

A study on the disclosure of key audit matters from the perspective of regulatory inquiry: evidence from Pan-China Certified Public Accountants LLP

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Abstract. Against the backdrop of the issuance of *Chinese Auditing Standard for Certified Public Accountants No. 1504—Communicating Key Audit Matters in the Independent Auditor's Report*, both the inclusion of Key Audit Matters (KAMs) in audit reports by accounting firms and the issuance of regulatory inquiry letters by stock exchanges are intended to enhance the vitality of China's capital market. Using data from companies audited by Pan-China Certified Public Accountants LLP between 2020 and 2024, this paper examines the disclosure of key audit matters. The findings indicate that the disclosure of KAMs exhibits a serious degree of homogenization and is often disconnected from the material issues actually faced by audited companies. In light of these findings, this paper suggests that stock exchanges should strengthen regulatory penalties and establish channels for public feedback, while accounting firms should develop rigorous procedures for identifying key audit matters and enhance the entity-specific nature of KAM disclosures.

Keywords: regulatory inquiry, key audit matter disclosure, Pan-China Certified Public Accountants LLP

1. Introduction

The *Government Work Report* reviewed at the *Third Session of the Fourteenth National People's Congress* emphasized the need to deepen comprehensive reforms in investment and financing within the capital market and to improve mechanisms for maintaining market stability. The stable operation of the capital market depends on investor confidence and the quality of listed companies. As an important means of enhancing information transparency and mitigating information asymmetry, auditing provides essential evidence for stakeholders' decision-making. With the accelerating digital transformation of enterprises, the traditional pass-or-fail audit report has become increasingly inadequate in meeting users' growing demand for information. To enhance the informational value of audit reports, the Ministry of Finance issued *Chinese Auditing Standard for Certified Public Accountants No. 1504—Communicating Key Audit Matters in the Independent Auditor's Report* in 2016, which has been implemented for listed companies since 2018. Meanwhile, regulatory inquiry letters issued by stock exchanges have become an important instrument of capital market supervision.

Existing studies have primarily examined the current practice of key audit matter disclosure, its economic consequences, and the impact of regulatory inquiries. Regarding key audit matters, Qianchi Wang [1],

Cameran M. et al. [2], and Ruoyu J. et al. [3] investigated disclosure from the perspective of the number of KAMs reported, while Xiayun Song and Jin Rao [4], together with Shiqiao Zheng and Bingqian Teng [5], focused on disclosure content and information value. Gang Liang and Xu Zeng [6], as well as Xinghua Liu and Wenzhen Li [7], argued that the disclosure of key audit matters plays a positive role in corporate governance. In contrast, Lin L. et al. [8] and Jindan Zhang et al. [9] contended that its governance effects are not consistently significant. Concerning regulatory inquiries, Shihui Li et al. [10], Yunsen Chen et al. [11], and Yilu Deng et al. [12] demonstrated the effectiveness of inquiry-based regulation from the perspectives of supply chain spillover, earnings management, and tax avoidance, respectively. As for the relationship between regulatory inquiries and KAM disclosure, Youran Zhao [13] argued that regulatory inquiries improve the quality of KAM disclosures, whereas Yingfei Liu et al. [14] pointed out that entity-specific disclosures can provide valuable clues for regulatory authorities. Overall, relatively few studies have examined the characteristics of key audit matter disclosure by individual accounting firms from the perspective of regulatory inquiries. To address this gap, this paper selects Pan-China Certified Public Accountants Limited Liability Partnership (LLP) as the research subject, analyzes its practices in disclosing key audit matters and the regulatory inquiries it has received, and, based on the findings, proposes recommendations for improving KAM disclosure.

2. Related concepts

2.1. Key audit matters

Key Audit Matters (KAMs) are a fundamental concept in auditing. They refer to matters that, in the auditor's professional judgment, were of the greatest significance in the audit of the current period's financial statements. KAMs are selected from matters communicated between the auditor and those charged with governance; however, not every matter communicated qualifies as a key audit matter.

The determination of key audit matters requires consideration of multiple factors. From a risk perspective, areas involving a high risk of material misstatement, significant risks, or fraud risks are more likely to be identified as KAMs. Typical examples include complex and error-prone accounting treatments such as revenue recognition and asset impairment. From a materiality perspective, matters that are likely to have a significant influence on users' decisions based on the financial statements also warrant particular attention, including significant related-party transactions and major investments or business acquisitions. The disclosure of key audit matters enables users of financial statements to gain a deeper understanding of the focus of the audit by highlighting the areas that received the auditor's greatest attention and the audit procedures performed in response. Consequently, it enhances the transparency and informational value of the auditor's report and increases its usefulness to financial statement users.

2.2. Regulatory inquiries

Before the formal implementation of the inquiry letter system, the financial statements disclosed by listed companies were subject to relatively rigorous review procedures before being made public. Under the current regulatory framework, post-disclosure inquiries have evolved into a key non-punitive supervisory mechanism through which stock exchanges oversee the financial reporting of listed companies. The Shanghai and Shenzhen Stock Exchanges issue inquiry letters to listed companies either at designated intervals or on an ad hoc basis, depending on regulatory needs.

The issues raised in these inquiry letters are generally tailored to the actual operating conditions of the recipient company. Listed companies or their external auditors are required to provide written responses within

a specified time frame. After reviewing these responses, the stock exchange conducts a professional assessment and may require the company to revise its disclosures, initiate further investigations, or, in serious cases, impose administrative sanctions. Such regulatory inquiries impose higher standards of information disclosure on both listed companies and auditing firms and play an important role in enhancing the openness and transparency of financial reporting.

Regulatory inquiry letters take several forms, each serving different supervisory objectives and focusing on different issues. Common types include restructuring inquiry letters, regulatory concern letters, and general inquiry letters. Among these, annual report inquiry letters are of particular significance because annual reports constitute the primary source of information through which investors assess the operating performance and financial condition of listed companies. Consequently, regulators maintain close scrutiny over the quality of annual report disclosures. Since accounting firms provide assurance on corporate financial reports, regulators also monitor the quality of audit practice. In addition to requiring responses from the listed companies themselves, regulatory authorities may request the engagement auditors to explain specific audit issues in order to further verify the accuracy and reliability of the disclosed information.

The issues covered by annual report inquiry letters are extensive. On the one hand, they typically focus on matters such as changes in a company's ability to continue as a going concern and unusual fluctuations in financial statement items compared with previous reporting periods, with the aim of identifying potential operational or financial risks. On the other hand, regulators also examine the evidential basis supporting the auditor's opinion and whether the audit was conducted in strict accordance with the prescribed auditing standards and procedures, thereby assessing the quality of audit execution. As the principal vehicle through which companies communicate their operating and financial performance to external stakeholders, annual reports contain comprehensive and multidimensional information and have consistently been regarded by both the Shanghai Stock Exchange and the Shenzhen Stock Exchange as a regulatory priority. Accordingly, this study confines its analysis of regulatory inquiries to annual report inquiry letters and examines their role and implications within the context of capital market supervision.

3. Key audit matter disclosures and regulatory inquiries involving Pan-China Certified Public Accountants LLP

3.1. Overview of Pan-China Certified Public Accountants LLP

Established in 1983, Pan-China Certified Public Accountants LLP marked the emergence of one of the earliest and most influential accounting firms in China's auditing profession. Over more than four decades of steady development, the firm has achieved remarkable progress in expanding its business scale, improving audit quality, and strengthening its professional reputation, making it one of the leading accounting firms in China. Owing to its rigorous professional standards, strong technical expertise, and high-quality services, Pan-China has earned the trust and recognition of numerous clients and has become a long-term professional partner for many enterprises.

As shown in Table 1, the firm's principal sources of revenue include audit, consulting, taxation, and construction cost consulting services. Through continuous innovation in service delivery and ongoing improvements in service quality, Pan-China has successfully expanded its business opportunities while further enhancing its market influence and brand value. The firm also places considerable emphasis on corporate social responsibility by actively participating in public welfare initiatives and contributing to the healthy development of the accounting profession and the broader economy. According to the 2023 Comprehensive

Evaluation Ranking of Accounting Firms, Pan-China ranked fourth nationwide. It also ranked among the industry's leaders in terms of the number of certified public accountants and branch offices. These indicators demonstrate the firm's substantial scale, extensive business coverage, and strong professional talent base.

Table 1. Comprehensive evaluation ranking of accounting firms, 2023

Accounting Firm	Ranking	Operating Revenue (RMB 10,000)	Number of Branch Offices
Ernst & Young Hua Ming LLP	1	681,392.11	23
KPMG Huazhen LLP	2	510,294.45	20
BDO China Shu Lun Pan Certified Public Accountants LLP	3	604,743.88	31
Pan-China Certified Public Accountants LLP	4	481,870.50	14
Rongcheng Certified Public Accountants LLP	5	322,738.24	19
Grant Thornton China	6	326,182.99	26
Baker Tilly China Certified Public Accountants LLP	7	377,058.86	25
Deloitte Touche Tohmatsu Certified Public Accountants LLP	8	523,003.01	15
ShineWing Certified Public Accountants LLP	9	409,845.73	28
Dahua Certified Public Accountants LLP	10	416,960.29	30

Note: Data Source: Compiled by the author based on data from the China Stock Market & Accounting Research (CSMAR) Database.

3.2. Key audit matter disclosures by Pan-China Certified Public Accountants LLP

As shown in Table 2, among Pan-China's audit clients, the computer, communication, and other electronic equipment manufacturing industry accounted for the largest proportion of engagements throughout the three-year period and exhibited a gradual upward trend. The numbers and proportions of audit engagements in industries such as special equipment manufacturing and chemical raw materials and chemical products manufacturing remained relatively stable, with only minor fluctuations. The proportion of clients in the real estate industry first increased from 2.5% to 2.9% before declining to 2.1%, a trend that may be associated with changes in regulatory policies or market conditions. The proportion of clients in the retail industry declined slightly from 2.1% to 1.9%, suggesting a modest contraction in audit demand within that sector. The shares of the wholesale and fabricated metal products industries remained relatively stable at 1.8% and 1.9%, respectively. Overall, Pan-China's client portfolio is dominated by manufacturing enterprises while encompassing a broad range of industries.

Table 2. Industry distribution of key audit matter disclosures by Pan-China Certified Public Accountants LLP

Industry	2020		2021		2022	
	Count	%	Count	%	Count	%
Computer, Communication and Other Electronic Equipment Manufacturing	486	10.3%	436	10.3%	577	11.3%
Special Equipment Manufacturing	322	6.8%	270	6.4%	364	7.1%
Chemical Raw Materials and Chemical Products Manufacturing	314	6.6%	279	6.6%	340	6.7%
Software and Information Technology Services	299	6.3%	256	6.1%	336	6.6%
Electrical Machinery and Equipment Manufacturing	298	6.3%	262	6.2%	324	6.3%
Pharmaceutical Manufacturing	297	6.3%	259	6.1%	316	6.2%
General Equipment Manufacturing	172	3.6%	151	3.6%	198	3.9%
Automobile Manufacturing	163	3.4%	144	3.4%	174	3.4%
Rubber and Plastics Manufacturing	112	2.4%	95	2.2%	122	2.4%
Non-metallic Mineral Products Manufacturing	106	2.2%	97	2.3%	113	2.2%
Real Estate	116	2.5%	122	2.9%	109	2.1%
Retail	100	2.1%	94	2.2%	99	1.9%
Fabricated Metal Products Manufacturing	90	1.9%	77	1.8%	98	1.9%
Wholesale	86	1.8%	74	1.8%	91	1.8%

Note: Data Source: Compiled by the author based on data from the CSMAR Database.

3.3. Regulatory inquiries and sanctions involving Pan-China Certified Public Accountants LLP

As presented in Table 3, during the period from 2022 to 2024, the number of companies receiving regulatory inquiry letters declined sharply at first and then remained relatively stable. Meanwhile, the proportion of these companies relative to the total number of companies audited by Pan-China increased initially and subsequently declined, rising from 5.06% to 8.64% before falling to 7.56%. Although the absolute number of audited companies receiving inquiry letters decreased year by year, their proportion among the firm's total audit clients increased during the period before declining slightly. This pattern indicates that, despite the continued implementation of inquiry-based regulatory supervision, deficiencies remained among companies audited by Pan-China.

Table 3. Regulatory inquiry statistics for Pan-China Certified Public Accountants LLP (2022–2024)

Year	Number of Companies Receiving Inquiry Letters	Percentage of Total Audited Companies (%)	Number of Inquiry Issues
2022	49	5.06%	412
2023	19	8.64%	158
2024	17	7.56%	127

Note: Data Source: Compiled by the author based on data from the CSMAR Database.

3.4. The impact of regulatory inquiries on the disclosure of key audit matters by Pan-China Certified Public Accountants LLP

Table 4. Length of key audit matter disclosures for Yaguang Technology (2020–2023)

Year	Key Audit Matter	Number of KAMs	Description (Words)	Audit Response Procedures (Words)	Total (Words)
2020	Revenue recognition	3	97	405	502
	Inventory valuation and cost allocation		192	442	634
	Goodwill impairment		193	404	597
2021	Goodwill impairment	2	258	404	662
	Provision for inventory write-down		173	433	606
2022	Revenue recognition	3	190	352	542
	Goodwill impairment		243	350	593
	Net realizable value of inventories		224	378	602
2023	Revenue recognition	2	187	322	509
	Impairment of accounts receivable and contract assets		221	515	736

Note: Data Source: Compiled by the author based on data from the CSMAR Database.

As shown in Table 4, with respect to the number of key audit matters disclosed, the auditing standards do not prescribe a specific number of matters to be reported; instead, the determination depends on the auditor's professional judgment and the characteristics of the audited entity. In the audit reports issued by Pan-China for Yaguang Technology between 2020 and 2023, the number of disclosed key audit matters ranged from two to three each year, with three matters reported in 2020 and 2022, and two matters in 2021 and 2023. Regarding the content of the disclosures, the length of the descriptive sections for key audit matters exhibited an overall increasing trend. Taking revenue recognition and goodwill impairment as examples, the description of revenue recognition expanded from only 97 words in 2020 to 190 words in 2022 and 187 words in 2023, representing increases of 95.9% and 92.8%, respectively. Similarly, the description of goodwill impairment increased from 193 words in 2020 to 258 words in 2021 and 243 words in 2022, corresponding to increases of 33.7% and

25.9%. Following the issuance of *Growth Enterprise Market (GEM) Annual Report Inquiry Letter No. 175 [2022]*, the total length of the key audit matter disclosures in Pan-China's audit report reached 1,737 words, an increase of 469 words (37%) compared with the previous year. This evidence suggests that regulatory inquiry letters prompted Pan-China to attach greater importance to the disclosure of key audit matters, resulting in more comprehensive disclosures that conveyed richer information to financial statement users.

4. Problems in the disclosure of key audit matters by Pan-China Certified Public Accountants LLP and analysis of their causes

4.1. Problems in the disclosure of key audit matters from the perspective of regulatory inquiries

Although the revised auditing standards provide general guidance on the identification of Key Audit Matters (KAMs), accounting firms often encounter difficulties in accurately identifying and appropriately determining KAMs in practice. When annual report inquiry letters are used as a benchmark for comparison, certain deficiencies become apparent in Pan-China Certified Public Accountants LLP's identification of key audit matters. These deficiencies are primarily reflected in standardized and formulaic descriptions that lack entity-specific characteristics and fail to adequately correspond to the material risk areas actually faced by the audited companies during the reporting period.

Homogenization of key audit matter disclosures across reporting periods: evidence from Pan-China Certified Public Accountants LLP. For the same listed company, the key audit matters identified by the engagement auditor exhibit a strong tendency toward consistency across different reporting periods. As shown in Table 5, this study selects six audit clients that received annual report inquiry letters two or three times between 2022 and 2024 as the sample for analysis. The results indicate that, for four of these companies, the disclosed key audit matters remained unchanged throughout the observation period. Furthermore, the descriptions of the identified matters, the wording employed, and the presentation of audit response procedures were highly consistent across the three years, with virtually no substantive revisions to the audit procedures described. However, a comparison between these audit reports and the corresponding annual report inquiry letters reveals that the companies were, in fact, confronted with other significant issues that were not reflected in the disclosed key audit matters. Sansheng Co., Ltd. provides a representative example. Over the three-year period, its disclosed key audit matters consistently included the audit of accounts receivable, goodwill impairment, the recognition of impairment provisions for long-term assets, and the impairment of fixed assets, construction in progress, and intangible assets. By contrast, the annual report inquiry letters focused on deficiencies in internal control, liquidity risk, and the adequacy of credit loss provisions or asset impairment related to accounts receivable and fixed assets. This discrepancy indicates that the matters disclosed as key audit matters did not fully align with the principal issues identified by regulators in the annual report inquiry process, suggesting that KAM disclosures were not always able to capture the most significant risks highlighted through regulatory supervision.

Table 5. Key audit matter disclosures of Pan-China's audit clients receiving annual report inquiry letters for two or three consecutive years (2022–2024)

Audited Company	Key Audit Matters	Major Issues Raised in <i>Annual Report Inquiry Letters</i>
Infotmic Co., Ltd.	Revenue recognition; impairment of accounts receivable; goodwill impairment	Significant increase in accounts receivable; abnormal increases in administrative and selling expenses; guarantee-related litigation; growth in operating revenue accompanied by declining net profit; substantial deterioration in financial performance
Hangzhou Gaoxin Rubber & Plastic Materials Co., Ltd.	Revenue recognition; impairment of accounts receivable	Declining revenue; non-compliant related-party borrowing and fund occupation; abnormal expense expenditures
Huatu Shanding Design Co., Ltd.	Revenue recognition; impairment of accounts receivable	Debt settlement through property transfers; substantial quarterly salary disparities; continuous decline in net profit
Nanhua Biotech Co., Ltd.	Revenue recognition; impairment of accounts receivable	Sharp decline in operating revenue; recognition of service costs as long-term deferred expenses
Yaguang Technology Group Co., Ltd.	Revenue recognition; goodwill impairment; net realizable value of inventories; impairment of accounts receivable and contract assets	Goodwill impairment; provision for bad debts; commercial acceptance bills; adequacy of inventory write-down provisions
Sansheng Industrial Co., Ltd.	Audit of accounts receivable; goodwill impairment; provision for impairment of long-term assets; impairment of fixed assets, construction in progress, and intangible assets	Internal control deficiencies; liquidity risk; adequacy of credit loss provisions or asset impairment relating to accounts receivable and fixed assets

Note: Data Source: Compiled by the author based on data from the CSMAR Database.

4.2. Causes of the problems in key audit matter disclosure from the perspective of regulatory inquiries

4.2.1. Insufficient rigor in the identification of key audit matters

In the current market environment, where financial fraud occurs with increasing frequency, listed companies have become one of the primary groups involved in such misconduct. Owing to deficiencies in internal governance, some companies manipulate their financial reports through unconventional accounting practices to obtain improper economic benefits, thereby misleading investors and the public. To curb such practices and prevent their recurrence, the China Securities Regulatory Commission (CSRC) has continuously strengthened

its regulatory oversight. At the same time, certified public accountants bear significant professional responsibilities and face considerable litigation and reputational risks. Consequently, when determining and disclosing key audit matters, auditors are expected to carefully evaluate the potential implications of their judgments for the accounting firm, the audited client, and the public interest. However, during the peak annual audit season, when numerous audit engagements must be completed within tight reporting deadlines, accounting firms often face substantial time pressure. To improve efficiency and ensure timely completion of audit reports, auditors may resort to standardized disclosure templates. Although such practices may be regarded by firms as an effective means of balancing audit efficiency, risk management, and cost control, they also reveal deficiencies in the rigor of the KAM identification process. The reliance on formulaic disclosures reflects an insufficiently cautious approach to determining matters of greatest audit significance and, to some extent, deviates from the original objectives of the key audit matter disclosure framework, which seeks to provide entity-specific and decision-useful information.

4.2.2. The formation of a standardized and formulaic disclosure pattern

Audit engagements are inherently continuous in nature. In the absence of significant changes in a company's operations or financial condition, listed companies generally prefer to retain the same accounting firm as their external auditor for successive years. This long-term engagement relationship naturally contributes to continuity in the disclosure of key audit matters across reporting periods. Over time, auditors accumulate experience and familiarity with individual clients, and this accumulated knowledge gradually develops into relatively stable and standardized disclosure practices. In some cases, auditors merely update the current year's financial figures while leaving the remainder of the disclosure largely unchanged. At the textual level, repetitive wording and template-based descriptions have become increasingly common, with auditors frequently relying on established language rather than tailoring disclosures to the audited company's specific operational characteristics, industry environment, or business risks. When such template-oriented practices persist over an extended period, both the identification and presentation of key audit matters inevitably become increasingly rigid, making it difficult for disclosures to reflect substantive year-to-year changes.

Moreover, the number of key audit matters ultimately disclosed is determined by several factors, including the auditor's professional judgment, the characteristics of the audit engagement, and the complexity of the audited entity's financial statements. Current auditing standards, however, do not prescribe either a minimum or a maximum number of matters that should be disclosed. In practice, most accounting firms report approximately two key audit matters, and the average number of disclosed matters has shown a declining trend in recent years. Under these circumstances, auditors may become constrained by prevailing disclosure conventions and overlook more significant risks arising in the current reporting period. As a result, the number of disclosed key audit matters often remains fixed at around two throughout a continuing audit engagement. This disclosure practice, which emphasizes formal consistency over substantive communication, limits the amount of decision-relevant information conveyed to users of financial statements and diminishes the informational value of key audit matter disclosures.

5. Recommendations for improving the disclosure of key audit matters

5.1. Recommendations at the regulatory level

Although China's stock exchanges have operated the inquiry letter system for a considerable period, the current regulatory framework has yet to reach full maturity. As the inquiry letter mechanism is primarily based on self-regulatory supervision, its capacity to constrain listed companies and accounting firms remains

relatively limited, reducing its effectiveness in addressing violations in the securities market. Recognizing these institutional limitations, regulators have revised and supplemented the *Measures for the Implementation of Self-Regulatory Measures and Disciplinary Actions by Stock Exchanges*, thereby providing stock exchanges with a clearer legal basis for carrying out supervisory responsibilities. Under the revised framework, stock exchanges have been granted disciplinary powers, including the authority to impose monetary penalties and disciplinary sanctions. In cases where listed companies repeatedly fail to rectify identified problems despite multiple warnings, the exchanges may refer relevant cases to the China Securities Regulatory Commission (CSRC) for further investigation and enforcement.

Nevertheless, these enforcement measures have not yet been fully utilized in practice. At present, the effectiveness of inquiry letters relies largely on the self-regulatory framework and reputational pressure arising from public scrutiny, while substantive disciplinary measures are invoked relatively infrequently. Accordingly, the regulatory inquiry system should be further strengthened by encouraging stock exchanges to make more active use of available enforcement tools when supervising listed companies, particularly during the review of annual reports, so as to enhance the deterrent effect of regulatory oversight. With respect to the supervision of accounting firms' responses to inquiry letters, stock exchanges could establish a regular evaluation mechanism to systematically assess the quality of firms' replies and determine whether auditors have adequately fulfilled their professional responsibilities. Such a mechanism would facilitate the continuous improvement of regulatory effectiveness and efficiency. In addition, stock exchanges could consider establishing formal feedback channels. On the one hand, these channels would enable investors and other stakeholders to provide supervisory feedback. On the other hand, they would offer accounting firms an official platform to communicate operational difficulties encountered during the audit process, such as obstacles in communicating with management or challenges in obtaining sufficient and appropriate audit evidence. These measures would help address existing weaknesses in the regulatory framework, encourage greater cooperation between listed companies and auditors, and create more favorable conditions for the effective execution of audit engagements.

5.2. Recommendations at the accounting firm level

5.2.1. Establishing a rigorous process for identifying key audit matters

When disclosing key audit matters, accounting firms should not only comply strictly with the identification and disclosure procedures prescribed by auditing standards but also develop a more operational and prudent internal framework tailored to their own practice characteristics and engagement experience. A rigorous identification process can improve the accuracy of auditors' judgments regarding key audit matters and thereby strengthen audit risk management.

Specifically, before commencing an audit engagement, auditors should conduct a comprehensive assessment of the audited entity, including its business activities, operating model, and internal control system. Only by obtaining a thorough understanding of the company's specific circumstances can auditors design audit procedures that appropriately address the entity's unique risk profile, thereby ensuring the overall effectiveness and appropriateness of the audit plan.

As the primary source of information reflecting a company's financial condition and operating performance, the financial statements should remain the central focus of audit analysis. For significant transactions, unusual events, or items that give rise to uncertainty, auditors should perform additional verification procedures and obtain sufficient audit evidence to support the accurate identification of key audit matters.

Furthermore, throughout the audit process, auditors should maintain comprehensive and substantive communication with both management and those charged with governance regarding significant issues identified during the engagement. Through effective two-way communication and the exchange of professional judgments, auditors can ensure that the identification of key audit matters is supported by sufficient evidence and that material issues are not overlooked. A systematic and rigorous identification process therefore constitutes the foundation for determining key audit matters. Accordingly, establishing a scientifically designed and practice-oriented identification framework is essential for enhancing audit quality, reducing engagement risk, and achieving the objectives of the key audit matter disclosure regime.

5.2.2. Strengthening entity-specific disclosure of key audit matters

Although the identification of key audit matters should generally follow the principles established by national auditing standards, their determination must also reflect the specific circumstances of each audited entity. From a cross-sectional perspective, even companies operating within the same industry differ in ownership structure, corporate governance, operational characteristics, and financial conditions. These differences inevitably give rise to variations in the risks faced by individual companies and, consequently, in the key audit matters identified by auditors. Therefore, the selection of key audit matters should be based on the particular circumstances of each entity rather than relying on industry-wide conventions. Since companies within the same industry often possess distinctive business models and management practices, auditors are expected to classify and evaluate audit risks on a case-by-case basis.

Revenue recognition provides a representative example. As an area that has long been associated with elevated audit risk, revenue recognition is frequently identified as a key audit matter. However, although companies across different industries all seek to strengthen their competitive positions, they vary substantially in terms of profitability, operational efficiency, and the sophistication of internal management. Moreover, the revenue-generating processes of companies operating in different industries are inherently heterogeneous and are therefore not directly comparable. For this reason, the disclosure of key audit matters should not focus disproportionately on revenue recognition alone. Instead, auditors should adopt a differentiated approach by selecting and describing key audit matters according to the specific risks and circumstances of each engagement. Such an approach would help reduce the homogenization of KAM disclosures and provide investors with more reliable and decision-useful information, thereby enhancing the value of audit reports and mitigating audit risk.

Admittedly, companies within the same industry inevitably share certain common characteristics, and some overlap in disclosed key audit matters, as well as the use of similar professional terminology, is therefore unavoidable. Nevertheless, this does not justify lowering professional standards or simplifying disclosure procedures. The presentation of key audit matters should be grounded in a thorough analysis of the audited entity's unique circumstances and should provide entity-specific explanations rather than relying on standardized disclosure templates.

From a longitudinal perspective, the key audit matters of the same company may also change across reporting periods as a result of factors such as changes in financial management personnel, adjustments to accounting policies, or shifts in business operations and financial conditions. However, because long-term audit engagements are common in practice, accounting firms may become overly reliant on accumulated knowledge of their clients and consequently overlook significant changes that occur over time. Therefore, certified public accountants—particularly engagement auditors who have audited the same client for multiple consecutive years—should remain alert to developments occurring during each reporting period and maintain effective communication with management so that key audit matters accurately reflect the company's current risk profile and support well-founded audit conclusions.

Accordingly, auditors should strive to achieve differentiated disclosure of key audit matters from both cross-sectional and longitudinal perspectives. Even when similar matters are disclosed, the information presented should be tailored through entity-specific descriptions and contextualized explanations rather than repetitive standardized wording. Such personalized disclosure would enhance the decision usefulness of audit reports and further advance the objectives of key audit matter reporting under the revised auditing standards.

6. Conclusion

This study takes Pan-China Certified Public Accountants LLP as the research subject and, using data from A-share listed companies on the Shanghai and Shenzhen Stock Exchanges during the period 2020–2024, examines the current practices and deficiencies in the disclosure of Key Audit Matters (KAMs) from the perspective of regulatory inquiries. The findings indicate that Pan-China's KAM disclosures exhibit several prominent shortcomings. First, significant high-risk areas, including goodwill impairment and related-party transactions, are not consistently identified and disclosed as key audit matters. Second, the disclosures tend to rely on standardized templates, with limited integration of quantitative analysis and industry-specific characteristics. Third, the audit response procedures described in KAM disclosures lack verifiability, as they are often expressed in general terms without sufficient supporting evidence or detailed explanations. A comparative analysis of the firm's KAM disclosures and the annual report inquiry letters issued by the Shenzhen Stock Exchange further reveals substantial discrepancies between the issues emphasized by regulators—such as unusual transactions involving subsidiaries and the use of proceeds from fundraising projects—and the matters disclosed by the auditor. These findings suggest that the disclosed key audit matters do not adequately reflect the actual risks faced by the audited companies.

In response to these issues, this paper proposes a series of recommendations from both regulatory and professional perspectives. At the regulatory level, it is recommended that the coordination mechanism between the inquiry letter system and audit supervision be strengthened and that a systematic evaluation framework for assessing the quality of key audit matter disclosures be established. At the accounting firm level, firms should improve their audit risk assessment models, develop industry-specific disclosure frameworks, and make greater use of digital technologies to enhance the documentation and traceability of audit procedures. These recommendations not only contribute to the theoretical understanding of the relationship between regulatory inquiries and key audit matter disclosures but also provide practical guidance for improving the decision usefulness of audit reports.

Nevertheless, this study has several limitations. First, the analysis is based solely on a single accounting firm, and the generalizability of the findings therefore requires further verification using broader samples. Second, the study does not examine the unique disclosure requirements of emerging industries, such as those associated with the digital economy. Third, the effectiveness of the proposed policy recommendations remains to be validated through future empirical research.

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