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Effect of Audit Committee, Institutional Ownership, and Risk Committee on Audit Quality of Public Companies

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ABSTRACT

This study examines the influence of audit committees, institutional ownership, and risk committees on the quality of audits in public companies. Using a quantitative approach, data were collected from 160 professionals involved in corporate governance through a structured questionnaire using a Likert scale (1–5). The data were analyzed using Structural Equation Modeling with Partial Least Squares (SEM-PLS 3). The results show that all three independent variables—audit committee, institutional ownership, and risk committee—have significant and positive effects on audit quality. The audit committee demonstrates the strongest influence, highlighting its critical role in overseeing financial reporting and auditor performance. Institutional ownership enhances external monitoring, while the risk committee contributes through improved risk oversight. These findings underscore the importance of strong governance structures in ensuring high audit quality and financial transparency in public companies.

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1. INTRODUCTION

In the context of increasingly complex business environments and regulatory demands, the quality of audits has become a central concern for stakeholders, including investors, regulators, and the general public, as high-quality audits are essential for ensuring the credibility and transparency of financial statements—particularly for public companies whose disclosures significantly influence capital markets and investor confidence. Despite the existence of regulatory frameworks and auditing standards, audit failures continue to surface, raising critical questions about the effectiveness of governance mechanisms in safeguarding audit quality [1], [2]. Research highlights several interrelated factors influencing audit quality, including auditor independence and competence—where independence ensures objectivity and competence guarantees a thorough and effective audit process [1], [2], audit firm characteristics, such as tenure, size, and industry specialization, which shape the reliability of financial reporting (Darmawan, 2023); and regulatory oversight by bodies like the PCAOB and SEC, which play a critical role in promoting audit quality by deterring fraud

and ensuring auditor accountability [2], [3]. Furthermore, effective corporate governance mechanisms—including strong audit committees and comprehensive regulatory frameworks—are vital for improving audit quality and financial reporting transparency [1], [2], while stakeholder trust, fostered through transparent disclosure practices and accountability, remains crucial for ensuring market efficiency and protecting investors [3].

Corporate governance plays a pivotal role in enhancing audit quality, with key mechanisms such as audit committees, institutional ownership, and risk committees collectively strengthening the integrity and reliability of the auditing process. Audit committees serve as critical oversight bodies that facilitate communication between auditors and the board of directors, ensuring adherence to both national and international auditing standards, as well as engagement in internal and external audits, internal control, accounting, financial reportizng, regulatory compliance, and risk management [4], [5]. The presence of committee members with accounting expertise has been shown to significantly improve audit quality [6]. Institutional ownership, though not always statistically significant in its direct effect on audit quality, contributes positively by introducing sophisticated and vigilant investors who demand high governance standards and promote transparency and accountability within firms [6]. Risk committees, while not as extensively detailed, are generally responsible for overseeing organizational risk management, which is deeply interconnected with internal control systems and the effectiveness of the audit process. Their function complements that of audit committees by ensuring potential risks are identified and addressed, further supporting the overall robustness of corporate governance in safeguarding audit quality.

Prior research suggests a positive association between governance components—such as audit committees, institutional ownership, and risk committees—and audit quality; however, findings remain inconsistent and highly context-dependent, particularly in emerging markets where governance structures and enforcement mechanisms differ from those in developed economies. Some studies highlight the pivotal role of audit committees in improving audit outcomes, especially when members possess postgraduate qualifications and engage in frequent meetings that enhance oversight and accountability [7], while others emphasize the significance of institutional ownership in promoting transparency and reliable financial reporting, though ownership concentration may conversely reduce voluntary disclosures [8]. Risk committees also contribute indirectly to audit quality by strengthening internal risk monitoring and comprehensive risk management practices, and their role becomes more prominent when supported by independent boards and transparent disclosure policies [2], [8]. In the context of emerging markets, the presence of independent boards, institutional ownership, and the use of Big Four or internal auditors is associated with stricter governance and improved audit quality, although each metric reflects different dimensions of governance efficacy [8], [9], [10]. These inconsistencies and contextual variances underscore the need for further empirical investigation to better understand how governance mechanisms interact with audit quality in diverse regulatory and institutional environments. This study aims to examine the influence of audit committees, institutional ownership, and risk committees on the quality of audits of public companies in Indonesia.

2. LITERATURE REVIEW

2.1 Audit Committee and Audit Quality

Audit committees are essential in enhancing audit quality by reducing information asymmetry between managers and stakeholders, with key characteristics such as financial expertise, independence, meeting frequency, size, and composition playing vital roles. Studies show that committees with strong financial expertise improve financial reporting quality, attract more analyst coverage, and reduce forecast

dispersion [11]. Financial expertise—particularly non-accounting expertise—also correlates with higher audit fees, reflecting greater demand for audit rigor [12]. Independent committees that meet frequently are less prone to financial restatements and help lower information asymmetry Additionally, committee size and the proportion of members with financial or accounting backgrounds are linked to better reporting outcomes [11], [13]. However, independence alone appears insufficient, emphasizing that expertise and meeting regularity are more critical. These findings align with agency theory, highlighting audit committees as key governance mechanisms that enhance oversight and transparency.

2.2 Institutional Ownership and Audit Quality

Institutional ownership plays a significant role in enhancing audit quality by shaping corporate governance practices through the influence and oversight capabilities of sophisticated investors who possess the resources and expertise to demand higher standards of financial reporting and auditing. Firms with higher levels of institutional ownership tend to hire Big Four auditors—recognized as proxies for high audit quality—especially when the ownership is held by long-term investors who value governance and seek to minimize monitoring costs [14]. Moreover, institutional investors often encourage the selection of auditors with industry-specific expertise, further contributing to improved audit outcomes [15]. The nature of institutional ownership also affects audit risk and audit fees: while long-term ownership is generally associated with enhanced audit quality, short-term ownership may elevate audit risk, prompting auditors to charge higher fees due to the greater perceived uncertainty [14]. Conversely, increased institutional ownership can reduce audit risk in the eyes of auditors, leading to lower fees [15]. Additionally, institutional ownership correlates positively with the implementation of strong internal controls and transparent accounting practices, both of which are critical for maintaining high audit quality [14], [15].

2.3 Risk Committee and Audit Quality

The establishment of a separate risk committee is increasingly recognized as a best practice in corporate governance, particularly for managing complex business risks, as it enhances risk oversight and contributes to stronger internal controls and audit quality. Functioning as a complement to the audit committee, the risk committee provides an additional layer of governance focused on operational, financial, and compliance risks, thereby improving audit planning, execution, and outcomes. Empirical studies support the hypothesis that the existence and effectiveness of a stand-alone risk committee positively influence audit quality and firm performance. For example, firms with separate risk committees exhibit significantly reduced corporate risk-taking and improved firm value compared to those with joint audit and risk committees [16], while companies in Brazil that established risk management committees reported higher economic performance than those without such committees [17]. Moreover, audit committees increasingly require comprehensive information on risk exposures, driven by the strategic adoption of Enterprise Risk Management (ERM), which enhances board-level oversight and integrates risk awareness into governance structures [18]. In Australia, firms with dedicated risk management committees have demonstrated better outcomes in financial distress probability, growth opportunities, and return on assets, further validating the governance benefits of this structure [19].

2.4 Audit Quality as an Outcome of Governance Structures

Audit quality is a key aspect of corporate governance, reflecting transparency and accountability in financial reporting, and is influenced by factors such as audit committees, institutional ownership, and risk committees. These relationships are explained through agency, stakeholder, and resource dependence theories, which stress aligning stakeholder interests and strengthening oversight. Financially literate audit committees and independent boards enhance audit quality by improving monitoring [6],

[20]. Institutional ownership promotes high-quality audits and increased fees, while family ownership may reduce audit demand unless mitigated by board independence [21]. Additionally, the use of Big Four and internal auditors, along with auditor tenure, firm size, and industry expertise, contributes to better audit outcomes through improved independence and competence [1], [10].

2.5 Hypothesis Development

Based on the reviewed literature, the following hypotheses are proposed.

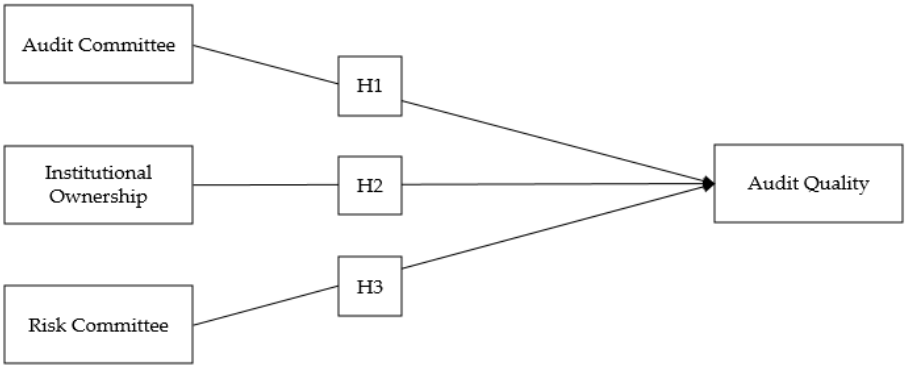

Figure 1. Conceptual Framework

3. METHODS

3.1 Research Design

The research employs a causal-comparative (explanatory) design, which is appropriate for analyzing the influence of independent variables—namely the audit committee, institutional ownership, and risk committee—on the dependent variable, audit quality. This design facilitates hypothesis testing grounded in theoretical frameworks and prior empirical findings, allowing for a systematic evaluation of the relationships among governance mechanisms and audit outcomes.

The study targets individuals engaged in corporate governance and financial oversight within public companies in Indonesia, including audit and risk committee members, internal and external auditors, financial managers, and board members. Using purposive sampling, respondents with relevant expertise were selected, resulting in 160 valid responses. This sample size satisfies the requirements for Structural Equation Modeling-Partial Least Squares (SEM-PLS), particularly for models with multiple constructs and indicators.

3.2 Data Collection

Data were collected through a structured questionnaire distributed both electronically and in printed form. The questionnaire items were adapted from validated instruments used in previous research to ensure their validity and reliability. A Likert scale ranging from 1 (Strongly Disagree) to 5 (Strongly Agree) was used to capture respondents' perceptions regarding the effectiveness and existence of governance mechanisms as well as the quality of audits. The questionnaire comprised four key sections: Audit Committee (e.g., independence, financial expertise, meeting frequency), Institutional Ownership (e.g., proportion of institutional shareholders, their monitoring role), Risk Committee (e.g., existence, competence, risk oversight), and Audit Quality (e.g., auditor independence, reliability, compliance with auditing standards).

Prior to full-scale analysis, the research instrument underwent testing to ensure construct validity and reliability. Convergent validity was confirmed through loading factors exceeding 0.70, while discriminant validity was assessed using the Fornell-Larcker criterion. Reliability was evaluated using Composite Reliability (CR > 0.70) and Cronbach's Alpha (α > 0.70), confirming internal consistency across all constructs. These validation steps ensured that each variable accurately reflected its

theoretical concept and provided a robust foundation for subsequent analysis.

3.3 Data Analysis Technique

To test the research model and hypotheses, this study utilized Structural Equation Modeling with Partial Least Squares (SEM-PLS) using SmartPLS 3 software, an approach well-suited for analyzing complex models and small to medium sample sizes while allowing simultaneous evaluation of both measurement models (outer models) and structural models (inner models). The data analysis process involved several key steps: (1) descriptive statistics to summarize respondent characteristics and responses to indicators; (2) outer model evaluation to assess indicator reliability, convergent validity, and discriminant validity; (3) inner model evaluation to analyze path coefficients, R-square values, and effect sizes; and (4) hypothesis testing through a bootstrapping procedure to determine the significance of relationships, based on the criteria of t-statistics > 1.96 and p-values < 0.05 for significance at the 5% level.

4. RESULTS AND DISCUSSION

4.1 Demographic Profile of Respondents

This section presents the demographic characteristics of the 160 respondents who participated in the study. The sample was selected using purposive sampling to ensure that participants had relevant expertise in corporate governance, auditing, and financial oversight within public companies in Indonesia.

Table 1. Demographic Sample

Demographic Variable	Category	Frequency	Percentage (%)
Gender	Male	100	62.5%
	Female	60	37.5%
Age	25–34 years	40	25.0%
	35–44 years	65	40.6%
	45–54 years	40	25.0%
	> 55 years	15	9.4%
Education Level	Bachelor's Degree (S1)	95	59.4%
	Master's Degree (S2)	55	34.4%
	Doctorate (S3)	10	6.2%
Years of Experience	Less than 5 years	25	15.6%
	5–10 years	60	37.5%
	11–15 years	45	28.1%
	More than 15 years	30	18.8%
Job Position	Audit Committee Member	55	34.4%
	Risk Committee Member	30	18.8%
	Internal/External Auditor	40	25.0%
	Financial Manager/Director	35	21.8%

The respondent profile reveals several key insights: the majority are male (62.5%) and fall within the 35–44 age group (40.6%), indicating a predominance of mid-career professionals. Most participants hold at least a bachelor's degree (59.4%), with a substantial portion also having earned a master's degree (34.4%). Additionally, a significant majority (66.3%) have more than five years of professional experience in auditing, finance, or governance-related roles. In terms of job function, audit committee

members represent the largest group (34.4%), followed by auditors (25.0%) and financial executives (21.8%).

4.2 Measurement Model Evaluation

The evaluation of the measurement model (outer model) in Partial Least Squares Structural Equation Modeling (PLS-SEM) is crucial for ensuring that the constructs are measured reliably and validly. The assessment includes analysis of indicator loadings, construct reliability, and validity through Composite Reliability (CR), Cronbach's Alpha (CA), and Average Variance Extracted (AVE).

Table 2. Measurement Model

Variable	Code	Loading Factor	CA	CR	AVE
Audit Committee	AC.1	0.838	0.896	0.924	0.712
	AC.2	0.917			
	AC.3	0.905			
	AC.4	0.862			
	AC.5	0.675			
Institutional Ownership	IO.1	0.883	0.855	0.902	0.697
	IO.2	0.879			
	IO.3	0.803			
	IO.4	0.768			
Risk Committee	RC.1	0.929	0.829	0.921	0.854
	RC.2	0.919			
Audit Quality	AQ.1	0.756	0.845	0.891	0.623
	AQ.2	0.727			
	AQ.3	0.853			
	AQ.4	0.874			
	AQ.5	0.812			

All indicator loadings in the measurement model exceed the recommended threshold of 0.70, except for AC.5 (0.675), which, while slightly below, remains acceptable in exploratory research as it does not compromise the overall construct reliability. The high loading factors across most indicators confirm that they effectively represent their respective latent variables. Additionally, all constructs demonstrate strong internal consistency, with Cronbach's Alpha (CA) and Composite Reliability (CR) values exceeding the 0.70 benchmark. The Average Variance Extracted (AVE) values for all constructs also surpass the minimum requirement of 0.50, indicating that each construct explains more than half of the variance in its indicators, thereby confirming convergent validity.

Discriminant validity assesses the extent to which a construct is truly distinct from other constructs, both conceptually and statistically. In this study, discriminant validity was evaluated using the Fornell-Larcker criterion, which compares the square root of the Average Variance Extracted (AVE) of each construct with the correlations between that construct and other constructs in the model.

Table 3. Discriminant Validity

	Audit Committee	Audit Quality	Institutional Ownership	Risk Committee
Audit Committee	0.844			
Audit Quality	0.735	0.859		
Institutional Ownership	0.759	0.860	0.865	

Risk Committee	0.644	0.753	0.677	0.874

The interpretation of the Fornell-Larcker criterion confirms discriminant validity, as indicated by the bolded diagonal values representing the square roots of the AVE for each construct. Each diagonal value is higher than the corresponding correlations in the same row and column, meaning that each construct shares more variance with its own indicators than with other constructs. For instance, the square root of the AVE for the Audit Committee is 0.844, which exceeds its correlations with Audit Quality (0.735), Institutional Ownership (0.759), and Risk Committee (0.644). Similarly, all other constructs—Audit Quality, Institutional Ownership, and Risk Committee—also meet this criterion, reinforcing the distinctiveness of each construct in the model.

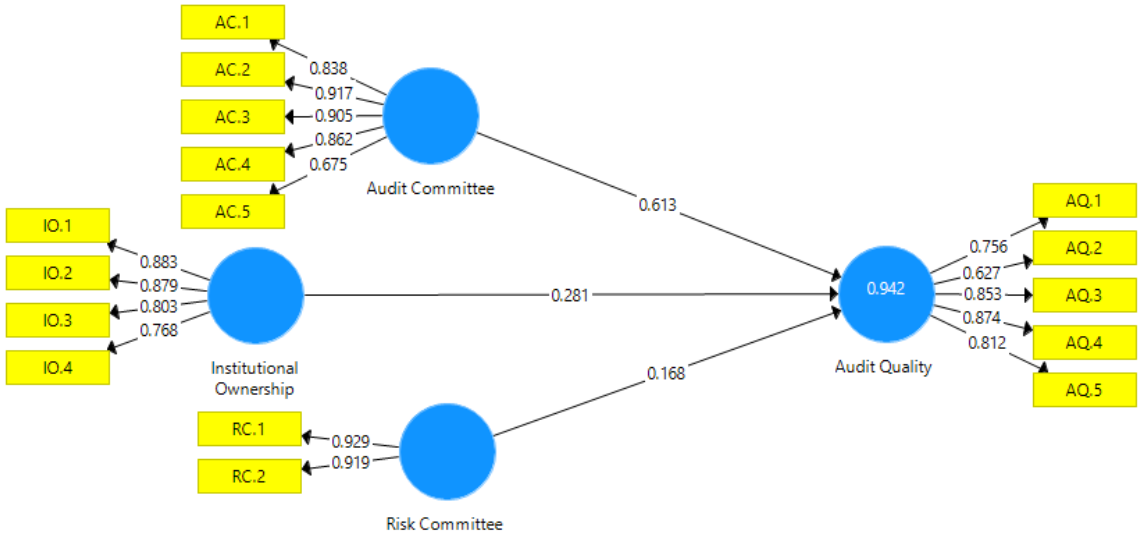

Figure 2. PLS Algorithm

4.3 Model Fit Evaluation

Evaluating the model fit in Partial Least Squares Structural Equation Modeling (PLS-SEM) is essential to determine whether the model adequately explains the observed data, even though PLS-SEM is primarily prediction-oriented and does not rely heavily on global fit indices like covariance-based SEM. Several key fit measures were used in this study. First, the Standardized Root Mean Square Residual (SRMR), which measures the difference between observed and predicted correlations, yielded a value of 0.062—well below the acceptable threshold of 0.08—indicating a good model fit. Second, the Normed Fit Index (NFI), which compares the Chi-square value of the proposed model to a null model, produced a result of 0.911, exceeding the 0.90 benchmark and suggesting a strong level of model fit. Lastly, SmartPLS reported low values for the d_ULS (0.983) and d_G (0.725) metrics, which represent discrepancies between the empirical and model-implied correlation matrices; while no strict thresholds exist, lower values generally support a better fit, confirming that the model effectively captures the observed data structure.

The R-Square (R^2) value for the main endogenous variable, Audit Quality, is 0.692, indicating that 69.2% of the variance in audit quality is explained by the combined influence of the audit committee, institutional ownership, and risk committee. According to Chin's (1998) criteria, where an R^2 value greater than 0.67 is considered substantial, this result demonstrates that the model possesses strong explanatory power in capturing the determinants of audit quality.

4.4 Hypothesis Testing

This section presents the results of hypothesis testing using Structural Equation Modeling with Partial Least Squares (SEM-PLS) via SmartPLS 3. Hypotheses were tested by evaluating the path coefficients, t-statistics, and p-values using the bootstrapping method

with 5000 subsamples. A path is considered statistically significant if the t-statistic > 1.96 and the p-value < 0.05.

Table 4. Hypothesis Testing

	Original Sample (O)	Sample Mean (M)	Standard Deviation (STDEV)	T Statistics (|O/STDEV|)	P Values
Audit Committee -> Audit Quality	0.613	0.612	0.042	14.652	0.000
Institutional Ownership -> Audit Quality	0.281	0.283	0.047	5.983	0.000
Risk Committee -> Audit Quality	0.168	0.167	0.034	4.931	0.000

The hypothesis testing results show that all three governance mechanisms have a significant positive impact on audit quality. H1 (Audit Committee → Audit Quality) demonstrates a strong effect with a path coefficient of 0.613, a t-statistic of 14.652, and a p-value of 0.000, indicating that well-functioning audit committees play a crucial role in enhancing audit quality in public companies. H2 (Institutional Ownership → Audit Quality) yields a moderate but significant effect, with a path coefficient of 0.281 and a t-statistic of 5.983, suggesting that institutional investors improve governance oversight and thereby contribute to better audit outcomes. H3 (Risk Committee → Audit Quality) also shows a statistically significant influence, albeit smaller, with a path coefficient of 0.168 and a t-statistic of 4.931, highlighting the value of risk committees in strengthening audit quality through enhanced risk governance.

4.5 Discussion

Audit Committee and Audit Quality

The study finds that the audit committee exerts the strongest influence on audit quality, supporting agency theory, which views audit committees as agents of shareholders responsible for monitoring and controlling managerial behavior. An effective audit committee—marked by independence, financial expertise, and consistent engagement—plays a critical role in enhancing the credibility of financial statements and ensuring auditor diligence. These findings are consistent with prior research emphasizing the audit committee's vital role in mitigating audit risk and improving the reliability of financial reporting. Public companies are therefore encouraged to ensure that their audit committee members possess adequate financial literacy and hold frequent meetings to sustain effective oversight of audit processes and internal controls.

Several key characteristics enhance the effectiveness of audit committees. Financial expertise is particularly important, as it equips committee members to comprehend complex financial data and monitor risk disclosures accurately [22]. Research suggests that the presence of at least three financial experts on an audit committee can significantly lower the risk of financial misconduct [23]. Meeting frequency is another vital factor; regular meetings allow members to remain updated on audit developments and strengthen internal controls, thereby reducing audit risk [24]. Independence is equally essential, as audit committees composed of outside directors are more likely to provide impartial oversight [24]. Regulatory frameworks like the Sarbanes-Oxley Act have expanded the responsibilities of audit committees, underscoring their role in ensuring high-quality financial reporting [18], while evolving standards such as IFRS also require audit committees to stay adaptive and informed [25].

Institutional Ownership and Audit Quality

The study also confirms that institutional ownership has a significant and positive impact on audit quality, aligning with stakeholder theory, which views institutional investors as external monitors who pressure companies to adopt transparent accounting practices and engage reputable auditors. This finding reinforces previous research indicating that an increase in institutional ownership enhances audit committee effectiveness and increases the likelihood of appointing auditors with industry expertise, resulting in fewer accounting restatements and reduced material internal control weaknesses—clear indicators of improved audit quality [15]. Moreover, institutional investors can influence audit quality by dissenting during auditor reappointment votes, encouraging greater independence and lower non-audit service fees [26].

Further evidence suggests that companies with higher levels of institutional ownership tend to invest more in internal audit functions (IAF), providing these investors with mechanisms to monitor managerial behavior more effectively and improve governance outcomes [27]. Additionally, in certain markets such as China, institutional investor cliques play a vital role in reducing information asymmetry, further contributing to audit quality improvements [28]. The structure and concentration of ownership also matter—when institutional investors dominate, firms are more likely to engage in high-quality audits to satisfy their demand for reliable financial reporting [29]. These findings support the conclusion that institutional shareholders function as a market-based governance mechanism, promoting accountability and reinforcing internal controls, which ultimately strengthens the integrity of the audit process.

Risk Committee and Audit Quality

Although the risk committee has the smallest path coefficient among the three predictors, it remains statistically significant, underscoring its meaningful role in supporting audit quality. This finding aligns with resource dependence theory, which posits that specialized committees like the risk committee enhance an organization's governance capacity by providing critical expertise and oversight. The establishment of a dedicated risk committee reflects a company's proactive approach to identifying and managing financial, operational, and compliance risks. By facilitating effective risk oversight, these committees ensure that auditors have access to accurate and reliable risk assessments, which in turn improves audit focus and quality.

This is consistent with the COSO ERM framework and supported by studies such as those by [18], which highlight the role of risk committees in enabling comprehensive risk oversight and informing strategic planning through a top-down view of organizational risk. Effective risk governance structures help auditors plan audits more accurately and reduce the likelihood of undetected issues [30]. The COSO framework enhances the reliability of internal controls and financial disclosures, both of which are critical for audit assurance [31], [32]. However, challenges remain, including the lack of standardized risk assessment methodologies and the need to keep pace with evolving business risks [30]. To address these issues, companies must embed risk management into their strategic planning processes, thereby ensuring that audit practices remain effective and responsive to emerging threats [33].

Practical Implications

The overall R^2 value of 0.692 indicates that audit committee effectiveness, institutional ownership, and the presence of a risk committee collectively explain approximately 69.2% of the variance in audit quality, which is considered substantial. This underscores the interdependent role of internal and external governance mechanisms in enhancing the transparency and accountability of corporate financial reporting. The strong explanatory power of the model affirms the theoretical foundations drawn from agency theory, stakeholder theory, and resource dependence theory, emphasizing the need for integrated

governance practices to ensure high audit quality.

From a practical perspective, the findings highlight several actionable insights. Public companies should prioritize the independence, financial expertise, and regular engagement of audit committees to maintain rigorous audit oversight. Institutional investors should be encouraged to take active ownership roles, as their presence enhances audit reliability and governance discipline. Furthermore, establishing a dedicated risk committee should be adopted as a governance best practice, especially in complex or highly regulated sectors. For regulators and policymakers, these results support the formulation of more stringent governance codes that mandate the formation of audit and risk committees and require transparent disclosure of institutional ownership, thereby reinforcing public trust and investor confidence.

5. CONCLUSION

The findings of this study provide clear empirical evidence that audit committees, institutional ownership, and risk committees significantly and positively influence the quality of audits in public companies. Among these, the audit committee plays the most dominant role in strengthening audit oversight and enhancing financial report credibility. Institutional ownership functions as an effective external governance mechanism by demanding higher levels of transparency and accountability, while the risk committee adds value by improving internal control and risk assessment processes. Collectively, these governance mechanisms account for a substantial portion of the variation in audit quality, confirming their strategic importance. Therefore, public companies and regulators should prioritize the establishment and continuous development of these governance bodies to promote audit effectiveness, investor protection, and long-term corporate sustainability.

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