

The Effect of Audit Quality and Audit Committee on Financial Reporting Quality

(Empirical Study on Hospitality Sector Companies Listed on the Indonesia Stock Exchange in 2019-2023)

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The author(s) declare that the research was conducted in the absence of any commercial or financial relationships that could be construed as a potential conflict of interest.

ABSTRACT

Purpose: This study aims to examine the effect of audit quality and audit committee on financial reporting quality in hotel sector companies listed on the Indonesia Stock Exchange (IDX) during 2019–2023. Based on agency, signaling, and corporate governance theories, this study proposes that higher audit quality and more effective audit committees positively influence the quality of financial reporting.

Research Method: This study employed a quantitative approach with descriptive and verificative methods. Secondary data were obtained from audited financial statements and annual reports of 31 hospitality subsector companies listed on the IDX from 2019 to 2023, yielding 155 observations. Audit quality was measured by KAP Big Four reputation, audit opinion, auditor switching, and audit fee disclosure. The audit committee was measured by size, independence, and financial expertise. Financial reporting quality was proxied by absolute discretionary accruals, as measured by the Modified Jones Model. Data were analyzed using multiple linear regression with SPSS version 29.

Results and Discussion: The findings show that audit quality partially has a significant positive effect on financial reporting quality, particularly through KAP Big Four reputation and audit opinion. Audit committee characteristics do not individually show significant effects, indicating symbolic compliance rather than substantive oversight. Simultaneously, audit quality and the audit committee significantly affect financial reporting quality.

Implications: The findings suggest that companies should strengthen audit committee effectiveness beyond formal structure, while regulators should enhance oversight of audit committee performance.

Originality: This study provides empirical evidence from the Indonesian hospitality sector by highlighting the dominance of external audit credibility over internal governance mechanisms in improving financial reporting quality.

Keywords: audit quality; audit committee; financial reporting quality; hospitality sector; discretionary accruals.

1. Introduction

The rapid development of the global business environment has created significant complexity in business processes, demanding stricter oversight of organizational activities. International accounting scandals such as those involving Satyam, Enron, and WorldCom demonstrate that management may



employ strategies to conceal relevant financial transaction data (Cohen, 2012). Such phenomena indicate fundamental weaknesses in corporate governance systems that threaten the credibility of financial information globally.

Financial statements are intended to provide useful information to existing and potential investors, lenders, and creditors to support resource allocation decisions (IASB, 2018). High-quality financial statements must fulfill fundamental qualitative characteristics, namely relevance and faithful representation (Kieso et al., 2019). However, the flexibility within Generally Accepted Accounting Principles (GAAP) provides managers with discretion to manage earnings in ways that may not reflect actual economic conditions, thereby reducing earnings quality and the usefulness of information (Healy et al., 1999).

According to the 2024 Report to the Nations, published by the Association of Certified Fraud Examiners (ACFE), financial statement fraud remains one of the most costly forms of occupational fraud. In the hospitality sector specifically, research by Altinay et al. (2020) shows that more than 40% of hotels in the United States face difficulties maintaining financial transparency due to operational complexity. In Indonesia, data from the Financial Services Authority (OJK) indicates violations in the presentation of financial statements in the hospitality sector, pointing to weaknesses in financial management systems (OJK, 2021).

External auditors play a crucial role in producing high-quality audit results, which in turn enhance the credibility of financial statements and strengthen investor protection (Hasan & Hamid, 2020). In parallel, audit committees serve as an essential element within organizations, assisting in supervising executive management and managing oversight responsibilities related to accounting, financial, and internal audit functions (Calomiris & Carlson, 2016). The combination of high-quality external auditing and effective audit committee oversight is theoretically expected to reduce information asymmetry and improve financial reporting quality.

This study focuses on the hospitality sector listed on the Indonesia Stock Exchange (IDX) during 2019-2023, a period marked by significant operational volatility due to economic recovery from the pandemic. Despite consistent findings in prior literature supporting the positive effects of audit quality and audit committees on financial reporting quality (Hasan & Hamid, 2020; Kamolsakuchai, 2021; Alhumoudi, 2024), evidence from the Indonesian hospitality sector remains limited, given its unique operational and regulatory characteristics. This study, therefore, aims to fill this gap by examining: (1) how audit quality and audit committee characteristics affect financial reporting quality in listed hospitality companies, and (2) whether both mechanisms jointly contribute to financial reporting quality.

The remainder of this paper is organized as follows. Section 2 provides a literature review and hypothesis development. Section 3 presents the research method and design. Section 4 provides the results and discussion. Section 5 is Concluding Remarks and Recommendations.

2. Literature Review and Hypothesis Development

2.1 Theoretical Framework

This study is grounded in three complementary theoretical perspectives. Agency Theory (Jensen & Meckling, 1976) explains the contractual relationship between principals (owners) and agents (managers), in which the separation of ownership and control creates information asymmetry and

potential for opportunistic behavior. The theory underpins the need for external auditing and audit committee oversight as mechanisms to align management behavior with shareholder interests.

Signaling Theory (Spence, 1973) posits that companies have incentives to send positive signals to external parties regarding firm quality through high-quality financial reports. High audit quality and an effective audit committee serve as credible signals to investors and creditors that financial information is reliable, thereby reducing information asymmetry and potentially lowering the cost of capital. Corporate Governance Theory (OECD, 2021) further emphasizes principles of transparency, accountability, responsibility, independence, and fairness as pillars of good governance that protect stakeholder interests and enhance market confidence.

2.2 Audit Quality and Financial Reporting Quality

DeAngelo (1981) defines audit quality as the joint probability that an auditor will discover and report a violation in a client's accounting system. This quality is influenced by auditor competence and independence, reflecting the ability and willingness to report material misstatements. KAP Big Four firms (PwC, Deloitte, EY, KPMG) are widely recognized as producing higher-quality audits due to superior resources, stricter methodologies, and reputational stakes that create stronger incentives for independence (Francis, 2011). Consistent with prior research (Hasan & Hamid, 2020; Lien et al., 2023), this study expects:

H1: *Audit quality has a positive effect on the financial reporting quality of hospitality companies listed on the IDX.*

2.3 Audit Committee and Financial Reporting Quality

The Board of Commissioners forms audit committees to oversee financial reporting processes, internal controls, and external audits (Dezort et al., 2002; OJK Regulation No. 55/POJK.04/2015). Three key characteristics determine audit committee effectiveness: size (the number of members providing oversight capacity), independence (freedom from management conflicts of interest), and financial expertise (the ability to critically evaluate accounting standards and audit findings). Effective audit committees reduce opportunities for earnings management and enhance the integrity of financial reports (Ardiyanti & Kurnia, 2023). Based on prior studies (Kamolsakuchai, 2021; Alhumoudi, 2024; Jabak, 2023):

H2: *The audit committee has a positive effect on the financial reporting quality of hospitality companies listed on the IDX.*

When operating simultaneously, audit quality and audit committee mechanisms create a comprehensive monitoring ecosystem. External audit credibility validates financial information while audit committee structures ensure proper internal oversight processes, together reducing information asymmetry more effectively than either mechanism alone (Shanif et al., 2020):

H3: *Audit quality and the audit committee simultaneously have a positive effect on the financial reporting quality of hospitality companies listed on the IDX.*

3. Research Method

This study employs a quantitative approach combining descriptive and verificative methods. The population consists of all hospitality sub-sector companies listed on IDX during 2019-2023, totaling 31 companies with 155 observation data points. Sampling used purposive sampling with criteria: (1) listed on IDX throughout the study period; (2) no delisting; (3) complete publication of audited financial statements; (4) complete data for all research variables; and (5) reporting in Indonesian Rupiah.

Secondary data were collected from audited annual financial reports and annual reports accessed through the official IDX website (www.idx.co.id) and individual company websites. The study period 2019-2023 was selected to capture the operational dynamics before, during, and after the COVID-19 pandemic, which significantly affected the hospitality industry. Financial reporting quality (Y) is measured by the absolute value of discretionary accruals (|DA|), calculated using the Modified Jones Model (Dechow et al., 1995), where higher |DA| indicates lower reporting quality due to more aggressive earnings management.

Table 1. Operationalization of Variables

Variable	Indicator	Measurement	Scale
Financial Reporting Quality (Y)	Discretionary Accruals (DA)	Modified Jones Model $ DA = TAC/At-1 - NDA $	Ratio
Audit Quality (X1)	KAP Big Four (KA_BIG4)	Dummy: 1 = Big Four, 0 = Non-Big Four	Nominal
	Audit Opinion (KA_OPINI)	Dummy: 1 = Unqualified Opinion, 0 = Other	Nominal
	Auditor Switching (KA_SWITCH)	Dummy: 1 = Change in KAP, 0 = No Change	Nominal
	Audit Fee Disclosure (KA_FEE)	Dummy: 1 = Disclosed, 0 = Not Disclosed	Nominal
Audit Committee (X2)	AC Size (KOM_SIZE)	Number of audit committee members	Ratio
	AC Independence (KOM_IND)	Independent members / Total members	Ratio
	AC Expertise (KOM_EXP)	Financial background members / Total members	Ratio
Control Variables	Profitability (K1_ROA)	Net Income / Total Assets	Ratio
	Leverage (K2_LEV)	Total Debt / Total Assets	Ratio

The regression model is specified as follows:

$$Y = \beta_0 + \beta_1KA_BIG4 + \beta_2KA_OPINI + \beta_3KA_SWITCH + \beta_4KA_FEE + \beta_5KOM_SIZE + \beta_6KOM_IND + \beta_7KOM_EXP + \beta_8K1_ROA + \beta_9K2_LEV + \epsilon$$

Prior to regression analysis, classical assumption tests were conducted, including normality (Kolmogorov-Smirnov), multicollinearity (VIF < 10 and Tolerance > 0.1), heteroscedasticity (Glejser test), and autocorrelation (Durbin-Watson). Hypotheses were tested using the t-test (partial effects), F-test

(simultaneous effects), and coefficient of determination (R^2). All analyses were performed using IBM SPSS version 29 at a significance level of $\alpha = 0.05$.

4. Results and Discussion

4.1 Analysis Results

4.1.1 Descriptive Statistics

The sample consists of 31 hospitality companies listed on IDX from 2019 to 2023, generating 210 total observations after applying selection criteria. Descriptive analysis shows that approximately 35% of companies used Big Four auditors, 78% received unqualified audit opinions, and 40% experienced auditor switching during the observation period. The mean audit committee size was 3.2 members, with an independence ratio averaging 0.74 and a financial expertise ratio averaging 0.56. The mean absolute discretionary accruals ($|DA|$) was 0.187, indicating moderate earnings management activity across the sample period.

4.1.2 Classical Assumption Test Results

Classical assumption tests confirmed model validity. The Kolmogorov-Smirnov test showed p -value > 0.05 , indicating normally distributed residuals. Multicollinearity tests showed VIF values < 10 and Tolerance > 0.1 for all variables, ruling out multicollinearity. The Glejser test for heteroscedasticity showed no significant pattern (all p -values > 0.05), and the Durbin-Watson value of 2.014 fell within acceptable bounds, indicating no autocorrelation.

4.1.3 Hypothesis Testing Results

Table 2. Multiple Regression Results (Coefficients)

Variable	Coefficient (β)	t-value	Sig.	Conclusion
Constant	0.264	8.412	0.000	-
KA_BIG4 (Big Four)	0.081	2.475	0.014	Significant (H1 partial \checkmark)
KA_OPINI (Audit Opinion)	0.190	3.278	0.001	Significant (H1 partial \checkmark)
KA_SWITCH (Auditor Switching)	0.012	0.318	0.751	Not Significant
KA_FEE (Audit Fee)	0.041	1.524	0.128	Not Significant
KOM_SIZE (AC Size)	0.021	0.520	0.603	Not Significant
KOM_IND (AC Independence)	0.058	1.364	0.173	Not Significant
KOM_EXP (AC Expertise)	0.047	1.185	0.237	Not Significant
K1_ROA (Profitability)	-0.039	-1.043	0.298	Not Significant
K2_LEV (Leverage)	0.028	0.804	0.422	Not Significant

Note: Dependent Variable: $|DA|$ (Discretionary Accruals); $N = 210$; $\alpha = 0.05$

Table 3. ANOVA Results (F-Test)

Model	Sum of Squares	df	Mean Square	F	Sig.
Regression	1.688	9	0.188	3.471	0.001
Residual	10.805	200	0.054		
Total	12.493	209			

Table 4. Model Summary

R	R Square	Adjusted R-Square	Std. Error
0.368	0.135	0.096	0.23243

4.2 Discussion

4.2.1 Effect of Audit Quality on Financial Reporting Quality

The partial test results indicate that audit quality has a significant positive effect on financial reporting quality, with KAP Big Four reputation (sig. 0.014) and audit opinion (sig. 0.001) as the key drivers. This supports H1. From the perspective of Signaling Theory, high audit quality acts as a positive signal to external parties. The use of Big Four auditors, with their superior technical resources and rigorous audit procedures, creates pressure on management to produce accurate financial statements and avoid audit findings that could damage the company's reputation.

The strong significance of audit opinion (sig. 0.001) confirms that auditor opinions are not merely procedural formalities but serve as crucial validation instruments. This finding aligns with Lien et al. (2023), who argue that financial reporting quality depends heavily on the auditor's assertiveness in issuing opinions that reflect the company's true economic condition. In the context of the 2019-2023 hospitality sector, characterized by significant volatility amid the pandemic recovery, the market appeared to rely more on external verification than on internal oversight, underscoring audit quality as the primary pillar of financial transparency on the IDX. Auditor switching and audit fee disclosure did not have significant effects, consistent with the findings of Khomariah & Khomsiyah (2023).

4.2.2 Effect of Audit Committee on Financial Reporting Quality

The partial test results for all audit committee indicator sizes (sig. 0.603), independence (sig. 0.173), and financial expertise (sig. 0.237) show no significant effects on financial reporting quality, leading to the rejection of H2. Theoretically, audit committees should function as internal monitoring mechanisms that reduce information asymmetry; however, this non-significance suggests a phenomenon of "symbolic compliance," where audit committee formation tends to fulfill formal regulatory requirements under OJK regulations rather than achieving substantive monitoring effectiveness.

This finding is inconsistent with studies by Alhumoudi (2024) and Alawaqleh (2021) that reported significant positive effects. The divergence may reflect sector-specific dynamics: during the economic recovery period, the operational complexity of the hospitality sector required visible external audit validation more than administrative internal oversight. This interpretation is supported by Shankaraiah (2017), who similarly found that audit committee independence and expertise often fail to



have significant effects when committees lack sufficient authority or meet infrequently enough to intervene in accounting policies meaningfully. The contrasting significance between audit quality (significant) and audit committee (not significant) suggests that Indonesian investors place greater reliance on third-party external verification from Big Four auditors than on internal company oversight mechanisms.

4.2.3 Simultaneous Effect of Audit Quality and Audit Committee

The F-test results show $F = 3.471$ with $\text{sig.} = 0.001 < 0.05$, confirming that audit quality and audit committee variables collectively have a significant effect on financial reporting quality (H3 accepted). Although individual indicators do not achieve statistical significance, the integration of external and internal governance mechanisms yields a meaningful collective contribution to the integrity of financial reporting. The Adjusted R^2 of 0.096 (9.6%) indicates that these governance variables explain 9.6% of the variance in financial reporting quality. In comparison, the remaining 90.4% is attributable to other factors, including internal control effectiveness, earnings management policies, and macroeconomic conditions during the observation period.

The simultaneous significance suggests that stakeholders, investors, and creditors view financial reporting quality as the product of the overall governance ecosystem. Even if individual audit committee attributes are not deterministic, their presence as an integral part of the governance structure bolsters the legitimacy of financial statements in the public eye. This finding reinforces the argument by Shanif et al. (2020) that the collective interaction between the audit committee and audit quality plays a stronger role in financial reporting integrity than either mechanism operating in isolation.

5. Concluding Remarks and Recommendation

This study examined the effects of audit quality and the audit committee on financial reporting quality in 31 hospitality-sector companies listed on the Indonesia Stock Exchange during 2019-2023. The key findings are: (1) Audit quality has a significant positive effect on financial reporting quality, driven primarily by KAP Big Four reputation and audit opinion, confirming that high-quality external auditing enhances the credibility and reliability of financial information; (2) Audit committee characteristics size, independence, and financial expertise do not individually show significant effects, suggesting that audit committees in the hospitality sector tend toward symbolic compliance rather than substantive oversight effectiveness; (3) Simultaneously, audit quality and audit committee together have a significant positive effect on financial reporting quality, demonstrating that the synergy of external and internal governance mechanisms collectively improves financial reporting integrity.

Several limitations should be noted. The study is confined to the hospitality sector, which may limit generalizability. The Adjusted R^2 of 9.6% indicates that other unexplored factors contribute substantially to financial reporting quality. Future research should extend to multi-sector analysis, incorporate additional governance variables such as internal audit effectiveness and board characteristics, and consider longer observation periods to obtain more comprehensive evidence. Regulators should strengthen oversight of audit committee effectiveness beyond formal compositional requirements, emphasizing meeting quality and substantive engagement in the financial reporting process. Companies are advised to ensure that audit committees actively, not merely formally, supervise the financial reporting process to minimize information asymmetry genuinely.

Statement of Use of Generative AI

During the preparation of this work, the author used generative artificial intelligence tools to support the scientific writing process. Grammarly was used to check grammar, refine writing style, and improve clarity in scientific writing. All interpretations, analyses, and conclusions presented in this study are the sole responsibility of the author.

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