

Auditor Industry Specialization, Institutional Ownership, and Independent Commissioners' Effect on Financial Reporting Integrity: The Moderating Role of Audit Quality

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ABSTRACT

This study investigates the effect of auditor industry specialization, institutional ownership, and independent commissioners on financial reporting integrity, with audit quality as a moderating variable. The research focuses on consumer goods manufacturing companies listed on the Indonesia Stock Exchange during the 2020–2024 period. The study is motivated by concerns regarding the reliability of financial reporting amid recurring cases of financial statement manipulation that undermine investor and public trust. A quantitative approach is employed using panel data regression and Moderated Regression Analysis (MRA). From a population of 132 firms, 35 companies met the sampling criteria, resulting in 175 firm-year observations. The Fixed Effects Model (FEM) was selected as the most appropriate panel regression model. Financial reporting integrity is treated as the dependent variable, while auditor industry specialization, institutional ownership, and independent commissioners serve as independent variables, with audit quality acting as the moderating variable.

The results show that auditor industry specialization and institutional ownership have a positive and significant effect on financial reporting integrity, whereas independent commissioners do not have a significant effect. Furthermore, audit quality moderates the relationship between auditor industry specialization and financial reporting integrity, strengthening its influence. However, audit quality does not moderate the relationship between institutional ownership or independent commissioners and financial reporting integrity. These findings indicate that external governance mechanisms supported by high audit quality are more effective in improving financial reporting integrity than internal governance mechanisms alone. This study contributes to the accounting and auditing literature and provides insights for regulators, auditors, and corporate management in enhancing the credibility of financial reporting.

Keywords: Financial Reporting Integrity, Auditor Industry Specialization, Institutional Ownership, Independent Commissioners, Audit Quality.

INTRODUCTION

Financial statements are used by stakeholders to determine a company's financial position, performance, and changes in its financial position over a specific period. These users include management, investors, the government, creditors, and the general public. Therefore, financial statements must be presented in accordance with the company's true financial condition.

However, there are growing concerns about the quality and reliability of the information presented in financial statements, particularly following the emergence of various accounting scandals that highlighted manipulation and fraudulent practices in financial reporting. Financial reporting integrity is crucial to ensuring that the information presented is free from material error



and bias and faithfully reflects the underlying economic reality. Financial statement manipulation is often carried out to improve a company's financial performance, which can influence investment decisions and overall corporate policy.

Financial statement integrity is a key foundation in the financial reporting system because it determines the level of reliability of the information used by investors, creditors, regulators, and other stakeholders in making economic decisions. Within the IFRS-based financial reporting conceptual framework, integrity is reflected through the principle of faithful representation, which requires financial information to be presented honestly, completely, neutrally, and free from material misstatement (Kieso et al., 2020). Financial statements lacking integrity have the potential to mislead users, weaken market mechanisms, and undermine public trust in companies and the existing oversight system.

One of the cases that emerged included falsification of financial data by the former President Director of PT. Indofarma Tbk, Arief Pramuhanto. From 2019 to 2023, President Director PT Indofarma (AP) is suspected of manipulating its 2020 financial statements by documenting receivables, payables, and fraudulent advance payments for the procurement of medical devices, so creating a misleading impression that the company's objectives have been achieved. As a result of the actions of Arief Pramuhanto as the President Director of PT Indofarma and the President Commissioner of PT IGM together with Gigik Sugiyo Raharjo, Cecep Setiana Yusuf, and Bayu Pratama Erdhiansyah, state finances have been harmed at PT Indofarma and its subsidiaries due to financial management at PT Indofarma, its subsidiaries and other related agencies, amounting to Rp. 377,491,463,411.23 (Rp. 377.4 billion).

PT Indofarma Tbk can be categorized as a consumer goods group because the products it produces and distributes are goods consumed directly by the public as end users. Indofarma's main products, such as medicines, supplements, and various health products, are used to meet the health needs of individuals and households, so their benefits are felt directly by consumers without undergoing further production processes. In economic terms, these characteristics are the main characteristics of consumer goods. Furthermore, although Indofarma's products are largely sold through intermediaries such as pharmacies, hospitals, and pharmaceutical distributors, the end users are still individual consumers. Therefore, conceptually, Indofarma can be categorized as a consumer goods company, particularly in the healthcare subsector, as its products are intended to meet the daily health needs of the public.

The cases involving PT Indofarma Tbk and eFishery are clear examples of how corporate governance irregularities occur not only in the financial or construction sectors, but also in sectors directly related to public needs. The operational complexity and high transaction volume of consumer goods companies create loopholes that can be exploited to manipulate financial records, particularly in accounts such as accounts receivable, accounts payable, inventory, and deferred revenue. Furthermore, the pressure to demonstrate sustainable growth is often a key driver for management to manipulate figures in financial statements to meet investor and shareholder expectations.

One of the external oversight mechanisms widely studied in the international literature is auditor industry specialization. Auditors with industry specialization have a deeper understanding of business characteristics, operational risks, and industry-specific accounting treatments, making them more effective in detecting material misstatements and financial statement manipulation practices (Ghosh, 2021). Several studies have found that auditor industry specialization positively impacts financial statement integrity by enhancing auditors' ability to identify industry-specific risks and design more relevant audit procedures (Oktaviani et al., 2021). These findings align with international research showing that industry-specialized auditors contribute to improved financial reporting quality and transparency (Chouaibi & Hichri, 2020).

However, the literature also shows inconsistent results. Several studies found that auditor industry specialization had no significant effect on financial statement integrity, particularly when client economic pressures or transaction complexity outweighed the auditor's own competency (Nurbaiti & Elisabet, 2023). This inconsistency suggests that auditor specialization does not always automatically guarantee financial statement integrity, and therefore needs to be examined in the context of other accompanying oversight mechanisms.

In addition to external oversight through auditors, institutional ownership is an internal governance mechanism that plays a crucial role in enhancing the integrity of financial reporting. Institutional investors possess the resources, analytical capacity, and long-term interests that motivate them to exercise closer oversight of management (Maqbool et al., 2019). Empirical research shows that high institutional ownership can suppress earnings management practices and increase the transparency and integrity of financial reporting (Oktaviani et al., 2021).

However, empirical findings regarding the influence of institutional ownership also show mixed results. Some studies suggest that institutional ownership has no significant effect on financial statement integrity because institutional investors are passive or short-term oriented, resulting in ineffective oversight (Ayunani & Handayani, 2024). These differing results indicate that the effectiveness of institutional ownership is highly dependent on the quality of corporate governance and the institutional environment.

Another internal governance mechanism that plays a role in maintaining financial reporting integrity is the independent commissioner. Independent commissioners are expected to perform checks and balances objectively and neutrally in overseeing management, particularly in the financial statements preparation process (Weygandt et al., 2015). Several studies have found that the presence of independent commissioners positively impacts financial statements integrity by limiting opportunistic management behavior and increasing reporting transparency (Oktaviani et al., 2021) (Wang, 2024).

However, other research shows that independent commissioners do not always significantly impact financial reporting integrity. This ineffectiveness is caused by formal independence, limited competence, and coordination and communication issues within the board of commissioners (Nurbaiti & Elisabet, 2023). This finding confirms that the structural presence of independent commissioners does not necessarily guarantee substantive oversight effectiveness.

Auditing literature emphasizes that the effectiveness of oversight mechanisms, both internal and external, is significantly influenced by audit quality. Audit quality reflects the auditor's ability to detect and report material misstatements independently and objectively (Arens et al., 2017). Research shows that high-quality audits can enhance the credibility and integrity of financial statements (Choi et al., 2020).

However, most previous studies position audit quality as an independent variable that directly influences financial statement integrity. This approach remains limited because it fails to fully explain how audit quality interacts with other oversight mechanisms, such as auditor industry specialization, institutional ownership, and independent commissioners (Rijal & Bakri, 2023) (Panjaitan et al., 2023)

Looking at the results of previous research which produced different conclusions. Therefore, this study aims to analyze the influence of auditor industry specialization, institutional ownership, and independent commissioners on financial reporting integrity, and to test the role of audit quality as a moderating variable in this relationship. This study makes a novel contribution to the accounting and auditing literature by reconceptualizing financial statement integrity as a result of the effectiveness of an integrated corporate oversight system, rather than solely as a consequence of accounting techniques or earnings quality. Unlike previous studies that tend to examine internal and external governance mechanisms separately, this study integrates internal oversight mechanisms (institutional ownership and independent commissioners) and external oversight mechanisms (industry specialist auditors) within a comprehensive theoretical framework. Furthermore, this study provides conceptual novelty by positioning audit quality as a moderating variable, rather than a direct determinant, thus emphasizing the role of audit quality as an institutional condition that determines the effectiveness of other oversight mechanisms. The findings of this study enrich the literature by demonstrating that external oversight mechanisms supported by high audit quality are more effective in maintaining financial reporting integrity than internal mechanisms alone, while challenging the normative assumption that formal governance structures automatically guarantee financial reporting integrity.

Although extensive research has been conducted on internal oversight mechanisms (institutional ownership and independent commissioners) and external oversight (auditor specialization), the empirical results are inconsistent and often tested separately. Furthermore, audit

quality is generally treated as a direct determinant of reporting integrity, thus failing to explain how audit quality acts as an institutional condition that strengthens/weakens the effectiveness of other oversight mechanisms. Therefore, this study fills this gap by examining audit quality as a moderating variable in the relationship between external and internal oversight mechanisms and financial reporting integrity in consumer goods companies listed on the Indonesia Stock Exchange (IDX) for the 2020–2024 period.

LITERATURE REVIEW

Agency Theory

Agency theory is a conceptual framework that explains the relationship between two things, parties, namely the principal (the party making the transfer) and the agent (the party receiving the transfer), who are involved in a employment contracts or cooperative relationships where there is an imbalance of information and Potential conflict of interest between the two (Jensen & Meckling, 1976). From an agency theory perspective, financial reporting integrity has direct implications for the relationship between principals (shareholders) and agents (management). Information asymmetry between the two parties can create room for agents to act opportunistically by presenting inaccurate or misleading information for personal gain. Therefore, financial reporting integrity is necessary to reduce moral hazard and build trust between company owners and managers. Auditor specialization also contributes to reducing the risk of information asymmetry between management and users of financial statements, because auditors have a more accurate understanding of common and uncommon reporting practices in a particular industry. Within the framework of agency theory, this helps reduce the potential for moral hazard by agents, as the presence of specialized auditors increases the probability that any irregularities will be detected. From an agency theory perspective, independent auditors act as a monitoring mechanism that mitigates conflicts between shareholders (principals) and management (agents). Auditors with industry specialization have superior information and technical expertise to detect indications of earnings manipulation common in specific sectors and tend to be more critical of management estimates. Agency theory provides a conceptual basis for the importance of institutional ownership. In an agency relationship, managers, as agents, tend to act in their own interests and not always in line with the interests of the company's owners (principals).

In this case, the presence of institutions as shareholders puts pressure on management to act in accordance with the company's objectives because institutions have strong bargaining power and analytical capabilities in monitoring management performance and decisions (Januarti & Fitrianasari, 2019). Institutional ownership is expected to reduce conflicts of interest and promote efficiency in the management of company resources. Within the framework of agency theory, the inherent conflict between principal and agent (management) requires an effective oversight mechanism, and independent commissioners are considered neutral external representatives to ensure management's adherence to shareholder interests. When large institutions own shares in a company, they have long-term interests and the resource acumen to demand good governance. Therefore, large institutions tend to encourage companies to appoint more independent commissioners. Therefore, this ratio serves as an indicator of the existence and effectiveness of quality external controls, while also demonstrating how institutions exercise their influence on the supervisory board.

Stakeholder Theory

Stakeholder theory is a conceptual approach that emphasizes the importance of identify and manage the various interest groups (stakeholders) involved in or affected by an event organizational activities. This theory was introduced systematically by (Freeman & McVea, 1984) and has experiencing various developments along with increasing business complexity and The social environment of the organization. Within the framework of stakeholder theory, Organizations are not only responsible to shareholders, but also to all parties who have an interest in them. Organizational sustainability, such as employees, customers, communities, etc. government, and the environment (Sari & Nugroho, 2018)

In principle, stakeholder theory is based on the assumption that an organization's success and

sustainability depend on its ability to manage the relationships and interests of the various parties involved. This differs from the classical approach of agency theory or the theory of the firm, which places shareholders as the sole priority.

In practice, organizations are faced with various, often conflicting, demands from various stakeholder groups. For example, investors demand increased profitability, while society desires environmental responsibility, and employees desire improved well-being. Therefore, stakeholder theory encourages management to adopt an inclusive, dialogue-based approach with these various parties to reach fair and sustainable decisions (Fitria & Saputra, 2020).

Stakeholder theory normatively emphasizes the importance of ethical treatment of all stakeholders. Every stakeholder has a moral right to be considered in the organizational decision-making process, regardless of their economic power or formal legal standing. This view provides ethical and social dimensions to organizational management. In this context, the stakeholder approach supports the principles of good governance, accountability, and public participation (Hidayah & Rachman, 2021).

One important aspect of applying stakeholder theory is stakeholder mapping and analysis. This process aims to identify relevant stakeholders, their influence and importance to the organization, and appropriate communication and engagement strategies. Tools such as the stakeholder salience model, which measures stakeholder power, legitimacy, and urgency, are often used to prioritize management actions (Nugrahani & Syamsuddin, 2019). To address these challenges, several theoretical developments have been carried out through integration with other approaches, such as legitimacy theory, institutional theory, and the concept of sustainability. This approach strengthens the argument that stakeholder attention is not merely normative but also fulfills the organization's need to achieve long-term social legitimacy.

Financial Reporting Integrity

Financial reporting integrity refers to the extent to which financial statements convey information that is correct, comprehensive, impartial, and free from manipulation, therefore Financial statements that accurately depict the economic status of an entity. Integrity not only means adhering to technical accounting standards but also maintaining trust users, including investors, creditors, and other stakeholders.

Within the IFRS-based financial reporting framework, as explained by Kieso, the principle of faithful representation is the primary foundation of financial statement integrity. Faithful representation requires that accounting information reflect the true economic conditions, not merely the results of calculations that can be influenced by manipulation or fabrication. Integrity in financial reporting also encompasses honesty in data presentation, completeness of relevant information, and a neutral attitude free from bias. These three elements are essential for financial statements to be used as a basis for reliable decision-making. Conversely, financial reporting integrity will be degraded if there are transaction manipulations, material errors, or omissions of significant information that could potentially mislead users. Therefore, compliance with these principles is essential to maintaining the reliability and credibility of financial statements in accordance with IFRS standards. (Kieso et al., 2020)

In other words, financial reporting integrity is the foundation of reliability. Financial statement integrity is not simply about following accounting standards, but about a commitment to maintaining honesty and transparency, so that the statements truly serve as a reliable basis for decision-making. Without integrity, financial statements cannot be used as a basis for sound economic decisions.

Financial reporting integrity is closely related to management ethics and organizational culture. When management possesses high personal integrity, the tendency to engage in earnings management practices or manipulate financial reports is lower. Conversely, pressure to achieve specific financial targets or the push from company owners to maximize short-term profits can trigger low financial reporting integrity (Fauzan & Ardiansyah, 2021).

In conclusion, financial statement integrity is the primary foundation of a reliable and credible financial reporting system. Without integrity, financial statements become mere tools of manipulation that can harm many parties and disrupt economic stability. Therefore, financial

statement integrity must be maintained through a combination of regulations, good governance, information technology, and character and ethics development among business actors and accounting professionals.

Auditor Industry Specialization

Auditor industry specialization is a condition where an auditor has in-depth knowledge expertise, knowledge, and experience in the unique characteristics of a particular industry. This Specialization allows auditors to understand complexities more comprehensively transactions, regulations, and risks inherent in the industry being audited. Therefore, the auditor Industry specialization is believed to improve audit quality more accurately identify risks of material misstatement, design relevant audit procedures, and provide greater assurance regarding the fairness of financial statements .

Institutional Ownership

Institutional ownership is the ownership of shares by an institution or organizations that play a significant role in overseeing company management. These institutions use their knowledge and professionalism to monitor management performance and assess financial statements , thereby encouraging management to act in accordance with regulations and improving the quality of financial statements . Institutional ownership is considered an effective control mechanism in managerial decision-making and can reduce opportunistic behavior among managers (Pardede & Andesto, 2024). Overall, institutional ownership can be considered a crucial pillar of a modern corporate governance system. Its role as a professional, independent, and long-term-oriented shareholder contributes significantly to increased transparency, efficiency, and management accountability.

Independent Commissioner

Independent commissioners can be understood as a governance instrument that not only enhances the credibility of corporate management but also strengthens stakeholder trust in the reliability of financial information and the company's sustainability (Kieso et al., 2020). In the context of financial reporting integrity, independent commissioners have a strategic role in ensuring that the reports presented by management comply with generally accepted accounting principles and fairly reflect the company's financial condition.

Audit Quality

Audit quality is the level of professionalism in audit implementation, encompassing the technical, ethical, and attitudinal aspects of the auditor. Audit quality is determined not only by the auditor's technical skills, but also by the auditor's ethical orientation and integrity, which influence audit results. Auditors with high competence, integrity, and independence will produce quality audits that support transparency, accountability, and good governance, particularly in state financial management (Insanuadi & Muhyarsyah, 2025). Audit quality is influenced by various internal and external factors of the auditor, including competence, independence, experience, industry specialization, and regulatory pressure.

Hypothesis

H1: The Influence of Auditor Industry Specialization on financial reporting integrity

Auditors with industry specializations not only require formal education in Accounting and auditing, but also a deeper understanding of the client's industry to identify Misrepresentation in financial statements caused by error or fraud. This is supported by Research conducted by (Oktaviani et al., 2021), which states that the audit industry Specialization affects financial reporting integrity

H2: The Impact of Institutional Ownership on Financial statements Integrity

Institutional investors offer oversight that can reduce managers' tendency to Prioritizing personal interests over the collective goals of the company. Research by Ramadani and Triyanto (2019) show that institutional ownership has a positive Affect financial reporting integrity .

H3: The Impact of Independent Commissioners on financial reporting integrity

The involvement of independent commissioners is expected to improve quality and financial reporting integrity submitted by companies. Research by (Oktaviani et al., 2021) showed that independent commissioners have a negative impact on financial reporting integrity. This study confirms research by Sucitra et al. (2020), which shows that independent commissioners substantially increase integrity of financial statements

H4: The Impact of Auditor Industry Specialization on financial reporting integrity with Audit Quality as a Moderating Variable

High audit quality increases stakeholder confidence in financial statements and guarantee that the statement authentically and accurately represents the company's financial status. Research by (Oktaviani et al., 2021) shows that audit quality significantly improve the integrity of financial reporting. A high-quality audit can strengthen the integrity of financial reports because competent and independent auditors are able to effectively oversee a company's financial reporting practices. This reduces the risk of manipulation or misleading information presentation. Therefore, good audit quality will increase stakeholder confidence in financial reports and ensure that they honestly and accurately reflect the company's financial condition.

H5: The Influence of Institutional Ownership on financial reporting integrity with Audit Quality as a Moderating Variables

When audit quality is high, supervision becomes more effective due to competence. Auditors can provide accurate and reliable information regarding a company's finances. This condition increases the confidence of institutional investors and allows them to perform their supervisory function becomes more effective, thereby improving financial integrity statement. Research conducted by (Amelia et al., 2021) shows that audit quality, as moderating variables, can strengthen the influence of institutional ownership on financial integrity of the statement. Audit quality can strengthen the influence of institutional ownership on financial statement integrity because high-quality auditors enhance the effectiveness of oversight performed by institutional investors as representatives of shareholders. Institutional investors play a crucial role in monitoring management to prevent opportunistic behavior. When audit quality is high, this oversight becomes more effective because competent auditors can provide accurate and reliable information regarding the company's financial condition. This increases institutional investors' confidence and enables them to perform their oversight function more effectively, thereby improving financial reporting integrity.

H6: The impact of independent commissioners on financial reporting integrity with audits Quality as a Moderating Variable

A competent auditor provides accurate and reliable information to independent parties the commissioners, facilitating necessary and effective oversight activities. As a result, Audit quality is an important element that strengthens the effectiveness of independent institutions. Commissioners play a role in improving the integrity of a company's financial statements. Research by Yulinda (2016) shows that independent commissioners have a positive influence and have a significant impact on financial reporting integrity. Independent commissioners serve as supervisors, ensuring that management does not manipulate financial reports for their own personal interests. However, the effectiveness of this oversight depends heavily on the quality of the audit performed by the auditor. High-quality auditors, especially those with industry expertise, can more easily detect irregularities and errors in financial reports. Therefore, the presence of qualified auditors strengthens the role of independent commissioners in ensuring the integrity of financial reports. This is because qualified auditors provide accurate and reliable information to independent commissioners, enabling them to take appropriate and effective supervisory actions. Therefore, audit quality is a crucial factor supporting the effectiveness of independent commissioners in enhancing the integrity of a company's financial reports.

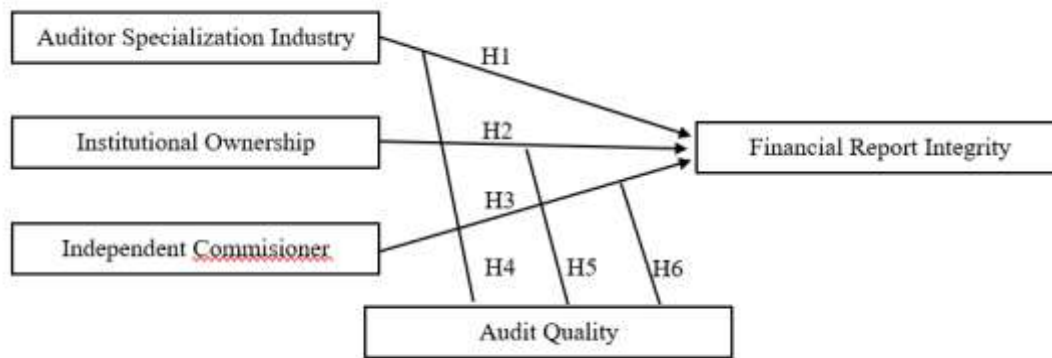


Figure 1. Conceptual Framework

METHODE

This research uses quantitative methodology and the population in this research is the entire population. manufacturing companies in the consumer goods sector listed on the Indonesia Stock Exchange for 2020-2024 period, with a total of 132 companies. In determining the sample companies, sampling The technique used is purposive sampling. Based on the established criteria, a sample of 35 companies was obtained that met the criteria over five (5) years of observation.

The data collection technique in this study uses The documentation method utilizes secondary data. The testing technique in this study was carried out in the following manner: using the Eviews application program. A quantitative approach is used to test the causal relationship between auditor industry specialization, institutional ownership, and independent commissioners on financial statement integrity, with audit quality as a moderating variable. Panel data regression was chosen because it can accommodate data characteristics that combine company and time dimensions, and provides more efficient estimation by controlling for unobserved heterogeneity. The selection of the estimation model is carried out systematically through the Chow test, the Hausman test, and the Lagrange Multiplier test to ensure the model's suitability to the research data structure. The moderating role of audit quality is analyzed using Moderated Regression Analysis (MRA) to evaluate the interaction mechanism between variables more comprehensively.

Financial Reporting Integrity

Financial reporting integrity is a fundamental principle that ensures the organization operates in a transparent, ethical and accountable manner with provide clear, accurate and timely financial information to stakeholders. The formula used for financial reporting integrity in this research is :

$$CONACC = \frac{(Niit - CFOit) \times (-1)}{Total Assets}$$

- CONACC : The level of company conservatism in a period
- Niit : Net income plus depreciation of company i in year t
- CFOit : Cash flows from the company's operational activities

This ratio is used as an indicator for calculating financial reporting integrity because it captures the magnitude of the accrual component in a company's earnings, reflecting earnings quality. According to (Dechow & Dichev, 2001), high total accruals, especially when NI significantly exceeds CFO, indicate poor-quality earnings or the possibility of earnings manipulation.

In general, when the conservatism value is at an extreme level, either too low (close to zero or positive), it reflects overstated earnings and aggressive behavior, or too high (large negative accruals), it indicates excessive profit suppression, indicating management bias. Therefore, bias in financial statement integrity can be detected when the conservatism value is at either extreme: too aggressive (optimistic) or too pessimistic (understated).

Auditor Specialization Industry

Auditor industry specialization is the auditor's ability or audit firm to develop in-depth expertise in a particular industry, which is usually measured by local or international market share, national expertise that auditors have in the industry. This specialization enable auditors to provide higher quality audits and charge a premium for better service. The formula for the auditor industry specialization variable is as follows :

$$\text{Market Share Auditor} = \frac{\text{Number of Companies Audited by KAP}}{\text{Number of sample companies}}$$

The calculation of the auditor industry specialization variable uses several approaches, one of which is based on the auditor's market share within an industry. This market share can be calculated using the number of auditor clients in that industry to avoid bias toward the size of large client companies (Marsetio et al., 2022). Specifically, an auditor's market share is calculated using a formula that involves the proportion of the auditor's clients to the total number of companies audited in that industry. If an auditor's market share in a given year exceeds the threshold value (WMSCO), the auditor is categorized as an industry specialist and is assigned a code of 1; otherwise, it is assigned a code of 0.

In measuring auditor industry specialization, a threshold of 20% is used. Therefore, a Public Accounting Firm with a client percentage in a single industry exceeding 20% is considered to have auditor industry specialization and is coded 1, while those with a percentage below 20% are coded 0 (Aronmwan et al., 2003).

Institutional Ownership

Institutional ownership is the ownership of shares by investors institutions that have significant interests (minimum 5% ownership) in several companies, especially in industries that same. Proxy formula used in institutional ownership variables as follows :

$$\text{Institutional Ownership} = \frac{\text{Number of shares owned by the institution}}{\text{Number of shares issued}}$$

The use of these proxies in assessing the presence and effectiveness of institutions is highly relevant. This is because they reflect the extent of external pressure from professional shareholders on management, which, according to agency theory, will influence the institution's oversight power. Consequently, companies are more likely to produce financial statements with greater integrity due to the presence of more credible and independent control mechanisms over management (Tran, 2020).

Independent Commissioner

Independent commissioners in Indonesia are parties appointed to represent the interests of minority shareholders and provide independent oversight of the company. They formally separate from the board of directors so that it is hoped that it can carry out supervision without any conflict of interest. Independent commissioners are measured using the following formula :

$$\text{Independent Commissioners} = \frac{\text{Number of independent commissioners}}{\text{Number of members of the board of commissioners}}$$

The use of these proxies quantitatively reflects the proportion of board members who are truly independent in the eyes of institutional shareholders. These proxies provide insight not only into board structure but also into the extent to which external institutional pressure influences the balance of power within the company, ultimately impacting financial reporting integrity . (Litasia et al., 2023)

Audit Quality



Audit quality is a combination of the auditor's ability to detect and report errors and compliance with standards applicable audits, which ultimately guarantee the quality of reporting high financial. Several indicators frequently used to measure audit quality include the size of the Public Accounting Firm (KAP), the auditor's industry specialization, audit tenure, auditor rotation, and auditor reputation. KAP size is often used as a proxy for audit quality, assuming that large auditors, such as the Big Four, have better resources, audit systems, and quality control procedures than smaller KAPs. Audit quality measurement using a dummy measurement scale namely by giving a value of 1 to companies that use Big four Public Accounting Firms, and a value of 0 for companies that do not using the big four Public Accounting Firms.

Audit quality is measured by distinguishing between Big Four (code 1) and Non-Big Four (code 0) auditors because large accounting firms typically have greater resources and a higher reputation, and are therefore assumed to produce better audit quality. Furthermore, Big Four auditors are considered to have greater capabilities and experience in auditing large and complex companies than auditors from small or non-Big Four accounting firms (Tandiontong, 2015).

Table 1. Variable Measurement

No	Variable	Indicator	Measurement Scale
1	Financial Reporting Integrity (Y) (Dechow & Dichev, 2001)	$CONACC = \frac{(N_{iit} - CFO_{it}) \times (-1)}{Total\ Assets}$	Ratio
2	Auditor Specialization Industry (X1) (Marsetio et al., 2022)	Market Share Auditor = $\frac{Number\ of\ Companies\ Audited\ by\ KAP}{Number\ of\ sample\ companies}$	Ratio
3	Institutional Ownership (X2) (Tran, 2020)	Institutional Ownership = $\frac{Number\ of\ shares\ owned\ by\ the\ institution}{Number\ of\ shares\ issued}$	Ratio
4	Independent Commissioner (X3) (Litasia et al., 2023)	Independent Commissioners = $\frac{Number\ of\ independent\ commissioners}{Number\ of\ members\ of\ the\ board\ of\ commissioners}$	Ratio
5	Audit Quality (Z) (Tandiontong, 2015)	a. Companies audited by non-Big Four accounting firms = code 0 b. Companies audited by Big Four accounting firms = code 1	Dummy

RESULT

Panel Data Regression Model Selection

Table 2. Chow Test

Redundant Fixed Effects Tests			
Equation: Untitled			
Test	Cross-section fixed effects		
Effects Test	Statistic	d.f.	Prob.
Cross-section F	4.018044	(34,136)	0
Cross-section Chi-square	121.695	34	0

The results of the Chow test show that the Cross-section F and Chi-square probability values are 0.0000, which is less than 0.05. The results of this model indicate that the best model is the Fixed Effect Model.

Table 3. Hausman Test

Correlated Random Effects - Hausman Test			
Equation: Untitled			
Test Cross-section random effects			
Test Summary	Chi-Sq. Statistic	Chi-Sq. d.f.	Prob.
Cross-section random	16.006359	4	0.003

The Hausman test results show a random cross-section probability value of 0.0030, which is less than 0.05. The results of this test indicate that the best model is the Fixed Effect Model.

Table 4. Lagrange Multiplier Test

Lagrange Multiplier Tests for Random Effects			
Null Hypothesis: No effects			
Alternative Hypothesis Two-sided (Breusch-Pagan) and one-sided (all others)			
Test Hypothesis			
	Cross-section	Time	Both
Breusch-Pagan	34.22601 (0.0000)	3.024217 (0.0820)	37.25023 (0.0000)

The Lagrange multiplier test results indicate that the Breusch-Pagan cross-section probability value is 0.0000, which is less than 0.05. The test results indicate that the best model is the Random Effects Model. Based on the results of the three models, it can be concluded that the best model used in this study is the Fixed Effects Model.

Classical Assumption Test

Normality Test

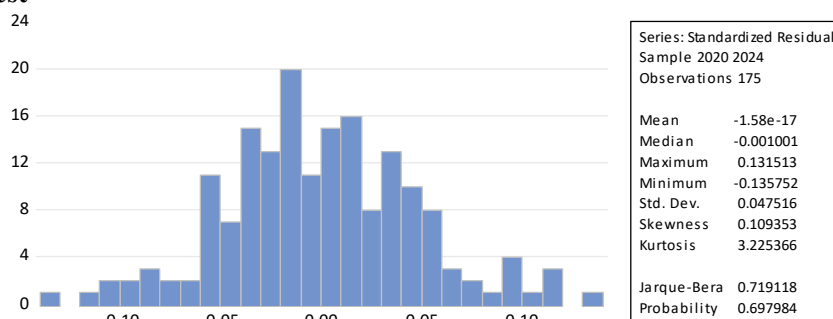


Figure 1. Normality Test

Based on the results of the normality test above, the Jarque-Bera (J-B) value is 0.719118 with a probability value of 0.697984. This probability value is greater than 0.05, so it can be concluded that the data in this study is normally distributed.

Multicollinearity Test

Table 4. Multicollinearity Test

Variance Inflation Factors			
Date	02/18/26		
Time	00:02		
Sample	1 175		
Included observations	175		
Variable	Coefficient Variance	Uncentered VIF	Centered VIF
C	0.007034	562.6399	NA
MSA	0.0000552	1.893622	1.08207
KI	0.0003	11.46381	1.106171

PDKI	0.002299	30.73064	1.094278
SIZE	0.0000079	563.2951	1.369469
ROA	0.003977	3.633551	1.053168
KA	0.0000708	3.688155	1.285585

The results of the multicollinearity test show that the centered Variance Inflation Factor (VIF) values for all variables are below 80, so it can be concluded that the model does not experience multicollinearity symptoms and the regression estimates remain reliable.

Heteroscedasticity Test

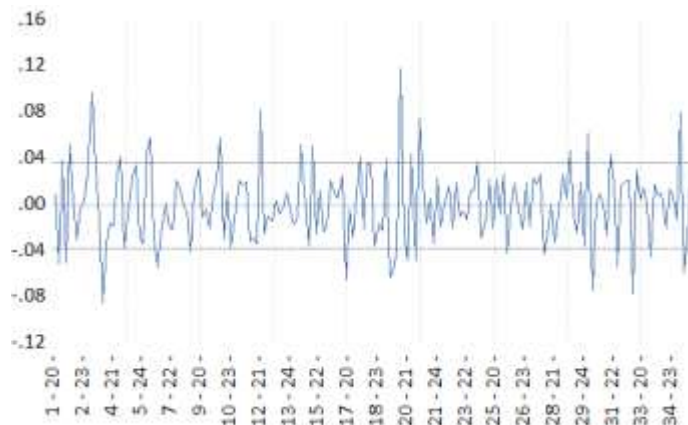


Figure 2. Heteroscedasticity Test

Analysis of the Coefficient of Determination (R2)

Table 5. Model 1 Multiple Linear Regression Analysis

Effect Spesification			
Cross-section fixed (dummy variables)			
R-squared	0.691223	Mean dependent var	0.004242
Adjusted R-squared	0.604947	S.D. dependent var	0.059596
S.E. of regression	0.037458	Akaike info criterion	-3.53761
Sum squared resid	0.190822	Schwarz criterion	-2.83231
Log likelihood	348.5407	Hannan-Quinn criter.	-3.25152
F-statistic	8.011782	Durbin-Watson stat	2.385967
Prob(F-statistic)	0		

Table 6. Model 2 Moderated Regression Analysis

Effect Spesification			
Cross-section fixed (dummy variables)			
R-squared	0.730661	Mean dependent var	0.004242
Adjusted R-squared	0.650261	S.D. dependent var	0.059596
S.E. of regression	0.035244	Akaike info criterion	-3.6514
Sum squared resid	0.16645	Schwarz criterion	-2.90993
Log likelihood	360.4972	Hannan-Quinn criter.	-3.35064
F-statistic	9.087834	Durbin-Watson stat	2.371032
Prob(F-statistic)	0		

Based on the results of the coefficient of determination test in the Fixed Effect Model (FEM)

above, in model 1, the Adjusted R-Square value is 0.604947 or 60.49%. This explains that the percentage of influence of the independent variables Auditor Specialization Industry, Institutional Ownership, Independent Commissioners, Company Size, and Profitability on Financial Statement Integrity is 60.49%. While the remaining 39.51% is explained by other variables outside this study. Based on model 1, the regression equation can be formulated as follows:

$$ILK = -0.2538 + 0.0630MSA + 0.0626KI + 0.0259PDKI + 0.0055SIZE + 0.1308ROA$$

The adjusted R-square value for model 2 was 0.650261, or 65.02%. This means that audit quality, as a moderating variable, can strengthen the influence of the independent variable on the dependent variable by 4.53%. Based on model 2, the following regression equation can be formulated:

$$ILK = -0.1666 + 0.0036MSA + 0.0009KI + 0.0369PDKI + 0.0031SIZE + 0.1813ROA + 0.0835MSAXZ + 0.0407KIXZ + 0.0204PDKIXZ - 0.0007SIZEZX - 0.1086ROAXZ$$

Table 2. T-Test Result

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	-0.253817	0.083867	-3.026427	0.0029
MSA	0.063040	0.007432	8.482111	0.0000
KI	0.062678	0.017307	3.621625	0.0004
PDKI	0.025997	0.047948	0.542190	0.5884
SIZE	0.005526	0.002811	1.965855	0.0510
ROA	0.130838	0.063060	2.074798	0.0395
KA	0.004368	0.008413	0.519212	0.6043

Source : Eviews Program

Based on the t-test results, the findings can be summarized as follows:

1. **Auditor Industry Specialization.** The significance value is 0.0000 (<0.05), and the t-value (8.482111) exceeds the t-table (1.97410), indicating a significant positive effect on financial reporting integrity.
2. **Institutional Ownership.** The significance value is 0.0004 (<0.05), and the t-value (3.621625) is greater than the t-table (1.97410), indicating a significant positive effect on financial reporting integrity.
3. **Independent Commissioners.** The significance value is 0.5884 (>0.05), and the t-value (0.542190) is lower than the t-table (1.97410), indicating no significant effect on financial reporting integrity.

Table 3. MRA Test

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	-0.166683	0.069960	-2.382566	0.0183
MSA	0.003644	0.008172	0.445906	0.6563
KI	0.000900	0.017328	0.051942	0.9586
PDKI	0.036978	0.054863	0.674011	0.5013
SIZE	0.003159	0.002321	1.360899	0.1754
ROA	0.181307	0.080857	2.242320	0.0263
MSAxZ	0.083507	0.008769	9.523441	0.0000
KIxZ	0.040706	0.021115	1.927834	0.0556
PDKIxZ	0.020400	0.068184	0.299198	0.7652
SIZExZ	-0.000764	0.001058	-0.722363	0.4711
ROAxZ	-0.108669	0.107030	-1.015318	0.3114

Source : Eviews Program

Based on the MRA results, the interaction between Auditor Industry Specialization and Audit Quality has a probability value of 0.0000 (<0.05), indicating that audit quality strengthens the effect of auditor specialization on financial reporting integrity. In contrast, the interaction between Institutional Ownership and Audit Quality ($0.0556 > 0.05$), as well as Independent Commissioners and Audit Quality ($0.7652 > 0.05$), shows that audit quality does not moderate these relationships.

These findings suggest that audit quality reinforces the role of auditor specialization but does not enhance the effect of institutional ownership or independent commissioners. From an agency theory perspective, institutional ownership already functions as a strong internal monitoring mechanism due to its analytical capacity, access to information, and direct oversight, making additional external mechanisms such as audit quality less impactful.

Conversely, for industry-specialized auditors, audit quality acts as a reinforcing factor because specialization alone does not guarantee objective and rigorous audit procedures. Familiarity risks may reduce professional skepticism, and high audit quality ensures adherence to professional standards. Additionally, institutional ownership measured by share percentage may not fully capture monitoring intensity, and potential endogeneity may exist, as firms with strong governance tend to select high-quality auditors. Therefore, the moderating role of audit quality is contextual and more relevant when internal governance mechanisms are weaker.

Firm size and profitability (ROA) are included as control variables to account for basic firm characteristics that may influence financial reporting integrity. These variables are not the main focus of hypothesis testing but serve to improve the accuracy of the model estimation.

DISCUSSION

Based on the results of multiple regression analysis and MRA, multiple regression analysis shows that Auditor Specialization Industry and Institutional Ownership have a significant effect on Financial reporting integrity, while Independent Commissioners have no significant effect. However, when tested using MRA, it was found that Audit Quality as a moderating variable was able to strengthen the relationship between Auditor Specialization Industry and Financial reporting integrity, but did not moderate the relationship between Institutional Ownership or Independent Commissioners and Financial reporting integrity.

These results confirm that Audit Quality is categorized as a pure moderator variable, because its role emerges through interactions with certain independent variables, not as a direct predictor variable.

The Influence of Auditor Specialization Industry on financial reporting integrity

The results indicate that auditor industry specialization has a significant positive effect on financial reporting integrity. This finding shows that industry-specialized auditors provide higher-quality audits due to their deeper understanding of industry characteristics, transaction patterns, and inherent risks. Such expertise enables them to identify unusual transactions, compare financial statements with industry norms, and more effectively detect errors or fraud. Consequently, management becomes more cautious in financial reporting, leading to higher integrity of financial statements.

From an agency theory perspective, conflicts between management (agents) and shareholders (principals) create incentives for opportunistic behavior. Industry-specialized auditors function as an effective external monitoring mechanism to reduce information asymmetry and limit financial manipulation. Theoretically, their superior knowledge enhances professional judgment in detecting material misstatements, thereby improving both audit quality and financial reporting integrity.

These findings are consistent with prior studies by (Oktaviani et al., 2021) and (Chouaibi & Hichri, 2020), which also report a positive and significant effect of auditor specialization on financial reporting integrity. This study extends the literature by emphasizing financial reporting integrity—rather than audit or earnings quality—as the primary outcome, highlighting that the benefits of auditor specialization are reflected not only in the audit process but also in higher-quality financial reporting outputs.

The Influence of Institutional Ownership on financial reporting integrity



The results show that institutional ownership has a significant positive effect on financial reporting integrity. This indicates that institutional investors—such as insurance companies, pension funds, and other financial institutions—enhance management oversight due to their superior analytical capacity, knowledge, and resources compared to individual shareholders. As a result, they tend to be more active in monitoring management, encouraging greater transparency and reducing opportunistic financial reporting practices. Higher institutional ownership increases management's incentive to present financial statements with integrity.

Moreover, institutional investors have substantial financial stakes in firm performance and sustainability. The higher their ownership, the greater the potential loss from misleading financial statements, prompting management to ensure accurate, complete, and reliable reporting in accordance with accounting standards.

From agency and stakeholder theory perspectives, institutional ownership serves as an effective monitoring and market discipline mechanism that suppresses opportunistic behavior and promotes transparency to maintain reputation and investor trust. These findings suggest that financial reporting integrity reflects the balance of power between management and institutional shareholders.

This study supports prior research by (Maqbool et al., 2019) and (Oktaviani et al., 2021), which also find a positive relationship between institutional ownership and financial reporting integrity. Importantly, this study emphasizes that the effect is not merely driven by ownership structure, but by the active monitoring role and long-term orientation of institutional investors.

The Influence of Independent Commissioners on financial reporting integrity

The results show that independent commissioners do not have a significant effect on financial reporting integrity. This may be explained by several common conditions, particularly in developing countries such as Indonesia. First, the presence of independent commissioners is often merely symbolic to fulfill regulatory requirements, with limited understanding of financial reporting, leading to suboptimal oversight. Second, multiple board positions may reduce their involvement and effectiveness, resulting in passive supervision. Third, close relationships with management or other board members may weaken their independence and limit critical oversight.

The insignificant effect indicates that the formal presence of governance mechanisms does not necessarily reflect substantive effectiveness. From an agency theory perspective, independent commissioners are expected to function as internal monitors to reduce opportunistic behavior; however, this role has not been fully optimized. This may be due to limited de facto independence, lack of financial expertise, or management dominance in decision-making, highlighting a gap between governance design and practice.

These findings are consistent with (Nurbaiti & Elisabet, 2023), which also found no effect of independent commissioners on financial reporting integrity. However, they differ from studies reporting a positive impact, suggesting that the effectiveness of independent commissioners is highly contextual and influenced by institutional settings, governance culture, and human resource quality. Therefore, this study emphasizes that the role of independent commissioners should be evaluated not only in terms of presence but also in terms of quality and actual effectiveness in oversight.

The Influence of Auditor Specialization Industry on Financial statements Integrity with Audit Quality as a Moderating Variable

The results show that audit quality strengthens the effect of auditor industry specialization on financial reporting integrity. This indicates that auditor specialization alone is insufficient without high audit quality. While industry-specialized auditors possess a deeper understanding of business characteristics, risks, and complexities, these advantages do not fully translate into high-integrity financial statements without strong audit quality standards. This is because specialization may also create familiarity risks, potentially reducing professional skepticism as auditors become accustomed to industry practices and may tolerate certain deviations.

In this context, audit quality functions as a control mechanism that ensures auditor competence

is applied objectively and in accordance with strict standards. High audit quality promotes more rigorous procedures, tighter oversight, and systematic review processes, thereby maintaining auditor skepticism and preventing reduced vigilance. Consequently, audit quality enhances the effectiveness of auditor specialization in improving financial reporting integrity.

From an agency theory perspective, industry-specialized auditors act as a monitoring mechanism to reduce opportunistic behavior by management, but their effectiveness is amplified by high audit quality, which ensures adherence to professional standards and limits financial manipulation. From a stakeholder theory perspective, financial statements represent corporate accountability to all stakeholders, who require reliable information for decision-making. The combination of auditor specialization and high audit quality produces higher-integrity financial reports and strengthens stakeholder trust.

Overall, these findings highlight the importance of synergy between auditor competence and audit quality. Auditor specialization will have a stronger impact on financial reporting integrity when supported by high audit quality, indicating that competence alone does not yield optimal outcomes.

The Effect of Institutional Ownership on financial reporting integrity with Audit Quality as a Moderating Variable

The results indicate that audit quality does not reduce or strengthen the effect of institutional ownership on financial reporting integrity. This suggests that monitoring by institutional investors is already sufficiently strong, making audit quality as an external mechanism provide limited additional value. Institutional ownership, as an internal governance mechanism, effectively mitigates opportunistic managerial behavior.

From an agency theory perspective, institutional investors have strong monitoring power through access to information and voting rights, enabling them to directly suppress agency problems. The findings show that this monitoring role is sufficiently effective, so audit quality does not further strengthen its impact. This implies that in certain contexts, strong internal governance can reduce reliance on external mechanisms such as audit quality. From a stakeholder theory perspective, institutional ownership encourages transparency and accountability, as long-term institutional investors demand reliable financial information to maintain firm value and reputation. Therefore, audit quality does not play a significant moderating role because institutional ownership alone already ensures accountability.

Overall, these findings highlight that audit quality does not always function as a reinforcing factor in every governance mechanism. In the case of institutional ownership, its monitoring effectiveness is already strong, making additional audit quality less impactful. This confirms that the effectiveness of governance mechanisms is contextual and depends on the strength of existing internal controls.

The Influence of Independent Commissioners on financial reporting integrity with Audit Quality as a Moderating Variable

The results show that audit quality does not moderate the effect of independent commissioners on financial reporting integrity. This indicates that the role of independent commissioners in ensuring transparency and reliability of financial statements is not yet effective, so audit quality does not strengthen this relationship. Even with high-quality audits, the supervisory effectiveness of independent commissioners does not necessarily improve, possibly due to weak substantive independence, limited competence, or low involvement in financial reporting decisions.

From an agency theory perspective, these findings suggest that independent commissioners are unable to optimally perform their monitoring function, so audit quality cannot strengthen their role in reducing agency problems. This implies that the effectiveness of external mechanisms depends on the strength of internal governance. If internal oversight is weak, audit quality cannot function as a moderating factor. From a stakeholder theory perspective, independent commissioners are expected to ensure accountability and transparency for stakeholders. However, the results indicate

that audit quality does not enhance this role, showing that financial reporting integrity depends not only on external audits but also on the effectiveness of internal governance.

Overall, these findings confirm that audit quality does not always act as a moderating variable in corporate governance. In the case of independent commissioners, weak internal oversight limits the ability of audit quality to strengthen financial reporting integrity, highlighting the need for a balanced and equally effective combination of internal and external governance mechanisms.

Contextual explanation (Indonesia governance setting)

In the context of corporate governance in Indonesia, the effectiveness of oversight mechanisms is heavily influenced by the characteristics of ownership structures and corporate governance practices, which tend to be concentrated. Many Indonesian companies have controlling shareholders or dominant institutional investors actively involved in management monitoring. This situation often means that internal oversight functions through institutional ownership are already strong, so the role of audit quality as an external mechanism does not always provide an additional strengthening effect on financial reporting integrity. This finding is consistent with the view that when internal mechanisms are effective, reliance on external mechanisms becomes relatively lower.

Furthermore, the regulatory framework in Indonesia requires the implementation of good corporate governance, including the existence of independent commissioners and the use of external auditors. However, regulatory compliance is not always followed by substantive effectiveness in practice. Therefore, audit quality becomes more relevant as a reinforcing factor based on professional competence, such as auditor industry specialization, rather than structurally robust mechanisms such as institutional ownership. This confirms that the role of audit quality in corporate governance in Indonesia is complementary and contextual, rather than universal.

CONCLUSION

Based on the analysis using the Fixed Effect Model (FEM), multiple regression, and Moderated Regression Analysis (MRA), this study finds that auditor industry specialization and institutional ownership have a significant positive effect on financial reporting integrity, while independent commissioners have no effect. Audit quality acts as a pure moderating variable that strengthens the effect of auditor industry specialization but does not moderate the influence of institutional ownership or independent commissioners. These findings indicate that governance effectiveness is contextual: audit quality is crucial when combined with auditor competence, but adds limited value when internal monitoring mechanisms are already strong. Theoretically, this study enriches agency and stakeholder perspectives by emphasizing the importance of combined governance mechanisms in determining financial reporting integrity.

This study has several limitations. First, potential endogeneity and reverse causality remain, as conventional panel methods cannot fully capture simultaneous relationships. Second, measuring financial reporting integrity using a single accrual model may limit the detection of earnings management. Future research is recommended to apply more robust econometric methods such as GMM or 2SLS, use alternative accrual models (e.g., Modified Jones, Kothari performance-matched, or real earnings management), and expand the sample across sectors and longer periods to enhance generalizability.

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