

# audit quality

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**Submission date:** 19-Oct-2022 10:02AM (UTC+0700)

**Submission ID:** 1929291506

**File name:** 125941222\_paper\_terindex.pdf (463.94K)

**Word count:** 3777

**Character count:** 19962

# The Effect of Audit Firms Size, Leverage, Going Concern Opinion, Audit Tenure, on Audit Quality in Indonesia

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## ABSTRACT

The research objective is to illustrate the credibility of financial statements issued by companies. The more credible the financial statements are able to provide a guarantee for the information used in decision making. Audit quality describes an auditor's social role in reducing the risk of an accountant material misstatement by providing adequate guarantees that financial statements are prepared in accordance with generally accepted standards. The research method used is a quantitative method that aims to see the probability of audit firm size, leverage, audit tenure, and going concern opinion on audit quality. The type of data used is secondary data obtained through the web site idx.go.id. company data sources used are all publicly listed companies listed on the Indonesia Stock Exchange, the period of observation from 2013 to 2017 in the sector (1) Agriculture, (2) Mining, (3) Infrastructure, utilities & Transportation, (4) Trade, Services & Investment sector. The results of this study indicate that audit firm size has a positive influence on audit quality, while leverage, and audit opinion and additional testing for company age do not affect audit quality.

**Keyword-** audit quality, audit firm size, leverage, audit tenure, opinion going concern

## 1. INTRODUCTION

The phenomenon of poor audit quality does not only occur in developing countries but also in developed countries, both small Public Accounting Firms (KAP) and BIG KAPs<sup>4</sup>. Some Public Accountants (AP) get administrative sanctions caused by low professionalism in the form of non-compliance with existing regulations in maintaining their competence. Public accountants in maintaining their competence are required to fulfill a minimum number of Continuing Professional Education Credit Units (SKP) of at least 40 SKP in one year reported starting from December and finally on January 30 the following year to the Indonesian Institute of Certified Public Accountants (IAPI). Public accountants who do not meet the minimum number of SKP will be subjected to written administrative sanction warnings. Violations committed by the Public Accountant against the Professional Standards of the Public Accountant (SPAP), the Professional Code of Ethics and or legislation relating to the services provided are grouped in violations as follows: minor, moderate, severe and very severe violations. Public accountants affected by sanctions are reported by the Financial Services Authority (OJK) as capital market watchdogs in Indonesia. The most sanctions in the period of 5 (five) years

occurred in 2013 as many as 103 Public Accountants and the most written warning sanctions in 2017. Sanctions issued by the OJK occur at all levels of KAP both small KAP and KAP affiliated with Foreign KAP (Foreign KAP KAPA), and Public Accounting Firms affiliated with Foreign Audit Organizations (OAA) that have a good reputation at the international level. Previous studies show audit quality is conceptualized as the lowest to highest theoretical series [1], while [2] shows audit quality as a joint probability that the auditor finds a violation in the client system and reports the violation. According to [3] and [4], service quality and responsiveness are very important. This study uses audit quality proxy with industry specialization owned by KAP in providing assurance services. The purpose of this study is to look at the quality of audits in Indonesia, which is reflected in the characteristics of auditors and company characteristics. The auditor's characteristics are reflected by the audit quality proxy by industry specialization owned by the KAP, an audit of firms size of the company as seen from the KAP affiliated with the Foreign Public Accounting Firm or with the Foreign Audit Organization, going concern opinion given by the auditor to assess corporate business continuity, and tenure audit conducted by the Public Accountant with the client. Company characteristics are reflected by the leverage held by the company. The difference between this study and previous studies in the use of proxy audit firm size is using KAPA and

OAA, while previous studies use more Big4 size to see audit firm size [5];[6]; [7]; [8].

## 2. LITERATURE REVIEW

Audit quality is very important to maintain public trust from the value of the audit, which shows the auditor's actual behavior. This is also supported by research [9]; [10] state that audit quality can affect investor perceptions of information risk because higher audit quality provides tighter verification of financial information, and thus stronger monitoring [11]; [12]; [13]; [14]. Improved audit quality will reduce uncertainty about the quality of financial information, thereby reducing the level of information risk and lower costs of equity capital (for example,[11]; [15]).

The amount of agency conflict between insiders and debtholders is measured by corporate leverage [16]. An increase in debt makes the risk of wealth transfer from debtholders higher [17] also believes that the leverage ratio can be used as a proxy for the importance of covenant restrictions. So expect a positive relationship between leverage and the choice of high-quality auditors [18].

Tenure audits have been arranged in various countries, both developed and developing countries. The Sarbanes-Oxley Act 2002 shows that longer tenure audits tend to show higher opportunity costs. Tenure audits, in Indonesia, are regulated through Government Regulation of the Republic of Indonesia No. 20 of 2015 but in 2017 through the Financial Services Authority Regulation (POJK) No. 13 / POJK.03 / 2017, article 16 regulates audit tenure for 3 years for AP. Issuers or parties that carry out financial service activities can only re-use audit services on annual historical financial information from the same AP after two years in a row. Some countries show that auditor changes take place over a period of 5 to 7 years such as in Greece, Latvia, Spain, the Czech Republic and Austria [19]. Changes in auditors have become the focus of debate, the importance of change of auditors shows if the KAP has a close relationship in the long term, will reduce auditor independence. Most studies show audit tenure improves audit quality [20]; [21]; [22]; [23]; [24]; [25]; [22]; [26]; [27]. The selection of audit tenure variables is based on the first group that focuses on measures of audit quality indirectly. The tenure audit in this study is proxy with dummy 1 short tenure 3 years or less, and 0 for long tenure if more than 3 years to 5 years.

The auditor issues a going-concern opinion depending on the client's financial situation, as an indicator of audit quality [28] finds that female auditors, *ceteris paribus*, are more likely to issue GCO than male auditors. Studies [28] also show that this effect is stronger when the client (ie representing the material portion of the auditor's income) or at high risk (ie associated with increased uncertainty and risk). [29] also shows from the auditor's point of view, the environment can be accurately described as an environment of low litigation risk.

This study questions whether the disagreement is an indication of either audit quality or professionalism.

The hypothesis proposed in this study is as follows:

H1: audit firm size affects the audit quality

H2: leverage affects the audit quality

H3: going concern audit opinion influences audit quality

H4: audit tenure influences audit quality

## 3. RESEARCH METHODS

Research design or research design is a plan of the research structure that directs the research process and results wherever possible to be valid, objective, efficient and effective (Jogiyanto, 2007: 53). This type of research is hypothesis-testing research which uses causal testing. This study was designed to determine whether audit firm size, leverage, going concern opinion, and audit tenure, affect the quality of audits that occurred in 2013-2017 in sector companies in the sector (1) Agriculture, (2) Mining, (3) Infrastructure, Utilities & Transportation, (4) Trade, Services & Investment in Indonesia. The approach used in this research is the binary logistic regression approach with quantitative methodology. The independent variables in this study are audit firm size, leverage, going concern opinion, and audit tenure while the dependent variable is Audit Quality. The population in this study are companies listed on the Indonesia Stock Exchange (IDX). The research period is between 2013 and 2017. The sampling method used is the purposive sampling method, which is a method of selecting samples based on certain criteria.

Audit firm's size is defined by the Public Accounting Firm that affiliates with the Foreign Public Accounting Firm (KAPA), as well as with the Foreign Audit Organization (OAA). KAP size will be measured by dummy variables, 1 if KAP is foreign-affiliated and 0 is not

Leverage is defined as the ratio used to measure how much a company relies on debt to finance its assets. Debt Ratio is calculated by dividing total debt (total liabilities) with the total assets owned.

Going concern opinion is defined as an opinion that shows the continuity of the company's business in the one year ahead issued by the Public Accounting Firm. The auditor's opinion is measured by a dummy variable, 1 if the opinion that is published is going concern opinion and 0 others.

Audit tenure is defined as the length of engagement between the auditor and the auditee within a period of 5 years. Audit tenure will be measured by a dummy variable, 1 if the auditor audits for five years and 0 others.

Audit quality is defined as the auditor's probability of finding errors and disclosing them to the public. The quality of audits is proxied with the industry specialization they have

The analysis model in this study uses logistic binary regression. In the independent variable regression technique in this study, 6 variables and Y variable one using the industry specialization proxy owned by KAP. As for this test using the linearity BLU estimation The analysis model used is as follows:

$$AQ_i = \alpha_0 + \alpha_1 AFS_i + \alpha_2 Lev_i + \alpha_3 Opini_i + \alpha_5 AT_i + \varepsilon_i$$

Dimana:

AQ: Audit quality

AFS: Audit Firm Size

Lev: Leverage

Opini: Opini Going Concern

AT: Audit tenure

## 4. RESULT

Table 1. Description Statistik

Variabel	Mean	std. Dev	min	max	observasi
AQ	0,5362	0,49899	0	1	828
PC	0,2448	0,43026	0	1	825
Lit	0,0568	0,23153	0	1	828
AGE	11,63229	9,00278	0	67	828
AFS	0,8333	0,37298	0	1	828
AT	0,9819	0,13345	0	1	828
GC	0,101	0,30211	0	1	828
LEV	4921737	6495233	7667233	9853210	828

Table 2. Logistic regression results

Var		Var	
AFZ	***8,715	Lev	0,752
	0,003		0,386
AT	0,526	Constanta	1,462
	0,433		0,227
GC	0,036	R square	0,014
	0,848		

### Effect of Firm Size Audit Probability on Audit Quality

The test results indicate the value of firm size audit probability on audit quality. Firm size audit variables indicate a probability of 0.003 on audit quality. These results indicate there is a possibility that an audit firm size affects audit quality. The value of the logit results shows the probability of affecting audit quality. This result is in accordance with the existing theory that shows that KAP affiliated with foreign Public Accounting Firms, both Big4 and non-Big4 KAP will have better standards and rules. When the Public Accounting Firm conducts cooperation or affiliation with Big4 KAP they have better audit guidelines in accordance with the foreign KAP. This shows that Public Accounting Firms that have a cooperative or affiliated relationship with Foreign Public Accounting Firms with Big4 and non-Big4 KAP will maintain a better professional code of ethics because they have guidelines for conducting more complex audits than other public accounting firms. The results of this study support the study of [30]; [31]; [32] and; [33].

### The Effect of Audit Tenure Probability on Audit Quality

The results of the analysis in this study amounted to 0.328 which shows this value is greater than 0.05 which means that this variable has no probability of audit quality. The available data shows that there are many public accountants who provide insurance services for less than three years by the Financial Services Authority (OJK) regulations. Financial Services Authority Regulation Number 13 / POJK.03 / 2017 regulates the use of public accountant services and the Public Accountant Office in Financial Services activities. This regulation states that in Chapter VI regulates restrictions on the use of audit services in article 16 paragraph one regulates parties conducting financial services activities must limit the use of audit services on the annual historical financial information of the same Public Accountant for the audit period for three consecutive financial reporting years [18] according to. From the available data, all available public accountants provide audit services for a maximum of two years from each Public Accounting Firm.

### Effect of Probability of Leverage on Audit Quality

The results of the analysis show the effect of leverage probability on audit quality has a value of 0.616 which indicates a value greater than 0.05 which indicates this variable does not provide the probability of leverage to influence audit quality. Results in some countries are still variations in results. [18] show that the relationship between leverage and high-quality auditors varies significantly in several countries. Each country has different legal protections, the more developed the country will have better legal protection for its investors. The stronger the legal protection for investors the stronger the protection of rights, the disclosure of creditor requirements and more informative information, the higher the demand for audit quality with corporate leverage. The available data shows that only 2 percent of the total companies have a ratio above 1 percent and the remaining less than 1 percent. This shows that 98 percent of companies have a total debt smaller than the total assets owned by the company, which shows that the company's operations are still running well so that the company can pay its debts when due. The smaller the leverage ratio, the better the company results are. This is supported by [18]; [34]; [33]; [35]; [36] and; [37].

### Additional testing

#### Effect of age on Audit Quality

The results of this study indicate a value of 0.662 which indicates this value is greater than 0.05, which means the probability of this variable does not affect audit quality. The age of a company that increasingly long does not provide a probability of audit quality. This shows that companies that are increasingly listed on the Indonesia Stock Exchange also show better audit quality probabilities than Public Accountants.

## 5. CONCLUSION

Audit quality shows that financial statements have high credibility in making decisions for users of financial statements. Audit Firm Size gives an impact on audit quality that shows when the Public Accounting Firm collaborates with the Foreign Public Accounting Firm or with the Foreign Audit Organization shows that the Public Accounting Firm has better quality control because every year the foreign Public Accounting Firm and Foreign Audit Organization will conduct a quality review of its affiliated Public Accountant Firm. Leverage does not indicate the probability of audit quality, which shows that very few companies have trade payables guaranteed with the total assets they have, this indicates the company's operations run well and shows the viability of a company in the coming year is very good. The audit opinion is dropped by a system that shows multicol. Audit tenure does not provide a probability of audit quality. The tenure of each public accountant is following existing laws and regulations, the existing Public Accountants comply with the 2017 Financial Services Authority regulations that govern the length of the engagement of the Office of Public Accountants and Public Accountants. For further research do not consider the audit opinion because most companies are very good at the continuity of their business going forward, audit opinion testing is good if the economic conditions of a country are experiencing a crisis.

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