





## Audit committee expertise and political connection towards financial reporting quality with audit quality as a mediator in ASEAN

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### ABSTRACT

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Internal oversight, specifically the work of the audit committee, and external oversight from external auditors can help minimize agency conflicts. Because the government acts as both a principal and an agent simultaneously, the agency relationship is complicated regarding government-owned enterprises. The quantitative approach used in this research involved selecting companies listed on the ASEAN Stock Exchange during the period from 2020 to 2022. A total of 620 firms were included in the sample, yielding 1,860 observations. Panel data regression analysis was employed. The results indicated that although the experience of the audit committee did not enhance audit quality, political connections had a positive effect. Additionally, the study revealed that audit quality served as a mediator in the relationship between the quality of political connections and the standard of financial reports, but it did not mediate the relationship between the competence of the audit committee and the quality of financial reports. The research findings are beneficial for prospective investors, as they should consider the existence of an audit committee, internal political connections, and the quality of audits, since these elements can improve the accuracy of financial statements.

**Contribution/Originality:** The study's novel discovery is how audit quality influences the way political ties affect the caliber of financial reporting. Employing qualified auditors is more common among companies with political clout than among those without.

## 1. INTRODUCTION

Although there is still disagreement about what constitutes a high-quality financial report, there are two general ways to define it. According to the first perspective, a company's performance, which is shown in its profit for the current year, is directly tied to the quality of its financial reports. If the profit for the current year is a reliable predictor of the company's future profit, then financial reporting is considered high-quality (Beneish & Vargus, 2002; Lev & Thiagarajan, 1993; Penman & Zhang, 2002; Richardson & Welker, 2001) or closely linked to operating cash flows in the future (Dechow & Dichev, 2002). According to the second point of view, a company's share performance on the capital market is correlated with the quality of its financial reports. There is more financial reporting information when profit and market returns are closely linked (Lev & Thiagarajan, 1993). This study uses the first perspective, accrual quality, which measures the quality of accounting-based financial reporting.

In the Asia Pacific region, financial reporting fraud is a relatively common occurrence (Sakti, Tarjo, Prasetyono, & Riskiyadi, 2020). Based on a survey conducted by the Association of Certified Fraud Examiners (ACFE) in their 2020 report, financial statement fraud cases in Asia Pacific ranked third out of eight countries, with 198 cases causing an average loss of US\$1,988,000. In the Asia Pacific region, the highest number of cases was reported in Indonesia, with 36 cases, while Thailand had 6 cases. In 2024, financial statement fraud contributed to 5% of the total global economic crime cases. Although this figure is relatively small compared to asset misappropriation (89%) and corruption (48%), it results in the greatest losses among these categories. Fraud in financial statements is currently a prominent topic in news reports across all countries, including Indonesia.

In 2018, PricewaterhouseCoopers (PwC) also conducted a survey in the ASEAN region, which included six countries: Malaysia, the Philippines, Thailand, Singapore, Vietnam, and Indonesia. After Vietnam and the Philippines, Indonesia ranked third in terms of financial reporting fraud in 2018, followed by Thailand, Malaysia, and Singapore. Each year, there are cases of fraud that become problematic. Fraud in financial reports occurs due to encouragement or motivation from various parties, both internal and external, to make the reports appear more attractive to investors or potential investors.

Owners, as shareholders, managers, and agents who operate the business, are distinct entities, according to agency theory. Conflict, specifically a conflict of personal interest (agency conflict), is likely to arise in this type of agency relationship. This conflict arises because managers typically make decisions about managing assets to maximize profits, which are often inconsistent and tend to emphasize their own interests. At the same time, capital owners strive to use funds as efficiently as possible while minimizing risk. Based on agency theory, bonding and monitoring measures are in place to settle disputes between the company's agents and principals. A compensation plan for corporate management is part of the bonding structure. Both internal and external stakeholders carry out these measures under the supervisory framework. The internal arrangement utilizes the responsibilities of the audit committee, which fall within the jurisdiction of the non-executive boards (one-tier system) or the board of commissioners (two-tier system). Nonetheless, external auditors are used in the external supervisory framework.

The audit committee's composition is a crucial component of an effective plan to ensure high-quality financial reports, safeguard stakeholders' interests, and maintain the accuracy of the company's financial statements. The quality of a company's financial reporting is influenced by its internal controls (Lari Dashtbayaz, Salehi, & Safdel, 2019; Kaawaase, Nairuba, Akankunda, & Bananuka, 2021; Madawaki, Ahmi, & Ahmad, 2022). The quality of financial reporting is positively impacted by the audit committee's independence (Mardessi, 2022). The quality of financial reports is influenced by the audit committee's background in accounting and/or finance (Almaqatari, Hashed, Shamim, & Al-Ahdal, 2021; Badolato, Donelson, & Ege, 2014; Bilal, Chen, & Komal, 2018; Kusnadi, Leong, Suwardy, & Wang, 2016; Mardessi, 2022; Safari Gerayli, Rezaei Pitenoei, & Abdollahi, 2021; Salehi & Shirazi, 2016; Zalata, Tauringana, & Tingbani, 2018).

The presence of political ties is another element that influences the quality of financial reports. A nation's economic and political policies are often influenced by the close interaction between the public and private sectors, as reflected in the ownership status of state-owned enterprises. The state's ownership grants it authority over vital industries such as infrastructure, transportation, and energy. However, the management of state-owned enterprises frequently involves politicians and political party elites who also control key decisions related to contracts, investments, and public policies. This enables the government to establish economic policies that can address the needs of the community.

Politicians, particularly those in positions of authority, can use their influence to select directors or other key personnel for state-owned businesses and to distribute funds to them, giving them more access to the state budget. By establishing connections with businesspeople, party members, or even specific factions that can aid in securing political triumphs, this influence can occasionally improve their political standing. Because state-owned enterprises (SOEs) are a part of the public administration, they may benefit from or be impacted by the bureaucracy's performance.

The government has an interest as an implementer in state-owned businesses, specifically in raising state revenue and serving as a business owner to prevent scandals. As an implementer, the government has an interest, but it also has an interest as a business owner who aims to improve management standards for optimal investment returns. Consequently, there is a conflict between the limited resources owned and the amount of resources required. The high number of state-owned corporate executives appointed based on political ties is evidence of this phenomenon. Due to the gaps in connections, this closeness may also hinder state-owned corporate executives from managing the business independently. Unlike private enterprises, which typically have a more selective process for resource allocation due to the absence of political coalition groups, state-owned enterprises often face challenges in resource management. This is a way to avoid scandals that could cost the business money. Nonetheless, it must be acknowledged that many state-owned businesses today demonstrate adequate management. For example, in 2019, Wijaya Karya Public Limited Company was ranked tenth in Forbes Magazine's list of the fifty best companies in Indonesia.

Previous studies have demonstrated that political connections have a reciprocal effect, either enhancing financial report quality, which benefits the corporation, or degrading it. This study assumes that financial report quality is positively influenced by political relationships. From the perspective of stewardship theory, political relationships are advantageous to the business as political agents and principals typically share similar objectives. Conversely, resource dependence theory states that businesses relying on financial sources benefit from political connections, as these connections are closer to resources, making it easier to secure additional funding, including government funding. Some benefits of political connections include reduced competition costs, lowered regulatory requirements, and simplified processes for obtaining government contracts (Chaney, Faccio, & Parsley, 2011). Companies connected to the Soeharto dictatorship in Indonesia, for instance, were given preferential treatment regarding import approvals over their rivals.

It is easier for the government to "bail out" companies with political connections when they are experiencing financial difficulties (Faccio, Masulis, & McConnell, 2006). Even in further research, it was found that companies with political connections pay lower taxes, resulting in reduced operating costs (Faccio, 2010). Previous research has suggested that shareholders actually benefit from companies with political connections (Bunkanwanicha & Wiwattanakantang, 2009; Fisman, 2001; Johnson & Mitton, 2003; Leuz, Nanda, & Wysocki, 2003).

Strong political ties and the resources they hold give businesses excellent access to banks and the government, which can enhance their financial performance and increase their corporate income, among other benefits. Soft budgetary restrictions, easy credit availability, and government guarantees typically benefit politically connected businesses by removing the need for them to engage in earnings management practices (Boubakri, Guedhami, Mishra, & Saffar, 2012). Better financial reporting is more likely to be produced by companies with politically linked directors than by those without (Bona-Sánchez, Pérez-Alemán, & Santana-Martín, 2019; Harymawan & Nowland, 2016; Song, Wang, & Yan, 2011).

Numerous studies have produced contradictory findings regarding the relationship between financial reporting quality and political connections. There is a negative relationship between financial reporting quality and politically connected corporations (Al-dhamari & Ismail, 2015; Bliss & Cooke, 2011; Braam, Nandy, Weitzel, & Lodh, 2015; Bushman & Smith, 2001; Chaney et al., 2011; Correia, 2014; Fan & Wong, 2002; Hashmi, Brahmana, & Lau, 2018; Huang, Cheng, Li, & Wei, 2014; Leuz et al., 2003; Mohammed, Ahmed, & Ji, 2017; Narayanaswamy, 2013; Piotroski, Wong, & Zhang, 2015; Tessema, 2020). Companies that have political connections tend to manipulate the presentation of company profits (Braam et al., 2015). Companies with political connections have much lower-quality financial reporting than those without (Hashmi et al., 2018). Accounting conservatism measures how negatively political influence impacts the caliber of financial reporting (Mohammed et al., 2017). This shows that political connections can also cause information asymmetry problems.

The conflicting results of previous research on the influence of audit committee expertise and political connections on the quality of financial reports open the door to other factors that may serve as mediating variables.

In this study, audit quality acts as a mediating variable. The public is concerned about audit quality due to numerous cases of fraud and financial report manipulation. Recent international accounting scandals have heightened concerns regarding the quality of financial reporting (Klai & Omri, 2011). An instance of financial manipulation is the Enron case in the United States, where investor confidence was damaged by the false reporting of 600 million dollars in earnings. After auditing Enron for nearly 20 years, auditor Arthur Andersen was blamed for its lack of independence. The Sarbanes-Oxley Act (SOX), passed in July 2002 in response to this crisis, enforces more stringent audit procedures, including prohibiting audited clients from using non-audit services. Nonetheless, accounting fraud still occurs.

As a supervisory tool, the audit committee and external auditor have important responsibilities regarding the company's financial statements. The Board of Commissioners must receive the Audit Committee's recommendations for the employment of public accountants and public accounting firms before they can be presented at the General Meeting of Shareholders. This ensures that the audit committee's input is considered when selecting a public accounting firm that offers higher-quality attestation and audit services. The presence of effective internal control and auditing processes facilitates the external audit conducted by the public accounting firm and is generally related to the audit fees incurred for external auditing. However, the audit committee cannot oversee all aspects of financial statements, as management holds the primary authority and responsibility for overseeing the company's accountants during the financial statement preparation process (Iatridis & Dimitras, 2013). Consequently, the company's financial statements fail to adequately reflect the impact of the audit committee. When an external auditor conducts a thorough audit, there tends to be a stronger link between the experience of the audit committee and the quality of the company's financial statements. The audit committee's ability to support the board of commissioners in upholding the integrity of financial statements is enhanced by the involvement of qualified auditors. Greater experience on the audit committee is associated with higher audit quality (Ghafran & O'Sullivan, 2017).

Furthermore, several studies show that if politically connected businesses refrain from engaging in self-dealing or rerouting corporate resources through their ties, they will prioritize high-quality financial reporting to ensure that external investors value this trait. Politically linked businesses have a higher chance of hiring certified auditors than non-connected ones (Dyck & Zingales, 2004). This perspective is supported by research on the relationship between political connections and auditor selection, which indicates that companies with political ties are more likely to hire qualified auditors (Guedhami, Pittman, & Saffar, 2014). Additionally, they note that businesses with political influence in nations with very weak institutional frameworks, such as Indonesia (7.7% of the sample), are more likely to hire certified auditors. The firm's institutional context, which affects agency costs, influences the relationship between political ties and agency costs (Boubakri et al., 2012; Khan, Mihret, & Muttakin, 2016).

Every annual financial report that publicly traded firms publish must first pass an audit under the guidelines established by the Capital Market and Financial Institution Supervisory Agency. Encouraging public accounting firms to improve the quality of their audit performance outcomes is the goal of the financial report audit. Companies can use audit services, which are considered impartial, to review financial statements. The audit services in question are supplied by external auditors who work for public accounting firms. Public accountant-audited financial accounts are more trustworthy. Users of financial statements and other services rendered by public accountants have a high level of trust in them. Therefore, the quality of the audit is important. To enhance the report's credibility, the company hires a public accounting firm with a solid reputation. The quality of financial statements is influenced by audit quality (Almaqtari et al., 2021; Alzeban, 2020a, 2020b; Alzoubi, 2018; Guedhami et al., 2014; Pham, Ho, Nguyen, Pham, & Bui, 2023). Specialization in the auditing profession lowers the possibility of earnings manipulation, which enhances the caliber of financial reporting (Alzoubi, 2018; Soroushyar, 2023). There are studies that discover conflicting outcomes, in addition to those that support the idea that external audit and the quality of financial reporting are positively correlated. Financial reporting quality is unaffected by audit quality (Khalil, 2022).

This study examines businesses listed between 2020 and 2022 on the stock exchanges of several ASEAN nations. The limited number of prior studies that employed ASEAN as the research population led to the selection of ASEAN as the scope of the study. However, not all ASEAN member nations were included, as some Brunei Darussalam, Laos, Myanmar, Cambodia, and Timor-Leste do not yet have developed capital markets. The study focuses on the Philippines, Indonesia, Malaysia, Singapore, Thailand, and Vietnam, which comprise the six ASEAN nations involved. The ASEAN Exchanges website was developed in collaboration with these six nations. These countries have significant capital market potential; their combined gross domestic product, with a population of 538 million, amounts to US\$1.8 trillion, making them the ninth-largest market by GDP. According to ASEAN Exchanges, this partnership aims to promote cross-border cooperation, facilitate access to ASEAN markets, develop ASEAN-focused products, and implement targeted marketing campaigns to foster the growth of the ASEAN capital market. The period from 2020 to 2022 was selected to evaluate the quality of financial reporting by businesses. Furthermore, a forward-looking ASEAN will contribute significantly to the global community and advance ASEAN's shared interests, in line with the ASEAN 2020 vision. Research on the quality of financial reports using businesses registered in ASEAN nations during this period is considered appropriate for the reasons outlined above.

The quality of a company's financial statements and the audit committee's experience may be influenced by an exceptional audit conducted by an auditor. The audit committee's ability to fulfill its role in enforcing financial reporting requirements will be enhanced by the presence of a qualified auditor. Furthermore, companies with political ties are more likely than those without to employ qualified auditors (Dyck & Zingales, 2004). Firms with political power prefer qualified auditors to assure investors that the firm is being operated properly (Guedhami et al., 2014; Harymawan & Nowland, 2016). This study is unique in that it evaluates the quality of financial statements from ASEAN companies using a sample.

To enhance the quality of financial reports, the findings of this study can contribute to the scientific understanding of audit committee expertise, political ties, and audit quality. The study's results elucidate the applicability of agency, stewardship, and resource dependence theories in explaining the phenomenon and the plan to achieve high-quality financial reports through audit committee experience, political connections, and audit quality. Regarding the importance of audit committee experience, political ties, and audit quality in improving the caliber of financial reports, these findings also assist investors and regulators in considering these factors when making judgments and establishing regulations.

The study's conceptual framework is a conceptual model that illustrates how variables or elements identified as issues relate to one another. Figure 1 displays the study's conceptual framework.

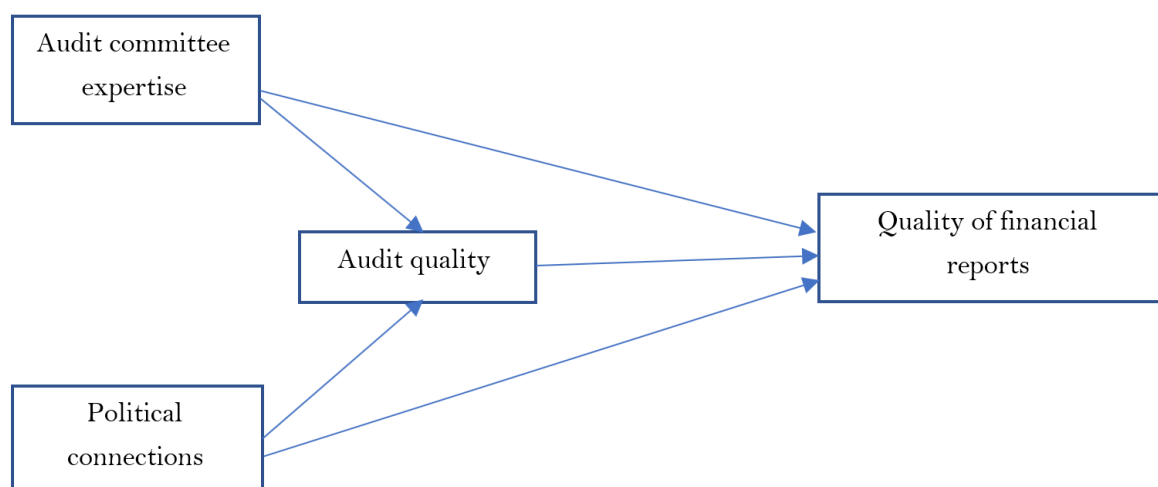


Figure 1. Research concept.

The hypothesis formulation that can be proposed is:



*H<sub>1</sub>: The expertise of the audit committee positively affects the quality of financial reports.*

*H<sub>2</sub>: Political connections have a positive effect on the quality of financial reports.*

*H<sub>3</sub>: Audit quality has a positive effect on the quality of financial reports.*

*H<sub>4</sub>: Audit committee expertise has a positive effect on audit quality.*

*H<sub>5</sub>: Political connections have a positive effect on audit quality.*

*H<sub>6</sub>: The expertise of the audit committee positively influences the quality of financial reports by enhancing audit quality.*

*H<sub>7</sub>: Political connections positively impact the quality of financial reports by improving audit quality.*

## 2. METHODOLOGY

All companies registered on the ASEAN Stock Exchange that is, companies listed on the stock exchanges of Indonesia, Singapore, Thailand, Malaysia, the Philippines, and Vietnam from 2020 to 2022, comprise the study's population. Table 1 presents the results of the systematic sampling process used to determine the research sample. This study employed a purposive sampling technique, which involves selecting non-random samples based on specific criteria relevant to the study's objectives. The following criteria were used to select the sample: 1) Businesses listed on the ASEAN Stock Exchange between 2020 and 2022; 2) Businesses without losses or negative cash flow issues; 3) Businesses with comprehensive financial and annual report data. Table 1 on the determination of research samples.

**Table 1.** Determination of research samples.

No.	Criteria	FLP	IND	MLY	SGR	THE	VN
1	Companies listed on the stock exchanges are Indonesia, Singapore, Thailand, Malaysia, the Philippines, and Hanoi, Vietnam.	284	886	1004	584	854	288
2	The company experienced losses and negative cash flow.	(201)	(671)	(762)	(415)	(556)	(248)
3	Companies with incomplete annual report and financial report data	(33)	(99)	(72)	(69)	(134)	(20)
Number of sample companies		50	116	170	100	164	20
Observation year (Year)		3					
Number of sample companies per year		150	348	510	300	492	60
Total number of samples		1,860					

**Note:** Information:  
 FLP: Country of Philippines.  
 IND: Indonesian country.  
 MLY: Country of Malaysia.  
 SGR: Country of Singapore.  
 THD: Country Thailand.  
 VN: Country of Vietnam.

The accrual quality is used in this study to gauge the caliber of financial reporting (Dechow & Dichev, 2002). Previous studies that primarily employ accrual quality as a measure of financial report quality serve as the basis for choosing accrual quality as the assessment of financial report quality. The correctness of accounting data is the main focus of the quality attribute known as accrual quality. The premise behind utilizing accrual quality as a substitute for financial report quality is that it provides information about the business's activities and estimates future cash flows.

$$WCit = \Delta CAit - \Delta CLit$$

$$WCit = \alpha + \beta_1 CFOt_{-1} + \beta_2 CFOt + \beta_3 CFOt_{+1} + \varepsilon \quad (1)$$

Information:

WCit = Working Capital of company i in period year t.

CFOt = Cash from Operation of the company i in period year t.

$\varepsilon$  = Error.

All variables are divided by the total assets of the previous year. From the regression equation, the residual variable is derived. High residuals indicate poor accrual quality, while low residuals indicate good accrual quality. To facilitate analysis, the residual variable is multiplied by -1; thus, the higher the residual, the higher the accrual quality.

The Audit Committee was established to assist the Board of Commissioners in overseeing financial reporting, audits, and compliance with relevant regulations. An audit committee is mandatory in countries such as Vietnam, Malaysia, Thailand, Singapore, and Indonesia. Members are required to have a solid background in finance or accounting. The independent variable is the level of knowledge of the audit committee, determined using information from the company's annual report. This includes the educational background and professional experience in the accounting or finance industry. The committee is considered competent in these areas if it meets one of the following criteria: possessing a background in accounting and/or finance education. Educational background is indicated by the degree obtained (S1, S2, or S3) and work experience in finance and/or accounting. To assess the proficiency of the audit committee, when members meet the requirements such as holding a degree in accounting or finance and having work experience the expertise variable is determined by the proportion of members with accounting and/or financial knowledge (Habbash & Alghamdi, 2015).

Political connection is a relationship between two parties in which one party has a political interest. The relationship is established to gain an advantage for both parties. Political relations in state-owned enterprises are a tool that supports company performance because the company is part of the public administration, so it complies with its governance and leadership schemes. They can benefit from or be influenced by the performance of their bureaucracy. In this study, the measurement of political connections is carried out by examining the ownership status of the company; if the company is a state-owned enterprise listed on the stock exchange in several ASEAN countries, it is considered to be politically connected. State-owned enterprises are companies whose shares are mostly or entirely owned by the government. This study measures the political connection variable with a dummy variable. The variable in question assigns the number one (1) to state-owned enterprises and zero (0) to those that are not.

Research indicates that the AQMS (Audit Quality Metric Score) approach is a substitute for audit quality and represents the elements of independence, including client importance (CI), reporting quality of the audit report (RQA), and competence, which encompasses public accounting firm size, auditor industry specialization, and audit tenure. The score for the Audit Quality Metric is calculated using the highest AQMS score namely, a value of five to weight the total scores of the five public accounting firms' audit quality proxies for client I in year t.

Utilizing the conceptual framework established earlier, the analytical approach for this study involves panel data regression analysis conducted with STATA software. When a multiple regression's independent variable exerts both direct and indirect influences on the dependent variable, path analysis serves as a method for examining the causal relationships that arise. The equation for path analysis is presented below.

$$\text{Sub Structure 1: } K L K = \beta_0 + \beta_1 K K A + \beta_2 K P + \beta_3 K A + \varepsilon_2 \quad (2)$$

$$\text{Sub Structure 2: } K A = \beta_0 + \beta_1 K K A + \beta_2 K P + \varepsilon_1 \quad (3)$$

Information:

KLK: Quality of Financial Reports.

KKA: Audit committee expertise.

KP: Political Connections.

KA: Audit Quality.

$\varepsilon_{1,2}$ : Error.

The analysis of mediating variables was conducted using the causal step method (Baron & Kenny, 1986). Indirect effects testing with STATA software is another method for testing mediating variables.

### 3. RESULTS

Using the lowest, maximum, average, and standard deviation values, descriptive statistics aim to describe the research sample. Table 2's descriptive statistics demonstrate that the average financial report quality (KLK) is 0.00. The average audit committee expertise (KKA) is 3.33. The average political connections (KP) in the company is 0.02. The average audit quality (KA) of the company is relatively high, at 3.48.

**Table 2.** Descriptive statistics.

Variables	N	Minimum	Maximum	Average	Standard deviation
KLK	1.860	-0.93	0.84	0.00	0.12
KKA	1.860	1.00	7.00	3.33	0.69
KP	1.860	0.00	1.00	0.02	0.14
KA	1.860	2.00	5.00	3.48	0.80

The research model testing is described in Table 3, which shows the best model for each hypothesis.

**Table 3.** Model testing results.

Model	Model testing			Model best
	<i>Chow test</i>	<i>Hausman test</i>	<i>LM test</i>	
1	<i>F statistic</i> = 1.00 Prob. = 0.5140	<i>Chi square</i> = 0.32 Prob. = 0.8501	<i>Chi square</i> = 0.00 Prob. = 1.000	CE
2	<i>F statistic</i> = 11.36 Prob. = 0.0000	<i>Chi square</i> = 1.05 Prob. = 0.2135	<i>Chi square</i> = 1111.79 Prob. = 0.0000	RE

This implies that the common effect model is the most effective for predicting the relationship between audit committee experience, political connections, audit quality, and financial reporting quality. The best model for forecasting how political connections and audit committee expertise affect audit quality is the random effect model.

Model 1 tests the effect of audit committee expertise (KKA), political connections (KP), and audit quality (KA) on financial report quality (KLK). The complete test results are presented in Table 4.

**Table 4.** Hypothesis testing results model 1.

Dependent variable = financial report quality (klk)				
Variables	Coefficient value		Statistical value t	Probability value
KKA	$\beta_1$	0.0621	2.820	0.003*
KP	$\beta_2$	0.0466	2.730	0.005*
KA	$\beta_3$	0.0090	2.100	0.008*
Constants	$\alpha$	-0.0754	-4.300	0.000*
R <sup>2</sup> = 0.4135				
Prob > F = 0.000				

**Note:** The \* sign indicates significance at the  $\alpha = 5\%$  level.

The random effect equation model for Model 1 is obtained as follows.

$$KLK = -0.0754 + 0.0621KKA + 0.0466KP + 0.0090KA \quad (4)$$

The audit committee expertise (KKA) test findings reveal that a p-value lower than the alpha level ( $0.003 < \alpha = 0.05$ ) indicates a significant influence of the audit committee's experience on the quality of financial reports (KLK). The positive regression coefficient ( $b_1=0.0621$ ) related to the audit committee's competence suggests a one-way effect on financial report quality. This result supports the acceptance of Hypothesis 1.

Furthermore, a p-value that is less than the alpha value ( $0.005 < \alpha = 0.05$ ) shows that political ties significantly affect the quality of financial reports, based on the evaluation of political connections (KP) on financial report quality (KLK). Political ties have a unidirectional impact on the quality of financial reporting, as indicated by the positive regression coefficient ( $\beta_2=0.0466$ ). This finding suggests that Hypothesis 2 is approved.



The findings of the audit quality test (KA) on financial report quality (KLK) indicate that audit quality significantly affects financial report quality, with a p value less than the alpha value ( $0.008 < \alpha = 0.05$ ). The influence of audit quality on financial report quality has a unidirectional effect, as indicated by the positive regression coefficient ( $\beta_3=0.0090$ ). This finding suggests that Hypothesis 3 is approved. The quality of financial reports improves with the company's audit quality.

The expertise of the audit committee (KKA), political connections (KP), and audit quality (KA) account for 41.35% of the variance in financial report quality (KLK), according to Model 1's R-squared value of 0.4135. Other factors not included in the research model account for the remaining 58.65%. The results of the F statistical test are smaller than alpha ( $\text{Prob} > F = 0.000 < \alpha = 0.05$ ) indicating that the independent variables have a simultaneous influence on the dependent variable.

Model 2 examines how political ties (CP) and audit committee expertise (ACE) affect audit quality (AC). Table 5 displays all of the test findings.

**Table 5.** Hypothesis testing results model 2.

Dependent variable = Audit quality (AC)				
Variables	Coefficient value		Statistical value t	Probability value
KKA	$\beta_4$	0.0345	1.150	0.310
KP	$\beta_5$	0.3221	2.860	0.003*
Constants	$\alpha$	2.2381	26.15	0.000*
R <sup>2</sup> = 0.4127				
Prob > F = 0.000				

**Note:** The \* sign indicates significance at the  $\alpha = 5\%$  level.

The random effect equation model for Model 2 is obtained as follows.

$$KA = 2.2381 + 0.0345KKA + 0.3221KP \quad (5)$$

The results from the audit committee expertise (KKA) evaluation regarding audit quality (KA) show that the expertise of the audit committee does not significantly influence audit quality, as evidenced by a p-value greater than the alpha value ( $0.310 > \alpha = 0.05$ ). The influence of audit committee experience on audit quality is one-directional, as demonstrated by the positive regression coefficient ( $\beta_4 = 0.0345$ ). This result indicates that hypothesis 4 is not supported.

The results of testing political connections (KP) on audit quality (KA) show a p-value smaller than the alpha value ( $0.003 < \alpha = 0.05$ ), which means that political connections have a significant effect on audit quality. The regression coefficient of the effect of political connections on audit quality is positive ( $\beta_5=0.3221$ ), indicating a unidirectional influence. This result indicates that Hypothesis 5 is accepted. The greater the political connection within a company, the higher the quality of its audit.

Model 2's R square value of 0.4127 indicates that 41.27% of the diversity in audit quality (KA) can be explained by the audit committee's (KKA) experience and political ties (KP). The remaining 58.73% is due to other factors that are not part of the research model. Because the independent variables are less than alpha ( $\text{Prob} > F = 0.000 < \alpha = 0.05$ ), the results of the F statistical test indicate that they have an influence on the dependent variable simultaneously.

Baron and Kenny (1986) methods are followed in the audit committee expertise (KKA) test findings on the quality of financial statements (KLK) through audit quality (KA). Using Model 1, the first step is to examine the relationship between the audit committee competence variable and financial statement quality. The p-value is less than 0.05 (0.003), indicating that the relationship is significant. In the second stage, the quality of the audit statement, as described in Model 2, is tested in relation to the audit committee's expertise variable. The p-value is 0.310, which is greater than  $\alpha = 0.05$ , indicating that the relationship is not significant. The final step assesses the relationship between financial statement quality in Model 1 and the audit quality variable, showing that the p-value is less than 0.05 (0.008). Consequently, the audit quality variable cannot serve as a mediator between the audit committee's

expertise and the quality of financial statements. The indirect effect (intervening) test, which examines the impact of audit committee expertise (KKA) and political links (KP) on quality, can also be used to evaluate the results using Stata software. The comprehensive test results are displayed in Table 6.

**Table 6.** Hypothesis testing results 6.

Variables	Coefficient value		Statistical value t	Probability value
Indirect influence				
KKA -> KA -> KKK	$\beta_6$	0.0006	1.830	0.067
R2 = 0.3872				

The results of the evaluation of audit committee expertise (KKA) in relation to financial report quality (KKK) using audit quality (KA) show a p value greater than the alpha value ( $0.067 > \alpha = 0.05$ ), indicating that audit quality is not a mediator of the relationship between audit committee expertise and financial report quality. The impact of audit committee knowledge on financial reports through audit quality is represented by a positive regression coefficient ( $\beta_6=0.0006$ ). In conclusion, the hypothesis testing findings indicate that Hypothesis 6 is not supported.

The outcomes of examining political connections (KP) in relation to the quality of financial reports (KKK) through audit quality (KA) adhere to the methodology established by Baron and Kenny (1986). The initial step involves analyzing the relationship between the variables of political connections and the quality of financial reports according to Model 1. The results show that if the p-value =  $0.005 < \alpha = 0.05$ , it means that the path is significant. The second step is to test the relationship between political connection variables and audit quality according to Model 2. The results show that if the p-value =  $0.003 < \alpha = 0.05$ , it means that the path is significant. The third step is to test the relationship between audit quality variables and financial report quality according to Model 1. The results show that if the p-value =  $0.008 < \alpha = 0.05$ , it means that the path is significant. Based on the test results with the Baron and Kenny (1986) approach, the test results meet the assumption of mediation variables. Audit quality variables can serve as mediators in the influence of political connections on the quality of financial reports.

Stata software can also be used to analyze the findings of the indirect effect (intervening) test, which measures how political connections (KP) affect financial report quality (KKK) through audit quality (KA). Table 7 summarizes the full test findings.

**Table 7.** Hypothesis testing results 7.

Variables	Coefficient value		Statistical value t	Probability value
Indirect influence				
KP -> KA -> KKK	$\beta_7$	0.0028	2.220	0.027*
R2 = 0.3872				

**Note:** The \* sign indicates significance at the  $\alpha = 5\%$  level.

Testing the impact of political connections (KP) on financial report quality (KKK) through audit quality (KA) yielded results with a p value less than the alpha value ( $0.027 < \alpha = 0.05$ ), suggesting that the influence of political ties on the caliber of financial reports may be mitigated by audit quality. Political ties' impact on financial report quality through audit quality has a positive regression coefficient ( $\beta_7= 0.0028$ ). Overall, the results of the hypothesis testing indicate that Hypothesis 7 is accepted.

The nature of audit quality mediation in mediating the influence of political connections on the quality of financial statements is examined by comparing the significance and coefficients of direct and indirect influences. Based on the test results, the significance of the direct influence is 0.005, and the significance of the indirect influence is 0.027. The direct influence coefficient is 0.04667, and the indirect influence coefficient is 0.0028. These results indicate that the mediation is of a complementary (partial mediation) nature, meaning that political connections can directly influence the quality of financial statements or indirectly through audit quality.

#### 4. DISCUSSION

The test findings demonstrate that the audit committee's experience positively impacts the quality of financial reports. The investigation's findings are consistent with agency theory. When the agent is thought to know more than the principal, the relationship between the two parties may result in asymmetric information. Since agency theory assumes that both the principal and the agent want to maximize their own interests, the agent will act to conceal information that the principal is unaware of. This allows the agent to manipulate earnings and alter the accounting figures of the financial statements without being noticed. One of the agents of the concept has been identified as the audit committee. Consequently, it is anticipated that an audit committee will enhance the quality of financial reporting and prevent fraud.

One important element of governance reform is the audit committee (Ghafran & O'Sullivan, 2017). The audit committee's theoretical foundation is agency theory, which states that a well-designed audit committee should enhance governance, particularly through improved financial reporting and audits. Bonding and monitoring arrangements are based on agency theory and are used to resolve disputes between agents and principals. The bonding structure incorporates corporate management and management compensation programs. It is implemented through supervisory arrangements by both external and internal parties. The internal arrangement utilizes the audit committee's duties, which are under the purview of the board of commissioners (two-tier system) or non-executive boards (one-tier system).

Regulations in Indonesia are governed by Financial Services Authority Regulation Number 55/POJK.04/2015, which addresses the formation of the audit committee and its implementation guidelines. It requires at least three members representing both external parties and independent commissioners. Members must possess high integrity, expertise in accounting or finance, an understanding of capital market laws and regulations, and effective communication skills. Bursa Malaysia oversees Malaysian regulations through listing requirements. The audit committee must have a minimum of three members, most of whom are independent directors and all are non-executive directors. At least one member must meet the standards for membership in accounting or finance. Thailand's regulations are supervised by the Securities and Exchange Commission (SEC) Thailand, requiring at least three individuals, all of whom must be independent directors. At least one member must be knowledgeable in accounting or finance. The Singapore Exchange (SGX) monitors Singaporean legislation through the Code of Corporate Governance and Listing Rules. The committee must have at least three members, all non-executive directors, with the majority being independent directors. At least two members need to be knowledgeable in accounting or finance. The Vietnamese Ministry of Finance oversees corporate governance via circulars and directives related to corporate governance. The audit committee of public companies must be composed of members of the Supervisory Board, with the majority being independent. Members must have expertise in accounting, finance, law, or other relevant fields. The Securities and Exchange Commission (SEC) of the Philippines governs audit committee standards through the Corporate Governance Code. The committee must have at least three members, with the chairperson and the majority of other members being independent commissioners. Additionally, at least one member must have adequate competence in accounting or finance.

According to broader research on audit committees, studies seem to provide some empirical support for the importance of having members with both accounting and financial expertise. Members with financial expertise, particularly in accounting, are better equipped to monitor financial reporting processes and ensure the production of high-quality financial reports, as the primary responsibility of the audit committee is to oversee the company's financial operations (Kusnadi et al., 2016). The quality of financial reporting is closely linked to the quality of internal audits (Kaawaase et al., 2021). Internal control in the company will affect the quality of financial reports (Lari Dashtbayaz et al., 2019). The quality of financial reports is influenced by internal auditing quality, internal control activities, and coordination between internal and external auditors (Madawaki et al., 2022).

The audit committee's experience has a favorable effect on the caliber of financial reports (Almaqtari et al., 2021; Badolato et al., 2014; Bilal et al., 2018; Gebrayel, Jarrar, Salloum, & Lefebvre, 2018; Kusunadi et al., 2016; Luvisi & Waweru, 2024; Mardessi, 2022; Obeitoh, Samaila, & Kantudu, 2024; Safari Gerayli et al., 2021; Salehi & Shirazi, 2016; Zalata et al., 2018). The efficiency of the company's internal governance procedures, such as the audit committee, internal audit, and its associations, is linked to the caliber of financial reporting. The experience of the audit committee directly contributes to high-quality financial reporting, which significantly affects the standard of financial reporting in financial services companies in Nigeria (Obeitoh et al., 2024). A positive and statistically significant relationship exists between audit committee expertise, particularly the presence of financial and industry experts, and earnings quality at Tier One banks, indicating that such expertise enhances financial reporting quality (Luvisi & Waweru, 2024).

The findings of the study demonstrate that political ties enhance the quality of financial reports. These findings align with the perspectives of resource dependence theory and stewardship theory. From the standpoint of stewardship theory, political relationships are advantageous to businesses because politicians act as agents, and principals typically share similar objectives. Within the framework of stewardship theory, agency costs often a concern in agency theory can be reduced. However, according to resource dependence theory, companies that rely on financial sources benefit because political connections are closer to resources, which ultimately facilitates access to other funding sources, including government funding.

Political ties as an external force can influence how an organization responds to resource requirements that support the company's sustainability. Businesses typically develop political ties to obtain benefits or conveniences such as government subsidies, tax exemptions, market dominance, and similar advantages (Al-dhamari & Ismail, 2015). Politically connected businesses typically have advantages such as easy access to finance, flexible budgetary restrictions, and government guarantees, which eliminate the need for profit management practices (Boubakri et al., 2012).

Companies with politically connected directors are more likely to have better-quality financial reporting than those without such connections (Song et al., 2011). The strong political ties and resources owned by the firm provide it with access to banks and the government, which could enhance its financial performance. For example, it might increase income to improve the quality of its financial reports. Soft budgetary restrictions, easy credit availability, and government guarantees typically benefit politically connected businesses by removing the need for earnings management practices (Boubakri et al., 2012). Financial reports will more accurately depict current financial situations if earnings management actions are curtailed. Financial reports may become of higher quality as a result. Transparent information from high-quality financial reports enables creditors, investors, and other stakeholders to make more informed financial decisions. Reducing earnings management also improves market trust, fortifies the company's financial integrity, and lowers the possibility of fraud and lawsuits that could harm the business in the future.

The quality of financial reports is positively impacted by political ties that are regulated by political stability and government efficacy (Almarayeh et al., 2024; Alsmady, 2023; Bona-Sánchez et al., 2019; Harymawan & Nowland, 2016). Family businesses with political ties are more transparent about their revenues than those without (Bona-Sánchez et al., 2019). Political connections can improve the quality of a company's financial reports. Politically connected companies often demonstrate better performance because they can select higher-quality financial reporting by involving the Big 4 auditors (Almarayeh et al., 2024). In Jordanian firms, political connections can maintain the positive effect of accounting information quality, acting as a governance mechanism that reduces information asymmetry (Alsmady, 2023). Politically connected businesses will select top-notch auditors to prevent insiders from falsifying their financial reports, thereby improving the quality of the financial reports produced (Guedhami et al., 2014).

The test results indicate that the quality of audits positively influences the quality of financial reports. According

to agency theory, the need for independent auditor services can be explained by the interaction between management (agent) and owners (principals). Conflicts between primary stakeholders, such as shareholders (investors), and management (board of directors) are common as businesses grow in size. The assumption that a company's management will consistently optimize its value is not always valid. Due to asymmetric information, management's personal interests may conflict with those of the business owners, creating what is known as the agency dilemma. To mitigate this issue, an impartial third party an independent auditor is necessary to mediate the dispute.

A qualified auditor assists in overseeing financial statements as part of the external monitoring role. Maintaining the quality of financial statements is supported by a reputable auditor knowledgeable about the company's sector. To examine financial accounts, the company can utilize independent audit services. These services include the work of an external auditor employed by a public accounting firm. Financial statements that have been audited by a public accountant are generally more reliable. Users of financial statements and other services provided by public accountants tend to trust them significantly. Therefore, the quality of the audit is crucial. To enhance the credibility of the report, the company hires a public accounting firm with a strong reputation.

The quality of audits has a beneficial effect on the caliber of financial reporting (Almaqtari et al., 2021; Alzeban, 2020a, 2020b; Alzoubi, 2018; Guedhami et al., 2014; Pham et al., 2021; Zhong, 2024). By guaranteeing accurate and trustworthy reporting, audit quality significantly enhances the caliber of financial reporting. High-quality audits are essential for identifying fraud in financial reports and elevating reporting standards. An example of the role audits play concerning the quality of financial reporting is their objective to detect fraud. Companies typically select reputable auditors because they leave a positive impression on investors. The choice of auditors is another indicator of their importance. The auditor's reputation also positively influences the extent of information sharing within the firm.

The test findings demonstrate that audit quality is unaffected by the audit committee's level of expertise. The establishment of an audit committee has no impact on its ability to enhance audit quality because its members are chosen solely for their compliance with legal requirements. An auditor's expertise in accounting and finance does not influence their motivation to improve audit quality. The larger the audit committee, the lower the quality of the audit tends to be. The audit committee oversees the process of preparing financial reports. Since each committee member's preferences may hinder the financial reporting process, which can reduce audit quality, it is not always the case that larger committees lead to greater success.

Despite the fact that audit committee independence affects fraud reporting, financial knowledge by itself does not appear to have a major effect, indicating that other characteristics could be more important (Haekal, Taqi, & Susanto, 2024). Qualified auditors, companies can still engage in earnings manipulation, indicating that expertise does not always equate to improved audit quality. Audit committee expertise in accounting and/or finance alone is not enough to ensure a high-quality audit (Czajkowska, Lizińska, & Czapiewski, 2024).

Audit committees with experience in finance tend to issue smaller audit fees. This indicates that the audit committee can strengthen corporate governance, reduce internal risks, or negotiate effectively with auditors (Casterella, Francis, Lewis, & Walker, 2004). The audit committee's expertise does not affect the quality of financial reports (Azizkhani, Hossain, & Nguyen, 2023; Elmashtawy, Che Haat, Ismail, & Almaqtari, 2024; Kim, Kwak, Lim, & Yu, 2017). An inexperienced audit committee is more conservative than an experienced one. An experienced audit committee is not conservative; it tends to improve the company's image to convince investors (Abdul Rahman & Haneem Mohamed Ali, 2006; Khudhair, Al-Zubaidi, & Raji, 2019; Suryanto, Thalassinis, & Thalassinis, 2017). The experience of the audit committee has no bearing on the quality of the audit because the members' knowledge of accounting and finance is insufficient to fulfill their duties and responsibilities in overseeing the business. Instead, the formal academic training of the audit committee members, which corresponds to the industry in which the company operates, has an impact. The average size of the audit committee, consisting of three members, is reportedly considered too powerless to influence the company's internal control framework.



The study's findings suggest that audit quality and auditor selection are not always positively influenced by the audit committee's financial and/or accounting experience. In fact, such knowledge may sometimes have a detrimental or negligible effect. This could be due to various factors, including the complexity of the audit committee's responsibilities, internal business dynamics, or interactions with external auditors. Therefore, it is important for organizations to consider multiple factors when establishing an effective audit committee, rather than focusing solely on financial or accounting expertise.

The test results demonstrate that audit quality is positively impacted by political connections. Politically linked businesses will select competent auditors to minimize agency issues. This will help them decrease asymmetric information and provide market participants with a favorable indication that the business has been well-managed (Cheng, Hsu, & Kung, 2015; Guedhami et al., 2014; Habib, Muhammadi, & Jiang, 2017; Knechel, Niemi, & Sundgren, 2008). Because they are more likely to be trusted to pledge not to redirect business resources, firms with political ties typically hire better auditors. Politically connected public companies are more likely to employ top-notch auditors, supporting the theory that these companies address the significant agency issues brought on by ties by enhancing accounting transparency, which is evident in the selection of auditors (Guedhami et al., 2014).

Political connections have a positive effect on audit quality (Almarayeh et al., 2024; Guedhami et al., 2014; Harymawan & Nowland, 2016). Politically connected companies prefer high-quality financial reporting, which leads them to appoint Big 4 auditors (Almarayeh et al., 2024). This is because qualified auditors are likely to detect and have the ability to force their clients to disclose quality and detailed information (Gul, Fung, & Jaggi, 2009). By using certified auditors, politically linked companies aim to improve the credibility of their financial accounts and accounting transparency because market participants typically view them as riskier.

The test results indicate that audit committee expertise and audit quality have a direct impact on financial reporting quality, even though audit quality does not mediate the relationship between the two. The study's findings suggest that audit quality and auditor selection are not always positively influenced by the audit committee's financial and/or accounting experience. In fact, such knowledge may sometimes have unfavorable or negligible effects. This may be due to various factors, such as the complexity of the audit committee's duties, the company's internal dynamics, or interactions with external auditors. Therefore, it is important for companies to consider various aspects when forming an effective audit committee, not solely focusing on financial or accounting expertise. Audit quality, especially from Big 4 firms, does not mediate the relationship between audit committee expertise and financial reporting quality (Bawuah, 2024). The Malaysian study indicates that there is no significant relationship between audit committee financial expertise and the timeliness of audit reports. This finding further supports the notion that audit quality may not serve as a mediating factor (Salleh, Baatwah, & Ahmad, 2017).

There is no difference between a qualified and an unqualified public accounting company. Since all auditors must adhere to the Public Accountant Professional Standards when reviewing annual financial statements, there is no significant difference between qualified and unqualified public accounting firms in auditing a company's financial accounts. This is because all public accounting firms audit financial statements in accordance with the Public Accountant Professional Standards. Audit quality does not influence the quality of financial statements (Khalil, 2022). Since the banking industry is already heavily regulated and has strict internal controls, there is no relationship between auditors and the quality of financial reporting. As a result, auditors can no longer fulfill their duties (Khalil, 2022). Due to the inadequate legal and regulatory framework in the nation, there is no discernible difference in the quality of financial statements audited by Big-4 and non-Big-4 auditors (Abid, Shaique, & Anwar ul Haq, 2018).

The test findings show that audit quality acts as a mediator between political ties and financial reporting quality. Numerous studies have demonstrated that politically connected businesses tend to choose high-quality financial reporting to ensure that external investors recognize this feature, provided they avoid self-dealing or using their connections to redirect corporate resources. As a result, these businesses are more inclined than those without political ties to hire competent audits (Dyck & Zingales, 2004). Businesses with political ties are more likely to hire qualified



auditors, according to research on the relationship between political connections and auditor selection. Additionally, they note that companies with political clout are more likely to hire certified auditors in nations with comparatively weak institutional frameworks (Guedhami et al., 2014).

Politically connected companies prefer quality auditors to convince market participants that the company is well-managed (Harymawan & Nowland, 2016). They contend that political connections influence the selection of high-caliber auditors and that there is a correlation between the two. Companies with politically linked boards of directors and commissioners have a favorable and significant impact on audit quality. Their study's findings imply that politically connected businesses typically choose competent auditors. If managers refrain from engaging in self-serving behavior that might harm investors, to persuade market participants that the company is not in danger, politically connected companies will naturally select high-quality auditors.

Rational economic decisions are generally influenced by considerations of benefits and costs. This consideration also applies when determining whether a connected company selects a qualified auditor (Fan & Wong, 2002). If the company chooses a qualified auditor, the benefits are that agency problems and information asymmetry decrease (Guedhami et al., 2014; Knechel et al., 2008), which ultimately lowers the cost of capital (Francis, LaFond, Olsson, & Schipper, 2004).

Companies with political ties tend to engage high-quality auditors, such as the Big 4, which improves the quality of their financial reporting (Almarayeh et al., 2024). In addition, politically connected clients often experience fewer adverse audit outcomes, indicating the potential for economic ties to affect audit quality (Heflin & Wallace, 2024). This relationship is further supported by the finding that audit quality serves as a protective mechanism against managerial opportunism, thereby improving the quality of financial reporting (Sari, Suhaili, & Lesfandra, 2024; Sihono & Munandar, 2023).

## 5. CONCLUSION AND CONTRIBUTIONS

The analysis and discussions presented in the preceding chapter culminate in the following insights: the experience of the audit committee enhances the quality of a company's financial statements on the stock exchange in various ASEAN nations; improved audit quality contributes to better financial statements of companies listed on the stock exchange in several ASEAN countries; political connections positively influence the quality of financial statements of companies on the stock exchange in several ASEAN nations, and these ties also have a beneficial impact on the quality of audits of companies listed in a number of ASEAN countries; the experience of the audit committee does not influence the quality of a company's audit in certain ASEAN nations; however, in many ASEAN countries, the quality of a company's financial statements on the stock exchange is influenced by the audit committee's experience; additionally, in many ASEAN countries, the quality of an audit can serve as a mediator between political ties and the quality of a company's financial statements on the stock exchange.

Based on study findings, recommendations or proposals are made to companies listed on the stock exchanges of several ASEAN countries in an effort to enhance corporate governance and financial report disclosure transparency and to provide high-quality financial reports. Because it can improve the quality of financial reports, the existence of an audit committee is expected to be considered by potential investors, the company's political ties, and audit quality. With this information, related parties can easily make decisions regarding investing or determining company policies. For regulators, disclosure of information on the existence of political connections is very important in the annual report. Therefore, at the policy-making level, the Financial Services Authority (OJK) is expected to establish regulations requiring each company to explicitly disclose the presence or absence of political connections.

The results of the study showed that the audit committee's level of experience had no impact on the quality of the audit. Other elements of the audit committee, including independence, meeting frequency, nationality, race, and dual leadership, can be explored through suggestions for further research. In 2020, the COVID-19 pandemic caused a significant economic downturn, which is when the data used in this study were collected. This condition may

influence the study's results. Therefore, to obtain more representative results reflecting stable economic conditions or a growth phase, it is recommended that future research utilize data from periods before or after the pandemic, such as years with more typical economic conditions, to provide a more accurate picture of long-term trends. Additionally, comparing data from before, during, and after the pandemic could offer valuable insights into the dynamics of change caused by the global crisis.

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