

Does auditor–client geographic proximity influence key audit matters disclosures?

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Abstract

Purpose – This study investigates whether auditor–client geographic proximity (ACGP) affects the key audit matters (KAMs) disclosures in the context of an emerging economy.

Design/methodology/approach – ACGP is measured using physical distance (kilometers) and travel time (minutes) between head offices, following prior studies, while KAMs are measured based on the quantity and words to explain KAMs disclosures. Data from 465 firm-year observations for the period 2018–2021 are collected and analyzed using panel regression and the results are explained in line with the communication theory.

Findings – The authors document a significant and negative association between ACGP, and both the number and the extent of KAMs reported. These results are robust to alternative measures of KAMs and ACGP. Geographic proximity between auditors and clients facilitates enhanced communication and provides auditors with an informational advantage, which can reduce perceived client risk and, in turn, lead to fewer and less extensive KAM disclosures. This negative association is particularly pronounced for smaller and lower-risk firms, likely because auditors of these firms face fewer complexities and challenges in assessing risk, allowing them to rely more on proximity-driven information advantages.

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Practical implications – The findings have important implications for boards and audit committees, regulators, investors and other stakeholders, providing guidance to improve decision-making and enhance audit oversight.

Originality/value – To the best of the authors' knowledge, this study is the first to examine the relationship between ACGP and KAMs, offering novel insights and extending the existing audit and disclosure literature.

Keywords Key audit matters, Auditor–client geographic proximity, Communication theory, Emerging economy

Paper type Research paper

1. Introduction

Recent reforms in auditor reporting have fundamentally altered the informational role of the independent auditor's report. Particularly, the introduction of key audit matters (KAMs) under International Standard on Auditing (ISA) 701 represents a global regulatory effort to enhance transparency, reduce information asymmetry and improve communication between auditors and financial statement users (IAASB, 2015; Sirois *et al.*, 2018; Bédard *et al.*, 2019). By requiring auditors to disclose matters of most significance in the audit, KAMs are intended to provide deeper insights into firm-specific risks, managerial judgment and audit complexity. This will ultimately strengthen the decision usefulness of audit reports for investors and other stakeholders (Maroun and Duboisée de Ricquebourg, 2024).

Despite their global adoption, substantial cross-sectional variation persists in the number and extent of KAMs disclosed across firms, auditors and institutional settings (Abdullatif and Al-Rahahleh, 2020; Pinto and Morais, 2019). Prior research has linked this variation to firm characteristics, governance mechanisms and auditor attributes, such as auditor size, audit committee effectiveness and client risk (Rahaman *et al.*, 2023; Rahaman and Karim, 2023, 2025; Suttipun, 2020; Velte, 2020). However, one important structural feature of the audit process that has received limited attention in the KAMs literature is the geographic relationship between auditors and their clients.

A growing body of international accounting and finance research demonstrates that geographic proximity between economic agents plays a critical role in shaping information flows, monitoring effectiveness and professional judgment (Choi *et al.*, 2012; Defond *et al.*, 2018; Kedia and Rajgopal, 2011). In the auditing context, closer physical proximity can facilitate more frequent face-to-face interactions, site visits and informal communication, enabling auditors to acquire richer client-specific and “soft” information (Bedard and Johnstone, 2004; Berger *et al.*, 2005). Such informational advantages may improve auditors' understanding of business operations and risks. This will potentially reduce the uncertainty during the audit process. On the other hand, geographic distance may exacerbate information asymmetry, increase audit risk and incentivize auditors to rely more heavily on formal disclosures such as KAMs, to mitigate litigation and reputation risk (Dong *et al.*, 2018; Gold *et al.*, 2020). At the same time, geographic proximity may also give rise to familiarity threats, particularly in settings where auditor–client interactions are frequent and long-standing. Close social and professional ties may impair professional skepticism, weaken auditor independence and reduce the willingness to publicly disclose sensitive audit issues (Francis *et al.*, 2022). These competing effects imply that auditor–client proximity may either increase or reduce KAM disclosures. As a result, whether local auditors report more or fewer KAMs than distant auditors remain an open and globally relevant empirical question.

Empirical research has extensively examined how auditor–client relationships shape outcomes such as audit fees, reporting timeliness and audit quality. Prior work on audit fees shows that both client and auditor characteristics, including size, risk, ethnicity, industry

specialization and operational complexity, systematically influence audit pricing across institutional settings (Cahyono *et al.*, 2023; Hay *et al.*, 2006; Miah *et al.*, 2020). Similarly, the audit report lag literature identifies several firm- and auditor-specific factors, including audit complexity and auditor expertise, as central determinants of reporting timeliness (Habib and Bhuiyan, 2011). Evidence also indicates that economic ties between auditors and clients can affect audit quality, particularly when client importance creates incentives that may influence auditors' reporting judgments (Chen *et al.*, 2010). Although there is some evidence on auditor–client geographic distance and audit outcomes such as audit quality, audit fees and audit report timeliness (Beck *et al.*, 2019; Choi *et al.*, 2012; Dong *et al.*, 2018; Francis *et al.*, 2022; Rahaman *et al.*, 2025), no prior study has directly examined how geographic proximity influences the reporting of KAMs. This omission is notable given that KAMs are explicitly designed as a communication mechanism and that proximity fundamentally affects communication efficiency, information acquisition and judgment formation. Addressing this gap is particularly important for global regulators and practitioners seeking to understand whether structural features of audit engagements systematically shape the content of expanded audit reports.

This study responds to this gap by examining the association between auditor–client geographic proximity (ACGP) and the quantity and extent of KAMs disclosed in independent audit reports. In addition, the study has tested the nature of this relationship using two different firm sizes (large and small) and two different risks levels of firms (high-risk and low-risk). Thus, the research questions (RQs) addressed in this study were:

RQ1. How does auditor–client geographic proximity impact the reporting of KAMs?

RQ2. Does the nature of this relationship vary for firms of different sizes and risk levels?

We empirically test these arguments using data from Bangladesh, an emerging economy that offers a particularly powerful setting for examining proximity effects. Bangladesh is not treated as a narrowly regional setting, but as a context in which the link between auditor proximity, information asymmetry and audit reporting is particularly pronounced. Emerging markets are expected to account for approximately half of global gross domestic product by 2050 (PwC, 2017), and they are characterized by institutional features such as weaker investor protection, concentrated/family ownership, weak corporate governance and limited enforcement that increases auditors' monitoring and communication roles (Khan *et al.*, 2016; Karim *et al.*, 2020, 2024; Muttakin *et al.*, 2017;). In such environments, auditors often serve as one of the few credible external governance mechanisms which makes their reporting behavior particularly consequential.

Bangladesh further provides a unique empirical context because geographic proximity does not necessarily imply ease of access. Although audit firms and corporate headquarters are often located within the same metropolitan area, severe traffic congestion, dispersed production facilities, small audit firm size and frequent mandatory auditor rotation create significant differences in effective proximity and communication costs (Mali and Lim, 2018; Rahaman *et al.*, 2023, 2025). These features enable us to distinguish physical distance from effective informational access and to examine how auditor proximity functions under institutional constraints that are common across many emerging and developing economies.

Using 465 firm-year observations from listed firms over the period 2018–2021, we measure auditor–client proximity using both geographic distance (kilometers) and travel time (minutes), and KAMs using both the number of matters disclosed and the total word count. Our findings indicate a significant negative association between proximity and KAM disclosures, suggesting that geographically closer auditors report fewer and less extensive

KAMs. Further analyses reveal that this relationship is more pronounced for smaller firms and lower-risk firms. This is consistent with proximity-driven reductions in information asymmetry and perceived audit risk.

This study makes several contributions to the global auditing literature. First, this study examines the impact of auditor–client proximity on the reporting of KAMs, an area that has received little to no attention in prior research. Existing studies on geographic proximity have primarily focused on its effects on audit quality (Birjandi *et al.*, 2013; Choi *et al.*, 2012; Rahaman *et al.*, 2025), internal control reporting (López and Rich, 2017) and real earnings management (Li *et al.*, 2020). However, with the recent enforcement of mandatory KAMs disclosure by the audit firms, the field of audit have reached a new dimension. As the geographic proximity between two parties plays an important role in audit procedures which now also includes KAMs reporting, their relationship has been analyzed in this study. Second, by grounding the analysis in communication theory, the study advances theoretical understanding of how structural features of audit engagements shape disclosure outcomes. Third, by leveraging an emerging market setting with pronounced institutional and logistical constraints, the study provides insights that are relevant not only for Bangladesh but also for regulators and practitioners in other jurisdictions where similar conditions prevail. Fourth, the study has conducted additional analysis on sub-sample firms to have an in-depth appreciation of how the nature of relationship between proximity and KAMs reporting is in firms of different sizes and risk levels. This will have significant contribution in both academic and practical fields. Finally, the study provides valuable insights into the role of geographic proximity on a relatively new auditing practice to the policymakers, regulators, top management, audit firms and other stakeholders from the perspective of an emerging economy.

The rest of the study is organized as follows: Section 2 discusses the underpinning theories used in the study. In Section 3, prior studies have been reviewed to develop hypotheses tested in this study. In Section 4, the research methodology used in the study has been discussed. Section 4 analyzes the findings of the study which includes descriptive statistics, multivariate analysis and sub-sample analysis. Finally, Section 5 draws a conclusion to the study by providing a brief discussion, some recommendations and highlighting some areas for future research.

2. Theoretical framework

Previous research has addressed the motivations underlying audit reporting by addressing different theories including agency theory (Srijunpetch, 2017), legitimacy theory (Suttipun, 2020; Rahaman *et al.*, 2023) and communication theory (Loughran and Mcdonald, 2016; Suttipun, 2020). Among these theories, communication theory has been predominantly used to explain the reporting of KAMs. According to Smith and Smith (1971), this theory elucidates communication systems by considering their definition, processes, methodologies, constituent elements, outcomes, outputs and the dynamic influence between senders and receivers. The essence of effective communication lies in enabling recipients to comprehend, to the greatest extent possible, the messages conveyed by the senders (Datejarutsri *et al.*, 2019). However, most of the traditional audit reports failed to maintain this comprehensive quality due to lack of readability and poor quality of communication. Introduction of KAMs reporting enhanced the communicative value of the audit reports by allowing auditors to disclose KAMs in the reports.

The question of geographical distance between different economic factors has been studied by researchers in recent times. According to Boubakri *et al.* (2016), a company's geographical location has a significant impact on the decision-making process of internal and

external users. Agency theory states that agency costs may come from the division of management from ownership since management may neglect owners' interests in pursuit of their own (Jensen and Meckling, 1976). This agency cost will increase if the geographical distance between owner and manager is long as this will create more separation between the two parties. On the other hand, transaction cost theory implies that geographical proximity between market participants reduces the extent of information asymmetry which causes a reduction in transaction costs. The requirement to expend more time, effort, money and other resources to get relevant information about firms will rise as geographic distance widens, which will impede economic entities' capacity to gather information (Zhang, 2020). Studies conducted by Coval and Moskowitz (1999) and Hau (2001) found that share investors prefer stocks of local companies for adding to their portfolio due to more familiarity with the local companies and easy accessibility to corporate information. Besides, local financial analysts show more accuracy in forecasting a company's production and revenue due to availability of more information (Malloy, 2005). Zhang *et al.* (2019) found that if the distance between independent directors and companies is longer, the percentage of independent directors attending the meeting is lower which leads to a decrease in quality of financial reporting by the companies. This shows that geographical distance can have an impact on the performance and supervisory role of independent directors. In other words, geographical distance will lead to high monitoring cost and more information asymmetry regarding management activities and internal operations. In the context of auditing, geographical distance can lead to increased information asymmetry. Distant auditors may not be able to detect and assess necessary information and thus report KAMs more extensively to avoid any sort of litigation risk. Based on this discussion, this study will try to investigate how the distance between auditor and clients can influence the reporting of KAMs in the context of an emerging economy like Bangladesh.

3. Development of hypotheses

3.1 Key audit matters and auditor distance

Stakeholders frequently base their decisions on an auditor's assessment of the accuracy of the financial data of a corporation. Because of the crucial function that auditors perform, there has been a great deal of scholarly research regarding the efficacy of their assessments. However, the traditional audit reports were not quite useful to the users due to the structural rigidity and over standardization. Dwyer *et al.* (2023) found that expanded audit report disclosures can reduce transparency when they become overly complex, arguing that "more disclosure" does not necessarily enhance users' understanding of audit judgments. The introduction of KAMs reporting has enhanced the informational value of the audit reports as auditors now have to disclose the most significant matters (as per their professional judgment) in auditing their clients. This added responsibility for the auditors has made them even more accountable than before. Auditors need to collect more information about their clients to get a deeper insight into the clients' actual situation and disclose every matter that they found important during the audit process. So, the practice of KAM reporting by the audit firms has led to the increased demand for client information which has ultimately resulted in the reduction of information asymmetry between the client and the auditor.

However, the nature and extent of information collected by the auditor for reporting KAMs and generating high-quality audit reports depend on many factors like the size of the client, exposure to risk and type of industry. One such important factor is the geographical distance between the auditor and the client. Prior studies have conducted studies on the relationship between auditor's geographical distance to client and audit quality and found an inverse relationship between them. According to Birjandi *et al.* (2013), local auditors can

have more access to clients' information more easily through direct interaction with the executives and employees of the client company. Geographically proximate auditors can establish deeper relationship with their clients and create a more reliable interaction medium compared to geographically distant auditors. [Choi et al. \(2012\)](#) found a positive relationship between local external auditors and audit quality and suggests that geographic proximity gives auditors an advantage in knowledge that improves their ability to keep a close eye on client managers. This advantage may stem from shared media markets, increased awareness of local business dynamics, social networks within the community or improved accessibility to client personnel, all of which may increase efficacy. On the other hand, when working with geographically distant clients, it is expected that the audit quality will suffer, mostly because these informative advantages will not be there.

[Berger et al. \(2005\)](#) suggested that auditors in close geographic proximity have the capacity to acquire qualitative information more readily and at a reduced expense by means of frequent in-person interactions and informal discussions with pertinent individuals. Soft information consists of intangible data, which extends to factors such as a nuanced comprehension of managerial personalities and dispositions, a grasp of localized market dynamics and associated business risks, as well as specialized knowledge within the relevant industry. It is of great importance to auditors as they can use the soft information during their judgment of different matters and disclose the significant ones as KAMs. Besides, geographically close auditors are more knowledgeable about regional markets and have a better understanding of client company business risks, both of which would be considered while evaluating the clients ([Bedard and Johnstone, 2004](#)).

[Chen et al. \(2016\)](#) highlighted the cluster theory in defining the relationship between auditors' geographical proximity and internal control weakness. They suggested that the closeness of businesses in a given area creates a social network that encourages more frequent social encounters between auditors and their clients ([Gordon and McCann, 2000](#)). This social network establishes trust between two parties and thus auditors will have access to valuable information about the clients which might not have been found in the financial transactions alone. Similarly, [Li et al. \(2019\)](#) introduced the "enhanced professional competence hypothesis" in their study and stated that geographical proximity potentially contributes to the augmentation of auditors' professional competence by virtue of the informational advantage it affords. [Saleh et al. \(2024\)](#) found that ACGP facilitates more effective communication and leads to timelier audit reports. The proper disclosure of KAMs in an audit is also regarded as a professional competence of an auditor. Therefore, the informational advantage offered by geographical proximity may result in a stretched list of KAMs in the independent audit reports.

On the other hand, ACGP can also result in reporting of fewer number of KAMs. [Dong et al. \(2018\)](#) found that the quality of auditing is significantly correlated with geographic proximity. This connection can be explained by the informational benefits gained by close proximity, which enable auditors to gather specialized knowledge about client-specific characteristics like their motivations, capacities and propensity for engaging in opportunistic earnings management. Moreover, this proximity facilitates a deeper understanding of client business exposure, encompassing the inherent audit risks involved. As the auditor becomes more acquainted with the client, the necessity to report a higher number of KAMs decreases. According to [Francis et al. \(2022\)](#), geographic proximity makes it convenient for the audit partner to have deeper understanding of client's top-level management and cultural environment. More frequent in-person encounters between audit partners and their clients, especially those that are near to one another, may put them in a better position to identify any potential financial reporting bias displayed by the clients' managers. This reduces not only

the presence of information asymmetry between the parties but also the need for a more extensive disclosure of KAMs. Besides, greater distance between the two parties can give rise to higher audit risk as the auditor may not be aware of the client's specific activities. So, the auditors will report a higher number of KAMs in the audit report as a mechanism to mitigate those risks. [Gambetta et al. \(2023\)](#) found that the informative value of KAMs varies systematically across audit firms and KAM types. They suggested that auditors strategically adjust the clarity and depth of KAM disclosures rather than applying a uniform reporting approach. Auditors bear no liability for matters previously disclosed as KAMs; however, they assume a substantial responsibility for matters that remain undisclosed ([Gold et al., 2020](#)). Auditors will try to compensate for the higher information asymmetry arising from geographic distance by reporting more KAMs and minimizing litigation risk as much as possible. Based on the findings of prior studies the following hypothesis can be drawn:

- H1a.* There is a significant association between auditor–client geographical proximity and number of reported KAMs.
- H1b.* There is a significant association between auditor–client geographical proximity and extent of reported KAMs.

3.2 Key audit matters, proximity and firm size

The size of the client company is an important factor in deciding the number and extent of KAMs to be disclosed in the audit reports by the auditors. Large firms tend to have more subsidiaries and a greater magnitude of business activities. So, auditors have to collect more evidence from different operating segments and subsidiaries before reaching to any decision and thus disclose more KAMs ([Suttipun, 2020](#)). Besides, large firms have more complex transactions compared to small firms which drive the auditors to perform the audit tasks more scrupulously ([Ahmet ÖZCAN, 2021](#)). Auditors will try to collect more information to have better understanding of these complexities in large organizations and to provide more reliable opinions regardless of the geographical distance. On the other hand, according to the legitimacy theory, larger corporations show a greater inclination for proactively addressing public expectations comparatively to their smaller counterparts ([Liu and Taylor, 2008](#)). To maintain the social contract, larger firms need to disclose more information compared to the smaller firms ([Velte, 2020](#)). The incorporation of KAMs reporting has enhanced the communicative efficacy of the audit report and is presently recognized as the preeminent medium of communication facilitating interaction between auditors and stakeholders ([Sirois et al., 2018](#); [Rahaman and Chand, 2022](#)). As a result, larger companies will try to provide all the necessary information to the auditors to legitimize their activities in front of their stakeholders. And to make sure auditors receive the required information, the larger companies will pay the auditors larger fees as compensation for their extensive audit activities including expenses arising due to geographical distance. On the other hand, due to the risk of losing a significant amount of business from the client, auditors may be hesitant to offer a modified opinion to a large firm ([Mutchler et al., 1997](#); [Carcello and Neal, 2000](#)). So, the auditors will try to gather sufficient information and mention any sort of judgmental issues in their audit reports irrespective of the existing geographical distance between them and their clients. Studies conducted by [Rahaman et al. \(2023\)](#), [Al Lawati and Hussainey \(2022\)](#) and [Liu and Taylor \(2008\)](#) found a positive relationship between firm size and KAM reporting. However, the scenario is different for the smaller firms located in close proximity of the auditors. Auditors can gain increased access to information concerning these clients as a result of their limited scope of business activities and a minimal number of intricate

operations. According to [Yoon et al. \(2011\)](#), the level of information asymmetry is higher in small firms. But this asymmetry can be reduced if the ACGP is closer. As the auditors can gain sufficient information, they can be more assured of the client's overall activities and thus, the need for reporting more KAMs reduces. So, although the geographic proximity is irrelevant when it comes to the KAMs reporting for larger clients, it results in lower number of reported KAMs for smaller clients. Based on this discussion the following hypothesis can be drawn:

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- H2. The association between auditor–client geographical proximity and KAMs reporting is more pronounced in small firms.

3.3 Key audit matters, proximity and firm risk

According to prior studies, the riskiness of a client can affect the reporting of KAMs in audit reports. If an audit firm finds one of its clients to be susceptible to more risk, it will disclose more KAMs regarding that particular client. This is being done to avoid litigation risk as clients with high risk can create higher risk of litigation for the auditor. A study conducted by [Kachelmeier et al. \(2017\)](#) found that, despite the presence of a resolution paragraph outlining the audit methods to be carried out, the information in KAMs makes legal professional find auditors less liable for a false declaration. [Brasel et al. \(2016\)](#) found that users are less likely to react badly when an auditor misses misstatements if a related KAM has already been reported. Although KAMs have little informative significance for nonprofessional investors, professional investors consider a negative KAM to be a representative of a better appraisal of a firm's economic status than a positive KAM ([Backof, 2015](#); [Köhler et al., 2020](#)). In general, a highly levered firm is considered to be riskier as higher leverage can generate higher financial risk. Managers are more compelled to adopt accounting practices that save costs but raise some areas' risks as leverage rises. Besides, highly leveraged companies typically have a harder time retaining the support of the lenders which further increases the risk ([Pinto and Morais, 2019](#)). So, auditors remain more vigilant while auditing risky firms to avoid litigation risk and maintain reputation. Enhancing an auditor's endeavors to mitigate liability typically results in the refinement of audit procedures, consequently enhancing the identification of KAMs. As auditors' primary concern is to minimize litigation risk and maintain its reputation in the market, the problem of geographical distance between auditors and their clients becomes secondary. Auditors will put more effort and collect as much evidence as possible regardless of the distance between the two parties to make sure that a comprehensive audit report is prepared by including a high number of KAMs with more details. On the other hand, litigation risk of the auditor reduces if the audited firm has lower level of risk. Proximity to such low-risk firms makes it quite convenient for the auditors to collect sufficient information and address almost every possible risk while preparing audit reports. According to [Fosu et al. \(2016\)](#) and [Petacchi \(2015\)](#), the presence of information asymmetry tends to be lower in low-risk firms than in high-risk firms. Geographic proximity can aid the auditors to alleviate most of the remaining asymmetry and comprehensive insights on the client. Lower information asymmetry along with lower level of risk of the geographically proximate clients decreases the need for disclosing more KAMs. Thus, the extent of KAMs reporting may not be influenced by the geographical proximity of the auditor and high-risk clients but it may be lower when it comes to auditing low-risk proximate firms. Based on this discussion, the following hypothesis can be drawn:

- H3. The association between auditor–client geographical proximity and KAMs reporting is more pronounced in low-risk firms.

4. Methodology

4.1 Data, sample and research design

Our sample comprises all firms listed on the Dhaka Stock Exchange (DSE), spanning from 2018 to 2021, coinciding with the initiation of KAM disclosures in 2018. Data were sourced from annual reports of these listed companies, with corporate governance information drawn from governance reports, and firm characteristics and financial data obtained from financial statements. The reliability of our data was confirmed using both simple and α coefficients, surpassing the 0.75 threshold proposed by Milne and Adler (1999). Initially, we had 915 firm-year observations, but 57 were excluded due to non-availability of extractible KAM reports, and an additional 385 were omitted due to missing variables of interest. Consequently, our final sample consists of 465 firm-years, representing over 80% of market capitalization. In Table 1, Panel B illustrates the distribution of the sample across industry sectors, with textiles being the most prominent at 18.28%, followed by insurance, engineering and banking at 13.76%, 13.12% and 12.26%, respectively. Other sectors collectively contribute approximately 40% of the sample. Observations by year are 173 for year 1, 165 for year 2 and 127 for year 3.

The study discovers the association between ACGP and KAM disclosures. Following the prior studies (Choi *et al.*, 2012; Dong *et al.*, 2018; Beck *et al.*, 2019; Francis *et al.*, 2022), proximity of auditor and client's office is measured in kilometers and time. Specifically, to compute the distance (in kilometers), we use Google Maps to determine the distance between the audit office and the client's head office. To calculate the travel time (distance in minutes),

Table 1. Sample design and sample distribution

Details	Companies	Observations
<i>Panel A: Sample selection</i>		
Initial Data from Dhaka Stock Exchange (DSE) listed firms during 2018–2021	305	915
Less: companies excluded due to non-availability of extractible KAM reports	–19	–57
Less: companies and observations excluded due to missing data	–113	–385
Final sample (unbalanced panel)	173	465
	<i>N</i>	<i>%</i>
<i>Panel B: Sample distribution by industry</i>		
Bank	55	11.83
Cement	16	3.44
Ceramic	10	2.15
Engineering	61	13.12
Financial institutions	43	9.25
Food and allied	17	3.66
Fuel and power	41	8.82
Insurance	64	13.76
IT sector	13	2.80
Pharmaceuticals and chemicals	42	9.03
Textile	85	18.28
Others	18	3.87
Total	465	100
<i>Panel C: Sample distribution by year</i>		
T ₁	173	37.21
T ₂	165	35.48
T ₃	127	27.31
Total	465	100

Source(s): Authors' own creation

we use Google Maps, particularly during office-going hours. We double check the distance measurements on alternate days to prevent disruptions caused by specific events, such as traffic congestion due to accidents. To examine our hypotheses, we perform relevant univariate and multi-variate analyses, including the use of tools like the descriptive statistics, and panel regression, in addition to conducting assessments of validity and reliability as needed.

4.2 Regression model

We use the following regression specifications to test our hypotheses following prior literature (Bepari, 2023; Pinto and Morais, 2019; Rahaman and Karim, 2023, 2025):

$$\begin{aligned} KAM_{it} = & \alpha_0 + \beta_1 \ln Prox_KM/Min_{it} + \beta_2 Chair_Gen_{it} + \beta_3 IDR_{it} + \beta_4 FD_Ratio_{it} \\ & + \beta_5 \ln AC_Size_{it} + \beta_6 \ln ARL_{it} + \beta_7 BIG4_{it} + \beta_8 Audit_Ten_{it} \\ & + \beta_9 \ln Audit_Fee_{it} + \beta_{10} \ln Firm_Size_{it} + \beta_{11} \ln Firm_Age_{it} + \beta_{12} ROA_{it} \\ & + \beta_{13} YearEndDec31_{it} + \beta_{14} Year\ FE + \beta_{15} Industry\ FE + \varepsilon_{it} \end{aligned} \tag{1}$$

Here, *KAM* indicates the key audit matters measured either in number of KAM (*NUM_KAM*) or number of words to explain KAM (*WORD_KAM*). The key variable of interest is the ACGP measured as the natural logarithm of distance in kilometers (*lnProx_KM*) or in minutes (*lnProx_Min*). Detailed description and measurement of the variables are explained in Table 2.

5. Empirical results and discussion

5.1 Descriptive statistics

Table 3 displays the descriptive statistics for our variables, including the number of observations, mean, standard deviation and the minimum and maximum values. On average, the annual reports of listed companies in Bangladesh disclose 3.66 KAMs in 937 words. The number and word count span from 1 to 10 and 161 to 2,361, respectively, revealing a wide spectrum in the level of detail and comprehensiveness with which KAMs are reported by the companies in the country. These results underscore the considerable diversity among company audit reports in terms of the reported number of KAMs.

Regarding the ACGP, the findings suggest that, on average, there is a 7.4-km separation between auditors and their clients, with distances ranging from as close as 0.03 km to as far as 50 km. We excluded a few observations considering them as outliers. However, auditors typically require around 24 min to travel to their client’s office, with travel times spanning from a minimum of 1 min to a maximum of 120 min. These statistics highlight the diverse geographic relationships between auditors and their clients, which could have implications for auditing processes and KAMs disclosed. The study has considered relevant control variables from prior literature. Notably, the presence of female as a Board Chair (*Chair_Gen*) is observed in approximately 14% of the cases and the proportion of independent directors in the board (*IDR*) is 24% with minimum 0% and maximum 83%, indicating differences in corporate governance structure among the firms in the economy. The proportion of female directors on the board (*FD_Ratio*) has an average value of 0.16 (with the presence of woman in board of 71% of the sample observations), indicating a significantly low women representation on the board in Bangladeshi companies. The average values of natural logarithm of audit committee size (*lnAC_Size*), natural logarithm of firm age (*lnFirm_Age*), natural logarithm of firm size (*lnFirm_Size*) and profitability (*ROA*) are 1.37, 3.21, 16.04

Table 2. Definition and measurement of the variables

Variables	Description	Expected sign	Reference
<i>Dependent variable</i>			
NUM_KAM	Number of KAMs disclosed by the auditor in the audit report		(Velte, 2020; Pinto and Morais, 2019; Rahaman <i>et al.</i> , 2023)
lnNum_KAM	The natural logarithm of the number of KAMs disclosed		(Velte, 2020; Pinto and Morais, 2019; Rahaman <i>et al.</i> , 2023)
WORD_KAM	Number of words used to explain KAMs disclosures		(Velte, 2020; Pinto and Morais, 2019; Rahaman and Karim, 2023; Rahaman <i>et al.</i> , 2023)
lnWord_KAM	The natural logarithm of number of words used to explain KAMs disclosures		(Velte, 2020; Pinto and Morais, 2019; Rahaman and Karim, 2023; Rahaman <i>et al.</i> , 2023)
<i>Independent variables</i>			
lnProx_KM	Natural logarithm of geographic distance between auditor and client's head offices measured in kilometers, multiplied by -1	+	(Dong <i>et al.</i> , 2018; Beck <i>et al.</i> , 2019; Francis <i>et al.</i> , 2022)
lnProx_Min	Natural logarithm of geographic distance between auditor and client's head offices measured in minutes, multiplied by -1	+	(Dong <i>et al.</i> , 2018; Beck <i>et al.</i> , 2019; Francis <i>et al.</i> , 2022)
<i>Control variables</i>			
Chair_Gen	Chair gender, 1 if the chair of the board is female, 0 otherwise	-	(Bepari, 2023; Rahaman and Karim, 2023, 2025)
IDR	Corporate governance variable measured by independent directors' ratio (IDR) compared to total board size	+	(Rahaman <i>et al.</i> , 2023; Rahaman and Karim, 2025)
FD_Ratio	The proportion of female directors on the board	-/+	(Abdelfattah <i>et al.</i> , 2020; Bepari, 2023; Rahaman <i>et al.</i> , 2023)
AC size	Natural logarithm of number of members in audit committee	+	(Bepari, 2023; Rahaman <i>et al.</i> , 2023)
ARL	Audit report lag (ARL) measured in days from accounting year end date to auditor's report date	+	(Abdullatif and Al-Rahahleh, 2020; Habib and Bhuiyan, 2011)
Big4	1 if the audit firm is one of the Big-4 auditors and 0 otherwise	+	(Pinto and Morais, 2019; Rahaman <i>et al.</i> , 2023)
Audit_Ten	Audit firm's tenure with the client in years	+	(Pinto and Morais, 2019; Lin and Yen, 2022)
Audit fee	Log of audit fees paid by the company to the audit firm in BDT	+	(Pinto and Morais, 2019; Rahaman <i>et al.</i> , 2023)
Firm size	Natural logarithm of total assets indicating the size of the firm	+	(Velte, 2020; Pinto and Morais, 2019; Rahaman <i>et al.</i> , 2023)
Firm age	Firm age is measured in terms of the number of years from the establishment of the company	+	(Rahaman, Hossain and Bhuiyan, 2023)
ROA	Return on assets, measures the profitability of the firm calculated as the net profit divided by total asset	+	(Pinto and Morais, 2019; Rahaman <i>et al.</i> , 2023)
YearEndDec31	Year-end effect measured in binary variable of 1 if the year ends at 31st December; 0 otherwise	+	(Rahaman <i>et al.</i> , 2023; Rahaman and Karim, 2025)
Source(s): Authors' own creation			

Table 3. Descriptive statistics

Variables	(1) N	(2) Mean	(3) SD	(4) Min.	(5) Max.
NUM_KAM	465	3.66	1.66	1.00	10.00
lnNum_KAM	465	1.19	0.47	0.00	2.30
WORD_KAM	465	936.56	426.60	161.00	2,361.00
lnWord_KAM	465	6.72	0.51	5.08	7.77
Prox_KM	465	7.31	8.89	0.03	50.00
lnProx_KM	465	1.49	1.06	-3.49	3.91
Prox_Min	465	23.39	22.87	1.00	120.00
lnProx_Min	465	2.75	0.91	0.00	4.78
Chair_Gen	465	0.14	0.35	0.00	1.00
IDR	465	0.24	0.10	0.00	0.83
FD_Ratio	465	0.16	0.14	0.00	0.63
lnAC_Size	465	1.37	0.26	0.69	3.76
lnARL	465	4.74	0.34	3.30	5.65
Big4	465	0.19	0.40	0.00	1.00
Audit_Ten	465	2.27	1.07	1.00	5.00
lnAudit_Fee	465	6.08	0.91	2.30	8.97
lnFirm_Size	465	16.04	1.87	12.39	20.05
lnFirm_Age	465	3.21	0.42	1.95	4.14
ROA	465	0.03	0.04	-0.14	0.24
YearEndDec31	465	0.64	0.43	0.00	1.00

Note(s): This table reports the descriptive statistics for the variables used in the study. Variable definitions are provided in [Table 2](#)

Source(s): Authors' own creation

and 0.03 with varied range and standard deviations indicating diversity in the financial and organizational attributes of the firms. Furthermore, data about audit-related variables like audit report lag (lnARL), audit firm tenure (Audit_Ten), audit fee (lnAudit_Fee) and big-4 status, with means of 4.74, 2.27, 6.08 and 0.19, respectively, suggest variations in audit-related practices.

5.2 Multivariate analysis

[Table 4](#) provides the outcomes of our econometric models, using the ordinary least squares method. Models 1 and 2 are associated with testing *H1a*, which pertains to the number of reported KAMs (dependent variable). In these models, we explore the influence of ACGP, measured in kilometers in Model 1 and in minutes in Model 2. Conversely, models 3 and 4 pertain to *H1b*, investigating the extent (in words) of reported KAMs (dependent variable). In these models, we analyze the impact of auditor-client closeness, with measurements in kilometers for Model 3 and in minutes for Model 4.

The results indicate a significant and negative relationship between ACGP, measured in both kilometers and minutes, and the number and extent of disclosed KAMs. This suggests that auditors tend to issue fewer KAMs when they are geographically close to their clients, while distant clients receive a greater number and more extensive KAM disclosures. These findings hold statistical significance at the 5% level across all models, underscoring the reliability of the results. These findings align with the conclusions of previous studies, such as [Beck et al. \(2019\)](#), [Dong et al. \(2018\)](#) and [Francis et al. \(2022\)](#), among others. They suggested that geographical proximity provides auditors with an informational advantage in

Table 4. Regression results (for *H1a* and *H1b*)

Variables	<i>H1a</i>		<i>H1b</i>	
	(1) Model 1 NumKAM	(2) Model 2 NumKAM	(3) Model 3 WordKAM	(4) Model 4 WordKAM
lnProx_KM	−0.041** (0.020)		−0.034* (0.022)	
lnProx_Min		−0.054** (0.023)		−0.054** (0.026)
Chair_Gen	−0.032 (0.061)	−0.035 (0.061)	−0.086 (0.067)	−0.088 (0.067)
IDR	−0.162 (0.232)	−0.171 (0.232)	−0.289 (0.257)	−0.307 (0.256)
FD_Ratio	0.351** (0.156)	0.366** (0.156)	0.381** (0.174)	0.397** (0.174)
lnAC_Size	−0.131* (0.079)	−0.126 (0.079)	−0.097 (0.088)	−0.093 (0.088)
lnARL	0.062 (0.065)	0.065 (0.065)	0.050 (0.072)	0.054 (0.072)
BIG4	0.045 (0.046)	0.046 (0.046)	0.041 (0.051)	0.044 (0.051)
Audit_Ten	0.072** (0.028)	0.073*** (0.028)	0.058* (0.031)	0.059* (0.031)
lnAudit_Fee	0.011 (0.031)	0.012 (0.031)	0.025 (0.034)	0.026 (0.034)
lnFirm_Size	0.034 (0.021)	0.033 (0.021)	0.058** (0.024)	0.057** (0.024)
lnFirm_Age	0.100* (0.052)	0.103** (0.052)	0.094 (0.058)	0.098* (0.058)
ROA	−0.414 (0.542)	−0.419 (0.541)	−0.930 (0.605)	−0.932 (0.604)
YearEndDec31	0.352** (0.148)	0.354** (0.148)	0.116 (0.164)	0.117 (0.164)
Constant	−0.264 (0.556)	−0.374 (0.561)	4.982*** (0.620)	4.854*** (0.624)
Observations	465	465	465	465
Adj. R-squared	0.184	0.186	0.158	0.162
Year FE	Yes	Yes	Yes	Yes
Industry FE	Yes	Yes	Yes	Yes
Prob > F	0.00	0.00	0.00	0.00

Note(s): This table reports the baseline regression results showing the impact of auditor–client geographic proximity on KAMs disclosures. Variable definitions are provided in Table 2. *** $p < 0.01$, ** $p < 0.05$, * $p < 0.10$. Standard errors are reported in parentheses

Source(s): Authors' own calculations

understanding client risk, leading to fewer KAMs, whereas greater distance results in increased information asymmetry, necessitating more KAMs to address complex client needs and risks. The geographical distance between auditors and client firms can lead to auditors being unaware of certain client activities, potentially elevating audit risk. To mitigate this risk, auditors may increase their disclosures in KAMs. Previous research has demonstrated that auditors are not held liable for issues already reported as KAMs, but they face significant responsibility for issues left unreported (Gold *et al.*, 2020). The physical distance may also reduce auditors' confidence in their knowledge of client affairs, prompting them to err on the side of caution by providing more extensive KAM disclosures as a proactive measure to mitigate litigation risk.

Among the control variables, the presence of female directors on the board, is significantly and positively associated with both indicators of KAM disclosure in all four models, with statistical significance at the 5% level. This outcome aligns with findings of Abdelfattah *et al.* (2020) and Rahaman *et al.* (2023) among others. Female directors tend to exhibit a heightened risk sensitivity, engage in less risky behaviors and make choices involving lower levels of risk (Ho *et al.*, 2015; Francis *et al.*, 2022). This results in higher audit quality and an increased number of KAMs. Conversely, having a female board chair shows a significant negative association with the extent of KAM disclosures, consistent with the study of Bepari (2023). A female-dominated board reduces the likelihood of earnings management, ensuring audit quality but leading to a reduced extent of KAM disclosures.

Additionally, a larger audit committee size is negatively associated with the number of KAMs, as a strong audit committee promotes quality financial reporting, resulting in fewer judgmental issues necessitating KAM disclosure (Bepari, 2023). Firm age, Audit_Tenure and fiscal year-end positively and significantly predict the number of KAMs reported (models 1 and 2). On the other hand, firm size and profitability affect the extent of KAM disclosures (models 3 and 4), with positive and negative associations, respectively. Notably, audit fees, audit report lag, Big-4 status and board independence do not exhibit significant associations, indicating governance challenges in emerging economies like Bangladesh.

The models incorporate fixed effects for year and industry to account for time-related and industry-specific fluctuations. These models exhibit a moderate level of explanatory power, with the included independent variables elucidating approximately 18.4% (Model 1), 18.6% (Model 2), 17.7% (Model 3) and 18.1% (Model 4) of the variation in both the number and extent of KAMs. This underscores that the regression models hold statistical importance in elucidating the fluctuations in the number and extent of KAMs.

5.3 Cross-sectional analysis

5.3.1 Small vs large firms. Table 5 presents the results of a regression analysis comparing small firms and large firms, with a focus on the impact of ACGP on KAMs for different firm sizes (H2). We use the median cut of firm size to identify small and large firms. For small firms (left side of the table), the results indicate a significant negative relationship between the proximity (both in kilometers and minutes) and KAMs (both number and word) at 1% level for all the four models which indicates robustness of the findings. In contrast, for large firms (right side of the table), there is no significant association between proximity and KAM disclosures in all the models. Thus, we can estimate that the negative association between ACGP and KAMs disclosures is applicable for small firms rather than large firms. Therefore, the null hypothesis (H2) is accepted. The result is consistent with the findings of Rahaman et al. (2023) and, Rahaman and Karim (2023) among others. While client proximity to auditors appears to influence KAMs disclosure for small firms, it does not have a significant effect on large firms. Literature shows that small firms have more information asymmetry compared to large firms (Yoon et al., 2011). Due to proximity, information advantage from small firms reduces the information asymmetry resulting in lower number and extent of KAMs. Additionally, small firms, being less complex and less risky compared to the opposite, may be more affected by the physical proximity of auditors. Furthermore, small firms might rely on a single auditor, or a smaller audit team compared to big firms, making proximity more significant for KAM disclosures. On the contrary, auditors may adopt distinct approaches when dealing with large companies in contrast to smaller ones due to complexity, diverse operations and riskiness. They might maintain consistent audit quality for larger firms, irrespective of their proximity to the auditor. Their disclosure practices for larger firms may also exhibit similarity. Therefore, the physical distance may not affect KAMs disclosure for large firms.

The analysis controls potential confounding factors and includes fixed effects for year and industry to account for time- and industry-specific trends. The regression models explain about 11% of the variance in KAMs disclosure for all the models in small firms while the adjusted R^2 for large firms are 25% for models 1 and 2 and 15% for models 3 and 4. The F -statistics confirm that the overall regression models are statistically significant.

5.3.2 Low-risk vs high-risk firms. Table 6 presents the results of a regression analysis that examines the impact of auditor-client physical proximity on KAMs disclosures for firms categorized as either low-risk or high-risk (H3). We use the median cut of firm leverage to identify low-risk and high-risk firms. For low-risk firms (left side of the table), the results

Table 5. Regression result of large vs small firms (H2)

Variables	Small firms				Large firms			
	(1) Num KAM	(2) Num KAM	(3) Word KAM	(4) Word KAM	(1) Num KAM	(2) Num KAM	(3) Word KAM	(4) Word KAM
lnProx_KM	-0.085*** (0.027)		-0.092*** (0.034)		-0.001 (0.030)		0.032 (0.031)	
lnProx_Min		-0.101*** (0.030)		-0.116*** (0.037)		0.010 (0.038)		0.040 (0.039)
Constant	0.137 (1.288)	0.129 (1.282)	4.842*** (1.590)	4.847*** (1.581)	-0.951 (1.058)	-0.899 (1.065)	5.833*** (1.088)	5.882*** (1.096)
Observation	233	233	233	233	232	232	232	232
Adjusted R ²	0.100	0.107	0.078	0.088	0.251	0.251	0.203	0.203
Controls	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Industry FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Prob > F	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000

Note(s): This table reports the cross-sectional results showing the impact of auditor–client geographic proximity on KAMs disclosures between large vs small firms. Variable definitions are provided in Table 2. *** $p < 0.01$, ** $p < 0.05$, * $p < 0.10$. Standard errors are reported in parentheses

Source(s): Authors' own calculations

Table 6. Regression result of high- vs low-risk firms (H3)

Variables	Low-risk firms				High-risk firms			
	(1)	(2)	(3)	(4)	(1)	(2)	(3)	(4)
	NUM KAM	NUM KAM	WORD KAM	WORD KAM	NUM KAM	NUM KAM	WORD KAM	WORD KAM
lnProx_KM	-0.067** (0.028)		-0.066* (0.034)		-0.043 (0.030)		-0.018 (0.032)	
lnProx_Min		-0.079** (0.031)		-0.084** (0.037)		-0.054 (0.037)		-0.032 (0.040)
Constant	0.404 (0.914)	0.225 (0.922)	5.7*** (1.092)	5.46*** (1.102)	-0.50 (0.792)	-0.59 (0.794)	4.6*** (0.835)	4.55*** (0.836)
Observation	233	233	233	233	232	232	232	232
Adjusted R ²	0.15	0.15	0.14	0.14	0.19	0.19	0.17	0.17
Controls	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Industry FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Prob > F	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000

Note(s): This table reports the cross-sectional results showing the impact of auditor–client geographic proximity on KAMs disclosures between low- vs high-risk firms. Variable definitions are provided in Table 2. *** $p < 0.01$, ** $p < 0.05$, * $p < 0.10$. Standard errors are reported in parentheses

Source(s): Authors' own calculations

indicate a negative relationship between the audit–client proximity (both in kilometers and minutes) and KAMs disclosures (in number and words), which is statistically significant at a 5% level ($p < 0.05$) in models 1, 2 and 4 and at a 10% level in Model 3. In contrast, for high-risk firms (right side of the table), the relationship between geographic closeness and KAMs is negative but not statistically significant. Thus, we can conclude that for low-risk firms, the geographic proximity of auditors appears to be a more important factor influencing KAMs disclosure, while high-risk firms may be less affected by the physical distance between them and their auditors in their KAMs reporting. Alternatively, the negative correlation between ACGP and KAMs disclosures is applicable for low-risk firms only. Therefore, the null hypothesis of our third hypothesis (*H3*) is accepted which is consistent with prior literature (Rahaman and Karim, 2023; Rahaman *et al.*, 2023). Low-risky firms have less information asymmetry than the high-risky (levered) firms (Fosu *et al.*, 2016; Petacchi, 2015). Additionally, proximity allows the auditors to further reduce the information asymmetry resulting in reduced uncertainty and lower KAM disclosures. Proximity facilitates auditors having more direct communication and face-to-face interactions with the low-risk firms to ensure that all risks are adequately assessed and addressed which ultimately result in a lower number and extent of KAM disclosures. In contrast, auditors in high-risk firms may rely less on geographic proximity due to higher risk levels, increased information asymmetry and thus devote more resources to have a more comprehensive understanding of the risks involved. As a result, the association between ACGP and KAM disclosures is not significant.

Among the control variables, the presence of female directors and the Big-4 status of auditors demonstrate significant associations, with a 1% and 5% significance level in the case of low-risk firms across all models. Additionally, profitability exhibits a significant negative relationship with the extent of KAM disclosures at the 1% level in models 3 and 4. Other noteworthy control variables include gender diversity in the chairman position of the board (significant at the 10% level in models 3 and 4), audit committee size (significant at the 10% level in models 1 and 2), firm age (significant at the 10% level in Model 3) and firm size (significant at the 10% level in models 3 and 4). In high-risk firms, significant control variables include firm size (significant at the 10% level in models 3 and 4), profitability (significant at the 10% level in models 3 and 4) and fiscal year end (significant at the 5% level in models 1 and 2, and at the 10% level in models 3 and 4). The adjusted R^2 values, which indicate the explanatory power of the regression models, are 15% (models 1 and 2) and 14% (models 3 and 4) for small firms, and 19% (models 1 and 2) and 17% (models 3 and 4) for large firms, which is considered moderately acceptable in explaining the variations in the dependent variable by the explanatory variables. The *F*-statistics are significant at the 1% level for both categories of firms in the models.

5.3.3 Additional analysis on sub-sample firms. We conduct further analyses to examine how financial expertise in the audit committee and the independent director ratio on the board moderate the association between ACGP and KAMs disclosure. We consider a firm as a financial expert AC when there is at least one member of the audit committee who is an ACA, FCA, ACMA, FCMA, ACCA, CIMA or CFA. We then conduct a subsample analysis for non-AC expert firms and AC expert firms. Table 7 presents the results. Our subsample analysis indicates that the inverse relationship between ACGP and KAMs disclosure is more pronounced when the audit committee includes a financial expert. In the context of an emerging market, this suggests that financial experts may exhibit greater trust in auditors who are geographically proximate, perceiving them as possessing a superior understanding of local business conditions. Consequently, they may require fewer public disclosures, opting instead for private communication and issue resolution during the audit process. Alternatively, the presence of financial experts, who are often integrated within local

Table 7. Regression result for AC expert vs non-AC expert firms

Variables	Non-AC expert firms				AC expert firms			
	(1) NUM KAM	(2) NUM KAM	(3) WORD KAM	(4) WORD KAM	(1) NUM KAM	(2) NUM KAM	(3) WORD KAM	(4) WORD KAM
lnProx_KM	-0.022 (0.026)		0.005 (0.028)		-0.062* (0.036)		-0.064* (0.038)	
lnProx_Min		-0.033 (0.032)		-0.010 (0.034)		-0.074** (0.039)		-0.078** (0.042)
Constant	-0.558 (0.799)	-0.623 (0.803)	4.076*** (0.869)	4.041*** (0.874)	0.602 (1.041)	0.401 (1.059)	6.384*** (1.119)	6.173*** (1.138)
Observation	284	284	284	284	181	181	181	181
Adjusted R ²	0.187	0.188	0.204	0.204	0.143	0.145	0.141	0.143
Controls	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Industry FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Prob > F	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000

Note(s): This table reports the cross-sectional results showing the impact of auditor-client geographic proximity on KAMs disclosures between audit committee (AC) expert vs AC non-expert firms. Variable definitions are provided in Table 2. *** $p < 0.01$, ** $p < 0.05$, * $p < 0.10$. Standard errors are reported in parentheses

Source(s): Authors' own calculations

networks in emerging markets, may reinforce auditors' tendencies to limit public disclosure of sensitive issues when geographic proximity fosters close relationships. These findings underscore that financial expertise does not invariably enhance transparency, and its effectiveness is contingent upon contextual factors such as auditor proximity in emerging markets.

Also, we examine how the independent directors influence our baseline findings. We use the median split of the independent director ratio to identify firms with no or low independent director ratio and high independent director ratio. Our findings, as presented in Table 8, indicate that the inverse relationship between ACGP and KAMs is more pronounced in firms with a lower proportion of independent directors on the board. This observation suggests that diminished board independence may impair effective monitoring, thereby enabling auditors in close geographic proximity to the client to disclose fewer KAMs. The limited independent oversight may inadequately challenge auditors' judgments or fail to demand comprehensive public disclosures, thereby reinforcing the tendency for proximity to diminish transparency in audit reporting.

Furthermore, we investigate how the financial distress of the clients influences the association between ACGP and KAMs. We consider all firms with negative or a small ROA of less than 2% as distress firms. Table 9 presents the results of our subsample analysis. We find that the negative association between ACGP and KAMs disclosure is more pronounced for financially distressed firms, such as those exhibiting negative or low profits. Auditors may exhibit a greater reluctance to disclose extensive KAMs for distressed clients when they are geographically proximate, potentially to avoid publicly emphasizing the clients' financial difficulties. Geographic proximity may cultivate closer relationships, prompting auditors to limit disclosures to protect client interests or sustain ongoing engagements, particularly when clients are financially vulnerable.

Overall, these findings indicate that the intended governance benefits of financial expertise and board independence may be conditional, and that proximity effects are amplified for distressed firms. This highlights the complex interplay between audit committee characteristics, financial condition and auditor behavior in emerging markets, where relational and contextual factors can undermine transparency in audit reporting.

5.4 Endogeneity concern

Endogeneity is a key concern in this study, as firms may self-select auditors, giving rise to selection bias, while reverse causality and omitted variable bias may also distort the established association. To mitigate these concerns, we use two complementary approaches. First, we use propensity score matching (PSM) to address potential selection bias arising from systematic difference between firms with high and low auditor–client proximity. Second, we implement a two-stage least squares (2SLS) approach with instrumental variables to further reduce endogeneity and strengthen causal inference.

5.4.1 Propensity score matching test. To mitigate potential selection bias and enhance causal inference, we use PSM technique. We create a dummy variable *Prox_KM* coded as 1 for the top quartile of the variable *lnProx_KM* and 0, otherwise. Similarly, we create another dummy variable, *Prox_Min*, coded as 1 for the top quartile of the variable *lnProx_Min* and 0, otherwise. First, we estimate a logit model that includes a comprehensive set of firm- and auditor-level covariates (as in our baseline models) to generate propensity scores. Treated observations (*Prox_KM*= 1) are then matched to control observations (*Prox_KM*= 0) with similar propensity scores using nearest-neighbor matching without replacement and a caliper distance of 0.025. We then run our baseline models on the matched sample. We follow a similar procedure for *Prox_Min*. Table 10 presents the results for PSM analyses. The

Table 8. Regression result for high independent director's vs low independent directors' firms

Variables	Low independent directors				High independent directors			
	(1)	(2)	(3)	(4)	(1)	(2)	(3)	(4)
	NUM KAM	NUM KAM	WORD KAM	WORD KAM	NUM KAM	NUM KAM	WORD KAM	WORD KAM
lnProx_KM	-0.064*** (0.030)		-0.050* (0.029)	-0.072** (0.034)	-0.018 (0.028)		-0.009 (0.034)	
lnProx_Min		-0.083** (0.035)		4.568*** (0.835)		-0.024 (0.033)		-0.028 (0.040)
Constant	-0.711 (0.847)	-0.855 (0.853)	4.716*** (0.830)	233	-0.151 (0.796)	-0.202 (0.801)	5.238*** (0.961)	5.166*** (0.967)
Observation	233	233	233	233	232	232	232	232
Adjusted R ²	0.262	0.266	0.260	0.265	0.153	0.153	0.145	0.147
Controls	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Industry FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Prob > F	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000

Note(s): This table reports the cross-sectional results showing the impact of auditor–client geographic proximity on KAMs disclosures between low- vs high-independent director firms. Variable definitions are provided in Table 2. *** $p < 0.01$, ** $p < 0.05$, * $p < 0.10$. Standard errors are reported in parentheses

Source(s): Authors' own calculations

Table 9. Regression result for distress vs non-distress firms

Variables	Non-distress firms				Distress firms			
	(1) NUM KAM	(2) NUM KAM	(3) WORD KAM	(4) WORD KAM	(1) NUM KAM	(2) NUM KAM	(3) WORD KAM	(4) WORD KAM
lnProx_KM	-0.024 (0.027)		0.001 (0.032)		-0.051* (0.034)		-0.078** (0.035)	
lnProx_Min		-0.023 (0.032)		-0.010 (0.038)		-0.068* (0.038)		-0.096** (0.039)
Constant	0.130 (0.789)	0.115 (0.798)	5.706*** (0.950)	5.646*** (0.961)	-0.333 (0.947)	-0.483 (0.949)	4.566*** (0.978)	4.357*** (0.979)
Observation	242	242	242	242	223	223	223	223
Adjusted R ²	0.130	0.129	0.103	0.103	0.142	0.146	0.133	0.138
Controls	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Industry FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Prob > F	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000

Note(s): This table reports the cross-sectional results showing the impact of auditor–client geographic proximity on KAMs disclosures between distressed vs non-distressed firms. Variable definitions are provided in Table 2. *** $p < 0.01$, ** $p < 0.05$, * $p < 0.10$. Standard errors are reported in parentheses

Source(s): Authors' own calculations

coefficients for Prox_KM and Prox_Min are negative and significant for both NumKAM and WordKAM, indicating that auditor–client proximity is associated with lower KAM disclosures.

5.4.2 *Two-stage least-squares test with instrumental variable approach.* In addition, we conduct a two-stage least-squares (2SLS) procedure to endogeneity sources such as omitted variables and simultaneity. We use industry average of the proximity measured in kilometers (IND_AVG_PROX_KM) and in minutes (IND_AVG_PROX_MIN) as our instrumental variables. The results are shown in Table 11. In the first-stage regression, IND_AVG_PROX_KM is significantly and positively associated with lnProx_KM ($p < 0.10$), and IND_AVG_PROX_MIN is also significantly positive with lnProx_MIN ($p < 0.05$) which is consistent with our expectation. In the second-stage regression, in which the dependent variables are proxies for KAMs disclosure (NumKAMs and NumWords), the coefficient on lnProx_KM is significantly negative ($p < 0.05$) for both NumKAMs and NumWords. Similarly, the coefficient on lnProx_MIN is also significantly negative ($p < 0.05$) for both NumKAMs and NumWords. The results suggest that client proximity indeed is negatively related to KAMs disclosure, supporting main results.

5.4.3 *Additional analysis.* While our baseline results document a statistically significant association between ACGP and KAM disclosures, particularly among relatively low-risk firms, these findings may raise concerns regarding client selection effects rather than auditors’ reporting behavior per se. Specifically, one might argue that geographically proximate auditors selectively accept less risky clients while avoiding higher-risk engagements. If this were the case, the observed negative association between ACGP and KAM disclosures could mechanically reflect lower underlying client risk rather than differences in audit reporting practices.

To address this concern, we conduct additional analyses examining whether firm risk is systematically associated with ACGP. We operationalize firm risk using alternative proxies commonly used in the audit literature, including high financial leverage and negative or low return on assets (e.g. distress firms). We use logit models to test the solicited association. In these tests, firm risk measures serve as the dependent variables, ACGP is the key explanatory variable, and the full set of baseline control variables is included. Table 12 reports the regression results from these client-selection tests. The results show no statistically

Table 10. Propensity score matching (PSM)

	(1) Model 1 NumKAM	(2) Model 2 NumKAM	(3) Model 3 WordKAM	(4) Model 4 WordKAM
Prox_KM	−0.168** (0.065)		−0.163** (0.074)	
Prox_Min		−0.298* (0.185)		−0.157** (0.076)
Constant	0.986 (0.994)	−1.068 (2.571)	6.941*** (1.157)	5.138*** (1.049)
Observations	180	190	179	190
Adjusted R ²	0.271	0.221	0.211	0.218
Controls	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes
Industry FE	Yes	Yes	Yes	Yes
Prob > F	0.00	0.00	0.00	0.00

Note(s): This table reports the results of the propensity score matching (PSM). Variable definitions are provided in Table 2. Robust standard errors are reported in parentheses. *** $p < 0.01$, ** $p < 0.05$, * $p < 0.10$
Source(s): Authors’ own calculations

Table 11. 2SLS test with instrumental variable

Dependent variable	First-stage regression		Second-stage regression		NumWords	NumKAMs	NumWords	NumKAMs	NumWords
	InProx_KM	InProx_MN	NumKAMs	NumWords					
IND_AVG_PROX_KM	0.062* (0.036)								
IND_AVG_PROX_MN		0.029** (0.016)							
Constant	2.367* (1.328)	3.575*** (1.160)	-0.038** (0.019)	-0.033* (0.022)	-0.054** (0.023)	-0.052** (0.023)	-0.054** (0.023)	-0.052** (0.023)	-0.054** (0.023)
Observations	465	465	-1.266 (0.862)	4.478*** (0.964)	-0.663 (1.124)	-0.663 (1.124)	-0.663 (1.124)	-0.663 (1.124)	-0.663 (1.124)
R-squared	0.176	0.430	0.233	0.157	0.184	0.184	0.184	0.184	0.184
Other controls	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Industry FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Prob > F	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000

Note **Note(s):** This table reports the results of the two-stage least squares (2SLS) estimation examining the effect of auditor–client geographic proximity on key audit matters (KAMs). The instrumental variables IND_AVG_PROX_KM and IND_AVG_PROX_MN are used to instrument *InProx_KM* and *InProx_MN* in the first stage regression. Variable definitions are provided in [Table 2](#). Robust standard errors are reported in parentheses. *** $p < 0.01$, ** $p < 0.05$, * $p < 0.10$

Source(s): Authors' own calculations

Table 12. Regression result for highly risky firms

Variables	(1) High leverage	(2) High leverage	(3) Distress	(4) Distress
lnProx_KM	−0.037 (0.052)		−0.519 (0.351)	
lnProx_Min		−0.034 (0.062)		−0.627 (0.399)
Constant	3.733** (1.189)	3.691** (1.504)	21.187 (7.612)	18.810 (6.961)
Observation	465	465	465	465
Adjusted R ²	0.109	0.108	0.103	0.887
Controls	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes
Industry FE	Yes	Yes	Yes	Yes
Prob > F	0.000	0.000	0.000	0.000

Note(s): This table reports the regression results showing the impact of auditor–client geographic proximity on KAMs disclosures only for highly risky and distressed firms. Variable definitions are provided in Table 2. *** $p < 0.01$, ** $p < 0.05$, * $p < 0.10$. Standard errors are reported in parentheses
Source(s): Authors’ own calculations

significant association between ACGP and any of the firm risk proxies, suggesting that geographically proximate auditors do not disproportionately serve lower-risk clients. This evidence alleviates concerns that our main findings are driven by endogenous auditor–client matching based on risk characteristics and supports the interpretation that ACGP is associated with differences in KAM disclosure behavior rather than client selection.

6. Conclusion, policy implications and recommendations

This study contributes to the existing literature on mandatory KAMs reporting in Bangladesh, focusing on the disclosure practices in annual reports of companies listed on the DSE. While the introduction of KAMs reporting is a significant step in meeting investors’ information needs, concerns about its effectiveness have arisen. The objective of this study is to explore the association between ACGP and KAM disclosures from the perspective of information and communication advantage. The research gap in this study pertains to the limited exploration of the impact of auditor–client geographic distance on KAMs disclosures, particularly in the context of an emerging economy like Bangladesh. While previous research has examined KAMs reporting and various influencing factors, the geographical proximity between auditors and clients has been an underexplored area. This study addresses the gap by investigating how the physical distance between auditors and client firms influences the quantity and extent of KAMs disclosures, shedding light on the dynamics of audit reporting in a geographically diverse environment.

This study adopts a broader communication theory framework to examine how the proximity between auditors and clients influences KAMs reporting and its effectiveness. Using a data set of 465 reports spanning from 2018 to 2021 from DSE-listed firms in Bangladesh, our findings indicate a significant impact of geographic proximity on the number and extent of KAMs reported by auditors in financial reports. As per our initial hypothesis, we observe a notable negative association between ACGP and KAMs disclosures. These results remain consistent when considering alternative measures for KAMs and proximity. According to communication theory, geographic proximity enhances auditor–client understanding, leading to information symmetry, reduced client risk levels and heightened auditor confidence, thereby resulting in fewer and less extensive KAMs disclosures.

Furthermore, our study highlights that the negative association between proximity and KAMs disclosure is more pronounced in smaller and less risky firms, as they benefit more from informational advantages conferred by proximity in comparison to their larger and riskier counterparts. For small and low-levered firms, proximity facilitates auditors in better understanding the clients and addressing the risky and judgmental issues confidently which results in lower KAM disclosures. The implications of these findings extend to auditors and clients, impacting decisions regarding client acceptance or auditor appointments. Overall, our results align with the predictions of communication theory and enhance the existing knowledge base in the context of KAM reporting.

This study stands out for its originality in several aspects, including its innovative concept, the measurement of the critical variable “auditor–client geographic proximity,” its research methodology and its findings. To the best of our knowledge, no prior research has explored the relationship between KAMs and the geographical distance between auditors and the client’s office, making this study unique in its approach. Additionally, the application of communication theory within the realm of KAMs literature is a novel and noteworthy aspect of this research.

Our findings offer important implications for practitioners, particularly in emerging-market settings where audit oversight resources are constrained and audit markets are highly concentrated. From a governance perspective, boards and audit committees should aware that ACGP may influence the extent of KAMs disclosures. Recognizing this risk can help strengthen oversight, encourage closer monitor of audit quality and reinforce the need for auditors to maintain professional skepticism regardless of physical proximity. For regulators, the results suggest that while fewer KAM disclosures by geographically proximate auditors may reflect efficiency gains due to improved communication and information flow, they may also signal potential risks to transparency if familiarity affects reporting rigor. Accordingly, regulators could incorporate geographic proximity into risk-based supervisory frameworks, prioritizing inspections of engagements with high proximity or concentrated local audit markets. Enhanced guidance on professional skepticism, auditor rotation and KAM reporting may further mitigate such risks and improve audit quality. From the perspective of audit firms, the findings highlight the need to strengthen internal quality control mechanisms by recognizing the potential influence of proximity on audit judgment and reporting. This may involve implementing additional review procedures or targeted training for engagements involving geographically close clients. Finally, for investors and other stakeholders, the findings suggest that lower level of KAM disclosures should be interpreted cautiously as they may not necessarily indicate lower audit risk but could reflect proximity-related dynamics. Overall, incorporating geographic proximity into decision-making processes can contribute to more informed judgments and improved confidence in audit reporting.

Despite its contributions, this study has several limitations that open avenues for future research. First, the study is based on an emerging-market context, which may limit the generalizability of the findings to developed economies with different audit infrastructures and market dynamics. Second, ACGP is measured as the distance between the client’s office and the audit firm’s office, rather than the auditor’s residential location, from which auditors may travel directly to the client. This measure may not fully capture actual travel patterns or the true intensity of auditor–clients interaction. It is also possible that auditors and client executives may reside in close proximity, which could facilitate informal communication and influence audit processes beyond what is reflected in office-based distance measures. Accordingly, this measurement approach may introduce some imprecision in capturing geographic proximity. Future research could address this limitation by using alternative measures, such as residential-based distance or more granular mobility data, to better reflect

real-world interaction patterns. Third, although we use PSM and 2SLS to mitigate endogeneity concerns, it is challenging to eliminate all sources of endogeneity entirely. Subsequent studies could explore additional strategies to address this issue. Finally, geographic proximity may interact with other organizational, relational or market-level variables; future research could investigate these interactions to provide a more comprehensive understanding of the role of spatial factors in auditing and financial reporting.

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Data availability

Data available on request from the corresponding author.

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