



## Effect of Tenure, Audit Specialization, and KAP's Reputation on the Quality of Audit Mediated by Audit Committees

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### ABSTRACT

The purpose of doing research is to analyze the influence of tenure, specialty audit, Audit Firm's reputation on quality auditing, and third variable interaction of audit quality when moderated by audit committee. A number of manufacturing companies of 156 listed in IDX period 2011-2016 become the population this research. A number of 44 companies selected as samples by using purposive sampling technique. The Research used multiple regression analysis, while interaction variables tested with Moderated Regression Analysis (MRA) by using IBM SPSS version 21. The results of this study showed tenure have no effect to audit quality. There are positive and significant influence of audit specialization to audit quality. Meanwhile, reputation of audit firm and significant influential audit committee with a negative direction against quality of audit. The study also proved that audit Committee was able to moderate the relationship of audit specialization to audit quality as well as relationship of audit firm's reputation of quality audit. However, the audit committee is not able to moderate relationship of tenure with audit quality. A summary of this research is role of audit committee is crucial in bridging audit firm and corporate relationships as well as maintaining quality of audit results.

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### INTRODUCTION

Go public companies have an obligation to report their finances to the public. This is because financial statements are the main media for companies to deliver financial information as a form of accountability from management. To ensure that the information presented by management is in accordance with the actual conditions, an audit on the financial statements is needed. This audit must be carried out by an independent third party. Public accountants as independent third parties are obliged to maintain their independence in order to produce qualified audits and produce credible, non-misleading, and accountable opinions. This is in line with Ika & Wibowo (2011) argued that independence is a very important and unique aspect of the public accounting profession, because it deals directly with the implementation of the assessment (accreditation) function on the financial statements.

Audit quality is very important because an audit report becomes more reliable information for decision

making by investors. However, the facts in the field show that audit quality is getting more attention after several fraud cases which occur involving auditors. 2015 These cases included the case of Toshiba in 2015, British Telecom in 2017, PT Ancora Mining Service in 2008, and PT Inovisi InfracomTbk which occurred in 2015. These cases were associated with poor audit quality and resulted in losses for investors. Meanwhile, the British Telecom case had an impact on stock prices which fell one-fifth.

Research on audit quality have been carried out by several researchers who stated that there are several factors that influence audit quality. As research conducted by Thuneibat et al (2011) and Mgbame et al (2012) who both found tenure has a negative effect on audit quality. Afterwards, Lim & Tan (2010) stated that tenure has a positive effect on audit quality. While Nugrahanti & Darsono (2014) found that KAP specialization has a significant influence with a positive direction on audit quality. As found by Al Khaddashet al (2013). Meanwhile, Putri & Wiratmaja (2015) found a negative influence of audit specialization on audit quality.

The results of research conducted by Prasetya & Rozali (2016) and Choi *et al* (2010) found that KAP's reputation has a positive effect on audit quality. Mean-

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while, Nadia (2015) found a negative influence of KAPs' reputation on audit quality. Audit committee as the implementation of good corporate governance mechanisms is considered capable of maintaining the quality of the audit results. Audit committee is able to control the involvement of external auditors to mitigate earnings management (Zgarni, Hlioui, & Zehri, 2016). Setiawan & Fitriany (2011) found the results that audit committee has a significant influence with a negative direction on audit quality and audit committee is not able to moderate the relationship of audit specialization to audit quality. Meanwhile, Rusli & Wiratmaja (2016) found that audit committee is able to moderate the tenure relationship to audit quality.

The purpose of this research is to analyze the effect of tenure, audit specialization, KAP reputation on audit quality, and the interaction of these three variables on audit quality when moderated by audit committee. The use of audit committee as a moderating variable becomes the originality of this study because the use of audit committee as the moderating variable is still rarely used. In addition, the KAP reputation variable is measured using a group of auditors affiliated with big four, non-big four international affiliates, and KAP without international cooperation, in contrast to previous studies that only used the big four and non big four KAP proxy. As well as the object of research in manufacturing companies listed on the Indonesia Stock Exchange in 2011-2016 also becomes the originality of this research.

Grand theory that forms the basis of this research is agency theory. Agency theory is a theory that explains contractual relations between parties that delegate certain decisions (owners / investors) and those who receive delegations (agents / management). According to Panjaitan & Chariri (2014) Agency theory has the main objective of finding answers to agency problems. Agency problems arise because both parties working together (agents and principals / owners) have different objectives. Therefore, an audit of the financial statements is needed to ensure that the information presented by management is in accordance with the actual conditions, the audit is carried out by an independent third party.

The Multiple Intelligence Theory describes the relationship between human experience and ability to solve the problems they face. Litfiah (2014) concluded that intelligence is a mental ability and process of thinking, reasoning rationally / logically, thinking abstract to capture learning relationships and solve problems and the ability to adapt to the situation to be faced. In this case, the ability factor obtained from learning and experience will help the auditor to produce a qualified audit. The quality of the audit results will be in harmony with the ability and the experience they have. The use of reputable KAPs and auditors specialization are expected to solve problems that arise and will produce a good audit quality so that they can be used by stakeholders in making right decisions. Public accountants as independent third parties are expected to overcome agency problems that arise. However, this independence can be disrupted by a too long tenure. The existence of a qualified audit committee as the implementation of the Good Corpo-

rate Governance concept is expected to be able to handle this.

An independent attitude will cause opinions on the client's financial statements to be free from bias. However, to have an independent attitude, auditors will be influenced by various factors, one of which is the length of the audit engagement (tenure) between the auditor and a client. According to agency theory, the agency problem of public accountants is based on institutional mechanisms, that is public accountants perform audit services for the interests of principals, but their services are paid by management. Therefore, the longer tenure can cause excessive closeness between public accountants and their clients, thereby reducing the independence of public accountants. Adeyemiet al (2012) found that long enough tenure negatively affects audit quality. Mgbame et al (2012), Thuneibatet al (2011) and Nadia (2015) also suggested that tenure that is too long will negatively affect audit quality.

### **H<sub>1</sub>: Partially Tenure Has a Negative Effect on Audit Quality**

In carrying out audits of public accountants have risks to be faced. In order to overcome these risks, public accountants must have a good understanding of the client's business. In line with this, Nugrahanti & Darsono (2014) emphasized the importance of understanding the client business, so that public accountants are able to minimize audit risk. Understanding the client business is an integral part of professional work, so by understanding the client's business is expected to produce audit results that can meet auditing quality standards. Experience in auditing certain industries can help public accountants understand the client's business. Public accounting who has specialization in auditing certain industries are considered to have better knowledge and understanding so as to minimize audit risk and produce qualified audits. In accordance with multiple intelligence theory that explains intelligence as a level of one's ability / experience in solving various problems that are directly faced and the ability to solve various problems that arise in the future. Likewise the findings of Setiawan and Fitriany (2011) and Al Khaddash et al (2013) stated that auditor specialization has a positive influence on audit quality.

### **H<sub>2</sub>: Audit Specialization Partially Has a Positive Effect on Audit Quality**

High reputed KAPs are identical to large KAPs, and are considered to have the ability to be independent and professional towards clients. This is because KAP does not have an economic dependency on clients. In accordance with agency theory, one of the causes of agency problems is based on institutional mechanism. Public accountants conduct audits for the benefit of shareholders, but the appointment and payment of public accounting services is carried out by management. The ability of reputable KAP to not depend on clients will maintain independence so as to produce a qualified audit. Reputable KAP also has more experience and capability in auditing. This is in accordance with multiple

intelligence theory which indicates that one's experience will help him in solving problems which encounters.

Al Khaddash et al (2013) revealed that the reputation of the Public Accountant Office affects Audit Quality in the Jordanian Banking Sector. Prasetia and Rozali (2016), in their research found that the reputation of KAP has a positive effect on audit quality, which means that the higher the reputation value of KAP will improve audit quality in a company.

**H<sub>3</sub>: Reputation of KAP Partially Has a Positive Effect on Audit Quality**

The formation of an audit committee is a mandatory thing for the company as a manifestation of the implementation of a good corporate governance concept. The better the audit committee, the better the supervision in the audit process, so that the audit quality produced will also be higher. In accordance with the monitoring mechanism in agency theory, which is to establish an audit committee to oversee corporate governance and monitor public accountants in order to be able to maintain their performance well. Agency theory also reveals that one of the causes of agency problems comes from institutional mechanisms. Public accountants conduct audits for the benefit of shareholders, but the appointment and payment of public accounting services is carried out by management.

With the supervision of the audit process carried out by the audit committee, it is expected that independence by public accountants will be maintained. In line with this, Anafiahet al (2017) and Soliman & Elsalam (2012) in their study found a positive influence of the audit committee on audit quality. The characteristics of the audit committee are able to improve the quality of the audit produced by the company.

**H<sub>4</sub>: The Audit Committee Partially Has a Positive Impact on Audit Quality**

The more qualified the audit committee, the more effective the audit committee will be in overseeing the performance of public accountants in carrying out audits. Authority held by the audit committee as a sub-committee of the board of commissioners, the audit committee has the authority to give recommendations in the appointment and replacement of public accounting firms. This has a close relationship with the quality of the audit committee will tend to shorten the tenure of public accountants. This aims to maintain the independence of public accountants. In accordance with the agency theory where one of the causes of agency problems comes from institutional mechanisms, public accountants are appointed by the management to carry out audits for the benefit of shareholders, but audit services are paid for by management. The existence of a qualified audit committee is expected to be able to maintain the independence of public accountants so that the quality of the audits carried out is maintained. This is also in accordance with the monitoring mechanism in agency theory, which is establishing an audit committee to oversee corporate governance and monitor public accountants in order to be able to maintain their perfor-

mance well.

**H<sub>5</sub>: Audit Committee Moderates Tenure's Effects on Audit Quality**

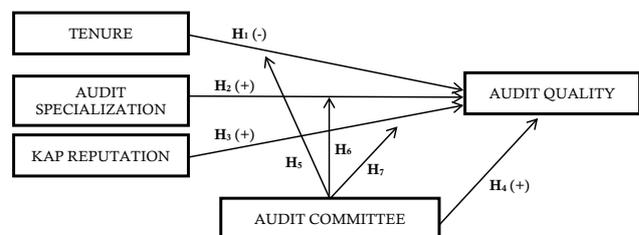
Companies that use the services of public accountants which have been specialists are then supported by qualified audit committees, are expected to produce a qualified audit. A good communication between audit committees and public accountants will make it easier to find solutions to problems encountered in the audit process so that it can encourage the realization of qualified audit results. This is in accordance with agency theory to reduce the opportunity for managers to carry out adverse actions on the principal, there are two ways that is the principal conducts monitoring with a mechanism to appoint public accountants to examine financial statements and establish audit committees to improve internal control of the company.

**H<sub>6</sub>: The Audit Committee Moderates the Effects of Audit Specialization on Audit Quality**

Agency theory explains that problems between principals and agents that occur because of different interests, each party has a tendency to maximize its authority for personal gain. According to the moral hazard hypothesis, agents have a tendency to maximize the level of personal welfare and choose to sacrifice the level of principal's welfare. The use of KAP which has a good reputation and supported by a qualified audit committee will be able to minimize the risk of the different interests. Well-reputed KAP has a good financial capacity so that it is able to maintain its independence. Monitoring carried out by the audit committee during the audit process ensures the implementation of the audit as it should be. Both of these are considered to be able to improve the quality of audit results. This is also in accordance with the monitoring mechanism in agency theory, that is establishing an audit committee to oversee corporate governance and monitor public accountants in order to be able to maintain their performance well.

**H<sub>7</sub>: Audit Committee Moderates the Effect of KAP's Reputation on Audit Quality**

Based on the framework above, the research model can be seen Figure 1.



**Figure 1.** Theoretical Framework

**RESEARCH METHOD**

This research is a quantitative research that uses secondary data. By using documentary techniques in data collection, while the data used are the annual re-

ports and financial statements of manufacturing companies listed on the Stock Exchange from 2011 to 2016. The design of the study used quantitative descriptive because the testing of variables emphasizes theory testing through variable measurement and data analysis done using statistical procedures. A total of 156 manufacturing companies listed on the Indonesia Stock Exchange from 2011 to 2016 became the subject of this research. A total of 44 companies were selected as samples by using purposive sampling technique. Table 1 shows the process of selecting samples in this study.

In this study, audit quality is calculated as the quality of earnings presented in the financial statements.

Audit quality is measured by discretionary accruals. High discretionary accruals indicate low audit quality. In this case, the positive / negative relationship of the independent variable on the discretionary accruals shown in the beta value coefficient in the hypotheses test shows the opposite direction to audit quality. Positive value on the beta coefficient shows the negative direction of the relationship of the independent variable on audit quality, whereas negative value on the beta coefficient shows the positive relationship of the independent variable on audit quality. In full, the operational definition of variables and their measurements can be seen in Table 2.

In analyzing the data, the researchers used

**Table 1.** Selection of Research Samples

No	Sample Criteria	Beyond Criteria	Number
1	Number of Manufacturing Companies listed on the IDX		156
2	Manufacturing companies listed on the Stock Exchange in a row from 2011 to 2016	29	127
3	Manufacturing companies provide complete financial information from 2011 to 2016	6	121
4	There is complete data on the audit committee and KAP auditing financial statements	52	69
5	Financial statements presented in rupiah	19	50
6	Data outlier		6
7	Research period		6
8	Number of unit of analysis		264

Source: Research data processed in 2018

**Table 2.** Operational definitions and Variable Measurements

No	Variables	Variables Definition	Measurement Indicators
1	Audit Quality	Audit quality is the probability that the auditor will find good and honest, Reporting material errors, errors and omissions detected in the client's accounting system (Mgbame, Eragbhe, & Osazuwa, 2012)	First Step: Calculating corporate accrual totals: $TACC_{it} = INCBFXT_{it} - CFO_{it}$ Second step : Calculating non-discretionary accruals $TACC_{it}/TA_{it-1} = \square_1(1/TA_{it-1}) + \square_1 [\Delta REV_{it}/TA_{it-1} - \Delta REC_{it}/TA_{it-1}] + \square_2(PPE_{it}/TA_{it-1}) + \square_3(\Delta CFO_{it}/TA_{it-1}) + \square_{it}$ Third step : Calculation of discretionary accruals $DACC_{it} = TACC_{it} - NDACC_{it}$ (Setiawan & Fitriany, 2011)
2	Tenure	Tenure is the number of years of engagement between public accountants (KAP) and the same clients in a row (Praselia & Rozali, 2016)	Tenure is measured by calculating the number of years the company is audited by one consecutive KAP. (Putri & Wiratmaja, 2015).
3	Audit Specialization	Specialist auditors are auditors who have more experience in auditing companies in one industry. So that it has a better understanding on the corporate internal controls, risks from the client's business, and audit risk in the industry. (Setiawan & Fitriany, 2011)	Market Share = $(\sum KAP \text{ clients in the Industry} / \sum \text{ all issuers in the industry}) \times (\text{Average of client assets in the industry} / \text{average of assets of all issuers in the industry})$ (Setiawan & Fitriany, 2011)
4	KAP Reputation	KAP's reputation is a view on the good name, achievements and public trust that the auditor carries and KAP where the auditor works. (Hidayanti & Sukirman, 2014)	KAP with big four affiliation : 3 KAP with non-big four affiliation : 2 KAP without international cooperation : 1  (Praselia & Rozali, 2016)
5	A u d i t Committee	Audit committee is the implementation of a GCG mechanism, a committee established to assist the duties and functions of the board of commissioners. (Setiawan & Fitriany, 2011)	Good = 3 Fair = 2 Poor = 1  (Setiawan & Fitriany, 2011)

Source processed from various sources in 2018

descriptive statistical analysis and multiple linear regression analysis. Descriptive statistics was used to describe variables in the study individually, including mean, standard deviation, minimum and maximum. Multiple linear regression was used to analyze the direct influence of several independent variables on the dependent variable. Multiple linear regression analysis was used to test the hypothesis and determine the coefficient of determination ( $R^2$ ).

**RESULTS AND DISCUSSIONS**

The result of the coefficient of determination test shows adjusted R square value of 0.031. This shows that only 3.1% of the variation in audit quality can be explained by variations in tenure, audit specialization, KAP reputation, audit committee, and the interaction variables between the audit committee with tenure, audit specialization, and KAP Reputation, while the remaining 96.9% is explained by factors outside the regression model.

This study uses the classical assumption test to test whether the data used has met the criteria of classical assumptions such as the test for normality, linearity, multicollinearity, autocorrelation, as well as heteroscedasticity. The results of classical assumption test can be seen in Table 3.

Multiple regression analysis and Moderated Regression Analysis (MRA) interaction test are used to test hypotheses using IBM SPSS version 21. The results of

hypothesis test are presented in Table 4 below:

**The Effect of Tenure on Audit Quality**

The result of hypothesis testing in Table 4 shows that tenure has a positive effect on discretionary accruals in other words tenure has a negative effect on audit quality and is not significant, so H1 is **rejected**. This result is in line with the research conducted by Wahyuni & Fitriany (2012) that tenure does not have a significant effect on audit quality. Wahyuni & Fitriany (2012) argued that the absence of influence of tenure on audit quality due to the existence of two factors that influence audit quality, namely competence and independence. Both of them have the same strong but opposite influence. The same strong relationship between the two factors is considered to be able to eliminate the significant influence between tenure and audit quality. The more tenure will improve the competence of public accountants which can improve audit quality. On the other hand, the longer tenure is assessed will reduce independence which can reduce audit quality. The results of this study are also consistent with Werastuti's research (2013) which suggests that client tenure does not affect on audit quality.

**The Effect of Audit Specialization on Audit Quality**

Table 4 shows that specialization has a negative effect on discretionary accruals in other words it has a significant and positive effect on audit quality, so H2 is

**Table 3.** Classical Assumption Test Results

No	Types of Test	Basic Decision Making	Result	Conclusion
1	Normality Test	Alfa 0.05	Significance : 0,178	Normal Distribution
2	Linearity Test	$c^2$ table : 129,56	$c^2$ count : 0	Model specifications are linear
3	Multicollinearity Test	Tolerances Values > 0.10 VIF < 10	There are no variables with values < 0.10 There are no variables with values VIF > 10	There are no multicollinearity problems
4	Autocorrelation Test	Alfa : 0.05	Significance of 0.805	There is no autocorrelation
5	Heteroscedasticity Test	Alfa : 0.05	All variables show significance above 0.05	Heterocedasticity does not occur

Source : Secondary data processed, 2018

**Table 4.** Summary of Hypothesis Tests

No	Hypothesis	Alfa	Beta	Significance	Result
1	Tenure has a negative effect partially on audit quality	0.05	1.116	.225	rejected
2	Auditor specialization partially has a positive effect on audit quality	0.05	-3.405	.025	accepted
3	Reputation of KAP partially has a positive effect on audit quality	0.05	3.864	.005	rejected
4	Audit committee partially has a positive effect on audit quality	0.05	1.043	.008	rejected
5	Audit committee moderates the influence of tenure on audit quality	0.05	-1.133	.233	rejected
6	Audit committee moderates the influence of audit specialization on audit quality	0.05	3.335	.028	accepted
7	Audit committee moderates the effect of KAP Reputation on audit quality	0.05	-4.194	.007	accepted

Source : Secondary data processed, 2018

accepted. This means that the use of specialist auditors can influence the level of audit quality.

A specialist auditor has good understanding and knowledge on the client's internal control, client's business risk, and audit risk in the industry. This understanding is derived from his experience of repeatedly auditing various companies in the same industry. With a good understanding on the client company can help auditors to minimize audit risk so as to produce a qualified audit (Nugrahanti & Darsono, 2014). In accordance with the Multiple Theory Intelligence describes intelligence as a level of ability and human experience to solve problems that are directly faced and the ability to overcome problems that arise in the future. Al Khaddash et al (2013), Setiawan & Fitriany (2011), and Nugrahanti & Darsono (2014) concluded that audit specialization has a positive effect on audit quality.

### The Effect of KAP's Reputation on Audit Quality

Table 4 shows that the reputation of KAP has a direction of positive relation towards discretionary accruals in other words it has a direction of negative and significant relationship towards audit quality, so that H3 is **rejected**. This negative influence can be caused by the pressure of work on public accountants in connection with the number of clients who use their services at the beginning of the year (workload) can result in decreased audit quality even though the KAP is reputable. This is supported by data obtained by the researchers, the data shows that companies tend to use reputable accounting firms. As much as 53.79% of sample companies use KAP services affiliated with big four, 44.70% of sample companies use KAP services that have affiliations with non-big four international companies and the rest use KAP services without international affiliation. In line with this, Setiawan & Fitriany (2011) in their research found that excessive workloads will negatively influence the quality of audit results. The results of this study support studies conducted by Giri (2010) and Nadia (2015) which concluded that audit reputation has a negative influence on audit quality.

### The Effect of the Audit Committee on Audit Quality

Table 4 shows that the audit committee has a positive relationship direction on discretionary accruals in other words having a negative and significant relationship towards audit quality, so that H4 is **rejected**. The negative influence of the audit committee can also occur because of the lack of auditor specialization roles (Setiawan & Fitriany, 2011). There is no auditor's rule can be caused by poor communication between the public accountant and the audit committee during the supervision process carried out. This is not in accordance with agency theory which explains that supervision is carried out to reduce the opportunity for managers to carry out adverse actions against the principal, monitoring is carried out by forming an audit committee. This research is different from Rusli & Wiratmaja's research (2010), but it is similar to the research of Setiawan & Fitriany (2011) which found that audit committees have a negative in-

fluence on audit quality.

### The Effect of Audit Committee Moderation on Tenure Relations to Audit Quality

Table 4 shows that the moderating variable failed to strengthen or weaken the tenure relationship to audit quality, so that H5 is **rejected**. This result is possible because of the regulation that requires the rotation of public accountants so that public accountants are likely to have a lot of experience in auditing different companies and systems so that there are many innovations and will be more careful in auditing. Thus, the role of the audit committee in carrying out monitoring is not very influential. This result is not in accordance with the monitoring mechanism in agency theory, that is establishing an audit committee to oversee corporate governance and monitor public accountants in order to be able to maintain their performance well.

### The Effect of Audit Committee Moderation on the relationship of audit Specialization to Audit Quality

Table 4 shows that audit committee is able to moderate the relationship of audit specialization on audit quality. However, this result has a negative relationship direction. This shows that the audit committee with good quality just decreases the positive influence of audit specialization on audit quality. So that H6 is **accepted**. This is in accordance with the monitoring mechanism in agency theory, that is to establish an audit committee to oversee corporate governance and monitor the implementation of audits by public accountants. Negative direction is possible because of lack of auditors specialization (Setiawan & Fitriany, 2011). There is no role of auditor specialization may be due to poor communication between public accountants and audit committees during the monitoring process carried out. This study supports Putri & Wiratmaja (2015) who found that the audit committee moderation variable is able to weaken or strengthen the influence of auditor specialization on audit quality.

### The Effect of Audit Committee Moderation on the relationship of KAP Reputation to Audit Quality

Table 4 shows that the audit committee is able to moderate KAP Reputation relationships on audit quality. This shows that the audit committee with good quality can reduce the negative influence of KAP reputation on audit quality. So that H7 is **accepted**. In line with agency theory, there are two ways to reduce agency problems, namely by monitoring and limiting. The existence of an audit committee is one of the manifestations and good corporate governance that is tasked with supervising the agents and conducting oversight of public accountants in carrying out audits. The more qualified the audit committee will increase the quality of the audit. This is also possible because of reputable KAPs and audit committees supporting each other's work. Reputable KAP has have experience in its work so that it can run the audit well. Supervision carried out by the audit

committee will ensure that the audit will proceed as it should so that the resulting audit is a qualified audit.

## CONCLUSIONS

Conclusions from this study are tenure does not have a significant effect on audit quality. Audit specialization has a significant positive effect on audit quality while the audit committee has a significant and negative effect on audit quality also the reputation of KAP. While the interaction variable between tenure and audit committee do not have a significant effect on audit quality. However, the audit committee is able to moderate the relationship between audit specialization and KAP reputation with audit quality.

Suggestion that can be given to this research for companies is in the formation of corporate audit committees it is recommended to comply with the guidelines provided by the Financial Services Authority (OJK) NOMOR 55 /POJK.04/2015 a which regulates the formation and guidance of the implementation of audit committee work and establish good and professional communication with public accountants to produce a good audit quality. For further research, it is recommended to use the latest regulations, namely Government Regulation No. 20 of 2015 which regulates the tenure period between a public accountant and his client company. The measurement of audit specialization can be further developed, not only looking at the market share of KAP, but it can also be observed by audit fees. The use of market share has a limitation, namely there is no clarity whether the market share is obtained from the experience of auditing companies in large numbers or auditing large companies in limited number. Further research is also expected to find complete financial report data to see the total number of tenure years. For KAP reputation variable, it is expected to use the IAPI data directory to view the latest KAP affiliate data so that the data used is more valid.

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