International Journal of Economics, Business and Innovation Research
https://e-journal.citakonsultindo.or.id/index.php/IJEBIR
E-ISSN : 2964-0865
IJEBIR

Analysis of Internal Audit, Audit Committee, and Board of Commissioners on the Quality of Financial Report Disclosure

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Abstract

The quality of financial report disclosure refers to the extent to which financial information is presented in a timely, transparent, accurate, and complete manner to meet the needs of stakeholders, including investors, regulatory authorities, and the public. Empirical studies show that the effectiveness of internal audits, audit committees, and boards of commissioners plays a crucial role in determining the quality of financial report disclosure. This is particularly relevant in the context of banking companies, which face challenges related to regulations, transaction complexity, and public trust. This research used data from 47 banking companies listed on the Indonesia Stock Exchange (IDX) for the period 2021-2023. The research method employed multiple linear regression analysis. The results show that the number of internal audit members, audit committee members, and board of commissioner members has a significant impact on the quality of financial reports, as reflected in the number of pages in the annual report.

Keywords: Internal Audit, Audit Committee, Board of Commissioners, Financial Report Quality, Bank

INTRODUCTION

The quality of financial report disclosure is a fundamental aspect of good corporate governance and transparency, particularly in the banking sector, which is characterized by high complexity and risk. Banking companies serve as key drivers in the financial system, managing public funds and providing vital financial services. Therefore, transparency and accuracy in financial reporting are essential to maintaining the trust of the public, investors, and regulators. The quality of financial report disclosure refers to the

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extent to which financial information is presented in a timely, transparent, accurate, and complete manner to meet the needs of stakeholders, including investors, regulatory authorities, and the public. International and national financial reporting regulations and standards, such as IFRS (International Financial Reporting Standards) and PSAK (Statement of Financial Accounting Standards) in Indonesia, have established strict standards for financial reporting to ensure consistency and comparability of financial information. In Indonesia, the Financial Services Authority (OJK) and the Indonesia Stock Exchange (IDX) require companies, especially banking companies listed on the IDX, to meet transparent and accountable reporting standards. However, not all companies are able to fully meet these standards, resulting in varying levels of financial report disclosure quality between companies.

Moreover, the occurrence of several financial scandals globally, such as the Enron and WorldCom cases, as well as in Indonesia, such as the Bank Century case, further emphasizes the importance of good corporate governance. These scandals arose from inadequate or even manipulative disclosures that concealed the actual financial condition of companies from the public and investors. This led to significant financial losses for shareholders and diminished confidence in capital markets. Thus, strict oversight is necessary to ensure that financial report disclosures are made in accordance with the principles of good governance.

In the context of corporate governance, internal audit, audit committees, and the board of commissioners play key roles in ensuring the transparency and quality of financial report disclosures. Internal audit functions as a control mechanism aimed at evaluating the effectiveness of internal controls and ensuring that financial reporting is free from material errors and compliant with applicable accounting standards. Effective internal audits can detect potential risks or errors early, enabling companies to take corrective action before financial reports are published. In previous research, Gramling *et al*. (2004) demonstrated that a strong internal audit plays a vital role in improving the quality of financial reporting, especially in companies with well-structured internal controls. Meanwhile, the audit committee is part of the board of commissioners responsible for overseeing the financial reporting and audit process. The audit committee is tasked with monitoring the performance of internal audits and communicating with external auditors. As a liaison between management, internal auditors, external auditors, and the board of commissioners, the audit committee plays a crucial role in maintaining the integrity and transparency of the financial reporting process. According to research by Carcello *et al*. (2002), the presence of an independent and competent audit committee

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has been proven to enhance the quality of corporate financial report disclosures. This is because independent audit committees tend to provide more objective oversight and are not influenced by management interests.

The board of commissioners also acts as the highest supervisory body in corporate governance. The board is responsible for ensuring that the company is managed properly and in the best interests of shareholders and other stakeholders. In the context of financial report disclosure, the board of commissioners plays a key role in reviewing and approving the financial reports prepared by management before they are published. Jensen (1993) stated that an independent board of commissioners with sufficient expertise can provide more effective oversight, which ultimately improves the quality of financial report disclosure. In some cases, weak or non-independent boards of commissioners tend to fail in providing adequate oversight, increasing the risk of violations or manipulation in financial reports.

Empirical studies show that the effectiveness of internal audits, audit committees, and boards of commissioners plays a crucial role in determining the quality of financial report disclosure (Cohen, 2004; DeFond & Zhang, 2014). This is particularly relevant in the context of banking companies, which face challenges related to regulations, transaction complexity, and public trust. Many previous studies have also shown that corporate governance mechanisms, such as internal audit, audit committees, and boards of commissioners, have a significant impact on the quality of financial report disclosure. However, this research focuses more on the banking sector, which has unique characteristics compared to other sectors. In the banking sector, oversight of operational, liquidity, and credit risks is stringent, making the role of internal audit, audit committees, and boards of commissioners even more critical. Banks also face significant pressure from regulators to comply with various strict regulations, particularly regarding timely and accurate financial information disclosure. Therefore, this study is highly relevant as it provides a better understanding of the factors influencing the quality of financial report disclosure in the banking sector. Given the important role of banking companies in the national economy, transparent and accurate financial information disclosure is not only important for investors but also for regulators and the wider public. The results of this study are expected to provide practical contributions for banking companies to improve their governance and the quality of their financial report disclosures. Thus, this research aims to examine the relationship between internal audit, audit committees, and the board of commissioners with the quality of financial report disclosure in banking companies listed on the IDX (2021-2023 period).

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LITERATURE REVIEW

In the framework of corporate governance, there are three main pillars that oversee financial reporting practices, namely internal audit, audit committee, and board of commissioners. These three components interact with each other to create an effective and transparent oversight system.

Internal Audit

Responsible for assessing and ensuring that the company's financial and operational processes comply with applicable standards and regulations. According to Gramling et al. (2004), effective internal audits can detect weaknesses in the internal control system that can affect the quality of financial statement disclosures.

Audit Committee

As part of the board of commissioners, the audit committee plays a central role in overseeing both internal and external audit processes. The effectiveness of the audit committee in maintaining auditor independence and ensuring the integrity of financial reports significantly influences the quality of disclosures (Carcello et al., 2002).

Board of Commisioners

This body serves as the highest authority in corporate governance, responsible for overseeing the overall policies of the company, including the disclosure of financial reports. Jensen (1993) emphasized the importance of the composition and independence of the board of commissioners in creating a healthy oversight environment.

Hypothesis Development

The development of hypotheses in this research aims to explain the relationship between three main corporate governance mechanisms, namely internal audit, audit committee, and board of commissioners, and the quality of financial statement disclosures. This study is grounded in corporate governance theory, agency theory, and empirical findings from previous studies showing that effective corporate governance mechanisms can improve financial reporting quality.

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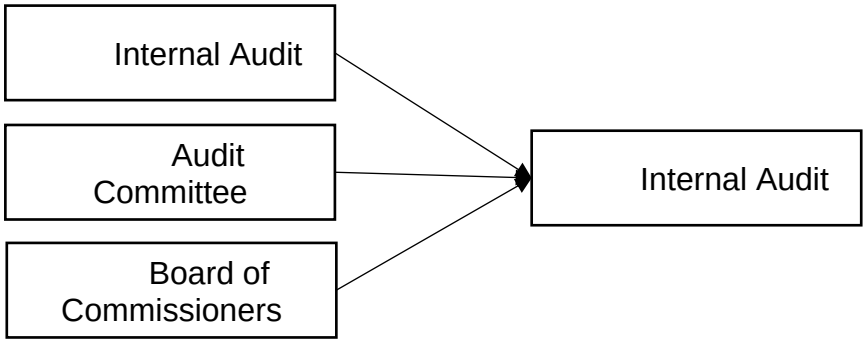


Figure 1 Conceptual Framework

Relationship Between Internal Audit and the Quality of Financial Statement Disclosures

Internal audit is one of the main oversight functions within a company that plays a crucial role in identifying risks, evaluating the effectiveness of internal controls, and ensuring that financial statements are prepared in accordance with applicable accounting standards. In the context of agency theory, internal audits help mitigate agency conflicts between management (agent) and shareholders (principal) by ensuring that the information presented in financial statements accurately reflects the company's financial position. Effective internal audits can detect errors or deviations early and enable companies to make corrections before financial reports are published.

Various studies, such as those conducted by Gramling et al. (2004) and Prawitt et al. (2009), have found that strong and independent internal audits positively contribute to improving the quality of financial reporting. This is due to the internal audit's ability to identify and rectify internal control issues, thereby enhancing the transparency of the reporting process. Effective internal audits can also assist companies in complying with applicable regulations, such as reporting requirements from capital market authorities or banking regulators. The first hypothesis of this study states:

H1: Internal audit has a positive effect on the quality of financial statement disclosures.

Relationship Between the Audit Committee and the Quality of Financial Statement Disclosures

The audit committee is one component of corporate governance that functions as a supervisor of the financial reporting and audit processes, including both internal and

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external audits. The audit committee is responsible for ensuring that financial statements are prepared in accordance with generally accepted accounting principles and monitoring the performance of internal and external auditors. An effective audit committee should be independent, competent, and have adequate access to necessary information for stringent oversight. Several empirical studies, such as those conducted by Carcello et al. (2002) and Klein (2002), show that the presence of an independent and competent audit committee enhances the quality of financial statement disclosures. This is due to stricter oversight of the reporting and audit processes, as well as a commitment to ensuring information transparency. An independent audit committee is more likely to provide objective oversight of management, thus reducing the likelihood of information manipulation or misleading financial statement presentation.

Furthermore, an effective audit committee often serves as the primary link between management, external auditors, and the board of commissioners, ensuring that the audit process proceeds smoothly and that audit findings are followed up with appropriate actions. In a study by Abbott et al. (2004), it was found that the existence of a more independent audit committee that meets regularly correlates positively with the quality of financial statement disclosures. Based on these findings, the second hypothesis of this study is:

H2: The audit committee has a positive effect on the quality of financial statement disclosures.

Relationship Between the Board of Commissioners and the Quality of Financial Statement Disclosures

The board of commissioners serves as the highest supervisory body in corporate governance, responsible for ensuring that management operates the company in the interests of shareholders and other stakeholders. The board of commissioners is responsible for evaluating and approving financial statements before publication and monitoring management's compliance with applicable regulations and policies. In agency theory, an independent and effective board of commissioners can reduce agency conflicts between management and shareholders and enhance the transparency of information presented in financial statements. A board of commissioners with expertise in finance and accounting is also more capable of providing deeper oversight of the quality of financial statements prepared by management.

Researches by Jensen (1993) and Fama and Jensen (1983) demonstrate that independent boards of commissioners with adequate expertise can provide more

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effective oversight, ultimately enhancing the quality of financial statement disclosures. An active board of commissioners can ensure that financial statements are presented transparently and in accordance with applicable accounting standards, and that the risks faced by the company are adequately disclosed to the public. In the banking sector, the role of the board of commissioners is especially important given the operational complexity and high level of regulation that must be adhered to. In this research, the presence of an independent and competent board of commissioners is expected to enhance the quality of financial statement disclosures in banking companies listed on the stock exchange. Thus, the third hypothesis of this study is:

H3: The board of commissioners has a positive effect on the quality of financial statement disclosures.

Relationship Between the Combination of Internal Audit, Audit Committee, and Board of Commissioners and the Quality of Financial Statement Disclosures

This study not only focuses on the individual effects of internal audit, audit committee, and board of commissioners on the quality of financial statement disclosures but also on the combined effects of these three corporate governance mechanisms. A strong combination of effective internal audit, independent and competent audit committee, and experienced and integrity-driven board of commissioners is expected to provide stronger oversight of the financial reporting process. The synergy among these three mechanisms can strengthen the company's internal control system, minimize the potential for errors or manipulation in financial reporting, and ensure that the resulting financial statements are accurate, transparent, and comply with applicable accounting standards. In a study by Beasley et al. (2009), it was found that companies with better governance, characterized by a combination of effective internal audit, audit committee, and board of commissioners, tend to have higher quality financial statement disclosures. Therefore, the fourth hypothesis proposed in this study is:

H4: The combination of internal audit, audit committee, and board of commissioners positively influences the quality of financial statement disclosures.

By formulating the four hypotheses above, this study aims to provide a more comprehensive understanding of how corporate governance mechanisms contribute to enhancing the quality of financial statement disclosures in the banking sector. The results of testing these hypotheses will provide practical insights for companies in improving governance and transparency, as well as for regulators in designing more effective policies to enhance accountability in the banking sector.

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RESEARCH METHOD

This study employed a quantitative approach with secondary data taken from the annual reports of banking companies listed on the Indonesia Stock Exchange (IDX) during the period of 2021-2023. The method of analysis used was multiple linear regression to examine the influence of internal audit, audit committee, and board of commissioners on the quality of financial statement disclosures.

The population of this research consists of all banking companies listed on the IDX during the period of 2021-2023. The sample was selected using purposive sampling, focusing on companies that meet specific criteria, such as the availability of complete financial reports and relevance to audit activities.

This research focuses on the period from 2021 to 2023, which includes the impact of new regulations and policies implemented by the Financial Services Authority (OJK), as well as developments in financial reporting systems in Indonesia. This period also reflects the dynamics faced by banking companies in overcoming post-COVID-19 challenges, where the role of corporate governance has become increasingly crucial in maintaining business sustainability and public trust. Therefore, this study offers a comprehensive analysis of how internal audit, audit committee, and board of commissioners contribute to improving the quality of financial statement disclosures, providing insights for enhancing corporate governance practices in the banking sector in Indonesia.

Research Variables:

1) Independent Variables (X): Internal Audit (X1), Audit Committee (X2), Board of Commissioners (X3)
2) Dependent Variable (Y): The quality of financial statement disclosures, measured by the number of pages in the company's annual report.

The data analysis technique in this research was assisted by SPSS version 16 software, using Multiple Linear Regression Analysis with the following formula:

$$Y = a + b1X1 + b2X2 + b3X3 + e$$

Where:

Y = Quality of Financial Statements
X1 = Number of Internal Auditors
X2 = Number of Audit Committee Members
X3 = Number of Board of Commissioners Members
a = Constant
b1 = Regression coefficient of internal audit

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b2 = Regression coefficient of audit committee
b3 = Regression coefficient of board of commissioners
e = Error term

RESULT AND DISCUSSION

Coefficient of Determination (Adjusted R^2)

Table 1 Coefficient of Determination (R2)

Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.681[a]	.464	.451	204.239

a. Predictors: (Constant). X3. X1. X2

This indicates that all independent variables simultaneously have an influence of 45.1% on the quality of financial statements, as reflected in the number of pages in the annual report. Meanwhile, the remaining 54.9% is influenced by other variables not tested in this study.

Classical Assumption Test

Multicollinearity Test

Table 2 Multicollinearity Test

Coefficients[a]

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.	Collinearity Statistics	
	B	Std. Error	Beta			Tolerance	VIF
1 (Constant)	7.062E-14	60.100		.000	1.000		
X1	.000	.824	.000	.000	1.000	.968	1.033
X2	.000	14.324	.000	.000	1.000	.654	1.528
X3	.000	8.995	.000	.000	1.000	.659	1.517

a. Dependent Variable: Unstandardized Residual

The test can be conducted by observing the Tolerance and Variance Inflation Factor (VIF) values in the regression model. The decision criteria for the multicollinearity test are as follows (Ghozali, 2016):

(a) If the VIF value is ≤ 10 or the Tolerance value is ≥ 0.01, then it is concluded that multicollinearity does not occur.

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(b) If the VIF value is > 10 or the Tolerance value is < 0.01, then it is concluded that multicollinearity occurs.

All VIF values are above 0.01, indicating that the independent variables do not exhibit multicollinearity symptoms.

Heteroscedasticity Test

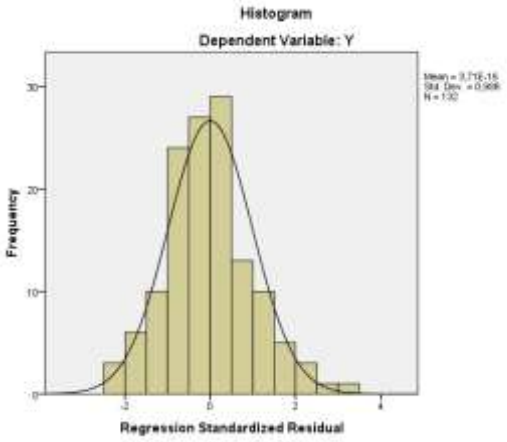


Figure 2 Regression Standardized Residual

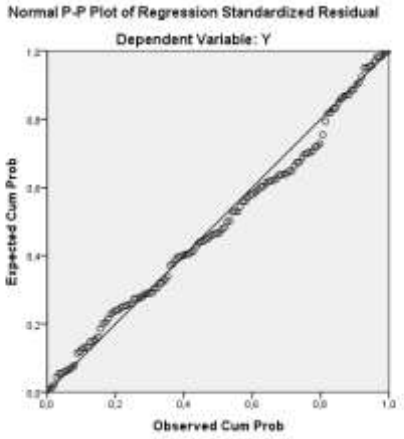
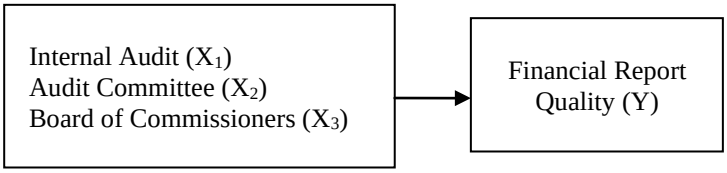


Figure 3 Observed Cum ProdThe histogram data shows a normal distribution. The research model can be illustrated as follows:



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Table 3 Heteroscedasticity Test

Coefficients[a]

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
1 (Constant)	167,523	60,100		2,787	,006
X1	1,636	,824	,131	1,986	,049
X2	52,534	14,324	,293	3,668	,000
X3	51,515	8,995	,457	5,727	,000

a. Dependent Variable: Y

The results of hypothesis testing for Hypothesis 1, which examines the effect of internal audit on the quality of financial reports, show a value of 1.986 with a significance of 0.006, indicating support for the hypothesis. This result demonstrates that internal audit has an impact on the quality of financial reports (proxied by ROI). The more numerous or higher the number of internal auditors a company has, the better the quality of the financial reports, as reflected in the number of pages in the annual report.

Hypothesis 2, which examines the effect of the audit committee on the quality of financial reports, shows a value of 3.668 with a significance of 0.049, indicating support for the hypothesis. The results suggest that the audit committee affects the quality of financial reports, as reflected in the number of pages in the annual report.

Meanwhile, Hypothesis 3, which examines the effect of the board of commissioners on the quality of financial reports, shows a value of 5.727 with a significance of 0.000, also indicating support for the hypothesis. The results suggest that the board of commissioners influences the quality of financial reports, as reflected in the number of pages in the annual report.

(a) Internal Audit: The statistical test results indicate that internal audit has a significant influence on the quality of financial report disclosures. This is in line with the first hypothesis (H_1), which suggests that the more effective the internal audit function, the better the quality of financial report disclosures. Banks with strong internal audits are able to detect errors earlier and correct weaknesses in internal controls.

(b) Audit Committee: The test of the second hypothesis (H_2) also shows significant results. An audit committee that works optimally, with the appropriate expertise and sufficient independence, is able to improve the quality of financial report

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disclosures. An independent audit committee can ensure that financial reports are prepared in accordance with generally accepted accounting principles and are reliable for stakeholders.

(c) Board of Commissioners: The third hypothesis (H_3), which tests the effect of the board of commissioners on the quality of financial report disclosures, is also supported by the analysis results. A board of commissioners with a composition of independent members is better able to provide objective oversight of company management, thereby improving the transparency and quality of financial report disclosures.

CONCLUSION

Based on the research findings, it can be concluded that internal audit, the audit committee, and the board of commissioners have a significant influence on the quality of financial report disclosures in banking companies listed on the Indonesia Stock Exchange (IDX) during the period of 2021-2023. The roles of these three corporate governance elements are crucial in maintaining the transparency and accountability of financial reports.

RECOMENDATIONS

Recommendations for companies are as follows:

(a) Enhancing Internal Audit Effectiveness: Companies should strengthen the internal audit function by providing adequate training and regularly updating internal control procedures.

(b) Strengthening the Independence of the Audit Committee: The audit committee should comprise competent and independent individuals to ensure that financial reports are prepared to high standards.

(c) Increasing the Role of the Board of Commissioners: The board of commissioners should become more involved in overseeing the company's financial management to ensure that the financial report disclosure process is conducted effectively and transparently.

LIMITATIONS OF THE STUDY

Although this study provides significant contributions to the understanding of the relationship between internal audit, the audit committee, and the board of commissioners with the quality of financial report disclosures, there are several limitations to consider:

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(a) Data Limitations: The data used in this study only covers the period from 2021 to 2023, which may not reflect the long-term dynamics of the influence of the three independent variables on the quality of financial report disclosures.
(b) Focus on the Banking Sector: This research is limited to banking companies listed on the Indonesia Stock Exchange (IDX). The findings may not be generalizable to other sectors that have different characteristics in terms of corporate governance.
(c) Other Variables: This study only examines three main factors, namely internal audit, the audit committee, and the board of commissioners. There is a possibility that other factors, such as risk management and the quality of external audits, also play a role in influencing the quality of financial report disclosures.

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