

Impact of Company Complexity and Investor Behavior on Key Audit Matters: Academic Literature Review

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Article Info

Article history:

Received Dec, 2024

Revised Mar, 2025

Accepted Mar, 2025

Keywords:

Complexity of company

Investor Behavior

Key Audit Matters

ABSTRACT

In the context of accounting and auditing, the term “key audit matters” refers to key issues that are of primary concern to auditors in conducting an audit. In today’s complex and dynamic business world, companies often operate in an environment full of challenges, risks and uncertainties. This study uses the following keywords: “Key Audit Matters”, “Complexity” and “Investor Behavior”. The search databases used are Google Scholar and Web of Science. We investigate studies that have examined the impact of KAM disclosure on (1) Corporate Complexity, and (2) investor behavior and market reaction. The purpose of this paper is to provide an overview of the existing literature and to summarize the preliminary findings and implications of 8 studies. Key Audit Matters have an effect on investor response and Corporate Complexity leads to increased disclosure in key audit matters.

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1. INTRODUCTION

In the context of accounting and auditing, the term “key audit matters” refers to the key issues that are of primary concern to the auditor in conducting an audit. In today’s complex and dynamic business world, companies often operate in an environment filled with challenges, risks, and uncertainties. Therefore, understanding key audit matters is crucial for auditors to ensure the integrity and reliability of the financial statements [1].

Auditing is not just an activity of examining the numbers in the financial statements, but also a deeper evaluation process of business practices and risks faced. The main audit issues arise from recognizing risks that may impact the

financial statements, including material risks, fraud, and non-compliance with applicable regulations. In this case, auditors are expected to be able to identify areas where errors or deviations are likely to occur, so that they can allocate their resources and attention appropriately.

In recent years, we have witnessed many cases of corporate failures caused by inaccurate financial statements. News about embezzlement, financial statement manipulation, and compliance issues have become more frequent in the media. These cases not only harm investors and shareholders, but can also have a negative impact on the reputation of the company and public confidence in the market as a whole. Therefore, it is important for auditors to pay special attention to key audit matters

so that preventive measures can be taken [2], [3].

In carrying out their functions, auditors need to adapt their audit approach by considering the complexity of the business and investor behavior. In an era of rapid and ever-changing information, positioning auditors as independent and objective parties is essential to maintaining the relevance and accuracy of financial statements. By understanding and responding to key audit matters, auditors not only function as supervisors, but also as strategic partners in maintaining the health of the company.

In the rapidly changing business world, the complexity of companies is one of the topics that interests many people. Companies no longer operate in just one field, but are starting to expand into various industries. This can increase risks and challenges, especially when managing financial information. For example, companies operating in many countries with different tax laws or companies involved in mergers and acquisitions. This situation makes auditors more careful in conducting audits [4], [5].

Investors don't just need to see the numbers, they also need to understand the complex business context. If you fail to identify potential problems with this level of complexity, the financial statements you audit may be misleading and, of course, detrimental to everyone involved, including investors. For investors, their actions are equally important. Investment decisions are the result of complex considerations and are often influenced by the information received.

Negative news about an audit or alleged fraud can quickly cause investors to panic and sell their shares, even though the company's situation is still stable. This shows how sensitive the market is to audit-related information. Furthermore, the situation is further complicated by the phenomenon of 'herd behavior', where investors tend to follow market movements. Once an investor starts selling, others may join in without a deep understanding. In this

context, auditors have a strategic role to ensure that financial statements are reliable in order to reduce uncertainty and increase investor confidence. The introduction of expanded audit report regulations around the world has sparked much debate about whether the benefits to users of financial statements of increased transparency in the audit process outweigh the costs of requiring auditors to disclose potentially sensitive client information in their audit opinions. Much of this debate centers on the requirement to disclose the areas of financial reporting that the auditor considers to have the most significant risks of material misstatement for the client company. In requiring this disclosure, called Key Audit Matters (KAMs) under the Auditing Standards (SAs) regulations, regulators aim to enhance the usefulness of the audit report by providing visibility into the areas that have the greatest impact on the overall audit strategy and require greater audit consideration.

2. RESEARCH METHODOLOGY

This study screens articles through several stages, starting from determining search terms, databases to be used for the search, and criteria for selecting papers to be excluded/included. In the first stage, we determine the search terms/keywords to be searched in the specified databases. Search terms should be based on words and concepts that are directly related to the research question. Therefore, to find articles relevant to the research question, we used the following keywords: "Key audit matters", "Complexity" and "Investor Behavior". The search databases used were Google Scholar and Web of Science. Google Scholar was used because of its capacity to identify highly cited documents effectively.

3. RESULTS AND DISCUSSION

A substantial and growing literature investigates the impact of KAM disclosure in the auditor's report. To find relevant studies, we used different

databases (e.g., EBSCO, Google Scholar, SSRN, Web of Science) and searched for the keywords "key audit issues" and "critical audit issues" in combination with "auditor reporting", "audit report" and comparable terms. Since the topic is recent, no time constraint was required. Although we generally consider only published studies in a literature review, we expanded our literature review to include publicly available working papers since most of the relevant studies have not yet been published. Therefore, we included working papers that have been presented at relevant

academic conferences (e.g., American Accounting Association (AAA) conferences, European Audit Research Network (EARNet), International Symposium on Audit Research (ISAR)).

We group recent studies on KAM disclosure into four categories. The first category examines the impact of KAM disclosure on investor behavior and market reactions and the second category focuses on firms' complexity of key audit matter disclosures. Table 1 provides an overview of recent studies on KAM disclosure.

Table 1. Summary of Reviewed Papers on the Disclosure of KAM's Complexity

Year Publication	Writer	Title	Variable Independent	Variable Dependent	Results
2019	[6]	Analysis of the relationship between a company's characteristics and key audit matters disclosed	Big 4 Auditor, Audit Opinion, Going Concern, Company Profitability, Characteristics	KAM (Key Audit Matters)	Positive relationship between number of KAMs and complexity. Audited company size, the auditor's opinion, and going concern modified opinion relate to disclosure of higher number of KAMs.
2020	[7]	Factors Influencing Key Audit Matters Reporting: Thailand	Company Size, Profitability, Audit Rotation	KAM	Three significant factors were number of loans and complexity. Profitability had a negative influence on level of KAM reporting.
2020	[8]	Research on Disclosure Status and Influencing Factors of Key Audit Matters	Audit Firm, Auditor Tenure, Auditor's Gender, Industry Expertise	KAM	The size of the firm, audit terms, the firm's industry expertise, and the auditor's gender, years of practice, and industry oversight significantly affect disclosure of key audit matters.
2021	[9]	What Factors Affect the Disclosure of Key Audit Matters? Evidence From Manufacturing Firms	Big 4 auditors, Modified opinion, Firm complexity	KAM	Auditors disclose more key audit matters when firm complexity increases. Statistically significant relationship between disclosure of KAM and audit opinion was found.
2023	[10]	The influence of company characteristics on key audit matters (KAM)	Company Size, Company Complexity, Profitability, Leverage	KAM	Company complexity had a positive relationship with KAM. Company size, profitability, and leverage did not affect

Year Publication	Writer	Title	Variable Independent	Variable Dependent	Results
					KAM for companies listed on the Stock Exchange in 2022.
2023	[11]	Determining key audit matters in Thailand	Company Size, Company Complexity, Company Risk, Auditor Size, Modified Opinion, Going Concern, Gender Auditor	KAM	Company size, complexity, liquidity, and solvency all affected disclosure of KAMs.

Table 2. Investor Behavior

Year Publication	Writer	Title	Variable Independent	Variable Dependent	Results
2021	[12]	The Impact of Key Audit Matters Disclosure on Communicative Value of The Auditor's Report: A Systematic Literature Review	Communicative Value	KAM	The results support the plan of AS 701 implementations in Indonesia because it will increase the communicative value of the auditor's report.
2019	[13]	The Investors Reaction to the Disclosure of Key Audit Matters: Empirical Evidence from Jordan	Investor Decision	KAM	The results revealed that the disclosure of KAMs has significantly affected the investors' decisions measured by the abnormal trading volume. The findings suggest that the mandating of KAM's disclosure has informational value to the investors.

3.1 Investor behavior and market reaction

[12] Regarding the impact of disclosure of key audit matters on the communicative value of the auditor's report, this study reveals two main results. First, disclosure of key audit matters (KAM) increases the communicative value of the auditor's report, which is useful for report users as a consideration in

decision making. This is in line with the objectives of KAM as stated in ISA 701.

[13] The results of the study show that KAM disclosure significantly affects investor decisions as measured by abnormal trading volume. Our findings suggest that the KAM disclosure mandate has information value for investors.

3.2 Complexity of the firm

[6] there is a consistent influence between the number of KAMs and the complexity of the audited company, but auditor fees and modified auditor opinions show a negative relationship with the number of KAMs.

[7] There is a significant positive influence between company size and complexity on the level of KAM. Profitability reporting has a negative influence on the level of KAM reporting.

[8] Company size, audit period, company industry expertise, and auditor gender, years of practice, and industry expertise will significantly affect the disclosure of key audit issues.

[9] the results of the regression analysis show that non-Big 4 auditors disclose more major audit issues and the complexity of the company significantly increases the number of major audit issues. And a statistically insignificant relationship was found between the disclosure of major audit issues and audit opinions.

[14] The results of the study show that company complexity has a positive relationship with key audit matters. In contrast, company size, profitability and leverage do

not affect key audit matters in financial sector companies listed on the Indonesia Stock Exchange in 2022.

[11] The results of the study show that company size, company complexity, and company liquidity and solvency have a significant influence on KAM.

4. CONCLUSION

The main audit matter has an effect on investor response because it is effective information and is strengthened by market response by making decisions that are measured by abnormal trading volume.

The complexity of the company causes increased disclosure in terms of the main audit, where the greater the number of subsidiaries, the higher the possibility of the auditor determine KAM related to operational risk. Complexity increases operational risk and compliance with regulatory violations or complex accounting standards. So the complexity of companies that are not regulated and closely monitored by authorized institutions will increase disclosures on the main audit matters.

In this study, there is a possibility of researcher subjectivity in understanding and interpreting the information in the article.

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