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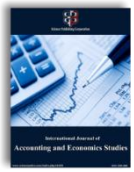

The Influence of Corporate Integrity Culture on Disclosure of Key Audit Matters

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Abstract

Integrity is the foundation of how companies operate, and a culture of integrity is vital for reducing corporate risks and building trust in capital markets. Using data from China's A-share-listed companies from 2019 to 2024, this study explores how corporate integrity culture influences the disclosure of Key Audit Matters (KAMs) and the mechanisms behind this relationship. The results show that a strong integrity culture is linked to fewer KAM disclosures. This connection works through several pathways: lowering business risks, reducing financial risks, and decreasing auditors' legal exposure. Analysis of different groups suggests that the negative impact of integrity culture on KAM disclosure is stronger in firms with many relational transactions and high institutional investor participation. Additional findings indi-cate that companies with a strong integrity culture tend to pay lower audit fees, produce fewer KAMs with inconclusive assessments, and have less similarity in KAM disclosures within the same industry, often with a less positive tone. Ultimately, this research recommends that companies develop long-term integrity-focused management systems to strengthen their cultural influence and support high-quality growth. Auditors should consider corporate cultural traits to improve audit efficiency and quality. Policymakers are advised to encourage firms to build their integrity culture, fostering healthy development within capital markets.

Keywords: *Corporate Integrity Culture; Key Audit Matters (KAMs); Information Disclosure; Textual Similarity; Tone Positivity.*

1. Introduction

In an era of increasing market complexity and information asymmetry, corporate integrity has become a key driver of sustainable business development (D'Orlando & Ricciotti, 2021). A series of global corporate scandals and governance failures has underscored the need for strong ethical foundations within firms. Within this context, corporate integrity culture goes beyond regulatory compliance: it reflects the core values and behavioural norms that shape organizational conduct and functions as both a moral compass and a strategic asset in capital markets (Wu et al., 2023).

The influence of corporate culture is rooted in institutional theory and behavioural economics. Culture operates as an implicit control mechanism that guides organizational outcomes through shared norms and mental models (Graham et al., 2022). In the case of integrity culture, prior research suggests two main roles: it serves as an internal governance mechanism that constrains opportunistic behaviour and as an external signal that enhances stakeholder trust (Tse & Pun, 2024). These dual functions are especially important in emerging markets, where formal institutions are still evolving.

In parallel, the auditing profession has undergone major reforms in response to demands for greater transparency. The introduction of Key Audit Matters (KAMs) represents one of the most significant changes in audit reporting worldwide (Moroney et al., 2020). In China, CAS 1504, implemented in 2016, requires auditors to disclose KAMs to narrow the information gap between auditors and financial statement users by highlighting areas of highest audit risk and most significant professional judgement (Li & Zheng, 2024).

However, existing KAM research is imbalanced (Rahaman & Bhuiyan, 2025; Elmarzouky et al., 2024; Ma et al., 2024). Much of the literature focuses on the consequences of KAM disclosures—such as market reactions or debt contracting—while the determinants of KAM reporting remain less explored. Prior studies mainly adopt a "hard attribute" perspective, emphasising auditor characteristics and client financial metrics (Moubarak & Elamer, 2024), and pay relatively little attention to "soft" organizational factors such as corporate culture, despite growing evidence that culture materially affects financial reporting and disclosure outcomes (Maroun & Duboisée de Ricquebourg, 2024).

This study addresses these gaps in both the corporate culture and auditing literatures. We examine how corporate integrity culture affects KAM disclosures and extend the analysis of integrity culture's economic consequences to external audit communications. We also develop a theoretical framework in which integrity culture shapes KAM disclosures through three risk channels: reduced business risk, lower financial risk, and decreased legal exposure for auditors. In doing so, we provide a more nuanced view of how informal institutions interact

with formal reporting requirements in shaping audit outcomes, offering insights for standard-setters, practitioners, and corporate governance stakeholders.

2. Literature Review and Research Hypothesis

In recent years, the influence of informal institutional factors on corporate financial behaviour has garnered significant academic attention. Corporate culture, particularly integrity culture, has been identified as a critical component of informal institutions that fundamentally shapes organisational conduct (Cherian et al., 2021; Rahaman et al., 2023). Concurrently, international reforms in auditing standards have introduced requirements for the disclosure of Key Audit Matters (KAMs), aiming to enhance the informational value of audit reports and improve the information environment in capital markets (Mah'd & Mardini, 2022; Sierra-García et al., 2019). Nevertheless, the extant literature remains relatively sparse on how corporate culture influences auditors' professional judgements, particularly their decisions regarding KAM disclosures (Alawadhi et al., 2024). This study constructs a theoretical framework examining the relationship between corporate integrity culture and KAM disclosures, drawing upon social norm theory, signalling theory, and risk-based auditing frameworks.

2.1. Theoretical analysis: corporate integrity culture and KAM disclosures

Grounded in risk-based audit theory, auditors' disclosure decisions are fundamentally a response to their overall client risk assessment. This study posits that corporate integrity culture suppresses KAM disclosures through three distinct theoretical channels:

Firstly, building upon social norm theory, integrity culture establishes shared values and behavioural standards that create a system of "soft constraints" on internal corporate conduct (Akerlof & Kranton, 2005). This constraining mechanism enhances internal control effectiveness, thereby reducing business risk and financial reporting risk, which consequently lowers the auditor's assessment of the risk of material misstatement.

Secondly, according to signalling theory, integrity culture functions as a signal of high firm quality, effectively mitigating information asymmetry (Spence, 1973). When a firm credibly signals its commitment to integrity, auditors may perceive reduced necessity for additional risk communication via extensive KAM disclosures.

Thirdly, informed by audit communication theory, shared values enhance communication efficacy between auditors and client management (Federsel & Hörner, 2025). The climate of trust fostered by an integrity culture reduces communication barriers, facilitating auditors' access to sufficient appropriate audit evidence, thereby diminishing their perception of audit risk.

Based on the foregoing theoretical analysis, we propose the following hypothesis:

H1: A stronger corporate integrity culture is associated with a lower level of Key Audit Matter disclosures.

2.2. Analysis of underlying mechanisms

2.2.1. Business risk channel

The modern risk-oriented audit model emphasises the foundational role of business risk in audit risk assessment. Corporate integrity culture influences business risk through two primary avenues. On one hand, it fosters stable customer relationships and reliable supply chain partnerships, mitigating operational uncertainties (Alberti et al., 2020). On the other hand, it constrains managerial opportunism and reduces the likelihood of non-compliant operations (Zhai et al., 2021). Within the audit risk model, a reduction in business risk directly leads to a lower assessed risk of material misstatement, consequently influencing the auditor's KAM disclosure decisions.

H2: The negative relationship between corporate integrity culture and KAM disclosures is mediated by a reduction in business risk.

2.2.2. Financial risk channel

The influence of integrity culture on financial risk manifests primarily in two aspects. Firstly, by enhancing accounting information quality and financial transparency, it strengthens a firm's financing capacity and alleviates financial constraints (Chang et al., 2022). Secondly, it facilitates access to more favourable trade credit terms, improving cash flow stability (Nguyen et al., 2022). In accordance with risk-based auditing principles, a reduction in financial risk directly affects the auditor's assessment of inherent risk, thus diminishing the need for extensive risk response measures, including detailed KAM disclosures.

H3: The negative relationship between corporate integrity culture and KAM disclosures is mediated by a reduction in financial risk.

2.2.3. Legal risk channel

Rooted in insurance theory, the legal exposure faced by auditors is a significant consideration in their disclosure decisions (Kellogg, 1984). Integrity culture indirectly influences auditors' legal liability risk by reducing clients' litigation and regulatory risks (Rautiainen et al., 2021). Primarily, it reduces the probability of corporate legal and regulatory violations, thereby lowering the auditor's vicarious liability risk stemming from client misconduct. Secondly, it elevates the firm's compliance standards, minimising legal disputes arising from regulatory penalties. As legal liability risk attenuates, the auditor's incentive to engage in "defensive auditing" through expansive KAM disclosures is correspondingly weakened.

H4: The negative relationship between corporate integrity culture and KAM disclosures is mediated by a reduction in auditors' legal risk.

3. Research Methodology

This study employs quantitative research methods and constructs an empirical framework based on principal-agent theory, information asymmetry theory, and risk-based auditing theory. The study uses panel data from China's A-share-listed companies spanning 2019-2024, applying multiple regression analysis and mediation-effect tests to verify the research hypotheses. Specifically, corporate integrity culture is measured through text analysis based on the Word2Vec model, while key audit matter disclosures are quantified across two dimensions: quantity and length.

To clarify the measurement strategy for corporate integrity culture, three issues are addressed. First, MD&A text is used as the primary source because it is the central narrative section in which management explains performance, risks, and strategy to external stakeholders.

It is prepared under senior management's responsibility and is less constrained by fixed templates than other report sections, allowing explicit discussion of values such as honesty, responsibility, and compliance. The frequency and prominence of integrity-related expressions in MD&A therefore provide a reasonable proxy for the integrity culture emphasised by management.
Second, alternative textual sources were considered, including the chairman's statement, CEO letters, CSR reports, and stand-alone codes of conduct. These documents may also convey cultural information, but they are often voluntary, not consistently available across firms and years, or highly boilerplate, which weakens cross-sectional comparability. In contrast, MD&A is mandatorily disclosed for all A-share firms throughout the sample period and is subject to uniform regulatory requirements, which helps to ensure coverage and comparability.
Third, several potential measurement biases are acknowledged. Integrity-related wording may be used for impression management, creating noise and biasing estimates towards zero. Larger firms may have longer MD&A sections and thus mechanically more integrity-related words. Meanings of integrity-related terms may also vary across industries and over time. These concerns are mitigated by combining TF-IDF weighting with a Word2Vec-based dictionary to downweight generic language, by constructing normalized integrity measures (e.g., integrity words as a share of total MD&A words and industry-adjusted scores), and by including firm and industry–year fixed effects. Although no single indicator can fully capture an abstract construct such as integrity culture, the MD&A-based textual measure, together with these design choices, provides a concise and empirically grounded proxy.
The research employs Stata 17.0 for data processing, controls for unobservable individual heterogeneity using fixed-effects models, and addresses heteroscedasticity using cluster-robust standard errors. The following sections elaborate on each component of the research design.

3.1. Sample selection and data sources

The choice of this time window holds significant theoretical importance. The year 2019 marks the first full observation year after the comprehensive implementation of the new audit reporting standards in China's capital market, ensuring the completeness and comparability of key audit matter disclosure data (Liu et al., 2022). By 2024, these standards had been implemented for over five years, providing sufficient time-series data to effectively capture the dynamic evolution of corporate integrity culture and audit disclosure behaviors (Li et al., 2025). This period also coincides with a critical phase of deepening reforms in China's capital market, including the comprehensive advancement of the registration-based IPO system, offering a rich institutional background for the study.
The research sample was rigorously screened according to academic standards based on the following criteria: First, companies subject to special treatment (ST, *ST) and suspension of listing (PT) during the period were excluded. Such companies typically face severe financial difficulties or operational abnormalities, where auditor behavior may be influenced by non-market factors such as regulatory intervention, and they often exhibit strong earnings management motivations that could confound the true relationship between integrity culture and the disclosure of key audit matters. Second, financial and insurance companies were excluded due to their industry-specific characteristics, which lead to systematic differences in business structures, risk profiles, and regulatory requirements compared to general listed companies. Their audit report formats and content follow special disclosure norms, lacking comparability. Finally, samples with missing key variables were removed to ensure the reliability of the empirical results.
After applying the above screening procedures, a final total of 14,908 valid firm-year observations were obtained. Corporate integrity culture data were constructed using advanced machine learning methods, employing natural language processing techniques to analyze annual report texts; internal control data were sourced from the authoritative DIB Database; both the key audit matter disclosure texts and the financial data of listed companies KAMe from the CSMAR Database. To control for the impact of outliers on the research conclusions, all continuous variables in this study were winsorized at the 1st and 99th percentiles. This data processing approach aligns with common practices in econometric research and effectively enhances the robustness of the estimation results.

3.2. Variable definitions

The dependent variables in this study comprise measures of Key Audit Matters (KAM) disclosures, operationalized along two distinct dimensions. The first dimension, KAM_Number (KAM), represents the natural logarithm of one plus the number of disclosed KAM categories. The second dimension, KAM_Length (Len), is defined as the natural logarithm of one plus the character count within the KAM disclosure section. These transformations are intended to normalize the distribution of the data and reduce potential skewness associated with raw disclosure counts and lengths.
The independent variable, Corporate Integrity Culture (Intg), is quantified through the Term Frequency–Inverse Document Frequency (TF-IDF) weighted word frequency associated with the "integrity" culture dimension. The construction of this variable involves a three-step computational linguistic process. First, the Management Discussion and Analysis (MD&A) section of annual reports is extracted and subjected to comprehensive text preprocessing procedures, including word segmentation, part-of-speech tagging, dependency parsing, and the removal of punctuation and stop words. The process also involves identifying MD&A-specific phrases to facilitate the learning of bigrams and trigrams. Second, a Word2Vec model is trained to transform all valid words, bigrams, and trigrams into 300-dimensional vector representations, enabling semantic analysis. Third, drawing from prior literature, seed words are established for five cultural dimensions—"integrity," "innovation," "team," "respect," and "quality." The Word2Vec model is then employed to generate additional semantically similar words for each dimension, thereby constructing a comprehensive corporate culture dictionary. A higher Intg score reflects a stronger corporate emphasis on an integrity culture within organizational discourse.
The study incorporates three mediating variables to examine the mechanisms through which corporate integrity culture may influence KAM disclosures. Business Risk (OpRsk) is measured as the coefficient of variation of the company's operating revenue over the preceding five years, capturing variability in operational performance. Financial Risk (FinRsk) is assessed using the Naïve Merton Distance-to-Default (DD) model, which estimates the likelihood of financial distress based on market and accounting data. Auditor Legal Risk (LitRsk) is operationalized as the total number of corporate violations identified in the current year that subsequently result in regulatory penalties, reflecting auditors' exposure to legal risk associated with client misconduct.
To control for potential confounding effects, the model includes several control variables derived from established literature. Audit-related characteristics encompass auditor change (Chg), auditor tenure (Tenu), engagement with a Big 10 audit firm (Big10), and audit opinion type (Clean). Firm-specific characteristics include accounts receivable to total assets (Rec), inventory to total assets (Inv), firm size (Size), revenue growth (Gro), leverage (Lev), return on assets (ROA), asset turnover (ATO), loss indicator (Loss), internal control quality (IC), ownership concentration (Top1), CEO-Chair duality (Dual), proportion of independent directors (Indp), and board size (Board). In addition, year and industry fixed effects are incorporated to account for temporal and sectoral heterogeneity.

All variables are defined and measured following established theoretical frameworks and prior empirical studies to ensure methodological rigor, construct validity, and comparability across research contexts. The detailed definitions and measurement procedures for each variable are presented in Table 1, which categorizes variables by type to facilitate clarity and comprehension.

3.3. Empirical models

3.3.1. Baseline regression model

To test the impact of corporate integrity culture on KAM disclosures, the following baseline model is constructed:

$$CriAud = \alpha_0 + \alpha_1 Intg + A'Controls + \varepsilon \quad (1)$$

Where CriAud represents the KAM disclosure measures (KAM or Len), Controls denotes the vector of control variables, and ε is the error term. Standard errors are clustered at the firm level to account for residual correlation. A significantly negative coefficient α_1 would support H1, indicating that a stronger integrity culture is associated with reduced KAM disclosures.

3.3.2. Mediation effect models

To test the mediating effects, the following models are employed:

$$Med = \beta_0 + \beta_1 Intg + B'Controls + \varepsilon \quad (2)$$

$$CriAud = \gamma_0 + \gamma_1 Intg + \gamma_2 Med + C'Controls + \varepsilon \quad (3)$$

Where Med represents the mediating variables (OpRsk, FinRsk, or LitRsk).
In summary, this study adopts a rigorous empirical research design, constructs a panel dataset of A-share listed companies from 2019 to 2024, uses text analysis methods to measure corporate integrity culture, and employs multiple regression models to test research hypotheses. The research design exhibits the following characteristics: First, sample selection fully considers data availability and representativeness, ensuring sample quality through strict screening criteria. Second, variable measurement integrates text analysis, financial indicators, and market data to provide the validity and reliability of core variable measurements. Third, the model specification controls for a series of corporate governance and audit characteristic variables and uses fixed-effects models to mitigate omitted-variable bias. This comprehensive research methodology system provides reliable assurance for the subsequent analysis of empirical results.

Table 1: Operational Definitions of Key Variables

Variable Type	Variable Name	Variable Symbol	Variable Definition
Dependent Variables	Number of KAM Disclosures	KAM	Natural logarithm of (1 + number of KAM categories disclosed)
	Length of KAM Disclosures	Len	Natural logarithm of (1 + number of characters in KAM disclosure section)
Independent Variable	Corporate Integrity Culture	Intg	TF-IDF weighted word frequency of "integrity" culture
Mediating Variables	Business Risk	OpRsk	Coefficient of variation of operating revenue over the past 5 years
	Financial Risk	FinRsk	Measuring corporate financial distress risk using the Naïve Merton DD model
	Auditor Legal Risk	LitRsk	Total number of violations occurring in the current year that result in regulatory penalties in future years
Control Variables	Auditor Change	Chg	Equals 1 if auditor changed, 0 otherwise
	Auditor Tenure	Tenu	Number of consecutive years the audit firm has provided services
	Big10 Auditor	Big10	Equals 1 if audited by CICPA's top 10 audit firms, 0 otherwise
	Audit Opinion	Clean	Equals 1 if received standard unqualified opinion, 0 otherwise
	Accounts Receivable Ratio	Rec	Accounts receivable divided by total assets
	Inventory Ratio	Inv	Inventory divided by total assets
	Firm Size	Size	Natural logarithm of total assets
	Revenue Growth	Gro	Current year revenue growth divided by the previous year's revenue
	Leverage Ratio	Lev	Total liabilities divided by total assets
	Return on Assets	ROA	Net income divided by total assets
	Asset Turnover	ATO	Total operating revenue divided by total assets
	Loss	Loss	Equals 1 if reported loss in current year, 0 otherwise
	Internal Control	IC	Natural logarithm of DIB internal control index
	Ownership Concentration	Top1	Percentage of shares held by the largest shareholder
	CEO-Chair Duality	Dual	Equals 1 if the CEO and chairman are the same person, 0 otherwise
	Proportion of Independent Directors	Indp	Number of independent directors divided by total board members
	Board Size	Board	Natural logarithm of the number of board directors

4. Research Findings

The following section presents the comprehensive empirical results examining the relationship between corporate integrity culture and Key Audit Matters (KAM) disclosures. The analysis proceeds systematically through four main sections: descriptive statistics that establish the fundamental characteristics of the dataset; baseline regression results that test the primary hypothesis; robustness checks that address potential endogeneity concerns; and mediation analysis that investigates the underlying risk transmission mechanisms. Collectively, the findings provide robust evidence that corporate integrity culture significantly constrains both the quantity and extent of KAM disclosures through multiple risk channels, offering important insights into how organizational ethical environment shapes auditor reporting behavior.

4.1. Results of descriptive statistics

Table 2 presents the descriptive statistics for all variables used in the study. The number of KAMs (KAM) shows a mean of 1.131 with a standard deviation of 0.231, ranging from 0.721 to 1.594. The length of KAM disclosures (Len) demonstrates greater variability with a standard deviation of 0.521, ranging from 4.572 to 7.073 and a mean value of 5.930. This pattern suggests that auditors exercise substantial professional judgment in determining the level of detail in KAM disclosures, adapting their reporting approach to specific client circumstances.

The corporate integrity culture measure (Intg) exhibits considerable cross-sectional variation among sample firms, with values ranging from 0 to 2.231 and a mean of 0.481 (standard deviation = 0.432). This distribution indicates significant differences in the emphasis placed on integrity culture across the sampled organizations.

Among the mediating variables, business risk (OpRsk) shows a mean of 0.211 with moderate variation (standard deviation = 0.188), while financial risk (FinRsk) displays substantially higher values and greater dispersion (mean = 8.782, standard deviation = 3.104). Auditor legal risk (LitRsk) presents a mean of 0.155, though the range extends to 6, indicating some firms experienced multiple regulatory violations.

The control variables generally fall within expected ranges. Most dummy variables, including Big10 (mean = 0.615) and Clean (mean = 0.979), show distributions consistent with prior literature. Firm characteristics such as Size (mean = 22.411), Leverage (mean = 0.423), and profitability measures align with typical values for Chinese listed companies, supporting the representativeness of the sample.

Table 2: Descriptive Statistics of Variables

Variable	Mean	Std. Dev.	Min	Max
KAM	1.131	0.231	0.721	1.594
Len	5.930	0.521	4.572	7.073
Intg	0.481	0.432	0	2.231
OpRsk	0.211	0.188	0.019	1.725
FinRsk	8.782	3.104	1.672	69.834
LitRsk	0.155	0.503	0	6
Chg	0.112	0.321	0	1
Tenu	7.933	5.755	1	25
Big10	0.615	0.492	0	1
Clean	0.979	0.143	0	1
Rec	0.134	0.122	0	0.473
Inv	0.133	0.121	0	0.651
Size	22.411	1.313	20.113	26.445
Gro	0.180	0.367	-0.542	2.042
Lev	0.423	0.192	0.071	0.871
ROA	0.041	0.065	-0.322	0.232
ATO	0.621	0.392	0.081	2.361
Loss	0.891	0.312	0	1
IC	6.462	0.153	5.681	6.705
Top1	0.331	0.143	0.080	0.732
Dual	0.311	0.461	0	1
Indp	0.318	0.054	0.331	0.573
Board	2.110	0.193	1.615	2.642

4.2. Analysis of baseline regression results

Table 3 presents the estimation results examining the impact of corporate integrity culture on both the quantity and length of Key Audit Matters (KAMs) disclosures. In column (1), the coefficient for corporate integrity culture (Intg) is -0.027 and statistically significant at the 1% level, indicating that a stronger integrity culture is associated with a reduction in the number of disclosed KAMs. Similarly, column (2) shows that the coefficient for Intg is -0.033 and significant at the 5% level, suggesting that firms with stronger integrity cultures tend to have shorter KAM disclosures in terms of length. These results provide robust support for Hypothesis H1.

Table 3: Results of Baseline Regression

Variable	KAM (1)	Len (2)
Intg	-0.027***	-0.033**
	(-3.423)	(-2.140)
Chg	0.008	-0.002
	-1.499	(-0.209)
Tenu	-0.001	0
	(-1.127)	(-0.233)
Big10	0.012**	0.131***
	-2.227	-9.262
Clean	0.047**	0.122***
	-2.477	-2.758
Rec	0.221***	0.493***
	-6.811	-6.321
Inv	0.079***	0.05
	-2.653	-0.653
Size	0.031***	0.072***
	-9.168	-10.61
Gro	0.031***	0.069***
	-5.751	-5.217
Lev	0.031	0.036
	-1.566	-0.748
ROA	-0.369***	-0.775***
	(-7.673)	(-6.432)

ATO	-0.019**	-0.050**
	(-2.251)	(-2.455)
Loss	-0.016	-0.043**
	(-1.621)	(-1.981)
IC	-0.062***	-0.090**
	(-3.871)	(-2.569)
Top1	-0.079***	-0.091*
	(-3.792)	(-1.766)
Dual	0.019***	0.051***
	3.385	3.615
Indp	-0.029	-0.071
	(-0.573)	(-0.433)
Board	0.009	0.018
	-0.477	-0.391
Year and Industry FE	Yes	Yes
Constant	0.939***	4.816***
	-6.425	-15.451
Observations	14,908	14,908
Adjusted R^2	0.083	0.085

Notes: ***, **, and * denote statistical significance at the 1%, 5%, and 10% levels, respectively. T-statistics, clustered at the firm level, are reported in parentheses. All regressions include year and industry fixed effects.

Regarding the control variables, the coefficient for Big10 is positive and statistically significant, consistent with prior literature suggesting that larger audit firms exhibit greater conservatism in their auditing practices and consequently provide more comprehensive KAM disclosures. Furthermore, the significantly positive coefficient on Clean indicates that auditors tend to provide more extensive KAM disclosures when issuing standard unqualified opinions, potentially reflecting auditors' incentive to use KAM disclosures as a defensive mechanism against potential legal liabilities.

The overall regression results demonstrate that corporate integrity culture exerts a significant constraining effect on both the quantitative and qualitative aspects of KAM disclosures, even after controlling for relevant firm characteristics and audit conditions. These findings remain robust to alternative model specifications and provide important insights into the role of organizational ethical culture in shaping auditor disclosure behavior.

4.3. Robustness tests

To mitigate potential endogeneity issues, this study employs the average corporate integrity culture of listed firms within the same province (PIntg) as an instrumental variable and conducts two-stage least squares (2SLS) estimation. The regional integrity culture in a firm's location is likely to influence the development of its own integrity culture, but is unlikely to directly affect auditors' disclosure of Key Audit Matters. As shown in Column (1) of Table 4, the first-stage regression results demonstrate that the average integrity culture of peer firms in the same province (PIntg) is statistically significant with a positive coefficient, satisfying the relevance condition for the instrumental variable. Furthermore, the Cragg-Donald Wald F-statistic of 159.298 exceeds the Stock-Yogo test critical value at the 10% level, indicating the absence of weak instrument problems.

Columns (2) and (3) of Table 4 present the second-stage regression results. The coefficients for corporate integrity culture (Intg) remain negative and statistically significant at the 1% level, confirming that the inhibitory effect of corporate integrity culture on KAM disclosures persists after addressing endogeneity concerns.

Table 4: Results of Endogeneity Treatment

Variable	Stage 1 Intg (1)	Stage 2 KAM (2)	Stage 2 Len (3)
PIntg	0.465***		
	-7.271		
Intg		-0.323***	-1.132***
		(-4.451)	(-5.409)
Controls	Yes	Yes	Yes
Year and Industry FE	Yes	Yes	Yes
Constant	0.029	0.818***	5.057***
	-0.121	-5.971	-13.603
Observations	14,899	14,899	14,899
Adjusted R^2	0.161		

Notes: ***, **, and * denote statistical significance at the 1%, 5%, and 10% levels, respectively. T-statistics, clustered at the firm level, are reported in parentheses for column (1); z-statistics are reported for columns (2) and (3). All regressions include the full set of control variables as well as year and industry fixed effects.

To mitigate the potential impact of sample characteristic differences on the baseline regression results, this study employs Propensity Score Matching (PSM) to examine the effect of corporate integrity culture on the disclosure of Key Audit Matters. Firms are classified into treatment and control groups based on the mean value of corporate integrity culture. A 1:1 nearest neighbor matching with replacement is utilized for the PSM procedure.

Table 5: Results of PSM Regression

Variable	KAM (1)	Len (2)
Intg	-0.020***	-0.031**
	(-2.875)	(-2.023)
Controls	Yes	Yes
Year and Industry FE	Yes	Yes
Constant	0.907***	4.903***
	-5.172	-12.698
Observations	7,576	7,576
Adjusted R^2	0.087	0.087

Notes: ***, **, and * denote statistical significance at the 1%, 5%, and 10% levels, respectively. T-statistics, clustered at the firm level, are reported in parentheses. All regressions include the full set of control variables as well as year and industry fixed effects.

The results in Table 5 show that the coefficients for corporate integrity culture (Intg) remain statistically significant and negative across all specifications, consistent with the baseline regression results. This robustness check confirms that the observed negative relationship between corporate integrity culture and KAM disclosures is not driven by systematic differences in firm characteristics between high- and low-integrity culture firms.

This study employs three alternative approaches to measure the explanatory variable. First, we use the proportion of integrity culture in the MD&A text (Intg2), calculated as the TF-IDF-weighted word frequency of corporate "integrity" culture divided by the MD&A text's total word count, multiplied by 100. Second, we apply the min-max normalized integrity culture frequency (Intg3), computed as (the firm-year integrity culture frequency minus the minimum annual integrity culture frequency) divided by the range between the maximum and minimum annual integrity culture frequencies. This metric ranges from 0 to 1, indicating a firm's relative position on integrity culture within the full sample. Third, we employ industry median-adjusted integrity culture (Intg4) to reflect the relative integrity culture level within industries.

Table 6: Results of Robustness Test Results

Variable	KAM (1)	Len (2)	KAM (3)	Len (4)	KAM (5)	Len (6)
X	-0.487***	-0.985***	-0.089***	-0.131*	-0.027***	-0.028**
	(-3.355)	(-2.839)	(-3.203)	(-1.885)	(-3.492)	(-2.156)
Controls	Yes	Yes	Yes	Yes	Yes	Yes
Year and Industry FE	Yes	Yes	Yes	Yes	Yes	Yes
Constant	0.937***	4.855***	0.932***	4.813***	0.908***	4.788***
	-6.511	-15.642	-6.472	-15.435	-6.327	-15.385
Observations	14,898	14,898	14,898	14,898	14,898	14,898
Adjusted R^2	0.084	0.084	0.084	0.084	0.084	0.084

Notes: ***, **, and * denote statistical significance at the 1%, 5%, and 10% levels, respectively. T-statistics, clustered at the firm level, are reported in parentheses. In columns (1)-(2), (3)-(4), and (5)-(6), X represents Intg2, Intg3, and Intg4, respectively. All regressions include the full set of control variables as well as year and industry fixed effects.

As shown in Table 6, Intg2, Intg3, and Intg4 all demonstrate statistically significant negative coefficients, confirming that our baseline regression results remain robust across these alternative measurement approaches.

4.4. Mediation effect analysis

To examine whether corporate integrity culture influences auditors' KAM disclosure decisions by affecting corporate risk perceptions, this study conducts the following mediation effect tests.

4.4.1. Testing the business risk channel

Table 7 presents the mediation effect test results for business risk. Column (1) shows that corporate integrity culture is statistically significant at the 1% level with a coefficient of -0.022, indicating that corporate integrity culture significantly reduces business risk. In columns (2) and (3), corporate integrity culture remains significantly negative, while business risk (OpRsk) is statistically significant at the 1% level with coefficients of 0.035 and 0.109, respectively. These results demonstrate that corporate integrity culture reduces KAM disclosures through the channel of lowering business risk, confirming that business risk plays a partial mediating role between corporate integrity culture and KAM disclosures. Thus, Hypothesis H2 is supported.

Table 7: Mechanism Test Results: Business Risk Channel

Variable	OpRsk (1)	KAM (2)	Len (3)
Intg	-0.022***	-0.017***	-0.030**
	(-3.674)	(-3.066)	(-2.018)
OpRsk		0.035***	0.109***
		-2.786	-3.162
Controls	Yes	Yes	Yes
Year and Industry FE	Yes	Yes	Yes
Constant	0.817***	0.908***	4.755***
	-6.328	-6.178	-15.131
Observations	12,722	12,722	12,722
Adjusted R^2	0.082	0.081	0.086

Notes: ***, **, and * denote statistical significance at the 1%, 5%, and 10% levels, respectively. T-statistics, clustered at the firm level, are reported in parentheses. All regressions include the full set of control variables as well as year and industry fixed effects.

The findings suggest that firms with stronger integrity cultures experience lower business risk, thereby reducing auditors' perceived need for extensive KAM disclosures. This mediation pathway aligns with risk-based auditing frameworks, where auditors adjust their disclosure strategies based on comprehensive risk assessments.

4.4.2. Testing the financial risk channel

Table 8 reports the results of the mediation effect test for financial risk. Corporate financial risk (FinRsk) is measured using the Naïve Merton DD model, which estimates the distance-to-default. A higher value indicates lower corporate financial risk. Column (1) shows that corporate integrity culture (Intg) is statistically significant, with a positive coefficient, indicating that it reduces financial risk. In columns (2) and (3), corporate integrity culture (Intg) remains significantly negative, while financial risk (FinRsk) is statistically significant at the 1% level with coefficients of -0.003 and -0.008, respectively. These results demonstrate that a corporate integrity culture reduces KAM disclosures by lowering financial risk. Thus, Hypothesis H3 is supported.

Table 8: Mechanism Test Results: Financial Risk Channel

Variable	FinRsk (1)	KAM (2)	Len (3)
Intg	0.331***	-0.020***	-0.027*
	-5.1	(-3.307)	(-1.947)
FinRsk		-0.003***	-0.008***
		(-3.706)	(-4.050)
Controls	Yes	Yes	Yes
Year and Industry FE	Yes	Yes	Yes
Constant	-1.885	0.933***	4.800***
	(-1.210)	-6.394	-15.433
Observations	14,908	14,908	14,908
Adjusted R^2	0.289	0.084	0.086

Notes: ***, **, and * denote statistical significance at the 1%, 5%, and 10% levels, respectively. T-statistics, clustered at the firm level, are reported in parentheses. All regressions include the full set of control variables as well as year and industry fixed effects.

The findings indicate that firms with stronger integrity cultures exhibit better financial health and lower default risk, thereby reducing auditors' assessment of inherent risk and their need for extensive KAM disclosures. This mediation pathway operates through the financial risk dimension of the audit risk model, where improved financial conditions directly affect auditors' risk assessments and disclosure decisions.

4.4.3. Testing the auditor's legal risk channel

Table 9: Mechanism Test Results: Auditor Legal Risk Channel

Variable	LitRsk (1)	KAM (2)	Len (3)
Intg	-0.027***	-0.020***	-0.029**
	(-2.825)	(-3.387)	(-2.081)
LitRsk		0.025***	0.036***
		-4.877	-3.921
Controls	Yes	Yes	Yes
Year and Industry FE	Yes	Yes	Yes
Constant	3.111***	0.863***	4.685***
	-11.638	-6.012	-15.221
Observations	14,911	14,911	14,911
Adjusted R^2	0.065	0.083	0.085

Notes: ***, **, and * denote statistical significance at the 1%, 5%, and 10% levels, respectively. T-statistics, clustered at the firm level, are reported in parentheses. All regressions include the full set of control variables as well as year and industry fixed effects.

Table 9 presents the mediation effect test results for auditor legal risk. In column (1), corporate integrity culture (Intg) shows a coefficient of -0.027 and is statistically significant at the 1% level, indicating that corporate integrity culture effectively reduces auditors' legal risk. In columns (2) and (3), corporate integrity culture (Intg) remains significantly negative, while auditor legal risk (LitRsk) is statistically significant at the 1% level with coefficients of 0.025 and 0.036, respectively. These findings demonstrate that integrity culture helps curb corporate misconduct, thereby reducing auditors' legal exposure and consequently leading to fewer KAM disclosures. Thus, Hypothesis H4 is empirically supported.

The results align with the insurance hypothesis of auditing, suggesting that when client firms maintain strong integrity cultures, auditors face diminished litigation risk, which reduces their incentive to employ extensive KAM disclosures as a defensive auditing strategy. This mediation pathway underscores the importance of corporate ethical culture in shaping auditors' legal risk assessments and subsequent disclosure behavior.

In summary, the empirical evidence consistently demonstrates that corporate integrity culture exerts a significant restraining effect on KAM disclosures through three distinct risk transmission channels: business risk mitigation, financial risk reduction, and auditor legal risk alleviation. The robustness of these findings is confirmed through multiple identification strategies, including instrumental variable approaches, propensity score matching, and alternative variable measurements. These results not only validate the theoretical framework but also provide practical insights for audit practitioners, corporate governance participants, and standard-setters regarding the crucial role of organizational ethical culture in shaping audit outcomes and disclosure quality. The convergence of findings across different model specifications and methodological approaches enhances confidence in the conclusion that integrity culture serves as an important informal institution influencing auditors' professional judgment and disclosure decisions.

5. Discussion and Implications

This study provides robust evidence that corporate integrity culture suppresses the disclosure of Key Audit Matters (KAMs) and operates through three mediating mechanisms: reduced business risk, lower financial risk, and diminished legal risk for auditors. These results validate the theoretical hypotheses and clarify the economic consequences of integrity culture in the audit context. By linking an informal institutional factor—corporate integrity culture—to a formal reporting outcome—KAM disclosure—this study moves beyond traditional, regulation-centred perspectives and highlights the substantive governance value of integrity culture in capital markets.

The findings show that integrity culture shapes auditors' professional judgement and disclosure decisions primarily by lowering perceived client risk. Firms with stronger integrity cultures exhibit more stable operations, healthier financial conditions, and fewer regulatory violations, all of which reduce auditors' assessment of audit and litigation risk. This confirms that informal institutions can be as influential as formal rules in shaping market behaviour (Joudeh & Aqel, 2024). Overreliance on compliance-oriented governance that ignores cultural soft constraints may therefore be insufficient. As an endogenous governance mechanism, integrity culture can exert more persistent and penetrating effects than purely external mandatory controls.

For the auditing profession, the evidence offers a quantitative basis for incorporating cultural factors into risk-based audit strategies. When clients exhibit a strong integrity culture, auditors may be able to adjust the intensity and scope of audit procedures without sacrificing quality, thereby improving audit efficiency (Wassie & Lakatos, 2023). In a context of limited audit resources and rising demands for transparency, such culture-sensitive risk assessment is particularly valuable. At the firm level, audit practices and client acceptance policies

should explicitly integrate integrity-related indicators into risk evaluation systems, instead of relying solely on financial and structural measures.

From a regulatory perspective, the results support more differentiated and incentive-compatible supervision. Regulators could consider recognizing firms with sustained integrity culture building by calibrating information disclosure requirements or inspection intensity accordingly (Höfmann et al., 2024). A classification regime that takes cultural factors into account can help allocate supervisory resources more effectively and motivate firms to invest in integrity construction. In the ongoing reform of the registration-based system, such an approach—emphasizing intrinsic firm quality rather than purely procedural compliance—may better support forward-looking and resilient capital market development.

For investors, the study introduces integrity culture as an additional dimension in risk assessment and valuation. Traditional analysis often centres on financial indicators while treating corporate culture as a soft, hard-to-measure attribute. Our findings suggest that integrity culture can meaningfully lower business, financial, and legal risks, and thus should be incorporated into long-term and value-oriented investment strategies. Institutional investors, in particular, may benefit from developing evaluation frameworks that systematically incorporate cultural signals, including integrity, into portfolio construction and stewardship activities (Wang et al., 2024).

At the corporate governance level, the results underscore that integrity culture should be treated as a core strategic asset rather than a purely ethical slogan. By improving internal controls, reducing compliance and regulatory costs, lowering audit fees, and strengthening investor trust, an integrity culture can generate tangible economic value (Pasc & Hategan, 2023). Firms should therefore establish formal governance arrangements—such as dedicated integrity policies, monitoring mechanisms, and incentive systems—to embed integrity into decision-making and daily operations, rather than relying solely on informal norms or ad hoc initiatives.

The findings also have particular relevance for the Chinese institutional context, where formal regulations and informal norms jointly shape corporate behaviour. China's corporate governance environment combines Confucian value traditions, strong state involvement, and evolving regulatory frameworks, making social trust and "guanxi" especially salient. In such a setting, corporate integrity culture is not only an ethical ideal but also a strategic resource that can mitigate business and legal risks, support regulatory compliance, and strengthen market credibility. For audit firms and regulators, this implies that cultural indicators should be integrated into risk assessments and policy design, helping to align corporate behaviour with longer-term goals of market stability, reporting quality, and investor protection.

In other institutional settings, such as in more developed markets with well-established legal frameworks and higher levels of regulatory enforcement, the role of corporate integrity culture in shaping audit outcomes may be less significant. In these contexts, formal institutions such as regulations, enforcement mechanisms, and market maturity may play a more dominant role in shaping business practices and auditing decisions, potentially reducing the relative impact of informal cultural factors like integrity.

Additionally, variations in the measurement and interpretation of "integrity" across cultural contexts could affect the generalizability of this study's approach. For instance, cultural differences in the way trust and ethical conduct are perceived and communicated may influence how integrity culture is embedded within organizational practices and disclosed in corporate reports.

For academic research, this study highlights the need to pay greater attention to the economic consequences of informal institutions. The text-based measure of corporate integrity culture developed here offers a feasible methodological path for future work. Subsequent studies could examine how integrity culture affects other key decisions, such as innovation, internationalization, or ESG performance, and whether these relationships vary across institutional environments. The documented negative association between integrity culture and KAM disclosure also suggests that simple volume-based indicators of disclosure may be misleading; evaluations of disclosure quality should account for firms' risk profiles and cultural attributes, especially in emerging markets such as China.

At the same time, several issues call for further investigation. Measuring integrity culture remains challenging because cultural constructs are inherently abstract. Although the text-based approach provides a structured proxy, interpretations of "integrity" may differ across organizations and countries. Future research could refine measurement by combining textual indicators with survey, interview, or case-study evidence, and by explicitly considering cultural nuances in non-Western settings, including hierarchy, trust in leadership, and the role of government regulation. Exploring how these cultural factors interact with formal governance mechanisms would contribute to a more comprehensive understanding of corporate governance beyond narrow compliance.

The finding that firms with stronger integrity cultures tend to disclose fewer KAMs presents a useful but nuanced insight. In this context, fewer KAMs should not be interpreted as weaker disclosure or inadequate audit scrutiny. Instead, it reflects the fact that firms with robust integrity cultures proactively manage risks, maintain more effective internal controls, and address issues before they escalate to significant audit concerns. As a result, auditors face fewer areas requiring KAM-level reporting and can issue more focused disclosures. This interpretation emphasizes that disclosure volume alone is an incomplete indicator of reporting quality and must be understood in light of underlying risk conditions and cultural context.

The documented negative association between corporate integrity culture and the number of KAMs should not be interpreted as implying that fewer KAMs are universally desirable or that they always signal higher audit or reporting quality. In some institutional or engagement contexts, a low number of KAMs may also reflect underreporting, insufficient auditor scepticism, or constraints on auditor communication, rather than genuinely lower underlying risk. The evidence in this study is consistent with the view that, after controlling for a rich set of risk and governance characteristics, firms with stronger integrity cultures exhibit fewer KAMs because auditors perceive and face lower residual risk. Nevertheless, KAM volume alone is an incomplete indicator of audit quality, and its interpretation must be conditioned on the firm's risk profile, institutional environment, and the broader disclosure regime.

The findings of this study are closely linked to International Standard on Auditing (ISA) 701, particularly regarding the disclosure of Key Audit Matters (KAMs). ISA 701 requires auditors to disclose areas of higher assessed risk and significant professional judgment, yet the evidence indicates that firms with stronger integrity cultures tend to disclose fewer KAMs due to more effective internal controls and risk management. Auditors should therefore incorporate corporate culture into their risk assessment frameworks to ensure that a reduction in KAM disclosures reflects genuinely lower audit risk rather than insufficient scrutiny.

To operationalize culture-based oversight, regulators may encourage firms to report on their integrity culture and governance practices in a structured manner, similar to existing corporate social responsibility (CSR) disclosures. Regulators can also require auditors to explicitly consider cultural factors when assessing audit risk and determining KAM disclosures, and may introduce culture or integrity ratings as part of supervisory tools. Such mechanisms would provide incentives for firms to strengthen their integrity culture and improve overall governance quality.

Corporate integrity culture may also influence audit fee determination. Firms with strong integrity cultures, lower compliance risk, and more reliable internal controls are likely to be perceived as lower-risk audit clients, potentially leading to reduced audit effort and lower fees. In contrast, firms with weaker cultures may require more extensive audit procedures and thus incur higher audit costs. Recognizing this dynamic, policymakers could support audit fee structures that better reflect underlying governance quality and audit risk, thereby encouraging firms to invest in building and maintaining a robust integrity culture.

Finally, the study reinforces that building an integrity culture is a long-term process requiring sustained commitment. Firms should treat integrity construction as a strategic investment with cumulative returns rather than as a short-term compliance exercise. Regulators, in turn, need to provide a stable and predictable institutional environment that supports long-horizon cultural development. Overall, by documenting how integrity culture shapes audit outcomes and risk perceptions, this study underscores the central role of cultural governance in enhancing capital market efficiency and promoting the high-quality development of the real economy.

6. Conclusion

This study systematically examines the impact of corporate integrity culture on the disclosure of Key Audit Matters (KAMs) and its underlying mechanisms using a sample of China's A-share listed companies from 2019 to 2024. The empirical results demonstrate that corporate integrity culture significantly suppresses both the quantity and length of KAM disclosures through three distinct pathways: reducing business risk, mitigating financial risk, and decreasing auditors' legal exposure. These findings not only enrich the theoretical understanding of how informal institutions shape economic activities but also provide a novel cultural perspective for risk assessment in auditing practice. Furthermore, the robustness of these conclusions is verified through multiple methodological approaches, including instrumental variable estimation, propensity score matching, and alternative variable measurements, ensuring the reliability of the research outcomes.

Several limitations warrant attention in this study. First, while the measurement of corporate integrity culture employs text analysis methodology with TF-IDF weighting and various alternative indicators, the inherent subjectivity of textual content may still affect measurement precision. Second, the research sample is confined to China's A-share market, which may limit the generalizability of findings to other emerging or developed markets. Third, although the mediation analysis reveals important transmission mechanisms, the dynamic interplay between corporate risk and auditor decision-making likely involves other unobserved complex factors that require further investigation.

Future research could advance this field in several promising directions. First, developing more comprehensive frameworks for measuring corporate culture, potentially incorporating interviews and case studies to complement text-based analysis, would enhance measurement validity. Second, cross-country comparative studies examining how different institutional environments moderate the effect of integrity culture would provide valuable insights. Additionally, exploring the application of artificial intelligence technologies in cultural measurement and audit decision-making represents an emerging frontier worthy of scholarly attention.

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