCTION

Financial statement users consider traditional audit reports to be less informative because almost all public companies receive the same opinion (unqualified) (Gold & Heilmann, 2019). This creates an expectation gap, which is the difference between what users expect from auditors and financial statement audits and the reality that occurs (IAASB, 2011). Fueled by these criticisms, the IAASB (*International Accounting Standard Board*) responded by introducing a new concept aimed at meeting the information needs of financial statement users (Gold & Heilmann, 2019). The new concept is Key Audit Matters (KAMs), which was introduced on 15 January 2015 and is contained in ISA (International Standard on Auditing) No. 701, entitled "Communicating Key Audit Matters in the Independent Auditor Report" (IAASB, 2015).

Key Audit Matters (KAMs) are defined as matters that, in the auditor's professional judgement, are the most significant in the audit of the current period's financial statements (IAASB, 2015). The purpose of communicating Key Audit Matters (KAMs) is to increase the communicative value of the auditor's report by providing greater transparency about the audit that has been performed. Otoritas Jasa Keuangan (OJK) stated that the adoption of ISA 701 in the presentation of financial statements is the most prioritized standard in Indonesia. As such, ISA 701 was adopted in the Indonesian auditing standard (SA) No.

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701, entitled “Pengkomunikasian Hal Audit Utama Dalam Laporan Auditor Independen”. SA 701 became effective starting 1 January 2022 (IAPI, 2021).

The disclosure of Key Audit Matters (KAMs) is one way to improve auditor effectiveness in communicating financial reporting risks (Nguyen & Kend, 2021). It requires auditors to conduct systematic audit planning to identify risks and significant matters of concern to be disclosed (Pratama & Lusiani, 2024). The disclosure of Key Audit Matters (KAMs) is considered to increase auditor accountability, transparency, and responsibility in financial reporting (Kitiwong & Sarapaivanich, 2020). Increased transparency in financial reporting will ultimately lead to improved reporting quality, which can reduce earnings management practices (Alqam, 2021). Auditors identify areas that require special and significant attention in the financial statements, including areas that are vulnerable to earnings management. Thus, the disclosure of Key Audit Matters (KAMs) can serve as a signal to stakeholders and other financial statements users regarding the quality and reliability of audited financial statements.

Previous studies have primarily focused on the impact of Key Audit Matters (KAMs) disclosure on earnings management practices. For example, Camacho (2024) found that the disclosure of Key Audit Matters (KAMs) has a significant impact on earnings management. This is consistent with the findings of Habeahan (2024), Bepari (2023), Suttipun (2021), and Alqam (2021) which show an improvement in audit quality following the disclosure of Key Audit Matters (KAMs). However, there is no research that directly examines the relationship between earnings management and the disclosure of Key Audit Matters (KAMs). Therefore, this study aims to fill the gap in previous research by focusing on companies listed on the Indonesia Stock Exchange (IDX) in 2022-2023.

RESEARCH FRAMEWORK AND HYPOTHESIS DEVELOPMENT

Signaling Theory

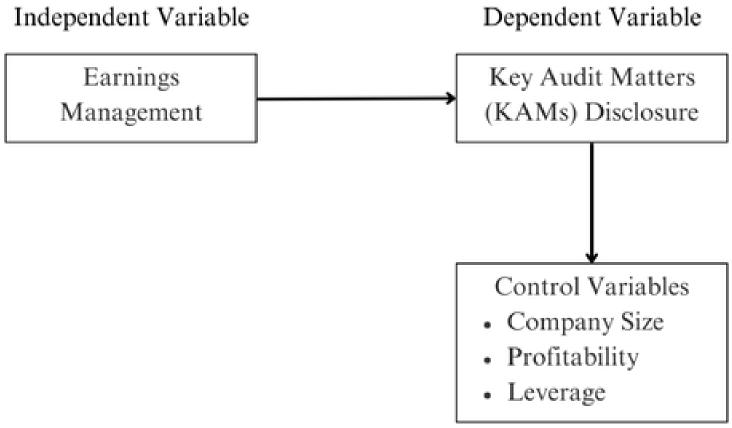
Signaling theory was first introduced by Michael Spence 1973 in his article entitled “*Job Market Signaling*". This theory was later adopted and widely applied in various fields including economics, finance, and accounting. Spence (1973) explains how in situations of information asymmetry, one party can signal to another party to communicate information that cannot be directly observed.

Signaling theory is relevant to this study because signaling theory explains the disclosure of Key Audit Matters (KAMs) as a way to reduce information asymmetry between auditors and users of financial statements by highlighting important areas in the audit. This transparency can assist stakeholders in making more informed decisions (Chirakool et al., 2022).

Research Framework

The framework is used to describe the relationship between the independent variable (earnings management) and the dependent variable (Key Audit Matters disclosure) in the study.

Figure 1 Theoritical Framework



Hypothesis Development

The Influence Of Earnings Management On Key Audit Matters (KAMs) Disclosure

The signaling theory perspective is based on the premise that when in situations of information asymmetry, one party seeks to provide information or signals to the other party to reduce the asymmetry. In the context of financial reporting, signaling theory explains that management can use various methods to communicate the quality of financial statements, including through transparent disclosure practices. The disclosure of Key Audit Matters (KAMs) by auditors can be viewed as a form of signaling that aims to provide additional information to stakeholders and other users of financial statements regarding critical areas in the financial statements that require special attention. In this case, the disclosure of Key Audit Matters (KAMs) by auditors can serve as a signaling mechanism that communicates risks or uncertainties associated with financial statements, including indications of earnings management practices. The disclosure of Key Audit Matters (KAMs) can signal to stakeholders and other report users that certain areas in the financial statements require more attention, enabling stakeholders to make better informed decisions.

Previous research has shown that after the disclosure of Key Audit Matters (KAMs), earnings manipulation decreases and the credibility of financial statements increases (Camacho et al., 2024) . Findings from other studies indicate that audit quality enhances Key Audit Matters (KAMs) disclosure, which ultimately reduces earnings management practices (Alqam et al., 2021). Other studies have also found that audit improves following the disclosure of Key Audit Matters (KAMs). Overall, previous research has demonstrated a relationship between Key Audit Matters (KAMs) disclosure and the reduction of earnings management, as well as improvements in audit quality. However, there has been no research examining how earnings management itself may influence the disclosure of Key Audit Matters (KAMs). In fact, these two aspects are interconnected in the company's financial reporting process. Therefore, the hypothesis developed in this research is as follows:

H1: Earnings Management positively influences the Key Audit Matters (KAMs) disclosure.

RESEARCH METHODOLOGY

Population and Sample

The research was conducted on companies listed on the Indonesia Stock Exchange (IDX) for the financial years 2022 and 2023. The purposive sampling method was used with the following criteria: Indonesian public companies listed on the Indonesia Stock

Exchange (IDX) in 2022 and 2023 that provided financial statements for 2022 and 2023; companies not included in the financial sectors; companies that have adopted SA 701 regarding of Communication of Key Audit Matters (KAMs) in their auditor's report by presenting KAMs; and companies that provide financial statements in rupiah (IDR) currency.

Variables and Measure

The dependent variable in this research is the disclosure of Key Audit Matters (KAMs), which is measured using three characteristics of Key Audit Matters (KAMs) disclosure the number of Key Audit Matters accounts (NumberofKAMs), the word count of Key Audit Matters disclosure (Lengths), and the reason for Key Audit Matters disclosure (Reason). The independent variable in this research is earnings management (EM). The control variables used are company size (SIZE), profitability (ROA), and leverage (DER).

Table 1 Variables and Measurement

Variables	Measure
NumberofKAMs (number of KAMs accounts)	Dummy variabel, 1 for more than one account, 0 if one account
Lenghts (word count of KAMs disclosure)	Natural log (word count of KAMs disclosure)
Reason (reason of KAMs disclosure)	Dummy variabel, 1 for more than one reason, 0 if one reason
SIZE (company size)	Natural log (total asset)
ROA (profitability)	Return / total asset
DER (leverage)	Total debt / total equity

Reasearch Methodology

The research uses the documentation method, with data obtained from secondary sources on the official IDX website. The study employs logistic regression analysis and linear regression to examine the relationship between earnings management and the disclosure of Key Audit Matters (KAMs). Data analysis is conducted using the statistical application EViews 12. The research uses several statistical techniques including descriptive statistical analysis, testing the feasibility of the logistic regression model, panel data model selection, classical assumption tests, coefficient of determination testing (R^2), simultaneous testing (F-test), and partial testing (t-test).

RESULTS AND ANALYSIS

Sample Description

The population used in this research consists of companies listed on the Indonesia Stock Exchange (IDX) in 2022 and 2023. Based on this population, the purposive sampling method was applied to determine the sample. The initial research data consisted of 1090 samples. However, the final sample used was 1080 samples after eliminating outliers.

Table 2 Sample Criteria

No	Sample Criteria	Total
1.	Company listed on the Indonesia Stock Exchange (IDX) in 2022 and 2023.	1852
2.	Companies that are included in the financial sectors.	(210)
3.	Companies that did not disclose their financial statements on the Indonesia Stock Exchange (IDX) in 2022 and 2023.	(276)
4.	Companies that do not have Key Audit Matters (KAMs) in their independent auditor report.	(98)
5.	Companies that report financial statements in currencies other than rupiah.	(178)
6.	Outlier data	(10)
	Total of sample	1080

Descriptive Statistics

Table 3 presents the descriptive statistics results. The number of KAMs account variable has a minimum value of 0 and a maximum value of 1 because it is measured using a dummy variable. The mean value is 0.268, meaning 27% of companies in the sample disclosed more than one Key Audit Matters (KAMs) account and the other disclosed only one KAMs account. The standard deviation value of 0.443 is larger than the mean value, indicating a varied data distribution. The variable for the word count of KAMs disclosure (Lengths) has a minimum value of 4.844 (127 words when converted from LN) from PT Repower Asia Indonesia Tbk in 2022 and a maximum value of 7.286 (1,460 words when converted from LN) from PT Indosat Ooredoo Hutchison Tbk in 2022. The mean value of 5.91 means that companies in the sample disclosed Key Audit Matters (KAMs) with an average of 350 to 400 words. The standard deviation of 0.418 is smaller than the mean, showing that the data distribution is not varied. The reason for KAMs disclosure (Reason) variable has a minimum value of 0 and a maximum value of 1 because it is measured using a dummy variable. The mean value of 0.519 indicates that 51.9% of companies in the sample disclosed more than one reason for Key Audit Matters (KAMs) disclosure. The standard deviation of 0.499 is smaller than the mean, suggesting that the data distribution is not highly varied.

The earnings management variable has mean of 0.052 or 5.2%, indicating that companies in the sample on average, engaged in positive earnings management (increasing profits). The magnitude of earnings management in the sample ranges from -2.123 to 4.632. The standard deviation value of 0.239 is larger than the mean value, indicating varied data distribution for earnings management. The company size control variable has a minimum value of 21.97 from PT Era Digital Tbk in 2023 and a maximum value of 33.73 from PT Astra International Tbk in 2023. The mean value of 28 suggests that companies in the sample tend to be medium-sized. The standard deviation of 1.862 is smaller than the mean, showing that the data distribution is not highly varied. The profitability variable has a minimum value of -0.393 from PT Global Digital Niaga Tbk in 2022 and a maximum value of 5.83 from PT Era Digital Media Tbk in 2022. The mean value of 0.069 indicates that companies in the sample generate approximately 7% profit from their total assets. The standard deviation value of 0.207 is larger than the mean value, indicating a varied data distribution. The leverage variable has an mean value of 1.375 with leverage ranging from 0 to 54.979. The standard deviation value of 3.135 is larger than the mean value, indicating a varied data distribution.

Table 3 Descriptive Statistics

	N	Mean	Median	Std. Dev	Maximum	Minimum
Numberof_KAMs	1080	0.268	0	0.443	1	0
Lenghts	1080	5.910	5.877	0.418	7.286	4,844
Reason	1080	0.519	1	0.499	1	0
EM	1080	0.052	0.033	0.239	4.632	-2,123
SIZE	1080	28	27	1.862	33	21
ROA	1080	0.069	0.045	0.207	5.830	-0,393
DER	1080	1.375	0.656	3.135	54.979	0

Source: Secondary data processed using EViews 12, 2024

Goodness of Fit Test

Goodness of fit test was conducted on Model I (number of KAMs accounts) and Model III (reasons for KAMs disclosure) using the Hosmer and Lemeshow test. The assumption is that if the chi-square p-value is greater than 0.05, the model is considered suitable. Based on table 4, both Model I and Model III have chi-square p-values greater than 0.05, indicating the models are suitable.

Table 4 Goodness of Fit Test

	Test	***Prob.Chi-Sq***
Model I	*Model Hosmer and Lemeshow*	0.153
Model III	*Model Hosmer and Lemeshow*	0.329

Source: Secondary data processed using EViews 12, 2024

Panel Data Model Selection

Chow Test

The Chow test is the first test conducted to determine the appropriate regression model between the Common Effect Model (CEM) and the Fixed Effect Model (FEM). The assumption is that if the chi-square value is less than 0.05, the Fixed Effect Model (FEM) is selected. When the chi-square value is greater than 0.05, the Common Effect Model (CEM) is selected. Based on table 5, the chi-square value is 0.000 which is less than 0.05. Therefore the Fixed Effect Model (FEM) is accepted and testing proceeds to the Hausman test.

Table 5 Chow Test

	Effect Test	***Probability***
Model II	Cross-section Chi-square	0.000

Source: Secondary data processed using EViews 12, 2024

Hausman Test

Hausman test is a statistical test used to compares the Fixed Effect Model (FEM) and the Random Effect Model (REM). The assumption is that if the chi-square value is less than 0.05, the Fixed Effect Model (FEM) is selected. When the chi-square value is greater than 0.05, the Random Effect Model (REM) is selected. Based on table 6, the chi-square for Model II is 0.039 which is less than 0.05, so the accepted model is using the Fixed

Effect Model (FEM). Since Model II uses the Fixed Effect Model (FEM), the Lagrange Multiplier (LM) test does not need to be conducted.

Table 6 Hausman Test

	Effect Test	***Probability***
Model II	Cross-section random	0.039

Source: Secondary data processed using EViews 12, 2024

Multicollinearity Test

Based on the tests conducted, the assumption is that multicollinearity exists if the correlation matrix value is above 0.90 and multicollinearity does not occur if the correlation matrix value is below 0.90. Overall, the variables in all three models (Model I, Model II, and Model III) have correlation matrix values below 0.90. Therefore, it can be concluded that there is no multicollinearity in Model I, Model II, and Model III.

Heteroscedasticity Test

The heteroscedasticity test was conducted for Model II (word count of KAMs disclosure) using the White test. The assumption is that heteroscedasticity occurs if the probability is less than 0.05 and heteroscedasticity does not occur if the probability is greater than 0.05. Based on table 7, the probability for Model II is 0.881, which is greater than 0.05. Therefore, it can be concluded that heteroscedasticity does not occur in Model II.

Table 7 Heteroscedasticity Test

	Probability	**Result**
Model II	0.881	homoscedasticity

Source: Secondary data processed using EViews 12, 2024

Autocorrelation Test

The autocorrelation test was conducted for Model II (word count of KAMs disclosure) using the Durbin Watson statistic. When the Durbin Watson value approaches or equal to 2, it indicates there is no autocorrelation. If the Durbin Watson value is less than 2, it indicates the possibility of positive autocorrelation. When the Durbin Watson value is greater than 2, it indicates the possibility of negative autocorrelation. Based on table 8, Model II has a Durbin Watson value of 1.008 which is close to 2, it can be concluded that no autocorrelation occurs in Model II.

Table 8 Autocorrelation Test

	Durbin-Watson	**Results**
Model II	1.008	no autocorrelation occurs

Source: Secondary data processed using EViews 12, 2024

Coeficient Of Determination Test (R^2)

The Coefficient of Determination (R^2) test is used to measure the percentage influence of earnings management and control variables such as company size, profitability, and leverage on the disclosure of Key Audit Matters (KAMs). In Model I (number of KAMs accounts), the coefficient of determination value is 0.016 or 1.6%. This indicates that earnings management and the control variables collectively explain 1.6% of the variation in disclosure of Key Audit Matters (KAMs) as measured by the number of accounts and 98.4% is influenced by other variables not included in the model. Model II (word count of KAMs disclosure), the coefficient of determination value is 0.849 or 84.9%. This suggest that earnings management and control variables collectively explain 84.9% of the variation in disclosure of Key Audit Matters (KAMs) as measured by the word count and 15.1% is influenced by other variables not included in the model. Model III (reasons for KAMs disclosure), the coefficient of determination value is 0.003 or 0.3%, which means that earnings management and control variables explain only 0.3% of the variation in the disclosure of Key Audit Matters (KAMs) as measured by the reasons for KAMs disclosure and 99.7% is influenced by other variables not included in the model.

Table 9 Coefficient Of Determination Test

	Model I	**Model II**	**Model III**
Adjusted R^2	0.016	0.849	0.003

Source: Secondary data processed using EViews 12, 2024

Simultan Test (F Test)

Based on table 10, the significance values of the F test for Models I and II are 0.000 (less than 0.05), indicating that collectively the earnings management variable and control variables influence the disclosure of Key Audit Matters (KAMs) as measured by the number of accounts and the word count in the disclosure. However, Model III has an F test significance value of 0.967 (greater than 0.05), indicating that collectively the earnings management variable and control variables do not influence the disclosure of Key Audit Matters (KAMs) as measured by the reasons for disclosure.

Table 10 F Test

	Model I	**Model II**	**Model III**
Prob. F	0.000	0.000	0.967

Source: Secondary data processed using EViews 12, 2024

Parcial Test (t Test)

Based on table 11, it is observed that earnings management has a positive influence on Model I, which is the disclosure of Key Audit Matters (KAMs) as measured by the number of accounts with a significance level of 0.005. However, earnings management does not influence Model II and Model III, which are the disclosure of Key Audit Matters (KAMs) as measured by the count of words and reasons for KAMs disclosure, because the significance levels are greater than 0.05, specifically 0.619 and 0.727.

Table 11 t Test

	Model I	**Model II**	**Model III**
Prob.	0.005	0.619	0.727

Source: Secondary data processed using EViews 12, 2024

Results Intrepretation

Table 12 Result Intrepretation

Model	Hypothesis	Adjusted R^2	T Test	Conclusion
Model I (number of KAMs disclosure accounts)	Earnings Management positively influences the Key Audit Matters (KAMs) disclosure.	0.016	0.005	H1 is accepted
Model II (word count of KAMs disclosure)	*Earnings Management* berpengaruh positif terhadap pengungkapan *Key Audit Matters* (KAMs).	0.849	0.619	H1 is rejected
Model III (reasons for KAMs disclosure)	*Earnings Management* berpengaruh positif terhadap pengungkapan *Key Audit Matters* (KAMs).	0.003	0.727	H1 is rejected

The hypothesis testing results regarding the influence of earnings management (EM) on the disclosure of Key Audit Matters (KAMs) as measured using the number of KAMs accounts, obtained a t-statistic value of 0.005. Therefore, it can be interpreted that earnings management has an influence on the disclosure of Key Audit Matters (KAMs) as measured using the number of KAMs accounts in companies listed on the Indonesia Stock Exchange (IDX) in 2022 and 2023. The positive influence of earnings management (EM) on the disclosure of Key Audit Matters (KAMs) as measured by the number of KAMs accounts (Numberof_KAMs) indicates that the higher the level of earnings management practiced by the company, the more accounts are disclosed as Key Audit Matters (KAMs). This can be explained because high earnings management practices encourage auditors to be more vigilant so they can identify more significant areas that are reflected in the increased number of Key Audit Matters (KAMs) accounts. As explained in signal theory, KAMs disclosure is a way to reduce information asymmetry between auditors and financial statement users by highlighting important areas in the audit. This transparency can help stakeholders make more appropriate decisions (Chirakool et al., 2022). Based on this analysis, H1 is accepted. Basically, there has not been any previous research on the direct effect of earnings management on the disclosure of Key Audit Matters (KAMs). However, there are studies by Bepari et al. (2023) and Minano et al. (2024) that indirectly support the research results.

The hypothesis testing results regarding the effect of earnings management on the disclosure of Key Audit Matters (KAMs) as measured using the number of words in KAMs disclosure, based on calculations, obtained a t-statistic value of 0.619. Therefore, it can be interpreted that earnings management does not affect the disclosure of Key Audit Matters (KAMs) as measured using the number of words in KAMs disclosure in companies listed on the Indonesia Stock Exchange (IDX) in 2022 and 2023. This finding provides an understanding that companies with indications of earnings management or profit management practices do not necessarily have longer Key Audit Matters (KAMs) disclosures. Or conversely, when Key Audit Matters (KAMs) disclosures are long, it does not necessarily mean that the company is practicing earnings management. Auditors can limit the length of Key Audit Matters (KAMs) disclosures only to matters considered most important, regardless of earnings management practices in the company. Based on this analysis, H1 is rejected. Basically, there has not been any previous research on the direct effect of earnings management on the disclosure of Key Audit Matters (KAMs). However, there is research by Zeng et al. (2021) that indirectly supports the research results.

The hypothesis testing results regarding the effect of earnings management on the disclosure of Key Audit Matters (KAMs) as measured using the reasons for KAMs disclosure, based on calculations, obtained a t-statistic value of 0.727. Therefore, it can be interpreted that earnings management does not affect the disclosure of Key Audit Matters (KAMs) as measured using the reasons for KAMs disclosure in companies listed on the Indonesia Stock Exchange (IDX) in 2022 and 2023. This indicates that earnings management conducted by companies is not always reflected in the reasons for Key Audit Matters (KAMs) disclosure presented in the audit report. Additionally, because the process of disclosing Key Audit Matters (KAMs) in audits is objective and independent. Auditors make professional judgments based on actual audit risks and complexities. Each company has different audit characteristics and risks, so Key Audit Matters (KAMs) disclosure is more determined by company-specific factors such as the size and complexity of the entity, the nature of the business and its environment, as well as the facts and conditions of the audit engagement (IAPI, 2021). Based on this analysis, H1 is rejected. Basically, there has not been any previous research on the direct effect of earnings management on the disclosure of Key Audit Matters (KAMs).

CONCLUSIONS AND LIMITATIONS

Conclusions

This research was conducted with to determine the influence of earnings management on the disclosure of Key Audit Matters (KAMs), where KAMs were measured by the number of accounts, the word count in the disclosure, and the reasons for disclosure. The study utilized data from companies listed on the Indonesia Stock Exchange (IDX) in 2022 and 2023, with the requirement that they meet all specified sampling criteria, resulting in a final sample of 1,080 data points. Data analysis used logistic and linear regression, as previously explained.

The research findings that earnings management has an influence on the disclosure of Key Audit Matters (KAMs) as measured by the number of Key Audit Matters (KAMs) accounts. However, earnings management does not influence the disclosure of Key Audit Matters (KAMs) as measured by the word count and reasons for disclosure. This is because the disclosure of Key Audit Matters (KAMs) is more influenced by company specific factors such as the size and complexity of the entity, the nature of the business and its environment, as well as the facts and conditions of the audit engagement (IAPI, 2021).

Limitation

This study also has a limitation. Based on the data, not all auditors from companies in Indonesia that were part of the research population disclosed Key Audit Matters (KAMs) in their Independent Auditor's Reports.

Suggestions

Following the limitation in the research, future research can expand the research data by using data from other than Indonesia or by adding more years to the research period. Consider other variables besides earnings management that potentially have a significant influence on the disclosure of Key Audit Matters (KAMs), such as company size, company complexity, and profitability.

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