



The Influence of the Audit Committee and External Audit on the Quality of Financial Reports in Manufacturing Companies

Evi Dora Sembiring¹, Deti Susilawati², Firli Agusetiawan Shavab^{3*}

^{1,2} Faculty of Economics and Business, Universitas Bina Bangsa

^{3*} Faculty of Economics and Business, Universitas Sultan Ageng Tirtayasa

Corresponding Author: firliagusetiawan@untirta.ac.id^{3*})

Keywords : *Audit Committee, External Audit and Quality of Financial Reports*

Abstract:

This study aims to analyze the effect of the audit committee and the external audit on the quality of financial statements. The population in this study are manufacturing companies listed on the Indonesia Stock Exchange (IDX) for the chemical sub-sector for the period 2018-2021. The data used in this study is secondary data, which comes from the annual report. The sampling technique used is purposive sampling with the number of companies as many as 12 times 4 periods to 48 sample data. Methods of data analysis using SPSS version 26 program, namely descriptive statistics, classical assumption test and multiple regression analysis. The results of this study indicate that partially the Audit Committee has a significant negative effect on the quality of financial reports and External Audit has a positive effect on the quality of reports. Simultaneously, the audit committee and the External Audit have an effect on the quality of financial reports.



Introduction

The quality of financial statements is the level of confidence in the presentation of financial information assessed by the auditor in the form of an opinion. The auditor's responsibility lies in the opinion issued, while management's responsibility is the preparation and presentation of financial reports fairly by following the Indonesian Financial Accounting Standards (Fajrin & Suryani, 2021) . The main purpose of financial reporting is to ensure, interpret notes, financial reports and to guide individuals who invest in various businesses to obtain the right information in making accurate financial resolutions to increase the level of company performance (Gebrayel et al., 2018) . A financial report can be considered relevant (*relevance*) if it is able to help users to predict past, present and future events; that is, it has *predictive value* . In addition, in SFAC No. 2 explained that relevant information must also have a *feedback value* that helps users of financial reports correct past expectations and have *timeliness* . Information can influence user decisions if delivered at the right time (INAWATI et al., 2021) .

The quality of financial reporting can be viewed from two perspectives, first stating that the quality of financial reporting is related to the overall performance of the company which is reflected in company profits, where high quality earnings are reflected in earnings that can be sustainable for a long period. The second view states that the quality of financial reporting is related to market performance of the capital market which is manifested in the form of rewards, so that the stronger relationship between company profits and rewards shows high financial reporting information (Ermawati et al., 2020) . Several empirical studies have provided evidence that the quality of the financial reporting system is highly dependent on corporate governance mechanisms, such as the effectiveness of the audit committee, external audit, financial expertise and board structure (Mohammad & Ahmed, 2017) .

One of the cases regarding the quality of financial reports occurred at PT. Kimia Farma, which is now a subsidiary of PT Bio Farma (Persero), which registered its initial public offering (IPO) on July 4, 2001, which reported a net profit of IDR 132 billion which was audited by Hans Tuanakotta & Mustofa (HTM). However, the Ministry of BUMN and the Capital Market Supervisory Agency (Bapepam, now OJK) considered that the net profit was too large and contained an element of engineering. Then it was decided to carry out a re-audit on October 3, 2002, it turned out that the company's profit was only IDR 99.56 billion, IDR 32.6 billion lower or 24.7% less than the initial reported profit. Errors occurred in the Raw Materials Industry unit, namely *overstated* sales of IDR 2.7 billion, in the Central Logistics unit, *overstated* inventory of IDR 23.9 billion, in the Pharmaceutical Wholesalers (PBF) unit, *overstated* inventories of IDR 8.1 billion and *overstated* sales of IDR 10.7 billion. According to the Head of the Legal Bureau of Bapepam, the 2001 financial report error case can be categorized as a criminal act because it is a financial manipulation that can mislead the public.

The audit committee's role is to oversee and monitor the activities of the company's financial reporting system. Asset ownership, operations management capabilities can also affect the quality of financial reports, so a board of commissioners is needed who is able to control the running of the company. The composition of the board of commissioners also plays

a role in increasing public confidence in the quality of financial reports. Committee audit contributes to the quality of reports finance, by : 1) supervising or reporting processes including internal control systems and the use of accounting principles in accounting, and 2) supervising the overall audit process. The results of the audit committee indicate that the audit committee has consequences for financial statements, namely: 1) reducing imprecise accounting measurements, 2) reducing inappropriate accounting disclosures, and 3) reducing actions management fraud and illegal actions (Nugrahani, 2020) .

The audit committee is defined as a group of people selected from members of the board of directors who are responsible for maintaining auditor independence (Zraiq & Fadzil, 2018) . Appropriately sized audit committees will enable members to use their experience and expertise for the best interests of stakeholders, and their size will be more effective in monitoring financial reporting because the level of knowledge is higher with the inclusion of qualified members (Rotich, 2017) .

Based on research (Al-Shaer et al., 2017) that the audit committee has a positive and significant effect on the quality of financial reports. This is contrary to research (Nugrahani, 2020) and (Andriani et al., 2020) stating that the Audit Committee has no effect on the quality of financial reports. Meanwhile, according to (INAWATI et al., 2021) that the Audit Committee has a negative effect on the quality of financial reports.

The increasing relevance of the characteristics of external auditors obtained from shareholders, investors and all related parties and the important role of audit quality in producing quality financial reports (Qawqzeh et al., 2020) . In other words, auditors with industry specialization tend to invest in additional audit process costs due to reputation (Xiong & Zhang, 2018), and legalization issues. Public accounting firms that have been worldwide are widely used by companies to produce quality financial reports, such as the Big Four KAP which consists of: 1). Ernst & Young, 2). Deloitte Touche Tohmatsu, 3).KPMG Peat Marwick, 4).Price Waterhouse Coopers. Several researchers state that external audit has a positive and significant effect on the quality of financial reports (Alzeban, 2020; Azzam et al., 2020; Qawqzeh et al., 2020) . Based on the phenomena described above, the authors examine how audit committees and external audits can affect the quality of financial reports. The purpose of this study is to empirically show the impact or influence of the audit committee and external audit on the quality of financial reports in chemical sub-sector manufacturing companies listed on the Indonesia Stock Exchange for the 2018-2021 period.

Research methods

The population of this study are manufacturing companies listed on the Indonesia Stock Exchange for the chemical sub-sector for the period 2018-2021 as many as 12 companies. The sample selection of this research was done by using *purposive sampling method*. companies that meet the criteria with a total of 4 years of observation so that the sample used in this study is 48. The criteria include: Manufacturing companies listed on the Indonesia Stock Exchange during the 2018-2019 period in a row. Manufacturing companies that have complete data in the research period such as audit committees, internal audits and financial reports.

The data collection method used in this study is a non-participant observation technique, that is, the researcher is not involved and only acts as an independent observer (Sugiyono, 2017: 204). The documents examined in this research are the *annual reports* of manufacturing companies listed on the IDX from 2018-2021. In this study, the data collection techniques used are as follows:

- 1) Documentation: this study retrieves data from annual financial reports published on the Indonesian Stock Exchange website, namely www.idx.co.id for the 2018-2021 period.
- 2) Literature study: books, writings and scientific journals as well as scientific research reports related to research themes. The tool used for data analysis in this study was the SPSS computer program version 26 (Statistical Program For Social Science Version 26) for windows.

The formula for calculating each variable is as follows:

- a. Audit Committee = Number of members who are competent in the field of auditing/accounting total number of members of the overall audit committee (INAWATI et al., 2021)
- b. External Audit = using a dummy variable that takes a value of 1 if a company uses the services of a big four KAP, and a value of 0 if the company uses the services of another KAP (Qawqzeh et al., 2020) .
- c. The quality of financial reports is measured by the company's ability to achieve profits as measured by ROI as a measure of company performance. Measurement of the variable quality of financial reports using a ratio scale (Nugrahani, 2020) .

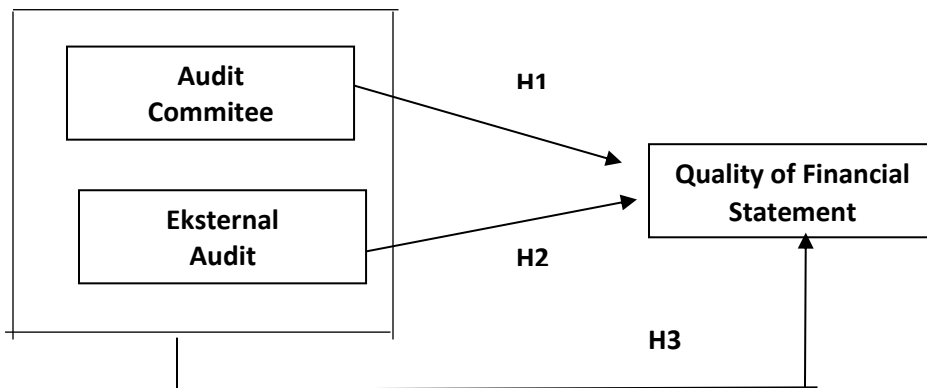


Figure 1 Research Model

Results And Discussion

In this study, researchers used measurements of the minimum value, maximum value, average value (mean) and standard deviation.

Table 1
Descriptive Statistics Results

	mean	Std. Deviation	N
Quality of Financial Statements	3.7654525	5.40119673	48
Audit Committee	.4450	,13069	48
External Audit	,5208	,50485	48

The descriptive statistical test table shows that there are three variables, namely the Audit Committee, External Audit, and Quality of Financial Statements with a total of 48 data for each

variable that have been obtained from the financial reports of chemical sub-sector companies for the 2018-2021 period.

Multicollinearity Test

According to Imam Ghozali (2011: 107-108), there are no symptoms of multicollinearity in the regression model if the Tolerance value is > 0.100 and the VIF value is < 10.00 .

Table 2
Multicollinearity Test

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.	Collinearity Statistics	
	B	Std. Error	Betas			tolerance	VIF
1 (Constant)	6.596	2,583		2,554	0.014		
Audit Committee	-11,421	5,408	-,276	-2.112	0.040	,998	1,002
External audit	4,323	1,400	,404	3.088	,003	,998	1,002

a. Dependent Variable: Quality of Financial Statements

From the results of calculating the tolerance value, it shows that there is no variable that has a tolerance value of less than 0.10, which means there is no correlation between the independent variables. Likewise, the results of calculating the *Variance Inflation Factor* (VIF) values also show the same thing. There is not one independent variable that has a VIF value of more than 10. So, there is no multicollinearity between Independent Variables in the regression model.

Heteroscedasticity Test

According to Imam Ghozali (2011: 139), there is no heteroscedasticity, if there is no clear pattern, (wavy, widened then narrowed) in the scatter plots and the points spread above and below the number 0 on the Y axis.

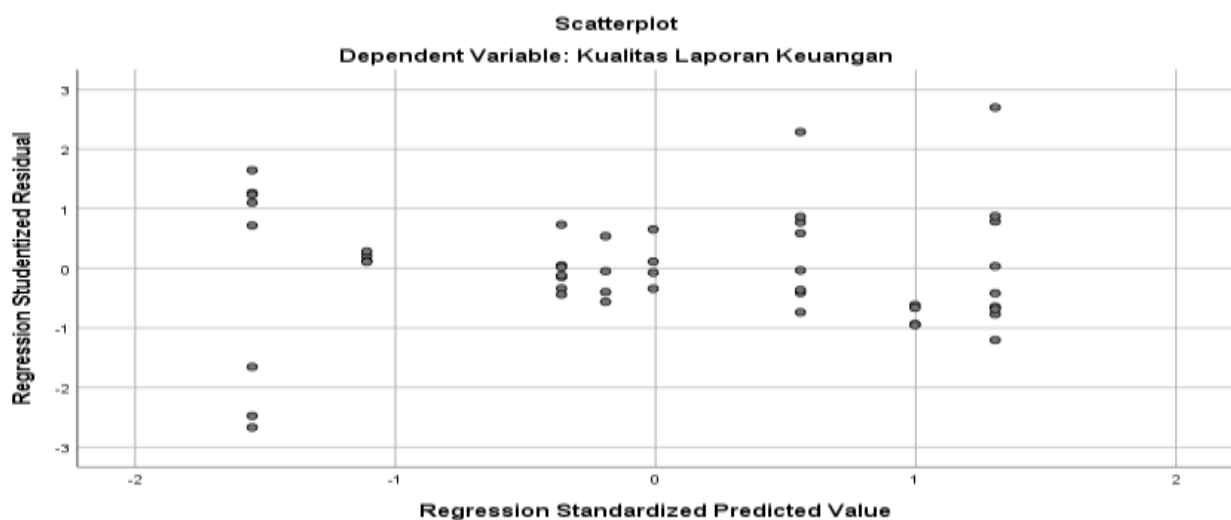


Figure 2 Scatterplots

Based on the output of the *Scatterplot* , it can be seen that the points spread in an unclear pattern or do not form a pattern above and below the number 0 on the Y axis. It can be concluded that the regression model does not have heteroscedasticity problems.

Autocorrelation Test

The autocorrelation test aims to test whether there is a correlation between the disturbances in the t-period and the errors in the t-1 period in the regression model. A good regression model is one that is free from autocorrelation. To overcome this, a Durbin Watson test (DW) is carried out with details, namely, a DW number below -2 means there is a positive autocorrelation, a DW number between -2 to +2 has no autocorrelation and a DW number above +2 means there is a negative autocorrelation. The results of the autocorrelation test are as follows:

Table 3
Autocorrelation Test

sModel Summary ^b					
Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
1	,480 ^a	,231	,196	4.84175667	1,644

a. Predictors: (Constant), External audit, Audit Committee

b. Dependent Variable: Quality of Financial Statements

Table 3 explains the Durbin Watson value of 1.644 so that the DW value is between -2 and +2, it can be concluded that all X variables are free from autocorrelation.

Multiple Linear Regression Analysis

Used to measure the magnitude of the influence between two or more independent variables on 1 dependent variable and predict variables using the dependent variable. Based on previous calculations, the equation for the quality of financial statements is as follows:

$$KLK = 6,596 - 11,421 \text{ Audit Committee} + 4,323 \text{ External audit.}$$

Where the above equation shows that the quality of financial reports is influenced by a constant value of 6.596 and has a negative influence from the audit committee of 11,421 and a positive influence of 4.3232 from external audit.

Partial Regression Coefficient Test (T Test)

The t test can be used to determine whether the independent variable has a significant effect or not on the dependent variable.

The hypotheses to be tested are as follows:

1. Ho: The independent variable has no effect on the dependent variable.
2. Ha: The independent variable has an effect on the dependent variable.

The basis for making the decision is:

1. If $t \text{ count} < t \text{ table}$ or $-t \text{ count} > -t \text{ table}$ then H_0 is accepted and H_a is rejected because = 5%.
2. If $t \text{ count} > t \text{ table}$ or $-t \text{ count} < -t \text{ table}$ then H_a is accepted and H_0 is rejected by = 5%.
3. If the probability ($\text{sig } t$) $< (0.05)$ then the probability level of the independent variable on the dependent variable is significant, and vice versa if ($\text{sig } t$) $> (0.05)$ then the probability of the variable is not significant.

Tabel 4
Uji T (Parsial)

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.	Collinearity Statistics	
	B	Std. Error	Beta			Tolerance	VIF
1 (Constant)	6,596	2,583		2,554	,014		
Audit Committee	-11,421	5,408	-,276	-2,112	,040	,998	1,002
Audit eksternal	4,323	1,400	,404	3,088	,003	,998	1,002

a. Dependent Variable: Quality of Financial Statements

According to Imam Ghozali (2011: 101), if the $\text{sig.} < 0.05$, it means that the independent variable (X) has a partial effect on the dependent variable (Y).

partial t test :

1. The results of the t test can be seen where Sig. Audit Committee $0.040 < 0.05$ or t-value - 2.112 $> t.\text{table} -2.01410$ then H_0 is rejected H_a is accepted.

Then it can be concluded that:

Audit Committee (X1) has a significant negative effect on the quality of financial statements (Y).

2. The results of the t test can be seen where Sig. External audit $0.003 < 0.05$ or t value 3.122 $> t.\text{table} 2.01410$ then H_0 is rejected H_a is accepted.

Then it can be concluded that:

Audit Quality (X2) has a significant positive effect on the integrity of financial statements (Y).

Simultaneous Test (Test F)

The F test is used to determine whether all the independent variables simultaneously affect the dependent variable. The hypothesis tested is:

- 1) If the value of f count $> f \text{ table}$ then the hypothesis is accepted, namely all independent variables simultaneously affect the dependent variable.
- 2) If the value of f count $< f \text{ table}$, the hypothesis is rejected, namely all independent variables simultaneously have no effect on the dependent variable.

Table 5
F Test (Simultaneous)

Model	Sum of Squares	df	MeanSquare	F	Sig.
-------	----------------	----	------------	---	------

1	Regression	316,210	2	158,105	6,744	,003 ^b
	residual	1054,917	45	23,443		
	Total	1371,128	47			

- a. Dependent Variable: Quality of Financial Statements
- b. Predictors: (Constant), External audit, Audit Committee

According to Imam Ghozali (2011: 101), if the sig. <0.05, it means that the independent variable (X) has a simultaneous effect on the dependent variable (Y).

Based on table 5 it can be concluded that the audit committee (X1), external audit has a simultaneous effect on the integrity of financial statements (Y), where the value of sig. 0.003 <0.05 or F value 6.744 > F. table 3.20.

Coefficient of Determination (R2)

The coefficient of determination (R2) is used to see how big the contribution of the variable X to the variable Y. The coefficient of determination measures how far the model's ability to explain variations in the dependent variable is. A small value of R2 means that the ability of the independent variable in explaining the variation of the dependent variable is limited. A value close to one means that the independent variable provides almost all the information needed to predict the dependent variable (Pudjianti & Ghozali, 2021) .

Table 6
Coefficient of Determination

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
1	,480 ^a	,231	,196	4.84175667	1,644

- a. Predictors: (Constant), External audit, Audit Committee
- b. Dependent Variable: Quality of Financial Statements

Table 6 shows the R Square value is 0.231 or equal to 23.1%, which means that the Audit Committee (X1) and External Audit (X2) variables simultaneously or jointly affect the financial statement integrity variable (Y) by 23.1 %, while the rest (100% - 23.1% = 76.9%) is influenced by other variables outside this regression equation or variables not examined.

Influence of the Audit Committee on the Quality of Financial Statements

The results of hypothesis testing show that the Audit Committee has a negative effect on the quality of financial reports. Where the increasing number of audit committee members will reduce the quality of financial reports, meaning that companies need a limited number of competent audit committee members, so that they can supervise and audit financial reports to the maximum . This is because the duties and functions of the Audit Committee are to review financial information that will be released by the company to the public and/or authorities, including financial reports, projections and other reports related to the Company's financial information. In accordance with research conducted by (Nugrahani, 2020) , (INAWATI et al., 2021) which states that the audit committee has a negative and significant effect on the quality of financial reports.

The Effect of External Audit on the Quality of Financial Statements

The results of hypothesis testing show that external audit has a significant positive effect on the quality of financial statements. The results of external audits of financial reports within the company affect the quality presented to those in need. The task and function of the external audit is to provide an opinion on the fairness of the organization's financial reporting, especially in presenting the financial position and results of operations in a period . Because in the audit process the company aims to check and ensure that the financial reports of past performance and the current financial position comply with the 'true and proper' principle. This finding is supported by (Mohammad & Ahmed, 2017) , (Qawqzeh et al., 2020) which states that external audit has a significant positive effect on the quality of financial reports.

Influence of the Audit Committee and External Audit on the Integrity of Financial Statements

The results of hypothesis testing show that the Audit Committee and the external audit have a significant positive effect simultaneously on the quality of financial reports. Cooperation between the audit committee and the external audit can determine the quality of financial statements within the company. The importance of collaboration between the audit committee and external audit can support quality financial reporting activities. The results of this study are in accordance with research (Alarussi & Nawafly, 2019; Sarhan et al., 2019) and (Alzeban, 2020) .

Conclusion

Based on tests carried out using Multiple Linear Analysis, the results of the analysis and hypothesis testing can be concluded, namely (H1) the Audit Committee has a significant negative effect on the Integrity of Financial Statements in Manufacturing Companies in the Chemical Sub Sector for the 2018-2021 Period. The existence of a high number of audit committee members in a company will reduce the quality of the report. (H2) External audit has a positive and significant effect on the Integrity of Financial Statements in Manufacturing Companies in the Chemical Sub Sector for the 2018-2021 Period. The role of external audit within the company plays a very important role in determining and determining the quality of financial reports. (H3) The Audit Committee and External Audit simultaneously have a significant positive effect on the integrity of financial reports in Manufacturing Companies in the Chemical Sub Sector for the 2018-2021 Period. The role of the Audit Committee and external audit has a good impact, because the two are interrelated in determining the quality of financial reports in a company.

References

- Al-Shaer, H., Salama, A., & Toms, S. (2017). Audit committees and financial reporting quality. *Journal of Applied Accounting Research*, 18(1), 2–21. <https://doi.org/10.1108/jaar-10-2014-0114>
- Alarussi, A. S., & Nawafly, A. T. (2019). Impact of Board Characteristics, Audit Committee Characteristics And External Auditor on Disclosure Quality of Financial Reporting. *Turk Turizm Arastirmalari Dergisi*, 1(1), 48–65. <https://doi.org/10.26677/tr1010.2019.60>
- Alzeban, A. (2020). The impact of audit committee, CEO, and external auditor quality on the

- quality of financial reporting. *Corporate Governance (Bingley)* , 20 (2), 263–279. <https://doi.org/10.1108/CG-07-2019-0204>
- Andriani, BF, Sucipto, & Indaryuni, D. (2020). The Influence of Audit Quality, Audit Committee, and Company Size on the Quality of Financial Statements (Study of Companies Registered on JII70 for the 2018-2020 Period). *J-ISACC: Journal of Islamic Accounting Competency* , 45–58.
- Azzam, MJ, Alrabba, HM, AlQudah, AM, & Mansur, HMA (2020). A study on the relationship between internal and external audits on financial reporting quality. *Management Science Letters* , 10 (4), 937–942. <https://doi.org/10.5267/j.msl.2019.10.001>
- Ermawati, L., Devi, Y., & Arramadani, NN (2020). The Influence of Audit Quality and Audit Committee on the Quality of Financial Reporting of Companies Registered on the Jakarta Islamic Index (JII). *Journal of Accounting and Finance*, 11(1), 92-111. *Trabajo Infantil* , 11 (1), 92–111.
- Fajrin, SS, & Suryani, E. (2021). The Influence of the Audit Committee, Institutional Ownership, and Audit Fees on the Quality of Financial Reports (Empirical Study on Consumer Goods Sector Companies Listed on the IDX for the 2017–2019 Period). *E-Proceedings of Management* , 8 (5), 5136–5144. .
- Gebrayel, E., Jarrar, H., Salloum, C., & Lefebvre, Q. (2018). Effective association between audit committees and the internal audit function and its impact on financial reporting quality: Empirical evidence from Omani listed firms. *International Journal of Auditing* , 22 (2), 197–213. <https://doi.org/10.1111/ijau.12113>
- Inawati, WA, Muslih, M., & Kurnia, K. (2021). The Influence of Audit Committee Competence, Management Ownership and Size of the Board of Commissioners on the Quality of Financial Statements. *Journal of Business And Accounting* , 23 (1), 121–132. <https://doi.org/10.34208/jba.v23i1.858>
- Mohammad, AJ, & Ahmed, DM (2017). The Impact of Audit Committee and External Auditor Characteristics on Financial Reporting Quality among Malaysian Firms The effect of audit committee and external auditor characteristics on financial reporting quality View project Aram Jawhar Erbil polyte. *Research Journal of Finance and Accounting Wwww.liste.Org ISSN* , 8 (13). <https://www.researchgate.net/publication/326521944>
- Nugrahani, TS (2020). Influence of the Board of Commissioners and the Audit Committee on the Quality of Financial Statements. *Akmenika: Journal of Accounting and Management* , 14 (1), 838–849. <https://doi.org/10.31316/akmenika.v14i1.1011>
- Pudjianti, FN, & Ghozali, I. (2021). The effect of audit committee characteristics on CSR disclosure with the existence of risk management as an intervening variable. *Diponegoro Journal of Accounting* , 10 , 1–13.
- Qawqzeh, HK, Endut, WA, Rashid, N., & Dakhllalh, MM (2020). Impact of The External Auditor's Effectiveness on The Financial Reporting Quality : The Mediating Effect of Audit Quality. *Journal of Critical Reviews* , 7 (6), 1197–1208. <https://doi.org/10.31838/jcr.07.06.215>
- Rotich, T. (2017). The Effect of Board Composition on Quality of Financial Reporting Among Firms Listed in Nairobi Securities Exchange. *Science in Finance, University of Nairobi* , V (1), 1–60.
- Sarhan, A. A., Ntim, C. G., & Al-Najjar, B. (2019). Antecedents of audit quality in MENA countries: The effect of firm- and country-level governance quality. *Journal of International Accounting, Auditing and Taxation*, 35(1), 85–107. <https://doi.org/10.1016/j.intaccaudtax.2019.05.003>

Zraiq, M. A. A., & Fadzil, F. H. (2018). and Research The Impact of Audit Committee Characteristics on Firm Performance : Evidence. *Scholar Journal of Applied Sciences and Research*, 1(5), 39–42.