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Implementation of Audit for the Earnings Management in Emerging Indonesia Market

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ABSTRACT

The setting of developing Indonesian companies this study analyzes the impact of audit quality, audit committee effectiveness, and IFRS adoption on auditor opinions, considering Earnings Management (EM) as a potential mediator. The research population comprises companies listed on the stock exchange of Indonesia, and the sample consists of 325 diverse industrial companies observed from 2013 to 2023. Data analysis was performed using Partial Least Squares-Structural Equation Modeling (PLS-SEM). Utilizing measures such as maximum and minimum values to specify what they measure, correlations, hypothesis tests, mediation analysis, and R-squared. The findings indicate that audit quality, the audit committee, and IFRS adoption significantly influence auditor opinions, and that earnings management successfully mediates the relationship between employee empowerment and job satisfaction, these factors and auditor opinions. Specifically, implementing high audit quality based on Indonesian Auditing Standards (SPAP) and adopting IFRS appears to contribute to more favorable auditor opinions, particularly the unqualified opinion.

Keywords: Audit Quality, Audit Committee, Audit Opinion, IFRS Adoption, Earnings Management

INTRODUCTION

Adherence to Indonesian auditing standards, which align with International Auditing Standards (ISA) as outlined in the Public Accountant Professional Standards, signifies high audit quality (AQ). When auditors conduct engagements in accordance with these standards, clients are more likely to trust the resulting audit opinion (AO), ensuring auditor accountability. In each audit, auditors must inspire confidence in their services through independent technical expertise, ongoing training, skillful application of competence, diligent supervision, evaluation of internal controls, thorough collection of audit evidence, and the issuance of a well-supported opinion on the financial statements according Agoes S, (2004).

Prior research suggests that the adoption of IFRS also plays a significant role in mitigating fraud. The IFRS, a globally recognized framework, is intended to improve the quality of financial information and broaden investor appeal by Abu Alia M. et al., (2025). Numerous nations have implemented IFRS to bolster the transparency, comparability, disclosure, and reliability of financial reporting. The impact of IFRS has been a subject of considerable academic inquiry by Chua Y. et al., (2012). While existing research frequently examines the impact of IFRS on accounting information quality and transparency, a notable gap exists in the understanding of how the AQ role in fraud reduction varies between countries that have adopted IFRS and those that have not according Zeghal. D. et al., (2012)

Consequently, understanding factors that help control fraud is crucial. Acknowledging that both bolstering AQ and implementing IFRS are key strategies for improving the reliability of financial information, the study explores the connection between AQ and fraud reduction. Furthermore, it seeks to understand if and how IFRS adoption influences this relationship, comparing companies that have adopted IFRS with those that have not according Sai. Q. et al., (2024). The study is driven by two specific objectives: 1) to determine the extent to which AQ affects fraud reduction, and 2) to evaluate whether the adoption of IFRS moderates the relationship between audit quality and fraud reduction, offering insights into IFRS's potential to curb fraud and the contribution of audit quality in this process by Ammer, M. A., & Pantamee, A. A. (2024).

Al Shaer, H., et al., (2017) suggest that a unified set of accounting standards increases pressure on managers to report more reliably and engage in less EM due to enhanced information accessibility and comparability, and Zeghal, D., et al., (2012) posit that extensive IFRS disclosure reduces opportunities for EM; other research presents a contrasting view. Wu, C.Y.H., et al., (2014) found that income smoothing and aggressive reporting increased, while timely loss recognition decreased after IFRS adoption, suggesting a decline in the quality of accounting information. Despite IFRS's goal of harmonizing national accounting practices, EM persists across adopting countries (Kusnadi Y. et al., 2016).

An audit committee, acting as an auditor within a company, is responsible for engaging public accountants to assess the accuracy of the company's financial reports. These accountants can be from either Big Four or non-Big Four firms. The adoption of IFRS by companies in their financial reporting is expected to influence the auditor's opinion. Furthermore, EM can act as a mediating variable; reduced EM by managers is believed to improve AQ and the impact of IFRS on the auditor's opinion. This research is motivated by several Indonesian cases involving AO and quality. Notably, public accountant Kasner Sirumapea, along with public accountant colleagues, were sanctioned for violations as auditors. The Ministry of Finance's investigation into the financial year revealed that the recognition of opinions regarding the cooperation agreement with PT. Matgi did not adhere to accounting standards. AP Kasner Sirumapea faced a 12 (twelve)-month license suspension (KMK.No.312/KM.1/2019. June 2, 2019) due to serious violations that could significantly impact the independent auditor's opinion.

LITERATURE REVIEW

Rbv Audit Financial

Financial resources, essential for settling debts and achieving strategic goals, are a clear necessity for any company (Stacey, R. 2011). Complementing strategic management, the resource-based theory emphasizes the accumulation of assets as a primary focus for companies (Degravel, D. 2012). In today's dynamic business landscape, competitive advantage arises from providing customers with unique value that rivals cannot easily replicate Barney, J., & Hesterly, W. (2012). According to the resource-based theory, companies generate value by strategically leveraging resources to create appealing offerings for customers Henard, D., & McFadyen, M. (2012). highlighted that the strategic importance of possessing, utilizing, and committing resources is central to value creation within this framework. This dedication enables companies to capitalize on market opportunities and influences their competitive standing. Financial resources empower organizations to obtain the other resources vital for their operations that ultimately justify the company's existence (Stacey, 2011).

Gill, A. & Biger, N. (2012) assert that sufficient financing is essential for the survival and success of businesses identified adequate financial resources as a key determinant of business success. Corroborated this, finding that financial resources are critical for the survival of SMEs enterprises based on a survey of owners and managers by Yallapragada, R., & Bhuiyan, M. (2011). Additionally, Lafuente et al. (2013) investigated success factors in new business creation, finding that financial resources significantly contributed to the degree of success achieved, in conjunction with marketing, innovation, globalization, and sustainability. They reached this conclusion after surveying 500 startup businesses created between 2006 and 2010.

A primary obstacle that can cause businesses to fail is a shortage of financial resources. Explored and categorized common barriers from existing research, aiming to understand how these barriers interact and to help entrepreneurs develop strategies to overcome them; a lack of financial resources was identified as a key barrier by Arens A.A. et al., (2015). The interview with owners about their experiences with business failures, considering the company's life cycle stage, determined that financial resource scarcity is a leading cause of failure Hamrouni, A., & Akkari, I. (2012).

Internal audits focus

Risk Management

Internal auditors perform thorough risk assessments to pinpoint operational, financial, compliance, and strategic business risks Pomeroy, B. and Thornton, D.B. (2008). Furthermore, they analyze the effectiveness of risk management procedures. By identifying and tackling a business's present difficulties, internal auditors deliver essential insights that empower business owners, management, and regulators to make well-informed and impactful choices (Johl S et al., (2007.

Operate Efficiently

Internal auditors contribute to a business's operational efficiency and productivity by assessing how well its processes and procedures function, focusing on aspects like cost reduction and improved resource optimization Bratten B. et al., ((2019).

Financial Reporting

Internal audits are indispensable for ensuring the accuracy and reliability of financial reports. This accuracy is paramount for effective management, sound decision-making, and the efficient use of valuable time and resources (Beasley et al., 2000; DeZoort, F.T. and Salterio, S.E. 2001; Nogler, G.E. 2008; Chandar et al, 2012; Johl, et al., 2013).

External audits focus

Audit Efficiency and Timeliness

Businesses should prioritize efficiency and timeliness when considering external audits. Engaging a professional, experienced audit firm equipped with streamlined methodologies and advanced technology can minimize operational disruptions and ensure the timely delivery of audit reports (Carcello, J.V. et al., 2010; Krishnan et al., 2011; Kusnadi et al, 2016; Moalla, H. 2017; Bilal et al., 2018).

Compliance With Accounting Standards And Regulations

Ensuring a company's financial statements align with accounting standards, regulatory mandates, and industry norms is the role of external auditors. An audit partner possessing comprehensive expertise in these areas is crucial for maintaining compliance and mitigating the risk of penalties and damage to the company's reputation (Skinner, D.J., & Dechow, P.M. 2000; Bronson et al., 2009).

Helps Provide Value-Added Services

External audit firms often provide value-added services that extend beyond the standard audit, offering companies benefits such as internal control assessments, risk management consulting, fraud detection, and benchmarking analysis. These supplementary services can align with and significantly enhance broader business objectives (Francis J.R. and Krishnan, J.1999; Peasnell, 2000; Reynolds, J. K., & Francis, J. R. 2001; Johl, et al., 2007; Hoitash and Hoitash, 2009; Cassia & Minola, 2012; Wu et al., 2014; Hichem, K. and Samaha, K. 2016).

Hunter (2011) investigated business failure by analyzing the perspectives of bankruptcy professionals evaluating business operations. Using a narrative approach, Hunter interviewed these professionals, identifying factors they considered controllable and uncontrollable for businesses. The study concluded that business owners must proactively implement strategies to manage both types of factors to ensure survival. Shifting the focus to the impact of business failure on the economy, Ucbasaran et al. (2013) posited that business failures can benefit the economy and society by freeing up knowledge and resources from failing ventures. According to Degravel (2012), they further suggested that surviving businesses might experience reduced costs through vicarious learning derived from these failures. Given that a lack of financial resources is often cited as a major contributor to business failure, there is a clear need to examine the strategies owners employ to secure funding.

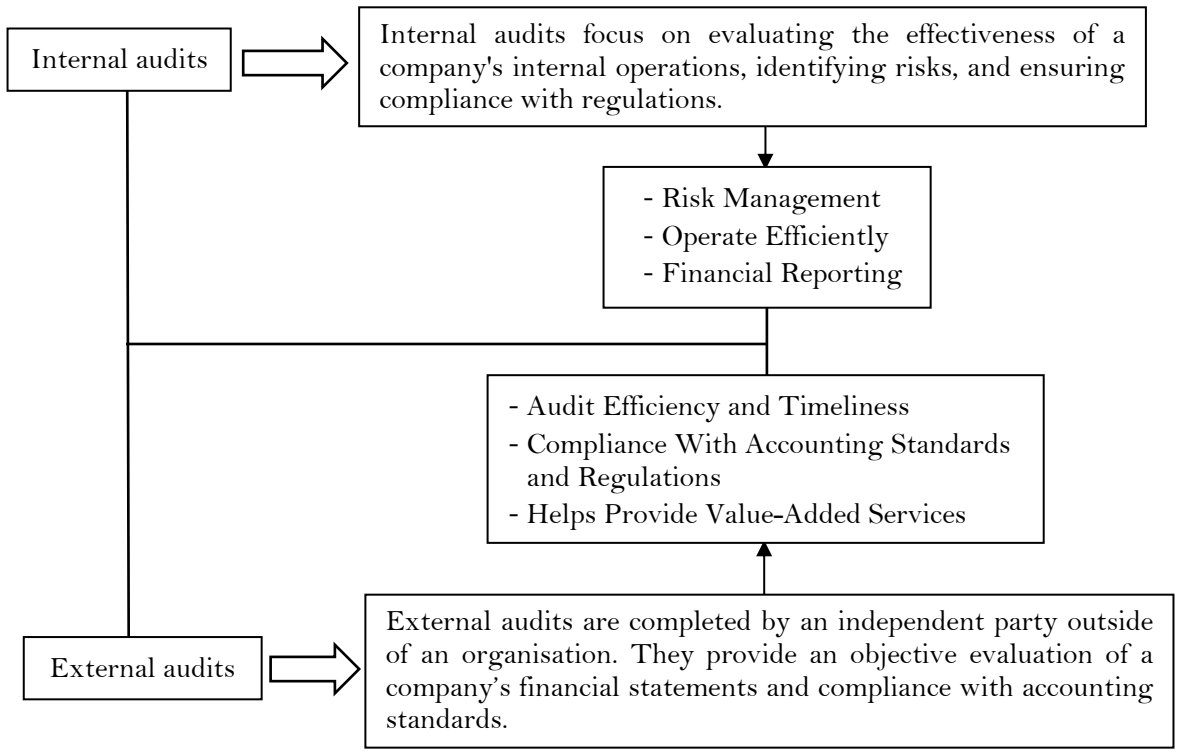

Figure 1. The differences between internal and external audits.

Audit Quality

Audit quality reflects the rigor and thoroughness of financial statement examinations conducted by both Big Four and non-Big Four audit firms, with consistent adherence to professional standards for public accountants (Chen et al., 2005; Nguyen & Tran, 2023). These standards address auditor characteristics, requiring competence, professional skills, and independence. Furthermore, SPAP outlines fieldwork standards, encompassing audit planning, evaluation of internal controls, and evidence gathering (DeFond, M.L. and Francis, J.R. 2005; Ananda & Faisal, 2023). Finally, it dictates reporting standards, ensuring financial statements are prepared in accordance with IFRS, consistently applied, fully disclosed, and accompanied by an auditor's opinion (DeAngelo, 1981; Cheong & Gould, 2012; Inaam, Z. and Khamoussi, H. 2016).

H1: Audit quality demonstrably influences the extent of earnings management practices.
H2: Audit quality demonstrably influences the extent of audit opinion

Auditor Committee

This research is motivated by several Indonesian cases involving AOs and audit committees, notably, public accountants, along with public accountant colleagues, were sanctioned for violations as auditor financial statements (Abbott, 2000; Klein, 2002; Beasley et al., 2009; Baxter, 2010; Yuniarti et al., 2014; Bratten et al, 2019). The Ministry of Finance investigation into the financial year revealed that the recognition of opinions regarding the cooperation agreement with a public accountant did not adhere to accounting standards (Suryanto & Grima, 2018). Public accountant AP faced a twelve-month license suspension (KMK.No.312/KM.1/2019. June 2019) due to serious violations that could significantly impact the independent auditor's opinion. Therefore, this study aims to investigate AQ, audit committees, and IFRS adoption in relation to AO, with EM as a mediating factor, within developing companie1s in Indonesia (Mohd Saleh, 2007; Taufiq, 2023).

Daske & Verdi (2008) suggest that a unified set of accounting standards increases pressure on managers to report more reliably and engage in less EM due to enhanced information accessibility and comparability, and Aussenegg, Inwinkl, & Schneider (2008) posit that extensive IFRS disclosure reduces opportunities for EM. Other research presents a contrasting view. Zeghal & Fourati (2012) found that income smoothing and aggressive reporting increased, while timely loss recognition decreased after IFRS adoption, suggesting a decline in the quality of accounting information. Despite IFRS's goal of harmonizing national accounting practices, EM persists across adopting countries.

H3: The presence and effectiveness of an audit committee significantly impact the degree of earnings management.

H4: The presence and effectiveness of an audit committee significantly impact the degree of audit opinion

Ifrs Adoption

IFRS comprises the mandatory guidelines that all business entities must follow when preparing and presenting financial statements, encompassing assets, liabilities, equity, income, and expenses for a specific accounting period, as well as the accounting methods and policies applied (Jarne & Inez, 2007; Daske et al., 2008; Cheong & Gould, 2012; Chtourou & Fourati, 2012; Chua et al, 2021). The International Accounting Standards Board (IASB) developed IFRS, a globally adopted framework of accounting principles aimed at promoting financial reports that are high-quality, transparent, and comparable. Implementing IFRS is frequently considered a strategy to mitigate fraud, especially by strengthening auditing procedures (Zgarni & Zehri, 2016).

The adoption of IFRS is believed to stimulate national economies by providing transparent accounting guidelines that contribute to economic expansion. Studies also propose that IFRS enhances the quality of audits, thereby diminishing the occurrence of fraudulent financial reporting (Jarne & Inez, 2007; Daske et al., 2008; Cheong & Gould, 2012; Chtourou & Fourati, 2012). Beyond this, IFRS supports the analysis of financial statements across international borders, promotes greater reporting clarity, decreases the expenses associated with information, and alleviates information asymmetry (Sai & Ouyang, 2024). Developing nations, in particular, may benefit from IFRS adoption through simplified and more efficient financial statement preparation, resulting in cost and time savings (Nguyen & Tran, 2023). Consequently, an investigation into the moderating influence of IFRS on the association of audit quality with the mitigation of fraud, examined both before and after its implementation, would be highly beneficial (Ananda & Faisal, 2023).

H5: The adoption of IFRS standards significantly shapes earnings management.

H6: The adoption of IFRS standards significantly shapes the audit opinion

Earnings Management

Earnings management involves strategically manipulating financial statements by managers to present a desired profit picture, whether it be inflating, deflating, or smoothing reported earnings (Burgstahler, D., and Dichev, I. D. 1997; Becker, et al., 1998; Beneish, 2001; Bedart et al., 2004; Butler et al., 2004; Caneghem, 2004; Choi et al., 2004; Chung et al., 2005; Bradburry et al, 2006; Alkdai & Hanefah, 2012). This manipulation is often driven by motivations like securing bonuses, minimizing political scrutiny, or influencing investor perceptions. Discretionary accruals, a proxy for EM, can be achieved through the selection of specific accounting methods, such as employing the FIFO method for inventory valuation (Dechow et al., 1995, 1996; Healy, P.M. and Wahlen, J.M.1999; Chen & Komal, 2018).

H7: The level of earnings management significantly affects the auditor's opinion.

Empirical Model

This research explores how AQ, AC characteristics, and the adoption of IFRS influence AO, considering the mediating role of EM. The empirical model analyzes the effects of AQ, AC oversight, and IFRS adoption on AO, with EM posited as a mediator in this relationship. The study aims to determine the influence of AQ, the effectiveness of the AC, and the implementation of IFRS on AO, through the mediating mechanism of EM practices.

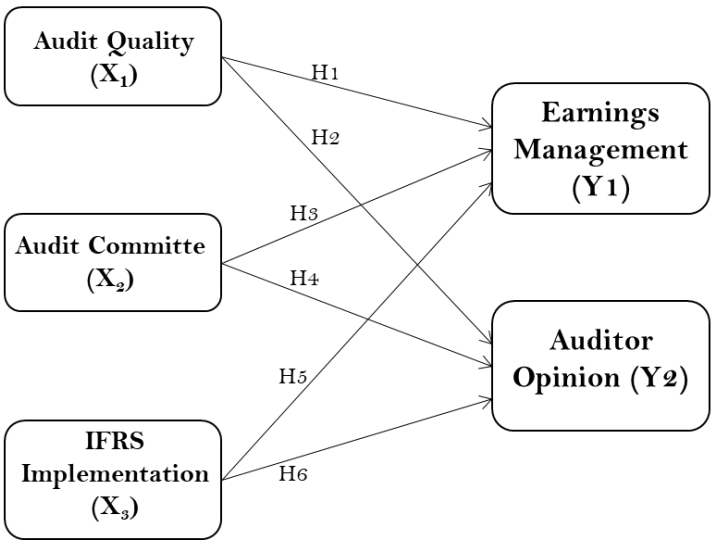

Figure 2. Conceptual Framework Model

METHODOLOGY

Research Design

A quantitative research design with an online survey questionnaire is employed in this research paper. According to Bougie and Sekaran (2019), quantitative research is the most commonly used technique for collecting data from respondents. A survey questionnaire was sent out to the tourists visiting the Maldives resorts or who have experience staying at a green resort to see their responses on the green image of the resorts with the social media attributes.

This quantitative applied research investigates companies listed on the Indonesian Stock Exchange (https://www.idx.co.id) between 2013-2023. A sample of this research, 325 (Slovin; $1.722/1+(1.722x0.05)^2$ diverse industrial companies was selected, resulting in 1.722 observations. Data were collected from company annual reports and analyzed using PLS-SEM. The analysis included minimum-maximum tests, correlation tests, hypothesis testing, mediation analysis, and R-squared evaluation.

Variables And Measured

The variables were measured as follows: AQ was assessed using a dummy variable (1 if the audit was conducted by a Big Four firm, 0 otherwise). Similarly, the presence of an AC was measured with a dummy variable (1 if present, 0 if absent). IFRS implementation was also measured with a dummy variable (1 for companies implementing IFRS, 0 for those that did not). EM was measured based on discretionary accruals. Finally, the auditor's opinion (AO) was represented by a dummy variable (1 for an unqualified opinion, 0 for qualified, adverse, or disclaimer of opinion).

In line with prior research (Hair et al., 2021; 2022), this study employs an audit model incorporating a temporal indicator and prior predictor variables as control variables to examine the effect of IFRS adoption. Unlike previous studies employing cross-sectional pooled regression models, this research utilizes a time-series panel regression model.

$$\text{Audit quality}_{it} = a + \beta_1(IFRS)_{it} + \delta_2(Audit\ lags)_{it} + \delta_3(Auditor\ switch)_{it} + \delta_4(Big4)_{it} + \delta_5(Firm\ size)_{it} + \delta_6(Profitability)_{it} + \delta_7(Return\ on\ assets)_{it} + \delta_8(Leverage)_{it} + \varepsilon_{it}$$

$$\text{Audit opinion}_{it} = a + \beta_1(IFRS)_{it} + \delta_2(Audit\ fees)_{it} + \delta_3(Auditor\ switch)_{it} + \delta_4(Big4)_{it} + \delta_5(Firm\ size)_{it} + \delta_6(Profitability)_{it} + \delta_7(Return\ on\ assets)_{it} + \delta_8(Leverage)_{it} + \varepsilon_{it}$$

Acknowledging that the inherent "before versus after" structure of post-IFRS data can introduce bias by conflating the short-term impact of transition and the ongoing costs of learning with the true long-term effects, we adopt an approach similar to Higgins et al. (2016) to mitigate this issue when estimating the enduring consequences of IFRS adoption. Specifically, we modify equation (1) by substituting the primary variable of interest, IFRS adoption itself.

Audit committee $_{it}$

$$- a - \beta_1(IFRS_1)_{it} + +\delta_2(IFRS)_{it} + \delta_3(IFRS-1)_{it} + \delta_4(IFRS-2)_{it} + \delta_5(Audit\ lags)_{it} + \delta_6(Auditor\ switch)_{it} - \delta_7(BigA)_{it} + \delta_8(Firm\ size)_{it} \cdot \delta_9(Profitability)_{it} \cdot \delta_9(Return\ on\ assets)_{it} + \delta_{10}(Leverage)_{it} + \varepsilon_{it}$$

Earnings management $_{it}$

$$- a - \beta_1(IFRS_1)_{it} + -\delta_2(IFRS)_{it} + \delta_3(IFRS-1)_{it} + \delta_4(IFRS-2)_{it} + \delta_5(Audit\ fees)_{it} + \delta_6(Auditor\ switch)_{it} - \delta_7(BigA)_{it} + \delta_8(Firm\ size)_{it} + \delta_9(Profitability)_{it} + \delta_9(Return\ on\ assets)_{it} + \delta_{10}(Leverage)_{it} - \varepsilon_{it}$$

Validity And Reliability Construct

The validity of the measurement model is evaluated through analysis of factor loadings, where a variable demonstrates good validity if its factor loading's t-test exceeds 1.96 and/or its standardized factor loading is at least 0.50 construct reliability (CR≥0.70) and the average variance extracted ≥0.50) are used to evaluate the reliability of the measurement model within the Partial Least Squares (PLS) framework (Solimun, et al., 2017). A summary of the validity and reliability assessment results is presented in Table 1. The result reveals that all reflective indicator loading factor values are ≥ 0.50, indicating validity, and Average Variance Extracted (AVE) values are ≥0.50, further supporting the validity of all indicators. Furthermore, Composite Reliability (CR) values are ≥0.70, demonstrating reliability. Therefore, all latent variables possess indicators that are both valid and reliable.

Table 1. Validity & Reliability Construct (Outer Model)

Construct (Latent Variable)	Proxy Indicator (Manifest Variable)	Partial Validity (LF > 0.5=Valid)		Construct Validity (AVE > 0.5=Valid)		Composite Reliability (CR > 0.7)	
		Outer Loading	Result	AVE	Result	CR	Result
Audit Quality (X1)	The Big Four Auditor (X1.1)	1.000	Valid	1.000	Valid	1.000	Reliable
Audit Committee (X2)	Oversight & Appointment of Auditors (X2.1)	1.000	Valid	1.000	Valid	1.000	Reliable
IFRS implementation (X3)	Compliance with IFRS (X3.1)	1.000	**Valid**	1.000	Valid	1.000	Reliable
Earnings Management (Y1)	Significant Changes in Accounting Methods (Y1.1)	1.000	**Valid**	1.000	Valid	1.000	Reliable
Auditor Opinion (Y2)	Unqualified Opinion (Y2.1)	1.000	**Valid**	1.000	Valid	1.000	Reliable

Table 2 reveals the descriptive statistics for each variable: AQ (X1), the range is from 0 to 1, with a mean of .61 and a standard deviation of 0.49. The AC variable (X2) also ranges from 0 to 1, exhibiting a mean of 0.67 and a standard deviation of 0.473. IFRS implementation (X3) similarly spans from 0 to 1 with a mean of 0.71 and a deviation of 0.456. Finally, EM (Y1) has a minimum value of -0.19, a maximum of 1.15, a mean of 0.12, and a standard deviation of 0.178

Table 2. Descriptive Statistics Research

Variable	Minimum	Maximum	Average	Std. Deviation
Audit Quality (X1)	0.000	1.000	0.610	0.490
Audit Committee (X2)	0.000	1.000	0.670	0.473
IFRS implementation (X3)	0.000	1.000	0.710	0.456
Earnings Management (Y1)	-0.190	1.150	0.120	0.178
Auditor Opinion (Y2)	0.000	1.000	0.560	0.499

RESULTS AND DISCUSSION

Correlation Analysis

To determine if a relationship exists between the causal and effect variables, Product-Moment correlation analysis is employed, followed by hypothesis testing. The strength of the relationship between these variables can then be assessed using the Guilford table, as presented by Sugiyono (2020). Table 3 reveals the correlations between the research variables. Specifically:

1. Audit Quality (X1) exhibits a moderately a strong, significant with correlation (r = 0.478, p =0.000) with EM (Y1).
2. The AC (X2) also shows a moderately strong, significant correlation (r = 0.498, p =0.000) with EM (Y1).
3. IFRS implementation (X3) demonstrates a moderately strong, significant, and positive correlation (r = 0.464, p = 0.000) with EM (Y1).
4. Audit Quality (X1) exhibits a moderately to strong, significant with correlation (r = 0.572, p = 0.000) with AO (Y2).

5. The AC (X2) demonstrates a strong, significant correlation (r = 0.572, p = 0.000) with AO (Y2).
6. IFRS implementation (X3) shows a moderately strong, significant correlation (r = 0.543, p = 0.000) with AO (Y2).
7. EM (Y1) exhibits a strong, significant correlation (r = 0.663, p = 0.000) with AO (Y2).

Table 3. Correlation Coefficients

Relationship	Correlation Coefficient	Strength of Relationship	P-value	Conclusion
Audit Quality (X1) with Earnings Management (Y1)	0.478	Moderate	0.000	Positive and Significant Relationship
Audit Committee (X2) with Earnings Management (Y1)	0.498	Moderate	0.000	Positive and Significant Relationship
IFRS Implementation (X3) with Earnings Management (Y1)	0.464	Moderate	0.000	Positive and Significant Relationship
Audit Quality (X1) with Auditor Opinion (Y2)	0.572	Moderate	0.000	Positive and Significant Relationship
Audit Committee (X2) with Auditor Opinion (Y2)	0.62	Strong	0.000	Positive and Significant Relationship
IFRS Implementation (X3) with Auditor Opinion (Y2)	0.543	Moderate	0.000	Positive and Significant Relationship
Earnings Management (Y1) with Auditor Opinion (Y2)	0.663	Strong	0.000	Positive and Significant Relationship

Hypothesis Test

This section focuses on evaluating coefficients or parameters that represent causal relationships, specifically the impact of one latent variable on another. The causal effect of the relationship is considered statistically insignificant at a .05 significance level if its critical ratio (CR) falls between -1.96 and 1.96. The structural model's estimated Critical Ratio values were generated using the PLS program application. Table 4 summarizes the results of these coefficient calculations.

Table 4 indicates a positive relationship between AQ (X1) and EM (Y1). Specifically, a higher AQ (X1) is associated with an increase in EM (Y1), as evidenced by a path coefficient of 0.267 and a t-test of 3.804. This t-test exceeds the critical value of 1.96 (3.804>1.96), leading to the acceptance of H1, which posits a significant positive influence of AQ (X1) on EM (Y1). Similarly, the AC variable (X2) also demonstrates a positive influence on EM (Y1). An increase in the effectiveness of the AC (X2) is correlated with a rise in EM (Y1), with a path coefficient of 0.249 and a t-test of 4.059. Given that the t-test is greater than the critical a value (4.059>1.96), H2 is accepted, suggesting that the AC variable (X2) has a significant and positive effect on EM (Y1). Furthermore, IFRS implementation (X3) exhibits a positive influence on EM (Y1). Greater IFRS implementation (X3) is linked to an increase in EM (Y1), indicated by a path coefficient of 0.309 and a t-test of 5.408. The t-test surpassing the critical value (5.408>1.96) leads to the acceptance of H3, confirming a significant positive impact of IFRS implementation (X3) on EM (Y1).

For the AQ (X1) positively influences AO (Y2); a higher AQ (X1) leads to an increase in AO (Y2). The path coefficient is 0.220, with a t-test of 2.207. Since the t-test exceeds the critical value (2.207>1.96), H4 is accepted, indicating a significant positive influence of AQ (X1) on AO (Y2). Similarly, the AC (X2) positively influences AO (Y2); a stronger AC (X2) increases AO (Y2). This relationship has a path coefficient of 0.262 and a t-test 2.479. Because the t-test is greater than the critical value (>1.96), H5 is accepted, implying that the AC (X2) significantly and positively impacts AO (Y2). Furthermore, IFRS implementation (X3) also positively influences AO (Y2); greater IFRS implementation (X3) results in a higher AO (Y2). The path coefficient is 0.251, with a t-test of 2.825. As the t-test exceeds the critical value (2.825>1.96), H6 is accepted, demonstrating a significant positive relationship between IFRS implementation (X3) and AO (Y2). Finally, EM (Y1) positively influences AO (Y2); increased EM (Y1) leads to an increase in AO (Y2), with a path coefficient of 0.311 and a t-test of 2.989. Because the t-test of is greater than the critical a value (>1.96), H7 is accepted, indicating that EM (Y1) significantly and positively influences AO (Y2). These path coefficients, along with factor weights of manifest variables, are visually represented in the path diagram for both the measurement and structural models.

Table 4. Results Analysis Path SEM-PLS

Influence Between Latent Variables Cause Variable --> Effect Variable	H	Path Coefficient	t-value	p-value	Conclusion
Audit Quality (X1) --> Earnings Management (Y1)	H_1	0.267	3.804	0.000	H_1 accepted
Audit Committee (X2) --> Earnings Management (Y1)	H_2	0.249	4.059	0.000	H_2 accepted
IFRS Implementation (X3) --> Earnings Management (Y1)	H_3	0.309	5.408	0.000	H_3 accepted
Audit Quality (X1) --> Auditor Opinion (Y2)	H_4	0.220	2.207	0.028	H_4 accepted
Audit Committee (X2) --> Auditor Opinion (Y2)	H_5	0.262	2.479	0.013	H_5 accepted
IFRS Implementation (X3) --> Auditor Opinion (Y2)	H_6	0.251	2.825	0.005	H_6 accepted
Earnings Management (Y1) --> Auditor Opinion (Y2)	H_7	0.311	2.989	0.003	H_7 accepted

The path diagram indicates that EM (Y1) has the strongest direct influence on AO (Y2), with a path coefficient of .311. Furthermore, IFRS implementation (X3) exerts the most substantial impact on EM (Y1), evidenced by a path coefficient of .309. In this study, Compliance with IFRS (X3.1) serves as the sole proxy for IFRS implementation (X3), resulting in a loading factor of 1.000, signifying that Compliance with IFRS (X3.1) fully represents the entire IFRS implementation construct (X3). Consequently, should management aim to enhance AO (Y2) through IFRS implementation (X3) and its subsequent effect on EM (Y1), statistical analysis suggests prioritizing the improvement of the Compliance with IFRS indicator (X3.1), making it a crucial element for strategic policy evaluation.

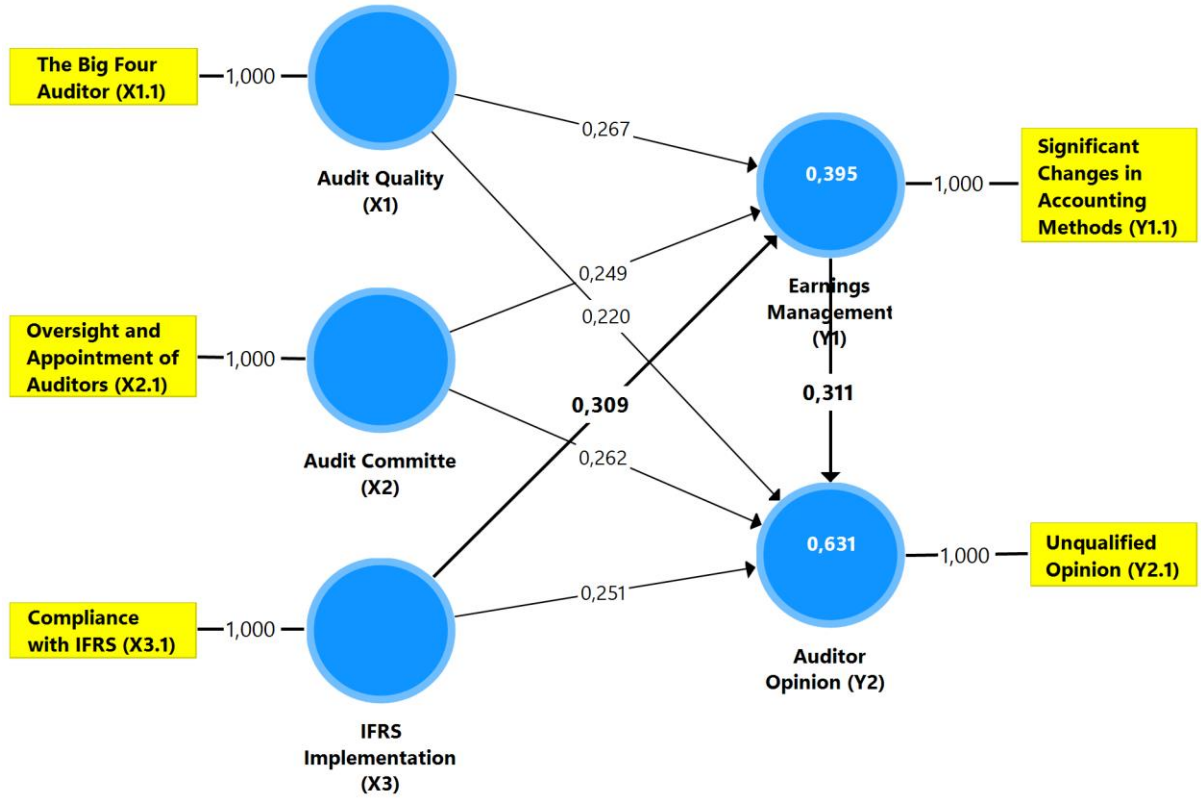

Figure 3. Path Diagram Model

Mediating Variable

Two methods exist for analyzing mediating variables: the coefficient difference approach and the coefficient multiplication approach. The coefficient difference approach compares analysis results with and without the inclusion of the mediating variable. The coefficient multiplication approach, on the other hand, uses the Sobel test. This study utilizes the coefficient of multiplication approach with the Sobel test for detecting mediation. The results of the coefficient at multiplication analysis are presented below.

Table 5 reveals significant indirect effects of the independent variables on AO (Y2) through EM (Y1). Specifically:

1. Audit Quality (X1) has a significant indirect effect on AO (Y2) via EM (Y1), with a path coefficient of 0.083 and a t-test of 1.988, exceeding the significance threshold of 1.96.
2. Similarly, the AC (X2) significantly influences AO (Y2) indirectly through EM (Y1), as evidenced by a path coefficient of 0.0774 and a t-test of 2.022, which is greater than 1.96.
3. The implementation of IFRS (X3) also demonstrates a significant indirect impact on AO (Y2) via EM (Y1), indicated by a path coefficient of 0.0961 and a t-test of 2.164, exceeding the 1.96 threshold.

These findings suggest that EM (Y1) effectively mediates the relationship between Audit Quality (X1), AC (X2), IFRS implementation (X3), and AO (Y2).

Table 5. Indirect Influence between Latent Variables

Indirect Influence	Calculation	Result	t-value	p-value	Description
Audit Quality (X1) on Auditor Opinion (Y2) through Earnings Management (Y1)	0.267 x 0.311	0.083	1.988	0.047	Significant
Audit Committee (X2) on Auditor Opinion (Y2) through Earnings Management (Y1)	0.249 x 0.311	0.077	2.022	0.044	Significant
IFRS Implementation (X3) on Auditor Opinion (Y2) through Earnings Management (Y1)	0.309 x 0.311	0.096	2.164	0.031	Significant

Structural Model

Evaluating the Structural Model (Inner Model) is crucial for solidifying scientific concepts derived from synthesizing various theories into comprehensive structural equations. This evaluation involves estimating the coefficient of determination (R^2) and the total coefficient of determination (Q^2).

Table 6. Determination Coefficient (R^2)

Influence			R Square	Determination
Audit Quality (X1)	-->	Earnings Management (Y1)	0.340	34.0%
Audit Committee (X2)	-->			
IFRS implementation (X3)	-->			
Audit Quality (X1)	-->	Auditor Opinion (Y2)	0.571	57.1%
Audit Committee (X2)	-->			
IFRS implementation (X3)	-->			
Earnings Management (Y1)	-->			

The R-squared value of 0.340, derived from the model assessing Audit Quality (X1) and IFRS implementation (X3) on EM (Y1), indicates that these two variables explain 34% of the variance in EM. The remaining 66% of the variation in EM is attributable to other factors not included in this study. The model, which includes Audit Quality (X1), AC (X2), EM (Y1), and AO (Y2), has an R-squared value of .571. This suggests that these variables explain 57.1% of the variance in the model. The remaining 42.9% of the variance is likely due to the variables not included in this research. To assess how well the model fits the data, the total coefficient of determination (Q^2) was

calculated. Q^2 values, ranging from 0 to 1, indicate the model's ability to represent the observed data, with higher values representing a better fit. The results of this calculation are detailed below;

$Q^2 = 1 – (1 – R_1^2) \times (1 – R_2^2)$

$Q^2 = 1 – (1 – 0.340) \times (1 – 0.571)$

$Q^2 = 0.717$

The model comprised Audit Quality (X1), AC (X2), EM (Y1), and AO (Y2), yielding a coefficient of determination (R^2) of 0.571. This implies that 57.1% of the variance in the dependent variable(s) is accounted for by the specified independent variables, while the remaining 42.9% is attributable to unexplained variance. The goodness-of-fit of the model was evaluated using the total coefficient of determination (Q^2), a measure of the model's capacity to represent the observed data. Q^2 values range from 0 to 1.0, with higher values signifying a superior model fit. The results of the Q^2 calculation are presented subsequently.

The SEM-PLS model exhibits a Total Determination Coefficient (Q^2) of 0.717, indicating that it explains 71.7% of the variance in the data. The remaining 28.3% of the variance is attributable to factors or variables not included in this study. A detailed assessment of the inner model of testing criteria, based on the total coefficient determination, is presented below.

Tables 7 and 8 present global optimization information used to assess the strength of theory confirmation based on the developed model. The total coefficient of determination is 0.717, exceeding the 0.670 threshold. According to standard R-Square testing criteria, this indicates a strong model for theory confirmation. Therefore, the synthesis of multiple theories into a holistic structural construct on the Path Diagram can be validated and considered a good fit, potentially representing a new scientific discovery or a currently valid Grand Theory.

Table 7: Stage Strong Structural Model

No	Rule of Thumb		Total Determination	Result
	Interval	**Category**		
1	0.19 - 0.33	Weak	0.717	Moderate
2	**0.33 - 0.66**	**Moderate**		
3	> 0.67	Strong		

Table 8: Test Cross Loading (Discriminant Validity)

	Audit Quality (X1)	**Audit Committee (X2)**	**IFRS implemen-tation (X3)**	**Earnings Management (Y1)**	**Auditor Opinion (Y2)**
The Big Four Auditor (X1.1)	**1,000**	0,448	0,255	0,409	0,572
Oversight & Appointment of Auditors (X2.1)	0,448	**1,000**	0,348	0,467	0,590
Compliance with IFRS (X3.1)	0,255	0,348	**1,000**	0,437	0,499
Significant Changes in Accounting Methods (Y1.1)	0,409	0,467	0,437	**1,000**	0,566
Unqualified Opinion (Y2.1)	0,572	0,590	0,499	0,566	**1,000**

In addition to assessing convergent validity, discriminant validity must also be examined by evaluating cross-loadings within the measurement model. A latent construct demonstrates good discriminant validity if the correlation between the construct and its primary indicator is stronger than the correlation between that indicator and other constructs, suggesting the construct is a better predictor of its indicator than alternative constructs.

CONCLUSION

Company's competitive advantage is rooted in its internal resources and capabilities. In this light, internal audit functions can be viewed as a valuable internal resource that, when leveraged effectively, can drive improved performance and competitive advantage. While external audits are important for compliance and stakeholder trust, they don't typically function as core internal resources in the same way. This aligns with Henard & McFadyen (2012). Applying the RBV allows us to recognize internal audit (IA) as a potentially valuable, rare, inimitable, and non-substitutable (VRIN/VRIO) resource driving organizational effectiveness and competitive advantage (Degravel, 2012).

Moreover, the RBV provides a framework for analyzing the internal factors that contribute to IA effectiveness, including management support, cooperation with external auditors, independence, and extrinsic rewards.

1. Harnessing Internal Audit Strengths: Companies can enhance performance by maximizing their internal audit function's impact on risk management, internal controls, and overall governance through strategic utilization of its inherent strengths and skills.
2. External Audit: A Compliance Mandate: While vital for reliable and credible financial reporting, external audits are typically perceived as a mandatory external obligation rather than a fundamental internal asset.
3. External Audit and Stakeholder Confidence: External audits bolster trust with external stakeholders (e.g., investors, creditors) by offering an unbiased evaluation of the company's financial position.

The RBV's primary emphasis is on leveraging a company's internal resources. Although RBV principles can offer insights into optimizing the relationship between a company and its external auditors (for example, maximizing the value derived from audit results), their direct applicability to external auditing is limited.

1. Focus: Internal audits assess the effectiveness of internal controls and risk management, whereas external audits verify the accuracy of financial statements.
2. Purpose: Internal audits aim to enhance internal operations and governance, while external audits assure external stakeholders.
3. Independence: Internal auditors are company employees, while external auditors are independent professionals.
4. Complementary Roles: Despite their differences, internal and external audits work together to contribute to sound corporate governance.

This research concludes that audit quality, audit committees, and IFRS adoption positively and significantly impact AO, with successful EM acting as a mediator in the relationship between these factors and AO. The implication is that high-quality audits, conducted in accordance with standards by both Big Four and non-Big Four firms, lead to more favorable AO and financial reports that adhere to IFRS. Future research could explore different research subjects to enhance the generalizability of the findings.

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