

The Effect of Capital Structure and Audit Committee on Earnings Quality

Dinne Febriane¹, Syamsul Asmedi²

^{1,2} Faculty of Economics and Business, University of Pamulang, Indonesia

Abstract

This study examines the effects of capital structure and audit committee on earnings quality in industrial companies listed on the Indonesia Stock Exchange during 2020–2024. Using a quantitative approach and panel data regression with the Random Effects Model, the study analyzes 14 companies with 70 firm-year observations. Earnings quality is measured using a logarithmic transformation, while capital structure is measured by the debt-to-equity ratio and audit committee by the number of members. The results show that capital structure has a positive but insignificant effect on earnings quality ($p = 0.0602$), while the audit committee has a negative but insignificant effect ($p = 0.1812$). The simultaneous effect is also insignificant ($p = 0.0586$). These findings indicate that capital structure and audit committee size alone are insufficient to explain earnings quality.

Keywords: Earnings Quality, Capital Structure, Audit Committee

JEL Classification: G34, C23

Corresponding author's email: fndinneee20@gmail.com

Copyright©2026 Dinne Febriane, Syamsul Asmedi



This work is licensed under a Creative Commons Attribution 4.0 International License

Introduction

The primary objective of a company is to generate optimal profits in order to primarily provide benefits for shareholders in the future. Corporate performance is not only assessed based on the amount of profit earned, but also on the quality of earnings. Earnings quality reflects the reliability, consistency, and ability of reported earnings to represent the company's actual economic condition and to predict future cash flows. High-quality earnings indicate that financial performance is presented fairly and without manipulation (N. Syanita & Sitorus, 2020).

In practice, however, not all reported earnings accurately reflect a company's true financial condition. Some companies engage in earnings manipulation to present better performance to attract investors and other external stakeholders. Such practices reduce earnings quality and may mislead users of financial statements, making earnings quality a crucial factor in evaluating corporate performance (Anggrainy & Priyadi, 2019).

According to Agency Theory proposed by Jensen and Meckling (1976), managers as agents may have incentives to pursue personal interests that conflict with shareholders' objectives due to information asymmetry. Such conflicts may encourage earnings management practices that reduce earnings quality. Therefore, effective corporate governance mechanisms are required to minimize agency conflicts and ensure that reported earnings faithfully represent the firm's actual economic performance. In addition, Signaling Theory (Spence, 1973) suggests that managers use financial statements as signals to external stakeholders. High-quality earnings provide positive signals regarding a firm's prospects, whereas manipulated earnings create misleading signals that may adversely affect investors' decisions.

Recent evidence also indicates that strong corporate governance mechanisms and high firm quality contribute to improving the credibility of financial reporting and enhancing investor confidence. Effective governance reduces information asymmetry, strengthens monitoring functions, and promotes more transparent financial disclosures, ultimately supporting higher earnings quality (Bark & Kang, 2024; Chen et al., 2024). Furthermore, firm quality has been shown to influence investor decisions through the reliability and transparency of financial information (Baghani et al., 2026).

A notable example of low earnings quality is the case of PT Indofarma Tbk, where in 2024 the Audit Board of the Republic of Indonesia (BPK) identified financial irregularities in the company's financial statements for the 2020–2023 period. These irregularities included fictitious transactions and accounting manipulation, causing the financial statements to fail to reflect the company's actual financial condition and resulting in significant estimated state losses. This case demonstrates that earnings quality can be adversely affected by intentional fraudulent practices (BPK, 2024).

One factor that is believed to influence earnings quality is capital structure, which reflects the proportion of debt and equity used to finance corporate activities. A high level of debt may increase managerial pressure to report favorable earnings performance, thereby potentially reducing earnings quality. Nevertheless, prior empirical studies on the relationship between capital structure and earnings quality have produced inconsistent results, indicating the need for further investigation across different sectors and time periods. Beyond financing decisions, recent studies emphasize that financial reporting quality is also shaped by broader corporate governance practices, political risk, and firms' financial behavior. These findings suggest that the relationship between capital structure and earnings quality is influenced by multiple organizational and institutional factors rather than leverage alone (Mos et al., 2025; Wang et al., 2025).

In addition to capital structure, the audit committee is considered one of the key corporate governance mechanisms for ensuring the credibility of financial reporting. An effective audit committee is expected to strengthen oversight of the financial reporting process, reduce information asymmetry, and limit managerial opportunistic behavior. However, previous studies have reported inconsistent findings regarding whether audit committee characteristics significantly improve earnings quality, suggesting that governance mechanisms may operate differently across industrial sectors and institutional environments.

Despite the growing body of literature on earnings quality, previous empirical findings remain inconclusive regarding the effects of capital structure and audit committee effectiveness. Some studies argue that higher leverage improves earnings quality through stricter creditor monitoring, whereas others suggest that excessive debt encourages earnings management and reduces reporting quality. Likewise, empirical evidence concerning audit committees remains inconsistent because differences in governance effectiveness, industrial characteristics, and institutional environments often produce conflicting results. Recent international studies have also emphasized that financial reporting quality is influenced by governance quality, political environments, and firms' financial decision-making, indicating

that the determinants of earnings quality remain far from conclusive (Chen et al., 2024; Mos et al., 2025; Wang et al., 2025). Moreover, empirical evidence focusing on Indonesian industrial companies during the post-pandemic period (2020–2024) remains relatively limited. Therefore, this study re-examines the effects of capital structure and audit committee on earnings quality in industrial companies listed on the Indonesia Stock Exchange during 2020–2024, thereby providing additional evidence from an emerging market context.

Literature Review

Agency Theory

Agency Theory, developed by Jensen and Meckling (1976), explains that conflicts arise because managers (agents) possess more information than shareholders (principals), creating information asymmetry that may encourage opportunistic behavior, including earnings management. Such behavior reduces the credibility of financial reporting and ultimately lowers earnings quality. Therefore, effective monitoring mechanisms are required to align managerial interests with those of shareholders. One important governance mechanism is the audit committee, which is expected to strengthen oversight, reduce agency conflicts, and improve the reliability of reported earnings (Jensen & Meckling, 1976). Recent studies also suggest that stronger corporate governance systems are associated with higher financial reporting quality and lower earnings manipulation, reinforcing the importance of governance mechanisms in protecting investors (Bark & Kang, 2024).

Signaling Theory

Signaling Theory (Spence, 1973) explains that managers communicate information about firm quality through financial reporting. High-quality earnings provide positive signals regarding future firm performance and reduce uncertainty among investors, creditors, and other stakeholders. Conversely, earnings manipulation generates misleading signals that may distort investment decisions. Therefore, companies have incentives to produce reliable financial statements to maintain market confidence. Recent evidence further indicates that firms with higher reporting quality receive more favorable responses from investors because transparent financial information reduces information asymmetry and improves market credibility (Baghani et al., 2026).

Corporate Governance Theory

Corporate Governance Theory emphasizes that effective governance mechanisms promote transparency, accountability, and fairness in corporate decision-making. The audit committee represents one of the most important governance mechanisms because it supervises financial reporting, internal control, and external audit processes. A well-functioning audit committee strengthens monitoring effectiveness, minimizes managerial opportunism, and enhances earnings quality. Consequently, the effectiveness of corporate governance should be assessed not merely by the existence of governance structures but also by their ability to improve the credibility of financial reporting (OECD, 2023).

Earnings quality

Capital structure refers to the proportion of debt and equity used to finance corporate operations. From the perspective of Agency Theory, debt may function as an external monitoring mechanism because creditors impose discipline on managers through contractual obligations. However, excessive leverage may also increase managerial pressure to satisfy debt covenants, thereby encouraging earnings management. Ashma and Rahmawati (2019) argue that higher leverage increases financial risk and managerial incentives to manipulate earnings. Previous empirical findings remain inconsistent. Several studies report that capital structure significantly improves earnings quality through enhanced monitoring (Silfi, 2016), whereas others find insignificant relationships (Mardiana & Kartini, 2022; Safitri, 2023). Recent international evidence similarly demonstrates that the influence of leverage on earnings quality depends on governance quality, financing behavior, and institutional environments rather than debt levels alone (Wang et al., 2025).

Capital structure

Capital structure is one of the factors that may influence earnings quality. Capital structure refers to the proportion of debt and equity used to finance a company's operations. Companies with high leverage tend to face greater pressure from creditors to meet debt obligations, which may encourage management to manage earnings in order to present favorable financial performance. (Ashma & Rahmawati, 2019) state that higher levels of debt increase financial risk and managerial incentives to manipulate earnings. Several empirical studies have found that capital structure has a significant effect on earnings quality (Silfi, 2016). However, other studies report insignificant results, indicating that the relationship

between capital structure and earnings quality remains inconclusive (Lydia Mardiana & Kartini, 2022; Safitri, 2023).

Recent evidence published in the *Indonesian Financial Review* further confirms the strategic role of capital structure in corporate financial decision-making. **Zelpani and Budi (2025)**, using the perspectives of Agency Theory and Signaling Theory, found that although the Debt-to-Equity Ratio (DER) is an important financing indicator, it did not significantly affect profitability when examined individually. Their findings suggest that financing decisions alone are insufficient to improve corporate performance without effective managerial policies and operational efficiency. Similarly, **Poetry and Habibah (2026)** argued that the influence of capital structure on corporate performance depends on firm-specific characteristics and operating conditions, indicating that leverage does not always produce better financial outcomes. These findings reinforce the view that the relationship between capital structure and earnings quality remains context-dependent and may vary across industries and institutional environments.

Audit committee

Audit committee serves as an important corporate governance mechanism that may affect earnings quality. The audit committee is responsible for overseeing the financial reporting process and ensuring the credibility of financial statements. According to (Juwita, 2020), the audit committee plays a strategic role in strengthening internal control and reducing the likelihood of earnings manipulation. Prior studies suggest that an effective audit committee can enhance earnings quality by improving monitoring and transparency. Nevertheless, empirical findings remain mixed, as some studies find a significant effect of audit committee characteristics on earnings quality (Aryengki, 2016), while others report no significant relationship (Hartoko & Astuti, 2021). Recent international studies also indicate that audit committee effectiveness depends not only on committee size but also on members' expertise, independence, meeting frequency, and governance quality (Bark & Kang, 2024). Recent evidence also suggests that governance mechanisms do not always produce direct improvements in corporate performance. **Suharna and Syamsuri (2025)** found that audit quality and good corporate governance did not significantly influence company profitability, although they jointly contributed to organizational stability and risk control. These findings

imply that governance effectiveness depends on the quality of implementation rather than merely on the establishment of governance structures.

Research Gap

Despite the extensive literature examining earnings quality, previous empirical findings remain inconsistent regarding the effects of capital structure and audit committee effectiveness. Some studies argue that leverage enhances earnings quality through creditor monitoring, whereas others conclude that excessive debt encourages earnings management. Likewise, evidence regarding audit committees remains inconclusive because differences in governance effectiveness, industrial characteristics, institutional environments, and measurement approaches often produce conflicting results. Recent international studies further suggest that financial reporting quality is influenced by broader governance practices and firms' financial behavior, indicating that the determinants of earnings quality remain far from conclusive (Chen et al., 2024); (Wang & Huang, 2025). Furthermore, empirical evidence focusing specifically on Indonesian industrial companies during the post-pandemic period (2020–2024) remains limited. Therefore, this study seeks to re-examine the influence of capital structure and audit committee on earnings quality in industrial companies listed on the Indonesia Stock Exchange, thereby providing additional empirical evidence from an emerging market context.

Hypothesis

Based on Agency Theory, Signaling Theory, and Corporate Governance Theory, capital structure and audit committee are expected to influence earnings quality through different mechanisms. Capital structure may strengthen creditor monitoring but may also increase incentives for earnings management when leverage becomes excessive. Meanwhile, audit committees are expected to improve monitoring effectiveness, enhance financial reporting transparency, and reduce agency conflicts. Given the inconsistent findings reported in previous studies, this research re-examines these relationships in Indonesian industrial companies. The study contributes to the accounting and corporate governance literature by providing updated empirical evidence regarding the determinants of earnings quality in an emerging market.

H1: Capital structure has a significant effect on earnings quality.

H2: Audit committee has a significant effect on earnings quality.

H3: Capital structure and audit committee simultaneously have a significant effect on earnings quality.

Research Methods

Research Design

This study employs a quantitative research approach to examine the effects of capital structure and audit committee on earnings quality in industrial sector companies listed on the Indonesia Stock Exchange (IDX). The research adopts an explanatory design because it aims to investigate the causal relationship between independent variables and the dependent variable using panel data regression analysis. The observation period covers five years, from 2020 to 2024, allowing the analysis to capture both cross-sectional and time-series variations in corporate financial performance.

Population and Sample

The population consists of all industrial sector companies listed on the Indonesia Stock Exchange (IDX) during the 2020–2024 period. The sample was selected using purposive sampling based on the following criteria:

1. Companies continuously listed on the Indonesia Stock Exchange during 2020–2024.
2. Companies publishing complete audited annual reports throughout the observation period.
3. Companies providing complete financial information required to measure all research variables.
4. Companies with financial statements presented in Indonesian Rupiah.
5. Companies with complete observations during the study period.

Based on these criteria, **14 companies** were selected as the final research sample.

Data Collection

This study uses secondary data obtained from audited annual reports and financial statements published through the official Indonesia Stock Exchange (IDX) website and each company's official website. Data were collected using documentation techniques by reviewing annual reports, financial statements, and supporting disclosures related to corporate governance and financial performance.

Research Variables and Measurement

This study uses one dependent variable and two independent variables. Earnings quality is used as the dependent variable, while capital structure and audit committee serve as independent variables. The measurement of each variable is described as follows.

Table 1 Operational Variables

Variables	Measurement	Formula / Indicator	References
Capital Structure (X1)	Debt to Equity Ratio (DER)	DER = Total Debt / Total Equity	Misnoni & Mayangsari (2023)
Audit Committee (X2)	Audit Committee Size	Number of audit committee members	Supomo & Amanah (2019)
Earnings Quality (Y)	Earnings Quality	Earnings Quality = Operating Cash Flow / Net Income	Safitri (2023)

Source: Journal

Panel Data Model Selection

Panel data analysis combines cross-sectional and time-series observations to improve estimation efficiency and capture both individual and temporal variations. Prior to estimating the regression model, panel data model selection was conducted through three sequential tests. First, the **Chow Test** was performed to determine whether the Fixed Effect Model (FEM) provides a better estimation than the Common Effect Model (CEM). A significant probability value indicates that the Fixed Effect Model is preferred. Second, the **Hausman Test** was employed to determine whether the Fixed Effect Model or the Random Effect Model (REM) is more appropriate. If the probability value exceeds the significance level of 5%, the Random Effect Model is selected because the individual effects are assumed to be random. Third, the **Lagrange Multiplier (LM) Test** was conducted to compare the Common Effect Model with the Random Effect Model. A significant LM statistic indicates that the Random Effect Model provides a better estimation than the Common Effect Model. Based on the results of these three

tests, the **Random Effect Model (REM)** was selected as the most appropriate estimation model for this study. The application of panel data regression is appropriate because it combines cross-sectional and time-series observations, thereby increasing estimation efficiency and reducing omitted-variable bias compared with conventional regression models (Alamsyah et al., 2022).

Regression Model

The panel regression model employed in this study is expressed as follows:

where:

$$EQ_{it} = \beta_0 + \beta_1 DER_{it} + \beta_2 AC_{it} + \varepsilon_{it}$$

- **EQ** = Earnings Quality
- **DER** = Capital Structure
- **AC** = Audit Committee
- **β_0** = Constant
- **β_1 – β_2** = Regression coefficients
- **ε** = Error term

Data Analysis Technique

Data analysis was performed using EViews 12. The analytical procedures consisted of:

1. Descriptive statistical analysis.
2. Panel data model selection (Chow Test, Hausman Test, and Lagrange Multiplier Test).
3. Panel data regression analysis.
4. Partial hypothesis testing using the t-test.
5. Simultaneous hypothesis testing using the F-test.
6. Model explanatory power assessment using the Adjusted R^2 coefficient of determination.

The significance level adopted throughout the study was 5% ($\alpha = 0.05$).

Results and Discussions

According to Sugiyono, (2019), descriptive statistics provide a picture or description of data that appears from the average value (mean), standard deviation, variance, maximum, minimum, sum, range, kurtosis, and skewness (distribution skewness). In quantitative research, descriptive analysis is aligned into the form of tables, curves or diagrams as a foundation to be explained narratively and descriptively for easy understanding.

Table 2 Descriptive Statistic

Variable	EViews Code	Mean	Median	Maximum	Minimum	Std. Dev.
Earnings Quality	EQ (Y)	0.169893	0.173953	1.981001	-3.912023	0.912635
Capital Structure	DER (X1)	0.571899	0.501582	2.391629	0.061755	0.469343
Audit Committee	AC (X2)	2.842857	3.000000	4.000000	1.000000	0.605188

Source: Data prossed using EViews 12

Descriptive statistics show that the dependent variable, Capital Structure has a minimum value of 0.061755 and a maximum value of 2.391629, with an average (mean) value of 0.571899 and a standard deviation of 0.469343. These results indicate a relatively high variation in capital structure among the observed companies, reflecting differences in leverage policies across firms.

Desriptive statistics show that the dependent variable, Audit Committee has a minimum value of 1.000000 and a maximum value of 4.000000, with a mean value of 2.842857 and a standard deviation of 0.605188. The mean value of approximately 2.84 and the relatively low standard deviation indicate that most companies in the sample have established audit committees, showing limited variation across firms.

Desriptive statistics show that the independent variable, Earnings Quality has a minimum value of -3.912023 and a maximum value of 1.981001, with a mean value of 0.169893 and a standard deviation of 0.91261233. This suggests considerable variation in

earnings quality among companies, indicating differences in the ability of firms to generate stable and reliable earnings.

Panel Data Regression Test

Panel data regression combines cross-sectional and time-series data, where the same cross-sectional units are observed across different time periods. Based on the results of testing the three panel data regression models, the Random Effects model is determined to be the most suitable model for this research.

Table 3 Panel Data Regression

Method: Panel EGLS (Cross-section random effects)
 Date: 10/27/25 Time: 15:58
 Sample: 2020 2024
 Periods included: 5
 Cross-sections included: 14
 Total panel (balanced) observations: 70
 Swamy and Arora estimator of component variances

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	0.731402	0.708245	1.032696	0.3055
DER	0.576225	0.301488	1.911271	0.0602
AC	-0.313435	0.231990	-1.351070	0.1812

DER = Capital Structure (Debt to Equity Ratio)
 AC = Audit Committee (Number of Members)

Source: Data processed using EViews 12

In the table mentioned above, The findings for panel data regression analysis test are as follows:

$$Y = 0.731402 + 0.576225 X_1 - 0.313435 X_2 + e$$

Y = Earnings Quality (EQ),

X₁ = Capital Structure (DER), and

X₂ = Audit Committee (AC)

Hypothesis Testing

t test

Based on the Random Effect Model (REM) estimation results, the Capital Structure (SM/X1) variable has a positive regression coefficient of 0.576225 with a t-statistic of 1.911271 and a probability value of 0.0602. The positive coefficient indicates that an increase in capital structure tends to be associated with an increase in earnings quality, *ceteris paribus*. However, the probability value of 0.0602 is greater than the 5% significance level ($0.0602 > 0.05$). Therefore, the effect of capital structure on earnings quality is not statistically significant. Accordingly, H1 is not supported, indicating that capital structure does not have a significant partial effect on earnings quality in the sampled industrial companies during the 2020–2024 observation period.

Meanwhile, the Audit Committee (KA/X2) variable has a negative regression coefficient of -0.313435 , with a t-statistic of -1.351070 and a probability value of 0.1812. The negative coefficient indicates that an increase in audit committee size tends to be associated with a decrease in earnings quality, *ceteris paribus*. Nevertheless, the probability value of 0.1812 is greater than the 5% significance level ($0.1812 > 0.05$). Thus, the negative relationship is not statistically significant. Therefore, H2 is not supported, indicating that the audit committee does not have a significant partial effect on earnings quality.

Overall, the t-test results indicate that neither capital structure nor audit committee has a statistically significant partial effect on earnings quality. Although capital structure shows a positive coefficient and audit committee shows a negative coefficient, neither relationship is sufficiently strong statistically to support the proposed hypotheses at the 5% significance level. These findings suggest that changes in leverage and the number of audit committee members alone may not be sufficient to explain variations in earnings quality among the sampled industrial companies.

F test

The purpose of this test is to understand whether the independent variable has an independent influence on the dependent variable. In this study, to determine the ttable value, it is determined at a significance level of 5% ($\alpha = 0.05$).

Table 4 F test

Weighted Statistics			
R-squared	0.081218	Mean dependent var	0.094603
Adjusted R-squared	0.053792	S.D. dependent var	0.754048
S.E. of regression	0.733487	Sum squared resid	36.04619
F-statistic	2.961335	Durbin-Watson stat	1.931721
Prob(F-statistic)	0.058561		

Source: Data prossed using EViews 12

Based on the F-test results presented in Table 5, the calculated F-statistic is 2.961335, which is lower than the F-table value of 3.133762. In addition, the probability value of the F-statistic is 0.058561, which is greater than the 5% significance level ($0.058561 > 0.05$). Therefore, the regression model does not show a statistically significant simultaneous effect of Capital Structure and Audit Committee on Earnings Quality. Accordingly, H3 is not supported, indicating that Capital Structure and Audit Committee do not jointly have a statistically significant effect on Earnings Quality during the 2020–2024 observation period.

Although the F-statistic indicates that the variables do not have a statistically significant simultaneous effect at the 5% significance level, the probability value of **0.058561** is relatively close to 0.05. This may indicate that the joint relationship between the independent variables and earnings quality is relatively weak and does not meet the conventional 5% significance threshold.

Coefficient of Determination Test (R2)

The coefficient of determination (R-squared) is used to estimate the extent to which the independent variables contribute to explaining the dependent variable, provided that the F-test results in the regression analysis are statistically significant. A smaller R-squared value indicates a weaker influence of the independent variables on the dependent variable, whereas an R-squared value closer to 1 indicates a stronger influence.

Table 5 Coefficient of Determination Test (R2)

Weighted Statistics			
R-squared	0.081218	Mean dependent var	0.094603
Adjusted R-squared	0.053792	S.D. dependent var	0.754048
S.E. of regression	0.733487	Sum squared resid	36.04619
F-statistic	2.961335	Durbin-Watson stat	1.931721
Prob(F-statistic)	0.058561		

Source: Data prossed using EViews 12

Based on the results presented in Table 6, the Adjusted R-squared value is 0.053792. This indicates that Capital Structure (X1) and Audit Committee (X2) jointly explain approximately 5.38% of the variation in Earnings Quality (Y). Meanwhile, approximately 94.62% of the variation in earnings quality is explained by other factors that are not included in the research model.

The relatively low Adjusted R-squared value suggests that Capital Structure and Audit Committee have limited explanatory power in accounting for variations in earnings quality in the sampled industrial companies. Therefore, other factors, such as profitability, audit quality, firm size, ownership structure, earnings persistence, managerial incentives, and other corporate governance mechanisms, may provide additional explanatory power for earnings quality.

Discussion

The Effect of Capital Structure on Earnings Quality

The empirical results show that Capital Structure (X1) has a positive but statistically insignificant effect on Earnings Quality (Y). The Random Effect Model (REM) estimation produces a coefficient of 0.576225, a t-statistic of 1.911271, and a probability value of 0.0602. Since the probability value is greater than the 5% significance level ($0.0602 > 0.05$), H1 is not supported. Although the positive coefficient suggests that higher capital structure tends to be associated with higher earnings quality, the relationship is not sufficiently strong to be considered statistically significant.

This finding indicates that the level of debt financing alone does not necessarily determine the quality of reported earnings in Indonesian industrial companies. Companies with higher leverage may face greater pressure to maintain financial performance and meet contractual obligations; however, such pressure does not automatically result in either higher or lower earnings quality. The effect of capital structure may depend on other firm-specific and governance characteristics, including profitability, firm size, audit quality, managerial incentives, and the effectiveness of internal monitoring.

The finding is consistent with Mardiana and Kartini (2022) and Safitri (2023), who report that capital structure does not have a significant effect on earnings quality. These results indicate that the relationship between leverage and earnings quality is not uniform across companies and research settings. In contrast, Silfi (2016) found a significant effect of capital structure on earnings quality, while Ashma and Rahmawati (2019) also incorporated capital

structure as an important determinant of earnings quality. The differences between these findings suggest that the influence of capital structure may depend on differences in observation periods, industrial characteristics, earnings quality measurement, and corporate governance environments.

The result is also relevant to the findings of Zelpani and Budi (2025), who demonstrate that the relationship between financing-related variables and corporate outcomes should not be interpreted solely from the level of leverage, because firm-specific characteristics and governance conditions may affect the effectiveness of financing decisions. Similarly, Poetry and Habibah (2025) show that capital structure needs to be considered together with other corporate characteristics when explaining financial performance. Thus, the insignificant effect identified in the present study reinforces the argument that capital structure alone is insufficient to explain variations in earnings quality.

From the perspective of Agency Theory, debt financing may potentially reduce agency conflicts through creditor monitoring. However, the present finding suggests that such monitoring may not be sufficiently strong to produce a statistically significant improvement in earnings quality. Debt can function as a monitoring mechanism only when creditors have sufficient incentives and ability to monitor managerial behavior. Therefore, higher leverage does not automatically guarantee higher-quality financial reporting.

Accordingly, the positive but insignificant coefficient should not be interpreted as evidence that increasing debt will improve earnings quality. Instead, the finding indicates that capital structure is not a dominant determinant of earnings quality in the observed sample. Other financial and governance variables may play a more important role in explaining differences in earnings quality among Indonesian industrial companies.

The Effect of Audit Committee on Earnings Quality

The results also show that Audit Committee (X2) has a negative but statistically insignificant effect on Earnings Quality. The REM estimation produces a coefficient of -0.313435 , a t-statistic of -1.351070 , and a probability value of 0.1812 . Because the probability value is greater than 0.05 ($0.1812 > 0.05$), H2 is not supported.

The negative coefficient indicates that an increase in the number of audit committee members tends to be associated with lower earnings quality, holding other variables constant. However, because the relationship is statistically insignificant, the negative coefficient cannot be interpreted as evidence that increasing audit committee size actually reduces earnings

quality. Rather, the result suggests that audit committee size alone is not a sufficiently strong indicator of audit committee effectiveness.

This finding is consistent with Juwita (2020), who found that the audit committee did not have a significant effect on earnings quality. However, it differs from Aryengki (2016) and Supomo and Amanah (2019), who reported a significant relationship between audit committee characteristics and earnings quality. The inconsistency among these studies suggests that the mere existence or size of an audit committee may not adequately capture its actual monitoring effectiveness.

One possible explanation is that companies may establish audit committees primarily to fulfill corporate governance and regulatory requirements. The number of committee members does not necessarily reflect their financial expertise, independence, professional experience, meeting intensity, or commitment to monitoring financial reporting. Consequently, an audit committee consisting of several members may still have limited effectiveness if its members lack sufficient expertise or independence.

This interpretation is consistent with Agency Theory, which emphasizes the importance of monitoring mechanisms in reducing conflicts between principals and agents. An audit committee is theoretically expected to monitor management and strengthen the reliability of financial reporting. However, the insignificant result suggests that the formal existence of the audit committee does not necessarily translate into effective monitoring of managerial behavior.

The finding is also relevant to Corporate Governance Theory, which emphasizes that governance effectiveness depends not only on the existence of formal governance structures but also on the quality and effectiveness of those structures. Therefore, the number of audit committee members may be a relatively weak proxy for monitoring effectiveness. Characteristics such as financial expertise, independence, meeting frequency, attendance, and professional competence may provide a more comprehensive representation of audit committee effectiveness.

Accordingly, the findings do not imply that audit committees are irrelevant to earnings quality. Rather, they indicate that audit committee size alone is insufficient to explain variations in earnings quality among the sampled industrial companies. Future research should therefore consider more comprehensive measures of audit committee effectiveness.

The Simultaneous Effect of Capital Structure and Audit Committee on Earnings Quality

The F-test results indicate that Capital Structure (X1) and Audit Committee (X2) do not have a statistically significant simultaneous effect on Earnings Quality (Y). The calculated F-statistic is 2.961335, compared with an F-table value of 3.133762, while the probability value is 0.058561. Since the probability value exceeds the 5% significance level ($0.058561 > 0.05$), H3 is not supported.

These results indicate that the combination of capital structure and audit committee does not provide sufficient explanatory power to establish a statistically significant simultaneous relationship with earnings quality during the 2020–2024 observation period. Although the probability value of 0.058561 is relatively close to the 5% threshold, it does not meet the conventional significance criterion adopted in this study.

The finding suggests that earnings quality is a multidimensional phenomenon that cannot be adequately explained by only two variables representing financing structure and audit committee size. Previous studies have demonstrated that earnings quality may also be associated with audit quality, profitability, firm size, earnings persistence, liquidity, intellectual capital, accounting conservatism, investment opportunities, and other corporate governance mechanisms (Anggrainy & Priyadi, 2019; Ashma & Rahmawati, 2019; Misnoni & Mayangsari, 2023; Safitri, 2023).

Therefore, the insignificant simultaneous effect does not mean that capital structure and audit committees have no relevance to financial reporting quality. Rather, it suggests that their individual and combined effects are insufficient to explain earnings quality when considered without other important determinants.

Explanatory Power of the Model

The Adjusted R-squared value of 0.053792 indicates that Capital Structure and Audit Committee jointly explain approximately 5.38% of the variation in Earnings Quality. The remaining 94.62% is explained by other factors outside the research model.

The relatively low explanatory power reinforces the argument that earnings quality is influenced by a broader combination of financial, managerial, and governance characteristics. Anggrainy and Priyadi (2019), for example, examine earnings quality in relation to capital structure, earnings growth, audit quality, and firm size, demonstrating that earnings quality cannot be adequately viewed from capital structure alone. Similarly, Misnoni and Mayangsari (2023) emphasize the importance of prudence and intellectual capital in addition to capital structure in explaining earnings quality. Safitri (2023) also demonstrates that earnings quality can be associated with several factors, including intellectual capital, accounting conservatism, and investment opportunities.

Thus, the relatively low Adjusted R-squared in the present study provides an important empirical indication that the two explanatory variables selected in this research represent only a small part of the determinants of earnings quality. The result also provides a basis for future studies to develop a more comprehensive model incorporating both financial and governance variables.

Theoretical Implications

The findings provide implications for Agency Theory, Signaling Theory, and Corporate Governance Theory. From the Agency Theory perspective, neither debt financing nor audit committee size appears to function as a sufficiently effective monitoring mechanism to significantly improve earnings quality. This suggests that the existence of monitoring mechanisms does not automatically eliminate information asymmetry and managerial opportunism.

From the perspective of Signaling Theory, the findings suggest that the presence of a particular financing structure or audit committee does not automatically constitute a credible signal of high-quality financial reporting. Governance mechanisms must operate effectively before they can generate credible signals regarding the reliability of reported earnings.

Meanwhile, from the perspective of Corporate Governance Theory, the insignificant effect of the audit committee emphasizes the distinction between formal governance structure and substantive governance effectiveness. The number of audit committee members may satisfy formal governance requirements, but it does not necessarily indicate the quality of monitoring activities.

Practical Implications

The findings have several practical implications. First, companies should not rely solely on changes in capital structure as a strategy to improve earnings quality. Financing decisions should be accompanied by effective financial controls, transparent reporting practices, and appropriate governance mechanisms. Second, companies should evaluate audit committee effectiveness beyond the number of members. Greater attention should be given to independence, financial expertise, professional competence, meeting frequency, attendance, and monitoring intensity. Third, investors should not use leverage or audit committee size as standalone indicators of earnings quality. Investors should instead consider a broader set of financial and governance characteristics when evaluating the reliability of corporate earnings. Finally, regulators and corporate governance practitioners may consider strengthening the substantive requirements concerning audit committee competence and independence rather than focusing primarily on the formal existence or number of committee members.

Conclusions

This study aimed to examine the effects of capital structure and audit committee on earnings quality in industrial sector companies listed on the Indonesia Stock Exchange during the 2020–2024 period. Based on the panel data regression analysis using the Random Effect Model (REM), the results indicate that capital structure has a positive but statistically insignificant effect on earnings quality, with a coefficient of 0.576225 and a probability value of 0.0602. Similarly, the audit committee has a negative but statistically insignificant effect on earnings quality, with a coefficient of -0.313435 and a probability value of 0.1812. Therefore, H1 and H2 are not supported.

The simultaneous test also shows that capital structure and audit committee do not have a statistically significant joint effect on earnings quality. The F-statistic is **2.961335**, with a probability value of **0.058561**, which exceeds the 5% significance level. Accordingly, **H3 is not supported**. These findings indicate that financing decisions and audit committee size, whether considered individually or jointly, are insufficient to explain variations in earnings quality among the sampled industrial companies.

Furthermore, the Adjusted R-squared value of 0.053792 indicates that capital structure and audit committee jointly explain approximately 5.38% of the variation in earnings quality, while the remaining 94.62% is explained by factors outside the research model. This relatively low explanatory power suggests that earnings quality is a multidimensional phenomenon influenced by broader financial, managerial, and corporate governance characteristics. Factors such as profitability, firm size, audit quality, ownership structure, earnings persistence, intellectual capital, and accounting conservatism may provide additional explanatory power.

From a theoretical perspective, the findings provide empirical implications for Agency Theory, Signaling Theory, and Corporate Governance Theory. From the Agency Theory perspective, debt financing and the existence of an audit committee do not automatically function as effective monitoring mechanisms capable of reducing managerial opportunism and improving earnings quality. From the Signaling Theory perspective, capital structure and the formal existence of an audit committee cannot automatically provide credible signals concerning the reliability of financial reporting. Meanwhile, the findings from a Corporate Governance perspective indicate that the effectiveness of governance mechanisms depends not merely on their formal existence but also on their independence, competence, expertise, and monitoring effectiveness.

Practically, the findings suggest that companies should not rely solely on financing decisions or the number of audit committee members to improve earnings quality. Companies should strengthen the substantive effectiveness of corporate governance, particularly through greater audit committee independence, financial expertise, professional competence, and monitoring intensity. Investors should also evaluate financial reporting quality using a broader set of financial and governance indicators rather than relying solely on leverage or audit committee size. For regulators, the findings highlight the importance of emphasizing the quality and effectiveness of audit committee oversight and financial reporting transparency rather than focusing exclusively on formal compliance.

This study has several limitations. First, the study is limited to industrial sector companies listed on the Indonesia Stock Exchange during 2020–2024, which may limit the generalizability of the findings to other sectors and periods. Second, the model includes only two explanatory variables, namely capital structure and audit committee, resulting in relatively low explanatory power. Third, audit committee effectiveness is represented by its size, which

may not fully capture qualitative characteristics such as independence, financial expertise, meeting frequency, and monitoring effectiveness.

Therefore, future research is encouraged to incorporate additional determinants of earnings quality, including profitability, firm size, audit quality, ownership structure, institutional ownership, managerial ownership, earnings persistence, intellectual capital, and accounting conservatism. Future studies may also employ longer observation periods, broader sectoral samples, alternative measures of audit committee effectiveness, and alternative measures of earnings quality to obtain a more comprehensive understanding of the determinants of earnings quality in Indonesian listed companies.

Acknowledgements

The author wishes to convey deep appreciation to the Faculty of Economics and Business, University of Pamulang. Heartfelt thanks are also directed at the academic advisors, thesis examiners, and the author's family for their constructive feedback, encouragement, and unwavering support.

References

- Alamsyah, I. F., Esra, R., Awalia, S., & Nohe, D. A. (2022). *Analisis Regresi Data Panel Untuk Mengetahui Faktor Yang Memengaruhi Jumlah Penduduk Miskin Di Kalimantan Timur*. 254–266.
- Anggrainy, L., & Priyadi, M. P. (2019). Pengaruh Struktur Modal, Pertumbuhan Laba, Kualitas Audit, Dan Ukuran Perusahaan Terhadap Kualitas Laba Maswar Patuh Priyadi Sekolah Tinggi Ilmu Ekonomi Indonesia (Stiesia) Surabaya. *Jurnal Ilmu Dan Riset Akuntansi*, 8(8), 1–20.
- Aryengki, R. (2016). *Pengaruh Komite Audit, Kualitas Audit, Likuiditas Dan Ukuran Perusahaan Terhadap Kualitas Laba Pada Perusahaan Industry & Chemical Yang Terdaftar Di Bursa Efek Indonesia Tahun 2011-2014*. 3(1).

- Ashma, F. U., & Rahmawati, E. (2019). Pengaruh Persistensi Laba, Book Tax Differences, Investment Opportunity Set dan Struktur Modal Terhadap Kualitas Laba dengan Konservatisme Akuntansi Sebagai Variabel Moderasi. *Reviu Akuntansi Dan Bisnis Indonesia*, 3(2), 206–219.
- Baghani, A., Sabzei, E., & Kianifar, A. (2026). Investigating the relationship between investor decisions, firm quality, and market sentiment in initial public offerings. *Finance Research Letters*, 107, 110173. [https://doi.org/https://doi.org/10.1016/j.frl.2026.110173](https://doi.org/10.1016/j.frl.2026.110173)
- Bark, J., & Kang, P. K. (2024). Stewardship code adoption and firms' decisions on treasury shares: Evidence from South Korea. *Research in International Business and Finance*, 71, 102452. [https://doi.org/https://doi.org/10.1016/j.ribaf.2024.102452](https://doi.org/10.1016/j.ribaf.2024.102452)
- BPK. (2024). *Temuan BPK: Indofarma Terindikasi Manipulasi Laporan Keuangan Sejak Lama*. BPK PERWAKILAN PROVINSI KALIMANTAN TIMUR.
- Chen, D., Li, Y., Lu, J., & Li, C. (2024). Do international tax treaties govern financial report quality? *Research in International Business and Finance*, 69, 102246. [https://doi.org/https://doi.org/10.1016/j.ribaf.2024.102246](https://doi.org/10.1016/j.ribaf.2024.102246)
- Hartoko S, & Astuti A. A. T. (2021). Pengaruh Karakteristik Dewan Komisaris, Karakteristik Komite Audit, Dan Kualitas Audit Terhadap Kualitas Laba. *Jurnal Akuntansi Dan Bisnis*, 21(1), 126–137.
- Jensen, M. C., & Meckling, W. H. (1976). Theory of the firm: Managerial behavior, agency costs and ownership structure. *Journal of Financial Economics*, 3(4), 305–360. [https://doi.org/https://doi.org/10.1016/0304-405X\(76\)90026-X](https://doi.org/10.1016/0304-405X(76)90026-X)
- Juwita, C. L. (2020). Analisis Pengaruh Kualitas Audit, Komite Audit, Likuiditas dan Ukuran Perusahaan terhadap Kualitas Laba pada Perusahaan Sektor Pertambangan di Bursa Efek Indonesia. *Urnal Bisnis Dan Akuntansi*, vol 5 No., 637–648.
- Mardiana, L, & Kartini, E. (2022). Pengaruh Struktur Modal, Ukuran Perusahaan, Pertumbuhan Laba, dan Likuiditas terhadap Kualitas Laba. *Jurnal Ilmiah Ekonomi Dan Bisnis*, 1(3), 96–106. <https://jurnal.penerbitseval.com/jurnal/index.php/kompeten/article/view/18>
- Mardiana, Lydia, & Kartini, E. (2022). Pengaruh Struktur Modal, Ukuran Perusahaan, Pertumbuhan Laba, dan Likuiditas terhadap Kualitas Laba. *Jurnal Ilmiah Ekonomi Dan Bisnis*, 1(3), 96–106.
- Misoni, & Mayangsari, S. (2023). Pengaruh Prudence, Intellectual Capital, Dan Struktur Modal Terhadap Kualitas Laba. *Jurnal Ekonomi Trisakti*, 3(2), 2995–3004. <https://doi.org/10.25105/jet.v3i2.17406>

- Mos, C. (2025). Political elections, doctrine shifts, voting margins, and earnings management: the mediating role of capital markets and financial analysts coverage. *Finance Research Letters*, 85, 108078.
<https://doi.org/https://doi.org/10.1016/j.frl.2025.108078>
- Poetry, H., & Habibah, H. (2025). The Effect of Sales Growth and Capital Structure on Return On Asset (ROA) At PT Unilever Indonesia Tbk 2014-2023 Period. *Indonesian Financial Review*, 5(2), 364–380.
- Safitri, L. A. E. & N. ketut M. (2023). Pengaruh Intellectual Capital, Struktur Modal, Konservatisme Akuntansi Dan Investment Opportunity Set Terhadap Kualitas Laba: Studi Empiris Pada Perusahaan Manufaktur Yang Terdaftar Di Bursa Efek Indonesia tahun 2018-2021. *Hita Akuntansi Dan Keuangan*, 4(1), 161–172.
- Silfi, A. (2016). Pengaruh Pertumbuhan Laba, Struktur Modal, Likuiditas dan Komite Audit Terhadap Kualitas Laba. *Jurnal Valuta*, 2(1), 17–26.
- Spence, M. (1973). Job Market Signaling. *The Quarterly Journal of Economics*, 87(3), 355–374. <https://doi.org/10.2307/1882010>
- Sugiyono. (2019). *Statistika untuk Penelitian*. CV Alfabeta.
- Suharna, S., & Syamsuri, S. (2025). The Influence of Audit Quality, Good Corporate Governance, and Operational Efficiency on Company Profitability. *Indonesian Financial Review*, 5(2), 516–531.
- Supomo, M., & Amanah, L. (2019). Pengaruh Komite Audit, Struktur Modal, Dan Persistensi Laba Terhadap Kualitas Laba. *Jurnal Ilmu Dan Riset Akuntansi (JIRA)*, 8(5).
- Syanita, N., & Sitorus, A. (2020). Kualitas Laba: Tinjauan Teoretis dan Praktis. *Jurnal Akuntansi Dan Keuangan Daerah*, 9(2), 142–155.
- Syanita, R. J., & Sitorus, P. M. T. (2020). Pengaruh Struktur Modal Terhadap Kualitas Laba Pada Perusahaan Sub Sektor Tekstil Dan Garmen Yang Terdaftar Di Bursa Efek Indonesia Periode 2016-2018. *Jurnal Mitra Manajemen*, 4(3), 326–340.
- Wang, L., & Huang, S. (2025). An empirical analysis of digital financial innovation, corporate financing behavior, and information transparency. *Finance Research Letters*, 86, 108840. <https://doi.org/https://doi.org/10.1016/j.frl.2025.108840>
- Yang, X., Shira, R. K., Dang, L. P., & Hao, P. (2025). Unforeseen benefits: Can ESG enhance corporate access to commercial credit financing? *Research in International Business and Finance*, 75, 102735.
<https://doi.org/https://doi.org/10.1016/j.ribaf.2024.102735>
- Zelpiani, D. A., & Budi, S. (2025). Agency and Signaling Perspectives on Working Capital

Turnover, Debt to Equity Ratio, and Profitability in PT Gudang Garam Tbk (2013–2023). *Indonesian Financial Review*, 5(2), 401–422.