

Analytical Analysis of the Relationship between Internal Corporate Governance Mechanisms and Key Audit Matters

دراسة تحليلية للعلاقة بين آليات الحوكمة الداخلية للشركات وأمور المراجعة
الجوهرية

Aya Ashraf Mahmoud Mohammed

Assistant lecturer

Accounting and Auditing Department

Suez Canal University

Supervised by

Prof. Dr. Ahmed Zaky Hussein Metwally

Professor of Auditing

Faculty of Commerce

Suez Canal University

Dr. Eman Abdalla Mohammed Yousef

Lecturer of Accounting and Auditing

Faculty of Commerce

Suez Canal University

Abstract:

This research aims to investigate the relationship between the internal corporate governance mechanisms (proxied by; audit committees and the board of directors) and key audit matters (KAMs). The research design is a quantitative approach. The

analysis relies on secondary data through a sample of 79 non-financial Egyptian-listed firms from 2018 to 2023. The researcher employs logistics analysis. The results show that there is a positive and significant impact of both audit committees and the board of directors on KAMs.

Key words: internal corporate governance mechanisms, audit committees, board of directors, and key audit matters.

الملخص:

يهدف هذا البحث إلى دراسة العلاقة بين آليات الحوكمة الداخلية للشركات (لجان المراجعة ومجلس الإدارة) وأمور المراجعة الجوهرية. يعتمد البحث على منهج كمي، ويعتمد التحليل على بيانات ثانوية من خلال عينة من ٧٩ شركة مصرية غير مالية مدرجة في البورصة خلال الفترة من ٢٠١٨ إلى ٢٠٢٣. ويستخدم الباحث تحليلاً لوجستياً. وتُظهر النتائج وجود تأثير إيجابي لكل من لجان المراجعة ومجلس الإدارة على أمور المراجعة الجوهرية.

الكلمات المفتاحية: آليات الحوكمة الداخلية للشركات، لجان المراجعة، وأمور المراجعة الجوهرية.

1. Introduction:

The traditional audit report has been subject to criticism for its limited usefulness, as it primarily offers a binary judgment of pass or fail, with little supplementary information provided (Alshdaifat et al., 2025). To enhance the audit reports' effectiveness and their informative value, Minutti-Meza (2021) highlights the main three factors that need to be taken into

consideration. Firstly, audit reports must include new information or indirectly motivate firms to uncover new information. Secondly, the new information must be relevant to the investment decisions. Lastly, the new information must focus on possible threats. Therefore, the addition of key audit matters (KAMs) to the audit report was necessary to provide highlights and key matters from the auditors' point of view.

Consequently, audit firms must record as KAMs the topics that received substantial attention throughout the audit process. Moreover, the KAMs enhance the working dynamic between the audit firm and their clients, which results in a more efficient audit process. KAMs have changed the way the audit is planned and how audit findings are gathered and discussed with governance bodies (Nguyen and Kend, 2021).

The disclosure of KAMs requires a 'two-way dialogue' between the audit firm and the governance bodies on the areas of risk, and the auditing procedures identified to control those risks. Consequently, the interaction between them as well as a more comprehensive dialogue throughout the audit process, from planning to completion, improved financial reporting transparency and enhanced audit quality.

International Standards on Auditing (ISA) 701 requires auditors to communicate during the audit process about key matters for significant accounting policies and estimates and

which KAM to select in the audit report (Hosseinniakani et al, 2024; Lee et al., 2024). Thence, they can clarify the accounting policies and estimates, and management disclosure choices.

Additionally, audit committees can use the auditor concerns as a tool to monitor the management, and a signal for high quality of governance. (Hosseinniakani et al, 2024). However, KAM is a disciplinary mechanism for managers rather than auditors (Gold et al., 2020), leading to a shrinking of any opportunity for managers to extract personal benefits and ensure high reporting quality.

In sum, this paper focuses on the impact of internal corporate governance proxied by the audit committees and board of directors' characteristics on KAMs' issuance in Egypt as an emerging market. This is because this market is characterized by relaxed regulations, ineffective enforcement, and lower litigation and reputational costs (Abdullatif and Al-Rahahleh, 2020).

The rest of the paper is structured as follows: Section 2 provides the literature review and hypotheses development. Section 3 explains the research method. Section 4 demonstrates the empirical results. Section 5 provides an overall conclusion.

2. Literature Review and Hypothesis Development

2.1 Literature Review

The association between internal corporate governance and key audit matters. In this context, Rahaman and Karim (2023)

identify the impact of the board characteristics and auditor characteristics on KAMs in Bangladesh. The findings of this study show an insignificant impact of AC expertise in finance and accounting, family CEO, and board political connections on KAMs. Moreover, there is a negative association between a female board and KAMs because the female board is risk-averse and skeptical, therefore, they avoid disclosing negative information and provide less detailed KAMs. However, board gender diversity and AC size are positively related to KAM disclosure. Also, there is a positive influence of auditor tenure and auditor–client relationship on KAMs.

However, the study of Boonlert-U-Thai and Suttipun (2023) investigates the effect of external auditor and audit committee characteristics on the KAMs of 200 listed companies in the Stock Exchange of Thailand. The findings show while audit fees, female auditors, audit committee size, and meeting frequency have a positive association with KAMs, financial expertise audit committees have a negative impact on the level of disclosed KAMs. Further, there is no impact of audit firm type, auditor’s rotation, and independent audit committee on KAMs.

There must be an interplay between audit standards and audit committees, this is proven by the study of Hosseinniakani et al. (2024). Hence, they investigate the association between KAMs and management disclosure and, additionally, examine

the moderating influence of audit committees on this association by depending on 515 Swedish firm-year observations from 2016 to 2018. The study's findings show a positive association between KAMs and management disclosure, and this association is greater with the audit committee, especially when they are separate from the board. Further, there is evidence that the quality of management disclosure increases after the implementation of IAS 701.

The research gap can be summarized as follows. Firstly, the findings of the consequences are mixed and are not needfully applicable to emerging markets (Zhang and Shailer, 2022). Secondly, the KAMs' requirements in emerging markets are associated with a higher amount of audit effort than in developed economies. This is because auditors in those markets are characterized by relaxed regulations, ineffective enforcement, and lower litigation and reputational costs (Abdullatif and Al-Rahahleh, 2020).

Third, the coronavirus leads to an increase in restrictions faced by auditors, in addition to the high requirements from audit clients for firm-specific information. Fourth, IAS 701 requires auditors to communicate the KAMs with those who have charge of governance.

2.2 Hypothesis Development

Theoretically, the addition of KAMs does not affect the audit process but it modifies the way information is disclosed in the audit report. However, practically, KAMs have changed the way the audit is planned and how audit findings are gathered and discussed with governance bodies (Nguyen and Kend, 2021).

To further illustrate, ISA 701 requires auditors to communicate with the governance bodies during the audit process about key matters for significant accounting policies and estimates and which KAM to select in the audit report (Hosseinniakani et al, 2024; Lee et al., 2024). In consequence, reducing the uncertainty that accompanies those disclosures. In firms that have high-quality corporate governance systems, fewer KAMs arise during the audit process and are disclosed in the audit report (Fera et al., 2022).

Moreover, the expanded audit reports motivate management to provide extra disclosure for items that are subjected to KAMs. Therefore, management reacts to the addition of KAMs disclosure by disclosing more information and decreasing their willingness to perform aggressive financial reporting (Gold et al., 2020; Fuller et al., 2021).

According to Rahaman and Karim (2023), the presence of a female board of directors decreases the chance of earnings manipulation to shrink litigation risks. Hence, the results show

that the board's gender diversity has a positive relationship with the number of disclosed KAMs. Also, audit committee sizes have a negative impact on KAMs. Consequently, the first research hypothesis can be formulated as follows:

1st Hypothesis: internal corporate governance significantly affects key audit matters.

H1a: The audit committee significantly affects key audit matters.

H1b: The board of directors significantly affects key audit matters.

3. Research Method

3.1 Sample and Data Collection

Initially, the sample is based upon the 100 active Egyptian firms listed in the EGX, as measured by the EGX 100 index in the financial year ended in 2023, covering six years from 2018 to 2023. The final sample consists of 79 non-financial firms from 2018 to 2023; there are 474 total observations.

3.2 Models and Variables Measurement.

Table (1) shows a list of the variable measurements. Logistics analysis can estimate the relationships between variables.

Table (1): Summary of Research Variables

Variables	Measure	Symbol
Key Audit Matters	Dummy variables, where (1) will be assigned, if there is a KAMs section in the audit report and (0) otherwise; the number of KAMs is represented in the number of KAMs in the KAMs section.	KAM _{it}
Audit Committees' Characteristics	Audit committee meeting frequency is measured by the number of audit committee meetings; the audit committee size is measured by the number of members in the audit committee.	IM_AC _{it}
Board of Directors Characteristics	The board of directors' gender, is measured using dummy variables with a value of (1) if the board composition has at least one female director and (0) otherwise; board size is measured by the number of members on the board of directors; the number of non-executive board members.	IM_BOD _{it}
Big 4	A dummy variable; (1) if the audit firm is big 4, (0) otherwise.	Big _{it}
Firm Size	The natural logarithm of total assets.	Firm_Size _{it}
Corona	A dummy variable; (1) for the sample's period in 2019,2020, and 2021 and otherwise (0).	Corona _{it}
Profitability	ROA = net income/total assets.	Profitability _{it}
Liquidity	Current ratio = current assets/current liability.	Liquidity _{it}
Leverage	LEVG= total debits / total assets.	LEVG _{it}
Audit Opinion	A dummy variable; (1) if the auditor issues a qualified audit opinion in the current period, (0) otherwise.	Audit_Opinion _{it}

Source: prepared by the researcher.

3.3 Research model

Multivariate regression models to examine the association between internal corporate governance and key audit matters.

$$KAM_{it} = \beta_0 + \beta_1 IM_AC_{it} + \beta_2 Big_{it} + \beta_3 Firm_Size_{it} + \beta_4 Corona_{it} + \beta_5 Profitability_{it} + \beta_6 Liquidity_{it} + \beta_7 LEVG_{it} + \beta_8 Audit_Opinion_{it} + \varepsilon_{it}$$

$$KAM_{it} = \beta_0 + \beta_1 IM_BOD_{it} + \beta_2 Big_{it} + \beta_3 Firm_Size_{it} + \beta_4 Corona_{it} + \beta_5 Profitability_{it} + \beta_6 Liquidity_{it} + \beta_7 LEVG_{it} + \beta_8 Audit_Opinion_{it} + \varepsilon_{it}$$

4. Empirical Results

The first sub-hypothesis (H1a) stated that the audit committee significantly affects key audit matters. The first model is used to test this hypothesis. Table (2) presents a logistic regression analysis to test the first empirical model.

Table (2): Logistics Regression Results of the First Model

KAM	Coef.	St.Err.	p-value	Sig
IM_AC	0.385	0.082	0	***
Big4	0.068	0.296	0.819	
Firm_Size	0.108	0.178	0.543	
Corona	0.7	0.38	0.066	*
Profitability	-4.339	1.628	0.008	***
Liquidity	-0.189	0.13	0.147	
LEVG	-0.047	0.803	0.953	
Audit_Opinion	0.752	0.286	0.009	***
Constant	-2.606	1.849	0.159	
Industry	Included			
year	Included			
Pseudo r-squared	0.159			
Chi-square	98.480			
Prob > chi2	0.000			
*** p<.01, ** p<.05, * p<.1				

Table (2) suggests the probability of chi-square is lower than 0.05 (0.000). This reveals the overall significance of the model and indicates that there is an effect of the independent

variables on the dependent variable. The value of the Pseudo R-square is 0.159 which indicates that the independent variable (IM_AC) and control variables (Big4, Firm_Size, Corona, Profitability, Liquidity, LEVG, and Audit_opinion) explain about 15.9% of the changes in KAM.

Table (2) shows that the logistic coefficient of the main independent variable (IM_AC) is positively associated with KAM (0.385) and statistically significant at level 1%. This implies that there is an impact of the audit committee as an internal mechanism of corporate governance (IM_AC) on key audit matters (KAM). Thus, the first sub-hypothesis (H1a) of the first hypothesis is accepted.

Regarding the control variables, the results of the logistic regression analysis revealed that BIG4, Firm_Size, Cornea, and Audit_Opinion are positively related to KAM. These relations are significant at 1% for Audit_Opinion and 10% for Corona. But it is insignificant for BIG4 and Firm_Size. It is also found that Profitability, Liquidity, and LEVG are related negatively to KAM. These relations are significant at 1% for Profitability, but insignificant for Liquidity and LEVG.

The second research sub-hypothesis (H1b) states that the audit committee significantly affects key audit matters. The first research model is used to test this hypothesis. Table (3) presents a logistic regression analysis to test the second empirical model.

Table (3): Logistics Regression Results of the Second Model

KAM	Coef.	St.Err.	p-value	Sig
IM_BOD	0.316	0.068	0	***
Big4	-0.042	0.29	0.885	
Firm_Size	0.091	0.18	0.613	
Corona	0.68	0.378	0.072	*
Profitability	-3.536	1.638	0.031	**
Liquidity	-0.185	0.127	0.145	
LEVG	-0.832	0.805	0.301	
Audit_Opinion	0.697	0.285	0.014	**
Constant	-2.183	1.881	0.246	
Industry	Included			
Year	Included			
Pseudo r-squared	0.156			
Chi-square	96.520			
Prob > chi2	0.000			
*** p<.01, ** p<.05, * p<.1				

Table (3) suggests the probability of chi-square is lower than 0.05 (0.000). This reveals the overall significance of the model and indicates that there is an effect of the independent variables on the dependent variable. The value of Pseudo R square is 0.156 which indicates that the independent variable (IM_BOD) and control variables (Big4, Firm_Size, Corona, Profitability, Liquidity, LEVG, and Audit_opinion) explain about 15.6% of the changes in KAM.

Table (3) shows that the logistic coefficient of the main independent variable (IM_BOD) is positively associated with KAM (0.316) and statistically significant at level 1%. This implies that there is an impact of the board of directors as an internal mechanism of corporate governance (IM_BOD) on key

audit matters (KAM). Thus, the research hypothesis (H1) is accepted.

Regarding control variables, the results of the logistic regression analysis revealed that Firm_Size, Cornea, and Audit_Opinion are positively related to KAM. These relations are significant at 5% for Audit_Opinion and 10% for Corona. But it is insignificant for Firm_Size. It is also found that BIG4, Profitability, Liquidity, and LEVG are related negatively to KAM. These relations are significant at 5% for Profitability, but insignificant for other variables.

5. Conclusion

The research investigates the relationship between internal corporate governance and Key audit matters through a sample of 79 non-financial Egyptian-listed firms from 2018 to 2023. The results support a positive and significant association between the audit committees and KAMs. In addition, a positive and significant association between the board of directors and KAMs. Generally, ISA 701 contextually highlights the need for an interaction between the auditor and its client's corporate governance to address the KAMs issues adequately. For that reason, the presence of high-quality corporate governance assists the auditor in the performance of its functions and can help pursue the ISA 701 aim.

In terms of the first sub-hypothesis, ISA 701 mandates auditors to communicate with audit committees about potential audit

matters regarding accounting estimates and select KAMs to include in the audit report based on their professional judgment. As audit committees receive information about auditors' matters during the process, they can use this information to clarify choices of accounting policies and estimates and management disclosures in the annual report, thereby reducing the uncertainty of disclosures. This result is consistent with Wuttichindanon and Issarawornrawanich (2020); Rahaman and Karim (2023); Boonlert-U-Thai and Suttipun (2023); Hosseinniakani et al. (2024).

Regarding the second sub-hypothesis, the result moves in the direction that agency theory suggests that the presence of females on the board, more female board directors will be more motivated and more effective in providing more information to the stakeholders, which means more information disclosed and more risk topics that auditors are required to investigate. A higher percentage of non-executive board members will enhance the management risk reporting behavior by providing more information in the audit report to disclose more information and provide a relatively lengthy report. This result is in contrast to Rahaman and Karim (2023) but is consistent with Wuttichindanon and Issarawornrawanich (2020).

The research recommends further research to consider other audit committees and board of directors' characteristics. Additionally, further research can examine the impact of the

readability of KAMs on stakeholders' reactions. Hence, the words selected for KAMs are the auditors' responsibility and should reflect the entity-specific information.

References

- Abdullatif, M., & Al- Rahahleh, A. S. (2020). Applying a new audit regulation: Reporting key audit matters in Jordan. *International Journal of Auditing*, 24(2), 268-291.
- Alshdaifat, S. M., Abdul-Hamid, M. A., Alhadab, M., Saidin, S. F., & Ab Aziz, N. H. (2025). Key Audit Matters and earnings management practice pre and during COVID-19: evidence from Jordan. *Asian Journal of Accounting Research*.
- Boonlert-U-Thai, K., & Suttipun, M. (2023). Influence of external and internal auditors on key audit matters (KAMs) reporting in Thailand. *Cogent Business & Management*, 10(3), 2256084.
- Fera, P., Pizzo, M., Vinciguerra, R., & Ricciardi, G. (2022). Sustainable corporate governance and new auditing issues: a preliminary empirical evidence on key audit matters. *Corporate Governance: The International Journal of Business in Society*, 22(1), 194-211.
- Fuller, S. H., Joe, J. R., & Luippold, B. L. (2021). The effect of auditor reporting choice and audit committee oversight on management financial disclosures. *The Accounting Review*, 96(6), 239-274.
- Gold, A., Heilmann, M., Pott, C., & Rematzki, J. (2020). Do key audit matters impact financial reporting behavior?. *International Journal of Auditing*, 24(2), 232-244.
- Hosseinniakani, M., Overland, C., & Samani, N. (2024). Do key audit matters matter? Correspondence between auditor and management disclosures and the role of audit committees. *Journal of International Accounting, Auditing and Taxation*, 55, 100617.

- Lee, N. L., Khalaf, M. S., Farag, M., & Gomaa, M. (2024). The impact of critical audit matters on audit report lag and audit fees: evidence from the United States. *Journal of Financial Reporting and Accounting*, 1985-2517.
- Minutti-Meza, M. (2021). The art of conversation: The expanded audit report. *Accounting and Business Research*, 51(5), 548-581.
- Nguyen, L.A. and Kend, M. (2021), “The perceived impact of the KAM reforms on audit reports, audit quality, and auditor work practices: stakeholders’ perspectives”, *Managerial Auditing Journal*, 36 (3), 437-462.
- Rahaman, M. M., & Karim, M. R. (2023). How do board features and auditor characteristics shape key audit matters disclosures? Evidence from emerging economies. *China Journal of Accounting Research*, 16(4), 100331.
- Wuttichindanon, S., & Issarawornrawanich, P. (2020). Determining factors of key audit matter disclosure in Thailand. *Pacific Accounting Review*, 32(4), 563-584.
- Zhang, P. F., & Shailer, G. (2022). The impact of audit committee expertise on external auditors' disclosures of key audit matters. *International Journal of Auditing*, 26(2), 151-170.