

Do Audit Committees Strengthen Reporting Quality? Evidence on Profitability, CSR, Liquidity, and Earnings Quality in IDX Firms (2019–2022)

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ABSTRACT

This study investigates how earnings quality (EARNQUAL) is influenced by liquidity, corporate social responsibility (CSR), and profitability, with the audit committee (AC) considered as a moderating factor. This research employs a quantitative design and utilizes secondary data from the Indonesia Stock Exchange (IDX), ESGI database, and public company reports. During the 2019–2022 period, the sample observed 140 companies from industrial and basic materials companies listed on the IDX. Data analysis was performed using SPSS 26.0. This research is based on agency, stakeholder, and legitimacy theories. Despite extensive prior research on earnings quality determinants, empirical evidence on the moderating effectiveness of audit committees in emerging market settings remains inconclusive. The empirical results demonstrate that profitability exerts a positive and statistically significant impact on earnings quality. Conversely, CSR is not found to be significantly associated with earnings quality, while liquidity exhibits a negative effect. Furthermore, the moderation test indicates that the audit committee does not enhance the effects of profitability, CSR, or liquidity on earnings quality. This study contributes to the accounting literature by clarifying the limited governance role of audit committees in enhancing earnings quality when governance structures are homogeneous. The findings imply that strengthening earnings quality in Indonesian firms requires not only formal governance mechanisms but also improvements in the substantive effectiveness of audit committee oversight

Keywords: *Audit committee, corporate social responsibility, earnings quality, liquidity, profitability*

INTRODUCTION

The rapid development of the business environment in the globalization era requires companies to maintain superior and transparent performance amid increasing expectations from stakeholders. Among the various indicators that receive considerable attention, profitability, liquidity, and CSR are widely used to assess a firm's financial condition as well as the sustainability of its business operations. In addition to these metrics, earnings quality is a key component that shows how trustworthy financial reports are and how well they reflect a company's actual financial or operational success (Dechow et al., 2010; Fassas et al., 2023). High-quality earnings not only signal a firm's capacity to generate persistent and sustainable income but also provide a critical foundation for risk assessment and informed investment decision-making (Francis et al., 2004; Siladjaja & Jasman, 2024)

Financial statements, as the primary source of information for investors, provide a comprehensive overview of a company's financial condition during a specific reporting period. Relevant and reliable information is essential for supporting strategic decision-making (Kepramareni et al., 2021). Among the components of financial statements, the income statement plays a central role, as it reflects the firm's success in generating profits and its operational

efficiency (Abed et al., 2022; Kothari et al., 2005) The reliability of earnings reports is crucial for investors when gauging a company's future and the longevity of their investments.

One important measure of a company's performance is its profitability, which shows how well it can turn its resources into earnings. Strongly profitable companies are more likely to declare high-quality results, according to the data. This is because consistently profitable companies are less inclined to manipulate their earnings and their stakeholders see this as an indication of good operational performance (Brigham & Houston, 2018; Intara et al., 2024). On the flip side, liquidity indicates how well a business can handle its immediate financial commitments. While a healthy cash flow is indicative of a well-run business, excessive liquidity could mask inefficient asset usage and provide managers an excuse to artificially inflate profits (Allini et al., 2025). CSR has also emerged as a determinant of earnings quality, as companies committed to social responsibility tend to uphold transparency and ethical reporting, thereby earning greater trust from the public and investors

Within the corporate governance framework, the audit committee is not only positioned as a monitoring mechanism but also plays a strategic role in shaping the effectiveness of financial reporting processes. Beyond its direct oversight function, the audit committee may condition how managerial decisions related to profitability management, liquidity policies, and CSR implementation are translated into reported earnings quality. An effective audit committee is expected to constrain opportunistic behavior by scrutinizing accrual choices, monitoring liquidity utilization, and ensuring that CSR activities are reported transparently and not exploited for earnings management purposes. Consequently, the audit committee is theoretically relevant as a moderating mechanism that may strengthen or weaken the relationship between firm-specific financial characteristics and earnings quality, rather than merely acting as an independent determinant.

In Indonesia, cases of financial statement manipulation continue to emerge. One notable example is PT Envy Technologies Indonesia Tbk, which was suspected of engaging in earnings manipulation by engineering revenue recognition from its subsidiary in the consolidated financial statements (Christian et al., 2022). Inconsistencies in financial reporting have also been identified in other companies, such as PT Hanjaya Mandala Sampoerna Tbk, which raised public concerns regarding EARNQUAL due to misstatements in liability recognition (Novel et al., 2021). The chemical and basic materials sector is not exempt from similar issues. For instance, PT Chandra Asri Petrochemical Tbk experienced a significant decline in profits, which was widely reported in business media and raised public attention from market participants (Citradi, 2019). These instances highlight the urgency of examining the factors that influence earnings quality, particularly liquidity, profitability, and CSR three indicators that have received substantial attention from investors.

Beyond empirical phenomena, prior research has also produced inconsistent findings. Puteri & Trisnaningsih (2022) found that profitability, firm size, and CSR significantly influence EARNQUAL, whereas (Agustin & Rahayu, 2022) emphasized the importance of liquidity and corporate governance mechanisms. Meanwhile, a study by Nirmalasari & Wahyu Widati (2022) showed that EARNQUAL is also greatly affected by leverage and the size of the firm. There needs to be additional study to provide more solid empirical data regarding industrial and basic materials enterprises listed on the Indonesia Stock Exchange (IDX). These contradictory results highlight the importance of this need. Despite extensive empirical evidence on earnings quality determinants, prior studies report mixed findings, partly due to heterogeneous earnings quality proxies, variations in CSR measurement, and differences in governance attributes across institutional settings. Most existing studies focus on direct effects, while relatively limited attention has been given to examining governance mechanisms particularly audit committees as conditional factors that shape the strength of these relationships. Moreover, empirical evidence from emerging markets remains scarce, especially within sectors characterized by high accrual intensity and distinct CSR expenditure patterns, such as industrial and basic materials firms.

The years 2019–2022 represent a critical period, as businesses were subjected to substantial strain brought about by the COVID-19 pandemic. Supply chain disruptions, demand fluctuations, and rapid digitalization requirements affected corporate financial performance. A company's ability to handle uncertainty and maintain business sustainability in such unpredictable times can be

measured by EARNQUAL.

This study extends prior research by (i) employing discretionary accrual-based earnings quality measures during the COVID-19 pandemic period, when managerial discretion and reporting uncertainty were heightened, (ii) focusing on industrial and basic materials firms where accrual intensity and CSR expenditure patterns differ from other sectors, and (iii) testing the moderating role of the audit committee under conditions of low variation in governance attributes. Accordingly, this study aims to investigate how profitability, CSR, and liquidity affect earnings quality, and whether the audit committee moderates these relationships in Indonesian industrial and basic materials companies listed on the Indonesia Stock Exchange during 2019–2022. The findings are expected to contribute to the accounting and corporate governance literature and provide practical insights for firms seeking to enhance financial reporting quality and governance effectiveness.

STUDY LITERATURE

Agency Theory

According to agency theory, disputes between owners and managers are inevitable in organizations with a clear separation of powers (Eisenhardt, 1989; Jensen & Meckling, 1976). Within the agency model, a system is designed to align the interests of two parties management and owners through a mutually agreed-upon employment contract (Daily et al., 2003). According to Lambert (2001), such contractual arrangements are expected to maximize the utility of the owners (principals) while simultaneously ensuring that managers (agents) receive adequate incentives or rewards for their performance. The firm's overall performance ultimately determines the benefits received by both parties.

Stakeholder Theory

Stakeholder theory has gained considerable prominence in various areas of business research (Hörisch et al., 2020). Contemporary managers increasingly acknowledge that the creation of sustainable and ethically responsible corporate value requires firms to accommodate the interests of diverse stakeholder groups (de Gooyert et al., 2017). The term "stakeholders" was first used by the Stanford Research Institute (SRI) to represent constituencies whose backing is crucial to an organization's capacity to stay in business (Freeman & Reed, 1983). Deegan (2002) explains that stakeholder theory suggests organizational strategies are designed to address the expectations of stakeholders broadly, as emphasized in the ethical perspective, as well as those of dominant stakeholders highlighted in the managerial perspective.

Legitimacy Theory

According to Gray (2002), as a system-oriented theory, legitimacy theory holds that an entity affects and is affected by the society in which it functions. The core idea underlying legitimacy theory is that companies must obtain societal approval often conceptualized as a "social contract" in order to conduct their business activities (Deegan, 2002). Hooghiemstra (2000) continues by stating that according to the legitimacy framework, a social contract suggests that a company's ability to stay in business is tied to how well it follows the rules, principles, and expectations of the community in which it works.

Relationship Between Profitability and EARNQUAL

Profitability reflects the effectiveness of managerial performance, as demonstrated through sales and investment returns. A high level of profitability indicates that a company is operating efficiently and optimally, thereby producing higher-quality earnings. In line with agency theory, managers who are efficient and effective in generating profits are also expected to maintain transparency and accuracy in financial report (Jensen & Meckling, 1976). High profitability suggests that managers have succeeded in managing the firm in a manner consistent with the interests of shareholders. Conversely, low profitability may signal that a company is facing challenges in generating adequate returns. Under such circumstances, managers may experience pressure to improve reported earnings, which could lead to questionable practices such as aggressive earnings management or even manipulation of financial statements.



High EARNQUAL reflects the transparency and accuracy of financial information provided to owners and investors. Therefore, EARNQUAL serves as a crucial indicator of the reliability of the information presented by the company.

Empirical studies by Ginting (2017) and Kepramareni et al. (2021) found that profitability has a positive influence on EARNQUAL. This implies that the higher a company's profitability, the better the quality of the earnings it produces. In this study, profitability is measured using ROA, a ratio that indicates how effectively a company utilizes its assets to generate profits. A high ROA signifies that the company is able to generate greater earnings from the assets under its control. Based on the explanation above, the hypothesis can be formulated as follows:

H1: Profitability has a positive effect on EARNQUAL.

Relationship Between CSR and EARNQUAL

CSR refers to business practices that are socially and environmentally accountable. CSR is often associated with corporate financial performance (CFP). Several studies have documented a positive relationship between CSR and CFP, suggesting that firms investing in CSR tend to exhibit superior financial performance (Surroca et al., 2010; Waddock & Graves, 1997). Companies that allocate resources to CSR typically strive to meet or exceed ethical and sustainability standards.

EARNQUAL reflects the extent to which reported earnings capture a firm's true economic performance, assuming that the earnings are free from managerial distortions. Research by Luo & Bhattacharya (2006) indicates that CSR aligns with stakeholder theory and corporate reputation, which in turn can influence EARNQUAL. Firms with strong CSR commitments are more likely to produce high-quality earnings because responsible CSR practices help reduce risk and foster greater customer loyalty, contributing to more stable and predictable revenue streams. This stability enhances investor confidence and supports higher EARNQUAL (Luo & Bhattacharya, 2006).

Findings from Puteri & Trisnarningsih (2022) and Siswantaya (2022) also demonstrate that CSR has a positive effect on EARNQUAL. This suggests that higher levels of CSR are associated with better EARNQUAL, as CSR enhances corporate reputation, reduces business risks, and promotes transparency all of which contribute to improved EARNQUAL. Based on the literature, the following hypothesis can be formulated:

H2: CSR has a positive effect on EARNQUAL

Relationship Between Liquidity and EARNQUAL

A company's liquidity reflects its ability to meet short-term obligations and continue operations without significant disruption. High liquidity ratios are often interpreted as indicators of financial stability, which may imply higher EARNQUAL because they signal the firm's capacity to manage its liquid assets effectively (Juan García-Teruel & Martínez-Solano, 2007). Within the agency theory framework, adequate liquidity reduces managerial pressure to engage in earnings management, thereby enhancing the quality of reported earnings (Jensen & Meckling, 1976). From the perspective of stakeholder theory, strong liquidity demonstrates a company's responsibility toward creditors and suppliers, reinforcing trust and strengthening relationships with key stakeholders (Freeman, 2010). Through the lens of legitimacy theory, firms with high liquidity are better positioned to meet societal expectations and market norms, thereby maintaining operational legitimacy (Suchman, 1995). The proposed hypothesis suggests that higher liquidity is associated with higher EARNQUAL, and this relationship may be more pronounced in firms with an effective AC.

Research conducted by Kepramareni et al. (2021) and Agustin & Rahayu (2022) found that liquidity has a positive effect on EARNQUAL. This indicates that firms with strong liquidity tend to produce higher-quality earnings due to increased confidence in their financial report. Companies with high liquidity levels are also more attractive to investors than those with poor liquidity conditions. Based on this explanation, the following hypothesis can be formulated:

H3: Liquidity has a positive effect on EARNQUAL

The Moderating Role of the AC on the Relationship Between Profitability, CSR, Liquidity, and EARNQUAL

The audit committee (AC), as an integral component of GCG, plays a crucial moderating role in the relationships between profitability, CSR, liquidity, and EARNQUAL. The AC functions to ensure the accuracy and reliability of reported financial information, adding an additional layer of oversight that minimizes manipulation and strengthens the validity of financial statements (Carcello et al., 2002).

With respect to profitability, the AC helps mitigate the risk of earnings overstatement during periods of strong performance, thereby moderating managerial optimism in financial reports (DeFond & Jiambalvo, 1994). In the context of CSR, the AC ensures that CSR initiatives are not merely symbolic or reputation-driven but genuinely reflect value creation for stakeholders, consistent with legitimacy theory (Gray et al., 1995). Regarding liquidity, the AC ensures that reported liquidity levels accurately portray the firm's true financial position (Aharony et al., 1980). Empirical evidence from Polimpung (2020) and Tampubolon et al. (2023) indicates that ACs have a positive influence on EARNQUAL.

Agency theory explains the relationship between owners (principals) and managers (agents), where GCG acts as a mechanism to mitigate agency problems. Effective GCG implementation can minimize conflicts of interest by enhancing managerial oversight. This aligns with the findings of Jensen & Meckling (1976), who assert that a strong GCG structure reduces managerial opportunities to pursue personal interests at the expense of shareholders and EARNQUAL. From the perspective of stakeholder theory, GCG enables companies to fulfill their responsibilities toward various stakeholders, including employees, customers, suppliers, and communities. The integration of CSR into governance structures, as highlighted by Jo and Harjoto (2012), strengthens corporate legitimacy and supports long-term value creation, ultimately contributing to improved EARNQUAL.

According to legitimacy theory, companies seek societal legitimacy by demonstrating behavior consistent with prevailing norms and values. Strong GCG typically demands higher levels of transparency and greater social responsibility, enabling firms to achieve social legitimacy and enhance their reputation, which may lead to better EARNQUAL (Suchman, 1995).

Based on the above explanation, the following hypotheses can be formulated:

H4a : The AC strengthens the effect of profitability on EARNQUAL

H4b : The AC strengthens the effect of CSR on EARNQUAL

H4c : The AC strengthens the effect of liquidity on EARNQUAL

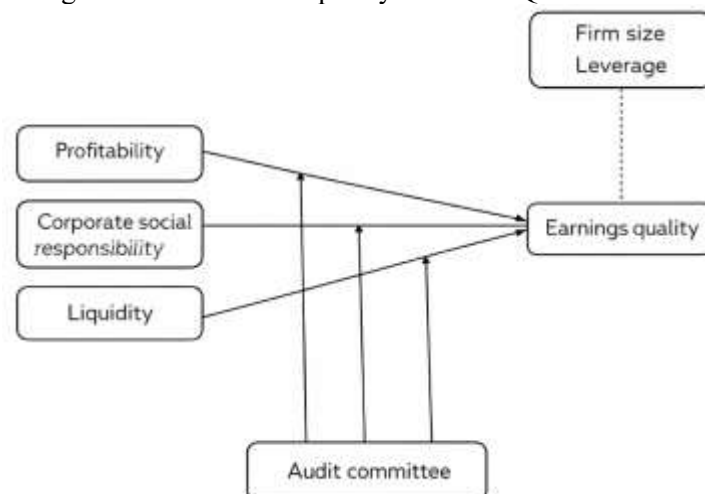


Figure 1. Conceptual Framework

METHODS

Using the AC as a moderator, this study uses a quantitative research strategy to look at how EARNQUAL is affected by profitability, CSR, and liquidity. This empirical study looks at

companies listed on the IDX that are involved in industrial and basic materials from 2019 to 2022. For this study, we relied on secondary data culled from IDX, ESGI, and company websites, specifically yearly financial statements, annual reports, and sustainability reports.

Any and all IDX-listed industrial and basic materials companies make up the population. The research sample was chosen using a purposive sampling technique, taking into account the following criteria: (1) companies consistently listed from 2019 to 2022, (2) publishing complete financial statements, (3) disclosing CSR expenditure, and (4) not reporting losses during the observation period.

The independent variables include profitability, measured using ROA following (Riyadh et al., 2022); CSR, measured as the ratio of CSR expenditure to net income as adopted from Kusuma & Aryani (2020); and liquidity, measured using the Current Ratio (CR) based on (Maulita & Dewi, 2023). The dependent variable, earnings quality, is measured using discretionary accruals derived from the Modified Jones Model, multiplied by (-1), following El Agha & Norfadzilah Rashid (2023). The formula is presented as follows:

- (1) $TACC_{it} = NI_{it} - OCF_{it}$
- (2) $\frac{TACC_{it}}{A_{it-1}} = \beta_1 \left(\frac{1}{A_{it-1}} \right) + \beta_2 \left(\frac{\Delta REV_t}{A_{it-1}} \right) + \beta_3 \left(\frac{PPE_t}{A_{it-1}} \right) + \varepsilon$
- (3) $NDA_{it} = \beta_1 \left(\frac{1}{A_{it-1}} \right) + \beta_2 \left(\frac{\Delta REV_t}{A_{it-1}} - \frac{\Delta REC_t}{A_{it-1}} \right) + \beta_3 \left(\frac{PPE_t}{A_{it-1}} \right) + \varepsilon$
- (4) $DACC_{it} = \frac{TACC_{it}}{A_{it-1}} - NDA_{it}$
- (5) $EQ = DACC_{it} \times (-1)$

Total accruals of firm *i* in period *t* ($TACC_{it}$) are defined as the difference between net income (NI_{it}) and operating cash flow (OCF_{it}). Total assets in the previous period (A_{it-1}) are used as a scaling variable. Changes in revenue (ΔREV_t) and accounts receivable (ΔREC_t) capture variations in sales and credit policies, while property, plant, and equipment (PPE_t) represent fixed asset intensity. The coefficients β_1 - β_3 denote regression parameters. Non-discretionary accruals (NDA_{it}) reflect normal accruals, whereas discretionary accruals ($DACC_{it}$) indicate managerial discretion. EARNQUAL represents the reliability of reported earnings and is measured as the absolute value of discretionary accruals multiplied by -1, so that higher EARNQUAL values consistently indicate higher earnings quality (i.e., lower earnings management), while ε denotes the error term.

Aprilian et al. (2020) found that the number of audit committee members is a good measure of the audit committee, which acts as a moderating variable. Control variables also include leverage, which is defined as the ratio of total liabilities to total assets (LEV) (Tamara & Suaryana, 2020), and company size, which is measured by the natural logarithm of total assets (SIZE) (Sari & Rokhmania, 2020).

Classical assumption tests, such as those for normality, multicollinearity, heteroscedasticity, and autocorrelation, are run to verify that the regression model satisfies statistical standards after descriptive statistics are used to describe the dataset. Using MRA to determine if the audit committee enhances or diminishes these associations, and multiple linear regression to investigate the direct impacts of profitability, CSR, and liquidity on earnings quality, we evaluate our hypotheses.

Here is the formula for the regression models:

$$EARNQUAL = \beta_0 + \beta_1(ROA) + \beta_2(CSR) + \beta_3(CR) + \beta_4(LVR) + \beta_5(SIZE) + \varepsilon \dots \dots \dots (1)$$

$$EARNQUAL = \beta_0 + \beta_1(AC) + \beta_2(ROA) + \beta_3(CSR) + \beta_4(CR) + \beta_5(LVR) + \beta_6(SIZE) + \varepsilon \dots \dots \dots (2)$$

$$EARNQUAL = \beta_0 + \beta_1(ROA) + \beta_2(CSR) + \beta_3(CR) + \beta_4(ROA * KA) + \beta_5(CSR * KA) + \beta_6(CR * KA) + \beta_7(LVR) + \beta_8(SIZE) + \varepsilon \dots \dots \dots (3)$$

This study uses EARNQUAL as its dependent variable. β_0 represents the intercept of the regression model, while $\beta_1-\beta_6$ denote the regression coefficients that measure the effect of each independent variable. AC reflects the firm’s governance mechanism, ROA represents profitability, CSR captures the firm’s sustainability engagement, CR measures liquidity, LVR indicates the firm’s capital structure, and SIZE reflects the scale of the company. Finally, ε represents the error term in the model.

Data analysis techniques in testing models 1 and 2 with multiple linear regression, while model 3 with moderated regression analysis (MRA). In contrast to the t-test, which evaluates the partial influence of each independent variable on earnings quality, the F-test looks at how all of the independent variables affect earnings quality at once. To find out how well the model can account for differences in the quality of earnings, researchers use the coefficient of determination (R^2). Depending on how significant the audit committee's direct effect and interactions with the independent factors are, the audit committee is classified as a pure moderator, quasi-moderator, predictor, or potential moderator for moderating variables. We used SPSS 26 or a similar statistical program to analyze all of the data.

RESULT

Following these guidelines, a purposive sampling procedure was used to carry out the sample process:

Table 1. Sample Selection Results

Sample criteria	2022	2021	2020	2019	Total
Industrial and basic materials companies listed on IDX for the period 2019–2022	148	148	148	148	592
Did not publish complete financial statements for the 2019–2022 period.	(8)	(6)	(17)	(18)	(49)
Did not disclose CSR expenditures in the annual report or sustainability report for the 2019–2022 period.	(69)	(78)	(74)	(79)	(300)
Recorded a loss in the current year’s profit account	(28)	(23)	(31)	(21)	(103)
Total	43	41	26	30	140

The descriptive statistics show the range of values for each study variable, including minimum, maximum, mean, and standard deviation. Using SPSS, we were able to get the following descriptive statistical results:

Table 2. Descriptive Statistics Results

Variable	N	Minimum	Maximum	Mean	Std. Deviation
EARNQUAL	140	-0.21639	-0.00195	-0.08101	0.04844
ROA	140	0.00095	0.26560	0.05800	0.05106
CSR	140	0.00003	0.81996	0.04559	0.11903
LIQ	140	0.39300	7.85939	2.08344	1.44816
AC	140	3	4	3.04	0.203
SIZE	140	25.04885	33.65519	29.23135	1.91196
LEV	140	0.06303	1.06554	0.42758	0.20438

Descriptive statistics indicate substantial variation across the study variables. Profitability (ROA) ranges from 0.00095 to 0.2656, with an average value of 0.05800, suggesting moderate differences in firms’ ability to generate profits from their assets. CSR disclosure also shows high dispersion, reflected in a wide range between 0.00003 and 0.81996, indicating uneven sustainability reporting practices among firms.

With a mean of 2.08344 and values ranging from 0.39300 to 7.85939, liquidity shows a lot of diversity, implying differences in firms’ short-term financial capacity. Earnings quality values are negative, with an average of -0.08101, reflecting the distribution of discretionary accruals after being multiplied by -1. In this context, values closer to zero indicate higher earnings quality. The

audit committee size is relatively homogeneous, ranging from three to four members, which may explain its limited moderating role. Firm size and leverage display moderate variation, reflecting differences in scale and capital structure among firms.

In order to proceed with hypothesis testing, it was necessary to ensure that all regression models met the classical assumption tests of normalcy, multicollinearity, heteroscedasticity, and autocorrelation. A determination of normalcy was made using the Kolmogorov-Smirnov test. The normalcy assumption is satisfied by the regression model if the significance value > 0.05. All of the variables were found to have normal distributions according to the test results. In this study indicate tolerance > 0.10 and VIF < 10. Therefore, the regression models (Models 1 and 2) can be concluded to be free from multicollinearity. In Model 3, the tolerance and variance inflation factor (VIF) values for the audit committee variable and its interaction with liquidity fall below the conventional threshold (tolerance < 0.10; VIF > 10), indicating the presence of multicollinearity. This condition persists even after mean-centering the interaction terms. Such multicollinearity is likely attributable to the limited cross-sectional variation in audit committee size across firms, reflecting relatively homogeneous governance structures rather than a misspecification of the regression model. The scatterplot shows points that are randomly dispersed and do not form any specific or systematic pattern. As a result, we may say that none of the regression models exhibit heteroscedasticity. The DW value indicates that there is no autocorrelation in the model.

Here are the outcomes of the regression analysis test conducted on all of the models:

Table 3. Results of Model 1, 2 and 3 Regression Analysis

Variable	EARNQUAL			Conclusion
	Model 1	Model 2	Model 3	
(Constant)	-0.243*** (-4.176)	-0.277*** (-3.838)	0.051 (0.552)	
ROA	0.237*** (3.121)	0.235*** (3.091)	0.196** (2.169)	H ₁ accepted
CSR	0.033 (1.007)	0.028 (0.842)	0.074 (0.876)	H ₂ rejected
LIQ	-0.008** (-2.484)	-0.008** (-2.349)	-0.156 (-0.948)	H ₃ accepted in model 1 and 2, H ₃ rejected in model 3
AC		0.016 (0.801)	0.303 (1.113)	
ROA×AC			-0.277 (-1.254)	H _{4a} rejected
CSR×AC			-0.131 (-1.666)	H _{4b} rejected
LIQ×AC			0.378 (0.602)	H _{4c} rejected
SIZE	0.005** (2.560)	0.004** (2.176)	0.178** (2.202)	
LEV	0.044* (1.854)	0.047* (1.965)	0.191* (1.869)	
R ²	0.241	0.245	0.260	
Adj R ²	0.213	0.211	0.209	
P value F statistics	0.000	0.000	0.000	
N	140	140	140	

*** significant at 0.01

** significant at 0.05

The regression results indicate that in Model 1, profitability, CSR, liquidity, leverage, and firm size jointly have a significant effect on earnings quality. Partial analysis shows that

profitability has a positive and significant effect, while liquidity exerts a significant negative effect on earnings quality. CSR does not demonstrate a significant influence. The model explains 21.3% of the variation in earnings quality. In Model 2, the inclusion of the audit committee as an additional independent variable does not alter the direction or significance of the main relationships and does not exhibit a significant direct effect on earnings quality. The explanatory power of the model remains relatively stable. In Model 3, the audit committee is tested as a moderating variable. The interaction terms between the audit committee and profitability, CSR, and liquidity are all statistically insignificant, indicating that the audit committee does not moderate these relationships. The model explains 20.9% of the variation in earnings quality. The findings suggest that profitability is the primary determinant of higher earnings quality, liquidity negatively affects earnings quality, and CSR and the audit committee do not play significant roles, either directly or as moderating variables, in industrial and basic materials companies during the study period.

DISCUSSION

Effect of Profitability, CSR and Liquidity on EARNQUAL

Profitability increases EARNQUAL, according to these results, which are in line with those of Ginting (2017), Kepramareni et al. (2021) and Laksono & Trisnaningsih (2019). Companies with high profitability tend to reflect efficient and optimal operational performance, and therefore are more likely to generate higher-quality earnings. Furthermore, high profitability may indicate that managers have been successful in managing the company effectively in accordance with shareholders' interests. However, managers who are oriented toward short-term performance may be tempted to manipulate financial statements to present higher reported earnings, which could harm owners in the long run. High EARNQUAL reflects transparency and the accuracy of financial information provided to owners and investors. Consistent with agency theory's central tenet, efficient and effective management in generating profits is also committed to transparent and accurate financial reporting (Jensen & Meckling, 1976).

This result agrees with what was found in the study of Sendy (2015), Aziz & Faisal (2018) and Sari & Rokhmania (2020), which also concluded that CSR does not influence EARNQUAL. This implies that CSR in this study is not used as a tool for earnings manipulation, as CSR expenditures more accurately reflect genuine social responsibility or philanthropic initiatives undertaken by the company. In this context, managers are not incentivized to shift CSR funds for opportunistic purposes, particularly because CSR obligations are regulated, reducing the possibility of managerial discretion for opportunism. As a result, CSR does not exhibit any significant influence on EARNQUAL. Both legitimacy theory and stakeholder theory, which stress the importance of companies undertake CSR activities primarily to obtain positive responses from external stakeholders and to gain legitimacy from society.

Statistical investigation revealed that liquidity significantly lowers earnings quality. This suggests that a correlation between a company's current assets and earnings quality is a negative one. This leads us to reject hypothesis 3. Both Septiano et al. (2022) found a negative correlation between liquidity and profits quality, lending credence to this conclusion. This suggests that when firms maintain excessively high liquidity levels, their earnings quality tends to deteriorate. High liquidity functions like a double-edged sword. On the positive side, it enables firms to meet short-term obligations promptly without relying on external funding. However, on the negative side, it increases the opportunity for managers to misuse liquid assets for personal interest or engage in opportunistic behavior. That fits nicely with the idea of agencies, which posits that managers may act opportunistically when they have the discretion and opportunity to do so. When such opportunities arise, there is a possibility that managers could engage in earnings management or falsify financial figures, ultimately reducing the EARNQUAL. Ideally, firms should minimize excessively high liquidity by reallocating excess liquid assets into profitable investments that can generate returns for the company.

Effect of Audit Committee Moderation on the Relationship Between Profitability, Corporate Social Responsibility (CSR), Liquidity, and Earnings Quality

In order to investigate the elements impacting EARNQUAL in Indonesian industrial and basic materials enterprises, this study makes use of a moderating variable alongside the independent and dependent variables. In this study, the number of AC members within the firm serves as the moderating variable. For the purpose of testing whether the AC moderates the link between EARNQUAL and each independent variable (profitability, CSR, and liquidity), we have three sub-hypotheses pertaining to moderation: H4a, H4b, and H4c.

This finding demonstrates that the AC, as an oversight body responsible for monitoring financial reporting, does not function optimally in this context. Basically, the amount of supervision that would make profitability have a bigger effect on EARNQUAL is not dependent on the size of the AC. A bigger AC runs the risk of being ineffective owing to members' divergent views and, on top of that, it can increase the company's compensation expense. But if its members labor to their full potential and follow the rules of governance, even a tiny AC can do a good job of overseeing. For this reason, we find no evidence that AC moderates the correlation between EARNQUAL and profitability in this analysis.

The absence of a moderating effect of the audit committee on the relationship between CSR and earnings quality suggests that CSR activities are not primarily used as a mechanism to influence reported earnings. CSR expenditures in the sampled firms appear to be directed toward fulfilling social and regulatory obligations rather than serving as a tool for earnings management. Consequently, the role of the audit committee is limited to ensuring compliance and transparency in CSR implementation, without materially altering the association between CSR and earnings quality. This indicates that the audit committee does not treat CSR reporting as an instrument for enhancing earnings quality, but rather as a separate accountability domain focused on social responsibility. In this context, audit committee oversight supports the credibility of CSR disclosures without translating into measurable improvements in earnings quality. This finding is consistent with legitimacy theory, which posits that CSR activities are primarily aimed at maintaining societal approval and organizational legitimacy, rather than directly shaping financial reporting outcomes.

Finally, the AC does not moderate the relationship between LIQ and EARNQUAL. Based on the evidence, hypothesis H4c is rejected. The β coefficient of the interaction term $LIQ \times AC$ is -0.378, the t-value is 0.602, and the significance level is 0.549, according to the results of the moderated regression analysis and the t-test. Being a financial ratio variable, liquidity likewise does not seem to have any moderating influence on the profitability-EARNQUAL relationship. Therefore, the size of the AC is irrelevant. The ability of the audit committee to serve as a moderating body is, instead, more dependent on the members' level of personal investment, professional integrity, and attention to their monitoring duties.

CONCLUSION

This study examines the effects of profitability, corporate social responsibility (CSR), and liquidity on earnings quality, with the audit committee serving as a moderating variable and firm size and leverage included as control variables. The findings indicate that profitability has a positive and significant effect on earnings quality, while liquidity exerts a negative influence. In contrast, CSR does not exhibit a significant association with earnings quality. Furthermore, the audit committee does not moderate the relationships between profitability, CSR, liquidity, and earnings quality, suggesting that formal governance mechanisms alone may be insufficient to enhance financial reporting quality in the absence of substantive governance effectiveness.

Theoretically, this study contributes to the accounting and corporate governance literature by demonstrating that the effectiveness of audit committees in improving earnings quality is highly context-dependent and may be limited in environments characterized by homogeneous governance structures. The findings extend prior research by highlighting that governance mechanisms may function symbolically rather than substantively, particularly in emerging market settings.

From a practical perspective, the results provide important implications for investors, regulators, and firms. Investors are encouraged to exercise caution when interpreting earnings figures, especially in firms with high liquidity levels, as excess liquidity may increase managerial discretion and weaken earnings quality. Regulators are advised to strengthen governance guidelines by emphasizing not only the formal existence of audit committees but also their functional

effectiveness, including expertise, independence, and activity levels. For firms, enhancing earnings quality requires improving governance practices beyond compliance, such as reinforcing internal controls and ensuring that audit committees actively engage in financial reporting oversight.

Methodologically, this study highlights the importance of improving measurement approaches in future research. The limited variation in audit committee characteristics and the use of CSR expenditure as a proxy may constrain the ability to detect governance effects. Future studies are therefore encouraged to employ more comprehensive governance proxies such as audit committee independence, expertise, and meeting frequency and alternative CSR measures, including disclosure-based or ESG score indices. In addition, the application of advanced panel data techniques, such as dynamic panel models or generalized method of moments (GMM), would help address potential endogeneity concerns and provide more robust causal inferences.

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