The Audit Quality: An Empirical Study of Indonesian Banking Company

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Abstract

The present study aims to empirically prove some independent variables that influence audit quality. These independent variables are auditor rotation, workload, and auditor specialization. The population of this study was the Indonesian banking company registered in Indonesia Stock Exchange year 2011-2015. The twenty-nine (29) of them were purposively selected as the sample of this study. The data gathered in this study were in the form of financial annual reports. The observation of these banking company was conducted throughout five years and resulted in 145 numbers of data. Furthermore, this study employed multiple regression as the method of data analysis. The result indicated that the auditor specialization was the only independent variable influencing the quality of audit, while the variable of auditor rotation and workload had no influence.

Keywords: the audit quality, auditor rotation, auditor specialization

Introduction

The audit quality remains an interesting topic to be studied. Although it has been examined for more than two decades, there is still no universal agreement of how to define and measure the audit quality. It is due to the different views about this variable as thought by financial report users, auditor, regulator, and societies. This results in various perceptions on the factors influencing the audit quality. This issue attracts more attention after the occurrence of several cases of fraud that involve auditors in manufacturing and banking company. Rosnidah (2010) states that the existence of these fraud cases especially in finance causes the doubt of audit quality.

Some fraud cases in Indonesian banking that involve the quality of audit are not successfully examined by the auditors, such as the violation of the maximum standard of credit lending regulation (BMPK) in Indonesian National Trading Bank, National Bank, Danamon, and Bank Central Asia. This infraction is in contradiction with the professional standard of public accountant and closely related to the auditors' irresponsibility in fulfilling the qualification standard of Auditing established by the Indonesian Accountant Association (Hastuti, 2010).

An auditor is required to obey the professional standards of Public Accountant, one of which is being independent. In relation to this, the Indonesian government establishes some regulations about the independency of a public accountant. Through the Ministry of Financial affais' regulation of Republic of Indonesia number 17 PMK.01/2018 about public accountant service, the government enacts the alteration of public accountant and auditor's office mandatory. For a public accountant office, six years of bookkeeping is the longest period and for a public accountant, he/she has three years of bookkeeping. It attempts to keep the professional relationship between the auditor and the client.

The mandatory rotation is based on the theoretical reason that the auditors' rotation can improve independency both physically and empirically. Rotation which is closely related to tenure is hoped to decrease the aberration done by the client. Additionally, the limitation of tenure is to prevent a close relationship between auditors and their clients which will potentially interfere the auditors' indepency (Giri, 2010).

Kurniasih in Rohman (2014), in her study, found that the auditor rotation significantly influenced the quality of audit. This variable certainly gave greater impact on the quality of independent auditing result. It was also revealed that auditor rotation policy has a positive effect on the quality of audit report as well as

restore public trust toward the function of auditing. In contrast, a study conducted by Hartadi (2012) showed that auditor rotation slightly influenced the quality of audit.

Another factor contributing to the audit quality is workload. The assumption is the over workload will be likely to result in poor quality of auditing, since auditors' workload will influence how they execute their duties. The over-amount of workload will likely cause dysfunctional audit behavior that could decrease the auditors' ability to find the faults or report the violation (Setiawan dan Fitriany, 2011).

According to Lopez dan Peters (2012), such a condition gives an opportunity for a manager to manipulate the financial process. It indicates that workload, along with the limited time of the auditing process, might decrease the quality of audit. This is in consistent with the result of study conducted by Rusli dan Wiratmaja (2016) which indicates that workload has an influence on the audit quality. On the other hand, however, Ardianingsih (2014) shows that workload does not influence the quality of audit, which means the great number of works does not become a reason for auditors to not to provide the optimal service of auditing.

Moreover, the present study also examines auditor specialization as an independent variable that may contribute to the audit quality. Specialist auditors are those who come from Public Accountant Office whose specialization is in a particular industry. The specialization makes the specialist auditors possess a good understanding about internal control, business risks, and company auditing riks in an industry (Setiawan dan Fitriany, 2011). Through the good understanding, the specialist auditors will not easily to do mistakes during the process of auditing. This has affirmed the statement given by Solomon et al. (1999) who said that a specialist auditor performs better than non-specialist auditor in the auditing process.

In relation to this, several previous researches have shown that auditor specialization has contributed to the quality of audit (Setiawan and Fitriany, 2011 and Panjaitan dan Chariri, 2014). Nevertheless, a study conducted by Pertiwi, et al (2016) concluded the opposite result. The inconsistent results of studies in the field of audit quality lead this study to examine the influence of auditor rotation, workload, and auditor specialization to the quality of audit in Indonesian banking company that are registered at Indonesian Stock Exchange.

The decision to implement public accountant rotation cannot be separated from some consideration, one of them is the implementation of audit conducted by Public Accountant Office to the clients that will potentially cause a close relationship between them and interfere the auditors' independency (Novianti, 2010).

Scholars who agree to the implementation of auditor rotation argue that the quality of audit tends to significantly decrease for the recent time. The auditors who only examine the same company every year are likely fail to improve their creativity in designing auditing procedures so that it will lessen the auditors' competency (Giri, 2010). This is in line with the finding of a study conducted by Kurniasih dan Rohman (2014) that shows a long relationship between auditor and auditee significantly influence the auditor independency. That is why auditor rotation is highly needed.

Hypothesis 1 (H1): Auditor rotation influences the audit quality.

Workload is the number of works encountered by auditors. It could be seen from the auditors' number of clients. The greater the number of clients is, the more workload the audior would be. Lopez and Peters (2012) define workload as a busy season in the first quarter of year since most companies have a fiscal year ending in December. Auditing process which is held during the auditors' workload will likely result in low quality of auditing. In this case, time limitation becomes a crucial part to determine the success of auditing process that will certainly influence the quality of the result.

The workload pressures are indicated by the unbalance between the number of auditors and the allocation of time to finish the process of audit. This condition makes the auditors encounter difficulties in finding mistakes and violations during the auditing process (Persellin *et.al*,2015). Furthermore, the auditors' workload could contribute to the quality of audit, so that the credibility of public accountant will be questioned. As a result, the public accountant is difficult to gain the public trust.

Setiawan dan Fitriany (2011), in their study, indicated that the over workload faced by the auditors significantly decreased the audit quality. Moreover, Lopez dan Peters (2012) revealed that the level of discretionary accruals tends to increase during the busy season. It causes the lessening of audit quality. This result is in consistent to the study conducted by Hansen et.al. (2007), Ishak et.al. (2015) and Rusli dan wiratmaja (2016) showing that the over workload encountered by the auditors definitely reduced their competency in discovering violation and fraud in the financial report.

Hypothesis 2 (H2): Workload influences the audit quality

The quality of audit requires auditors' competence and independency to achieve a good result of auditing. The auditors' competence is closely related to the auditors' level of understanding in executing the auditing process. An auditor who has many clients in a particular industry will likely have a better understanding and knowledge about the internal control of the company, business risks, and auditing risks in that industry. Besides, auditors whose specialization in a certain industry will acquire more knowledge and experiences rather than auditors without any specialization. Solomon et.al. (1999) states that specialist auditors will slightly perform mistakes in the process of auditing.

In relation to this, the result of Panjaitan and Chariri's (2014) research confirmed that auditors' specialization greatly influenced the quality of auditing result. The auditors whose specialization is in a certain industry possessed detail knowledge, as a result, they comprehensively understand the characteristics of the company.

Hypothesis 3 (H3): Auditor specialization influences the audit quality

Methods

The population of this study was Indonesian banking companies registered in the Indonesia Stock Exchange year 2011-2015. The sample then was selected by using purposive technique. The selected sample was banking company registered continuously during the period of observation in 2011-2015. These banking company consistently published their annual financial reports in Rupiah currency for the last period in every December 31 and had been examined by independent auditors. Twenty-nine (29) banking company matched the criteria required by this study. During the five-year observation, 145 data were gathered.

Since the present study examines the influence of auditor rotation, workload, and auditor specialization toward the audit quality, the operational definition of these key variables is as follows.

1. Audit quality

De angelo (1981) defines audit quality as a probability where an auditor finds and reports violation or fraud in the accounting system of the auditee.

The audit quality in this study is measured by using Discretionary Accruals (DA) which is counted with the accrual model (Beaver dan Engel, 1996) as utilized by Nasution dan Setiawan (2007). DA was determined by employing regression to reach the coefficient β, $\beta1$, $\beta2$, $\beta3$, and based on the following formula:

$$TA_{it} = \beta_0 + \beta_1 CO_{it} + \beta_2 LOAN_{it} + \beta_3 NPA_{it} + \beta_4 \Delta NPA_{it+1}$$

in which,

TA_{it} : the total accruals counted based on the allowance for loan losses of the company in year t.

CO_{it} : the charged-off loan balance of company i in year t.

$LOAN_{it}$: loans outstanding of company i in year t.

NPA_{it} : non-performing assets

ΔNPA_{it+1} : the difference of non-performing assets of company i in year t + 1 and non-performing assets of company i in year t.

Before the regression has been administered to obtain the coefficient β, β1, β2, β3, and β4, all variables (TAit, COit, LOANit, NPAit, ΔNPAit+1) were initially deflated by using book value of equity and loan loss reserve. After the coefficient β, β1, β2, β3, and β4 were obtained, the non-discretionary accruals (NDAit) value of the company in each year of observation was determined by the formula (Rahmawati, 2007) below:

$$NDA_{it} = \beta_0 + \beta_1 CO_{it} + \beta_2 LOAN_{it} + \beta_3 NPA_{it} + \beta_4 \Delta NPA_{it+1}$$

in which:

NDAit is the non-discretionary accruals value of company i in year t.

Furthermore, discretionary accruals (DAit) value was determined by using the formula as follows:

$$DA_{it} = TA_{it} - NDA_{it}$$

The higher the discretionary accruals (DAit) value indicates a great number of earning management practices, or the lower the audit quality which could not detect the earning management conducted by the company.

2. Auditor rotation

Auditor rotation is to describe the mechanism of the Public Accountant Office regular exchange of the sample company in relation to the audit quality. The auditor rotation that is measured by dummy variable proxied with the same public accountant office which is used continuously more than three years is given score (0). In contrary, the auditor rotation which is less than three years is given score (1) (Hartadi, 2012).

3. Workload

Workload represents the number of works faced by an auditor. Firstly, the level of workload could be seen from the number of clients that an auditor has. Secondly, it could be also indicated by the limited time to perform the process of auditing (Setiawan and Fitriany, 2011).

$$WL = \frac{\text{The number of auditees handled by a public accountant office in the on-going year}}{\text{Total number of patners in the public accountant office in the on-going year}}$$

4. Auditor specialization

Specialist and non-specialist auditors are categorized based on the marketshare, that is the percentage of a company's clients audited by a public accountant office. After that, the weighting is conducted based on the asset of company with the formula used by Siregar et.al (2011) and Setiawan and Fitriany (2011).

If a public accountant office dominates more than 10% marketshare, he/she is categorized as specialist accountant, but if no more than 10%, he/she belongs to non-specialist auditor. Thus, by using dummy variable, an auditee is given score 1 if examined by specialist auditor and score 0 if audited by non-specialist auditor (Siregar et al, 2011). The formula used to measure the marketshare weighting of auditor specialization is as follows:

$$\text{Market share} = \frac{\text{Number of KAP Clients in the Industry}}{\text{The total number of industrial issuers}} \times \frac{\text{the average KAP Client assets in the Industry}}{\text{the average assets of all industrial issuers}}$$

This study employed multiple regression as the technique of analysis data which is determined by the following formula:

$$Ln\_DA_{it} = \beta_0 + \beta_1 RA_{it} + \beta_2 WRL_{it} + \beta_3 SA_{it} + \varepsilon_{it}$$

in which:

Audit quality (Ln_DA) = natural logarithm of discretionary accruals as the proxy of audit quality

WRL (workload) = the number of auditee handled by a public accountant in the on-going year

RA (Audit rotation) = dummy variable (score 1 for auditor rotation and 0 if the auditor does not rotate)

SA (Spesialisasi Auditor) = dummy variable (score 1 if the auditor has specialization in banking and 0 if not)

α	= Konstanta
ε	= Error

Results and Discussion

Statistical Description

Table 1 shows the result of statistical description. 145 observation data in form of company financial reports indicate that the variable of audit quality has maximum value 8.052 and minimum value 17.013. Furthermore, the average value is 12.13025 with standard of deviation 2.316208.

The workload variable results in 1.80 of average value with the minimum value 1 and maximum value 2. Thus, from the data analysis, it was revealed that the average client of an auditor was 1.80 or 2 in one year. Furthermore, an audit partner examined minimum 1 client and maximum 2 client in one year.

In a similar direction, the auditor rotation had an average value 0,17 and standard of deviation 0,379. The minimum value was 0 which meant that the same public accountant office was assigned as auditors for more than three years repeatedly. Meanwhile, the maximum value was 1 which meant that public accountant office was appointed as auditors for less than three years.

Moreover, the variable of auditor specialization was measured based on the percentage of client or company audited by public accountant office. Auditor specialization is a dummy variable so that the minimum value is 0 and the maximum is 1. The result of data analysis indicated that the minimum value represented banking company which used non-specialist auditors. In contrary, the maximum value represented banking company which employed specialist auditors. The average value of auditor specialization was 0.69, meaning that the banking company that were audited by specialist auditors was 69% from the total number of banking company selected as the sample of this study.

Table 1. Statistical description of the research variables

	N	Minimum	Maximum	Mean	Std. Deviation
LnDA	145	8.052	17.013	13.13025	2.316208
WRL	145	1	2	1.80	.401
RA	145	0	1	.17	.379
SA	145	0	1	.69	.464
Valid N (listwise)	145				

Source: data processing, 2017

The Result of Multiple Regression

Before conducting multiple regression analysis, this study initially administered classical assumption test, i.e. normality test, heteroscedasticity test, multicolleniarity test, and auto-correlation test. Based on the normality test by employing Kolmogorov-Smirnov, it was shown that the asymp sig (2-tailed) or significant in 0,051 was higher than 5% or 0.05 which meant the distribution of the data was normal.

The result of multicolleniarity test shows that VIF value of WRL (workload) variable is 1.055, RA (auditor rotation) variable 1.002, and SA (auditor specialization) variable 1.053. The VIF value is less than 10. Furthermore, the tolerance value of WRL variable is 0.948, RA variable 0.998, and SA variable 0.950. The tolerance value is more than 0.1, which means there is no multicolleniarity among the independent variables.

The heteroscedasticity test in this study employs glejser which is conducted by reversing the independent variables with the residual absolute value. If the significant value between the independent variables and the residual absolute value is more than 0.05, there is no heteroscedasticity problem. For the details, the heteroscedasticity test result is presented in the table 2.

Table 2. Result of Glejser test

Model		Unstandardized Coefficients		Standardized Coefficients		
		B	Std. Error	Beta	T	Sig.
1	(Constant)	2.482	.478		5.197	.000
	WRL	-.335	.262	-.109	-1.281	.202
	RA	.107	.270	.033	.397	.692
	SA	-.255	.226	-.096	-1.129	.261

Dependent Variable: AbsUt

Furthermore, the autocorrelation test was administered to find out whether the linear regression model has autocorrelation between the interfere variable of t and the interfere variable of t-1 (previous period). The detailed result of the autocorrelation test is presented in the table below.

Table 3. Result of Autocorrelation test

Model Summary[b]					
Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
1	.401[a]	.161	.143	2.143810	1.851

Source: data processing, 2017

Table 3 shows that the Durbin-Watson value is 1,851. This value is compared to the table value by using significance 5%, the number of sample 145 (n) and the number of independent variables (3) (k=3). The dL value is 1,6866, dU value 1,7710 and the Durbin-Watson table is 1,950. Therefore, it is concluded that the Durbin-Watson value (1,814) is in between dU (1,771) and 4-dU (2,299), which means there is no autocorrelation.

After the classical assumption test has been conducted, the present study employed multiple regression test to answer the problem statements and hypothesis. The result of multiple regression test is presented in table 4.

Table 4. Result of Multiple regression

Variabel Dependen: Audit Quality (LnDA)	Coefficient	P-Value
Auditor Rotation	-.909	.056
Workload	.725	.115
Auditor Specialization	1.599	.000
F test	0.000	
R² test	0.143	
N	145	

Source: data processing, 2017

Table 4 indicates that the level of significance of F test is 0.000 (less than 0.05), which means that the regression model has been correct in which all independent variables simultaneously influence the dependent variable. Table 4 also explains the determinant coefficient value of this research which is 0.143 or 14.3%. It implicates that the variables of auditor rotation, workload, and auditor specialization could only explain 14.3% of audit quality, while the rest (85.7%) is explained by other variables.

The result of multiple regression as presented in table 4 shows that only the variable of auditor specialization significantly influences the audit quality. In other words, the hypothesis 3 (H3) is accepted. However, the table also explains that the variable of auditor rotation and workload do not have any influence on the audit quality. Thus, the hypothesis 1 (H1) and 3 (H3) are rejected.

This study has proven that auditor specialization significantly influences the audit quality. The use of a specialist auditor will greatly enhance the result of audit quality. The concept of audit quality could be realized by an adequate competence. A competent auditor possesses a good ability to discover the violation performed by his/her client during the process of auditing. In order to have such competence, an auditor should develop outstanding knowledge and expertise on company internal control, company business risks, and auditing risks of the industry that is being audited. Auditor specialization in a certain industry aims to improve the result of audit quality. Thus, the use of specialist auditors to do auditing of financial reports in banking company is highly recommended. The result of this study is in consistent with the results found by Setiawan and Fitriany (2011) and Putri and Wiratmaja (2015). They have revealed an evidence that auditor specialization significantly influenced the result of audit quality. However, this result does not agree with the finding of Pertiwi et.al. (2016) that auditor specialization had no influence the audit quality.

The data analysis proved that another variable involved in this study, auditor rotation, slightly influenced the audit quality. It might because of the lack of awareness to change the auditors during the process of auditing. Besides, most banking company has already implemented the regulation of the Ministry of financial affairs number 7/PMK.01/2008 about the rotation of auditors. This result agrees with the study conducted by Hartadi (2012), in which audit rotation slightly influenced the audit quality since the client did not realize whether the auditors have been rotated. In the contrary, the finding of this study is not in line Kurniasih and Rohman (2014) who stated that there was a positive correlation between auditor rotation and the audit quality. The result found by Kurniasih and Rohman implicates that supporting the auditor rotation policy has a positive impact on the quality of financial reports as well as maintain the public trust toward the function of auditing.

Additionally, this study is also failed to find a positive correlation between workload and audit quality. It is assumed that the auditors experience a busy time at the beginning of the year. As a result, the auditors will have workload and therefore they could not provide the optimal service during the process of auditing. However, to sum up, the present study revealed that the workload had no influence on the audit quality. This finding confirms the study conducted by Ardianingsih (2014), but is in contrast with the finding revealed by Lopez and Peter (2012), Setiawan and Fitriany (2011), Ishak, et.al (2015).

Conclusion

The present study examines the influence of auditor rotation, workload, and auditor specialization on audit quality. The finding reveals that only auditor specialization influences audit quality. However, this study could not prove the influence of other variables in this study, auditor rotation and workload, to the quality of audit. Furthermore, the result of this study indicates that the three independent variables only explain 14.3% of the audit quality, and the rest is explained by other variables excluded in this study.

Although auditor rotation slightly influences the audit quality, the banking company are hoped to obey the regulation of the Ministry of financial affairs number 7/PMK.01/2008. Besides, it is important for public accountant offices to maintain their office hours and the number of clients so that the public accountant offices do not experience workload that could be a cause of the deficient audit quality.

Last but not least, auditors have to consistently maintain and improve their specialization, knowledge and experiences in the field of auditing so that they will be able to continuously enhance the result of audit quality.

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