

The Influence of Financial Statement Audit and The Role of Internal Audit on the Quality of Financial Reporting

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Abstract: This study aims to analyze the influence of external financial statement audits and the role of internal audit on the quality of financial reporting within an organization. The quality of financial reports is a critical factor in ensuring transparency, accountability, and informed decision-making by stakeholders. Both external and internal audits play strategic roles in enhancing the credibility and reliability of financial statements. A quantitative approach is used in this research, employing multiple regression analysis. Data were collected through questionnaires distributed to finance staff and internal auditors in various public and private sector companies. The independent variables in this study are financial statement audit (X_1) and internal audit role (X_2), while the dependent variable is the quality of financial reporting (Y). The findings indicate that financial statement audits have a positive and significant effect on financial reporting quality. Similarly, the role of internal audit also shows a significant influence, where the more effective the internal audit function is, the higher the level of accuracy and reliability of the financial reports. These results emphasize the importance of synergy between external and internal auditors in maintaining the integrity of corporate financial reporting.

Keywords: financial statement audit, internal audit, financial reporting quality, transparency, accountability.

INTRODUCTION

Financial statements are a primary medium for communicating an entity's financial information to stakeholders such as management, shareholders, investors, regulators, and the general public (Gilchrist et al., 2023). The quality of these financial reports is crucial, as it forms the foundation for economic and business decision-making. Therefore, financial statements must be prepared in accordance with generally accepted accounting principles and must meet qualitative characteristics such as relevance, reliability, understandability, and comparability (Mesioye & Bakare, 2024).

However, the quality of financial reporting is not solely determined by the accounting systems used; it is also significantly influenced by the auditing process both external and internal (Dewi et al., 2024). An external audit of financial statements serves to provide an independent professional opinion on the fairness of the financial report

presentation, thereby increasing users' trust in the financial information disclosed (Darmawan, 2023). Meanwhile, the internal audit plays a critical role within the organization's internal control system. It functions to evaluate and improve the effectiveness of risk management, control processes, and governance.

With the increasing complexity of business operations and regulatory requirements, the quality of financial reporting has become a key indicator in assessing a company's performance and financial health (Olayinka, 2022). Consequently, it is important to examine how both external audits and internal audit functions contribute to enhancing the quality of financial reporting. Previous studies have suggested that external audits improve transparency and accountability, while a strong internal audit function helps detect and prevent errors or fraud at an early stage.

Based on this background, this study aims to analyze the influence of financial statement audits and the role of internal audits on the quality of financial reporting, particularly in companies operating in Indonesia. The findings of this research are expected to provide both academic and practical insights into efforts to improve financial reporting quality through strengthening audit functions.

Financial reporting serves as the backbone of organizational accountability and transparency. High-quality financial statements enable stakeholders-including investors, regulators, management, and the public to make informed decisions. A reliable financial report must fulfill the qualitative characteristics outlined in financial reporting frameworks, such as relevance, faithful representation, verifiability, timeliness, understandability, and comparability.

However, producing high-quality financial reports requires more than accurate bookkeeping; it necessitates robust auditing mechanisms-both internal and external. External audits conducted by independent auditors enhance the credibility of financial statements by providing reasonable assurance that the reports are free from material misstatement, whether due to error or fraud. Meanwhile, internal audit plays a preventive and detective role by ensuring internal controls are functioning effectively and organizational risks are properly managed. In developing countries like Indonesia, the role of auditing has become more vital due to increasing corporate governance expectations and regulatory requirements. Numerous accounting scandals in both private and public sectors have led to growing concerns regarding the accuracy and integrity of financial reporting. This highlights the importance of assessing how the presence and performance of external audits and internal audit units impact financial reporting quality.

Despite the regulatory requirements for financial audits, there is still variability in the quality of financial reports among organizations. Some entities exhibit strong financial transparency, while others still face issues related to delayed reporting, inconsistent disclosures, or undetected financial misstatements.

THEORETICAL REVIEW

Financial Reporting Quality

Financial reporting quality refers to the extent to which financial statements reflect the true financial condition and performance of an organization (Kaawaase et al., 2021). High-quality financial reports minimize information asymmetry and enhance stakeholders' confidence in reported data. Indicators of reporting quality include timely

disclosure, compliance with accounting standards, consistency, and low levels of earnings management. Audits are conducted professionally and in accordance with current auditing standards to enhance the reliability of financial statements, as this can reduce the likelihood of fraud or manipulation in the evaluation of financial.

Audit and Reporting Quality

Audit and Reporting Quality refers to the reliability, transparency, and accuracy of financial statements presented by an entity, as well as the effectiveness of the audit process in ensuring those statements are free from material errors and misstatements (Babalola et al., 2025). High audit quality reflects the auditor's competence in evaluating internal control systems, identifying risks, and providing an objective and independent opinion (Indah, 2022). This is crucial because investors, stakeholders, and regulators rely heavily on trustworthy financial information to make informed decisions.

Meanwhile, financial reporting quality pertains to how well the financial statements present relevant, honest, and timely information in accordance with applicable accounting standards (Abu Hamour & Malahim, 2023). Factors such as corporate governance, management integrity, and oversight by external auditors play a significant role in enhancing reporting quality (Obasan & Kuola, 2025). The combination of effective auditing and transparent reporting not only increases public trust but also strengthens the overall credibility and stability of the financial sector. In the context of public companies like PT Wismilak Inti Makmur Tbk, fixed assets play a pivotal role not only in supporting production but also in affecting asset turnover, depreciation expense, and ultimately the company's profitability and tax obligations.

Integration of Audit Functions

Integration of Audit Functions refers to the coordination and collaboration among various types of audit activities within an organization such as internal audit, external audit, compliance audit, and risk management functions to enhance efficiency, reduce redundancy, and improve overall audit quality (Tolstyykh et al., 2023). When audit functions are well-integrated, they share information, align objectives, and work towards common goals, such as ensuring financial accuracy, regulatory compliance, and operational effectiveness. This integration also enables a more comprehensive view of the organization's risks and controls.

Effective integration minimizes the duplication of audit efforts, promotes consistency in audit findings, and strengthens internal control systems (Odetunde et al., 2021). It allows internal auditors to provide valuable insights to external auditors, and vice versa, creating a more robust assurance framework. Additionally, integrated audit functions can leverage shared data, technology, and methodologies, leading to better resource allocation and timely identification of issues. Ultimately, the integration of audit functions enhances governance, transparency, and stakeholder confidence.

Theory Agency

Agency Theory is a concept in economics and management that explains the relationship between two parties: the principal (the one who delegates authority) and the agent (the one who receives and acts on that authority) (Alrawashedh, 2025). The theory addresses issues that arise when the principal delegates decision-making power to the

agent, particularly due to information asymmetry and conflicts of interest. The agent may not always act in the best interest of the principal, leading to what is known as the agency problem.

In a business context, this often refers to the relationship between shareholders (principals) and company managers (agents). Shareholders expect managers to operate the company in a way that maximizes shareholder value, but managers may pursue personal goals such as bonuses, job security, or other benefits (Park, 2021). To align the interests of both parties, mechanisms such as auditing, incentive systems, and monitoring are used. Agency Theory serves as a fundamental framework for understanding and improving corporate governance practices (Naz et al., 2022).

Good Governance

Corporate governance refers to the principles governing corporate collaboration and oversight. The role of the audit committee and board of commissioners reflects the level of managerial control within the organization (Arjang & Rahman, 2023). The presence of these two components is expected to strengthen the application of good corporate governance in a more comprehensive and transparent manner. To improve governance effectiveness, Bank Indonesia Regulation No. 14/14/PBI/2012 concerning Financial Transparency and Disclosure in Banks mandates transparency in financial reporting. Enhanced disclosure practices are expected to increase company value for shareholders and motivate issuers to maintain compliance .

Internal auditors must be able to distinguish between morally right and wrong (or illegal) behavior without exception, without bias, and without collusion (Jiang, 2023). They must not operate in a “gray area” where ethical clarity is lacking or where they are reluctant to make decisions-especially not when silence is influenced by bribery or other improper incentives. The audit report must clearly state the scope of activities and responsibilities related to the financial statements to comply with reporting standards.

METHODS

This study employs a quantitative approach using a causal-comparative research design to examine the effect of financial statement audits and the role of internal audit on the quality of financial reporting. The study aims to determine the strength and direction of the relationship between the independent variables and the dependent variable using statistical analysis. The population in this study includes internal auditors, financial managers, and accounting staff of companies listed on the Indonesia Stock Exchange (IDX) as well as selected public sector institutions. The sample was determined using purposive sampling with the following criteria:

- a. Companies or institutions that have undergone external audits.
- b. Entities that maintain internal audit functions.
- c. Respondents who hold relevant positions and have knowledge of the company’s financial reporting process.

A total of 100 valid responses were collected through structured questionnaires distributed via email and online platforms. Primary data were collected through a closed-ended questionnaire using a Likert scale ranging from 1 (strongly disagree) to 5 (strongly agree). The questionnaire consists of three sections:

- a. Financial Statement Audit (based on audit quality indicators)
- b. Role of Internal Audit (based on IIA standards)
- c. Financial Reporting Quality (based on criteria such as timeliness, transparency, and compliance)

Secondary data, such as audit reports and company disclosures, were also used to support the analysis.

Research Variables

- a. Independent Variables:
 - X₁: Financial Statement Audit
 - X₂: Role of Internal Audit
- b. Dependent Variable:
 - Y: Financial Reporting Quality

The instrument was tested using validity and reliability analysis. Validity was tested through Pearson correlation between item scores and total scores. Reliability was tested using Cronbach’s Alpha, with an acceptable threshold of $\alpha > 0.7$, indicating good internal consistency. The data were analyzed using multiple linear regression analysis with the help of SPSS or STATA software. The regression model used is as follows:

$$Y = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \epsilon$$

Where:

- YY = Financial Reporting Quality
- X₁X₁ = Financial Statement Audit
- X₂X₂ = Internal Audit Role
- ϵ = Error term

In addition, classical assumption tests such as normality, multicollinearity, and heteroscedasticity were conducted to ensure the model’s reliability and validity.

RESULTS

Respondent Results

Based on Table 1, most respondents were male and held a Bachelor's degree (57.5%). In terms of education, 25% had a Diploma, 12.5% a Master's, and 5% a Doctorate. The majority (77.5%) had less than five years of work experience. Regarding job roles, 55% were employees, 40% auditors, and 5% supervisors. Descriptive statistics and hypothesis testing results are discussed in later sections.

Table 1. Audit Reliability Test of Financial Statements

No.	Cronbach's Alpha	Number of Items
1	0.634	10
2	0.687	14
3	0.680	14
4	0.634	10

According to the Cronbach alpha statistical approach used in the aforementioned reliability test, findings are significant when a variable's Cronbach alpha value is greater than 0.60 (Ghozali 2011). Each question asked in terms of instrument measurement has

high and sufficient reliability if the variable's Cronbach Alpha value is greater than 0.60. Based on the findings of the aforementioned reliability test, which includes 4 factors-financial statement audit, good governance, internal audit, and financial statement quality-it is determined to be reliable because the reliability value of each variable is > 0.6. Based on the findings of this experiment, it can be concluded that respondents sometimes provide fixed or consistent answers to provide questionnaire content that will not change if used again in the future and to provide explanations for the same items.



Figure 1. Normality Test Results

The distribution of points on the normality plot graph is concluded to follow a diagonal line, based on the normality P-plot graph above. The graph in the figure shows that the regression model can be used realistically because it meets the normality assumption (Ghozali 2011).

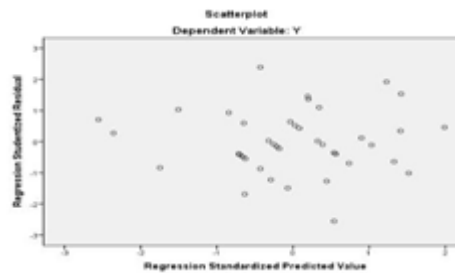


Figure 2. Heteroscedasticity Test Results

The scatterplot above shows no discernible relationship between the expected value of the dependent variable and the residuals, with the points randomly scattered above and below zero on the Y-axis. This indicates that the heteroscedasticity component of the regression model is absent, allowing one to use this regression to predict the truth of the balance sheet based on the influencing variable i.

Table 2. Multicollinearity Test

Model	Unstandardized Coefficients		Standardized Coefficients		Sig.	Collinearity Statistics	
	B	Std. error	Beta	t		Tolerance	VIF
(Constant)	9.009	4.127		2.136	.044		
X1	.444	.114	.421	3.903	.000	.617	1.620
X2	.103	.069	.159	1.495	.144	.609	1.640
X3	.360	.088	.447	4.100	.000	.577	1.732

Since each variable has a tolerance value greater than 0.1 and a VIF value lower than 10, the findings indicate that the regression equation is not multicollinear. Therefore,

it can be concluded that the regression equation model does not have multicollinearity problems, and this study is considered the best.

Table 3. Results of the Determination Coefficient Test

Model	R	R Square	Adjusted R Square	Std. error of the Estimates
1	.868 ^a	.753	.732	.93730

DISCUSSION

The results of other relevant research also need to be explained and compared in this section. The findings of this study indicate that financial statement audits have a positive and significant effect on the accuracy of financial reporting in industrial companies in Malang City. These results suggest that respondents recognize the importance of a strong financial statement audit, which allows companies to present objective, timely, complete, accurate, clear, and straightforward financial reports—ultimately enhancing reporting quality. A robust audit reflects a company that is free from conflicts of interest, particularly those arising between shareholders and management. The findings also highlight that addressing or correcting audit violations is directly linked to improved financial reporting quality. As the audit process becomes more effective, the risk of material misstatements is reduced, making it easier for users to verify the accuracy and reliability of financial statements.

The second finding reveals that good corporate governance has a relatively weak impact on financial reporting quality in industrial companies in Malang City. Good governance is intended to enhance corporate performance through oversight of management behavior and transparent disclosure to stakeholders. Ideally, effective governance enables investors to evaluate financial statements more accurately. However, even though governance practices exist within manufacturing companies, respondents indicated a lack of active participation in social responsibilities, possibly due to limited concern for environmental and community issues. This implies that the actual implementation of governance principles remains limited. The relatively low adoption of good governance practices suggests that many companies are still in the early stages of understanding and applying these principles. Successful implementation of ethical and transparent practices is essential to demonstrate organizational accountability and build trust.

The third finding shows that internal audit significantly influences the quality of financial statements in industrial firms in Malang City. The effectiveness of internal audits is directly correlated with the effectiveness of financial reporting. Internal audit functions are identified as key factors that improve report quality, particularly in areas such as auditor independence, professionalism, and the scope of audit activities. When internal auditors maintain a high level of professionalism and adhere to ethical standards, the credibility and value of financial statements are significantly enhanced. A strong internal audit system contributes to better financial monitoring and more accurate reporting, ultimately supporting stakeholder confidence in the reported financial information.

CONCLUSION

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Based on the results of this study, several key conclusions can be drawn regarding the factors influencing the quality of financial reporting in industrial companies in Malang City. Firstly, financial statement audits have a positive and significant impact on financial reporting quality. Strong external audits enhance the reliability, accuracy, transparency, and timeliness of financial statements. When conducted in accordance with applicable standards, audits serve as a credible mechanism to ensure that financial statements are free from material misstatements and fairly represent a company's financial condition. Secondly, internal audit functions also contribute significantly to improving the quality of financial reporting. Through their independence, professionalism, and comprehensive audit scope, internal auditors help maintain effective internal controls and ensure the integrity of financial data. Their role supports compliance with ethical and regulatory standards, which in turn strengthens stakeholder trust in the financial information presented.

However, good corporate governance was found to have a relatively weak influence on financial reporting quality within the context of this study. The implementation of governance principles remains suboptimal in many of the surveyed companies, particularly in areas such as corporate responsibility and stakeholder engagement. This suggests that companies need to place greater emphasis on transparency, accountability, and ethical management to improve their governance structures. In conclusion, financial audits and internal audit functions are critical components in ensuring high-quality financial reporting. To further enhance reporting practices, companies must not only maintain rigorous audit procedures but also invest in strengthening their corporate governance frameworks.

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