Analysis of requirements for audit service quality in companies that go public on the Jakarta stock exchange based on ownership structure, company size, and liability.

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Abstract-The purpose of this study is to analyze the quality of audit services, companies listed on the Jakarta Stock Exchange based on ownership structure (managerial ownership and institutional ownership), size, and debt. The main issue of this research is the agency which indicates a decrease in the quality of financial reporting. Agency conflicts can be reduced by audit quality in the form of high quality audit services. The demand for high quality audit services by decision makers has increased the credibility of corporate financial reporting. The object of this research is a company registered in the Indonesian Capital Market Directory (ICMD) for the 2018-2022 period. The data collection method is the pooling method and produces 76 company observations. Logistic Regression was used to analyze data and develop theoretical models. The results of the study show that managerial ownership, institutional ownership, and debt have an effect on high quality audit services in order to increase public confidence in financial reports. Of the four hypotheses proposed, there are only three hypotheses. The hypotheses are hypothesis 1 (managerial ownership), hypothesis 2 (institutional ownership) and hypothesis 4 (debt) affect the demand for quality auditing services). while hypothesis 3 (size) has no effect on the demand for high quality auditing services.

Keywords: Audit Quality, Managerial Ownership, Institutional Ownership, Size, Debt.

I. INTRODUCTION

Financial statements are a form of accountability and withdrawal of financial information from a company to parties who have an interest in financial reports. In increasing the credibility of financial reports, financial reports need to be audited by external auditors. However, the credibility of external financial reporting is becoming an issue for today's users. According to Kane and Velury (2020), this is caused by audit failures. These forms of audit failure occurred in a number of leading companies, such as Enron, Xerox, Tyco and Worldcom which involved many parties and had broad impacts. As an example of the Enron case that occurred in 2000, involving the Chief Executive Officer (CEO), commissioners, audit committee, internal auditors to external auditors. Meanwhile, cases of audit failure in Indonesia occurred in Kimia Farma and Bank Lippo (Sekar, 2003).

Of the various cases that have occurred, it is necessary to find solutions so that the trust in the integrity and earning quality of financial reports in the eyes of users does not decrease. The need for a third party to conduct a quality audit of the company's financial statements. Kane and Velury (2005) define audit quality as the capacity of external auditors to detect material errors and other forms of irregularities. In corporate governance mechanisms (such as board oversight), audit quality is said to be related to agency conflict. Agency conflict is a conflict of interest that occurs between managers, directors and shareholders. This conflict arises because of the desire of managers to maximize their own level of satisfaction, while on the other hand the shareholders also want the same thing. Thus conducting a quality audit will create a control such as preventive control, detective control and reporting control within the company.

Auditing is a form of monitoring used by companies in reducing agency costs of companies with bondholders and shareholders (Jensen and Meckling, 1976; Watts and Zimmerman, 1983 in Aloysia, 2003). It can be said that the higher the agency cost, the higher the demand for audit quality. The importance of auditing because it can reduce misreporting of accounting information. The company's demand for quality audit services varies. According to Chow (1982), the level of demand for audit services is influenced by the factors of company size (size), total debt, and the proportion of ownership (ownership influences). While Peter, Roger, and Tanawski (2000) who examined internal audit requests and external audits in family firms, found that auditor requests were influenced by company size, total debt, and ownership influence.

Research from Kane & Velury (2005) explains that the level of managerial ownership influences the demand for audit quality. This research is based on research conducted by Walfield and Wild (1995) discussing the levels of managerial ownership and earning quality. Based on this research, Kane & Velury (2005) explained that audit quality is affected by the low managerial ownership and high managerial ownership levels that exist within the company. At low managerial ownership, actions such as allocating company resources, transferring wealth in an inconsistent manner, and tending to make consumptive (unproductive) expenditures for personal gain, such as salary increases, bonuses and status are costs for shareholders. Therefore, non-managing

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shareholders want a high quality auditing service. These requests are used to control the behavior of managers, and help report to investors about the risk. This phenomenon is referred to as "divergence of interest". Whereas for companies that have a high level of managerial ownership, the use of company resources for consumption, setting regulations, including the selection of low quality auditors are influenced by managers. This is of course due to the amount of power possessed or the increased influence of the "defense management" (entrenchment) possessed by the manager. This also causes the demand for quality audits of financial reports to be able to detect inefficiencies that occur.

The deviations committed by managerial ownership are caused by factors of different interests and defenses with outside shareholders, lenders and the government. The difference in interests factor will become a dominant factor that can influence the decision-making process, such as choosing a Public Accounting Firm that is not qualified. Therefore, outside ownership will ask managerial ownership to carry out high quality auditing service financial reports in order to reduce agency risk.

The results of research conducted by Kane and Velury (2005) on the managerial ownership level, resulted in a significant and negative relationship between managerial ownership and the demand for audit services at the managerial ownership level below 5% and above 25%. This percentage of ownership is based on research from Mork, Shleifer, and Vishny (1988) who argue that firm value increases when the percentage of managerial ownership is below 5% and above 25%. For the intermediate managerial ownership level between 5% and 25%, it is known to have a negative relationship with the need for audit quality. The results of their research are consistent with the notion that companies with intermediate levels in managerial ownership (5 - 25%), differences in interests are more dominant than entrenchment as a determining factor in audit decisions.

The larger the size of the company, the more influential it is in the demand for audit services. This is because many developing companies are always marked by a separation between the owner and the company manager (principal-agent). According to Chow (1982), company size will directly affect the demand for audit services as a result of conflicts between shareholders and managers caused by the separation of duties and responsibilities in managing the company. The more the company develops (company size), the owner cannot manage the company himself so he needs someone else to manage the company. Under these conditions, managers often act in accordance with their interests and not the interests of the owner (shareholders), so that the owner will request audit services from the auditor. Audit services are used so that the accounting data presented by management is not misleading or biased. Company size is measured by the value of company assets (Chow, 1982).

. Debt is said by Chow (1982), affects the company's demand for audit services. It is said further that the greater the proportion of total debt on own capital (leverage), the greater the demand for audit services. Easterbrook (1984) in Fitri and Mamduh (2003) said that if the monitoring costs for managers are high, then they will use third parties (debtholders and bondholders). Thus, debtholders who have invested their funds in the company will automatically monitor the use of these funds. However, management tends to present financial reports by displaying company assets that are larger than they should be. This is done to convince creditors that the company is able to guarantee debt repayment at maturity, which is indicated by low leverage. The cause of using debt in high-risk companies by Saunders, Strock and Travlos (1990) is because they will enjoy the transfer of prosperity, from debtholders to shareholders. Under these conditions, creditors (debtholders) want to use audit services for the company concerned.

Companies listed on the Jakarta Stock Exchange are required to periodically present financial reports to the public (KEP-38/PM/1996 and Kep.-36/PM/2003) using audit services from auditors registered with Bapepam. Recognizing the importance of high quality auditing services in improving the integrity of company financial statements, prompted researchers to examine the effect of ownership structure consisting of managerial ownership, institutional ownership (Untung and Hartini, 2006), size, and debt on audit services provided. quality. The basic reference of this research is the research conducted by Kane and Velury (2005) namely the effect of managerial ownership on the demand for high quality audit services by adding other variables such as institutional ownership, size, and debt.

II. RESEARCH METHODS

This research is a causality study, namely research that aims to explain the effect of independent variables, namely ownership structure (managerial ownership and institutional ownership), size, and debt, on audit quality.

Population and Sampling Procedure

The population of this study are all companies whose shares are listed and traded on the Jakarta Stock Exchange in 2018-2022. The sampling method in this study, namely by using purposive sampling method, with the following sample criteria:

a. All companies listed on the Jakarta Stock Exchange in 2018-2022
b. The company has a separation of share ownership consisting of managerial ownership and institutional ownership. This can be seen from the records of the company's financial statements.

Data types and sources

The type of data used in this study is secondary data whose data sources were obtained and collected from the Indonesian Capital Market Directory (ICMD) for the 2018 to 2022 observation period on an annual basis. The type of data taken is related to companies audited either by The Big Four or not, the proportion of share ownership, institutional ownership, size, debt.

Operational Variables

This study uses a dichotomous variable as the dependent variable to indicate members of the Big Six (now Big Four). This variable is measured by a dummy variable; 1 for companies that use auditors affiliated with the Big Four Public Accounting Firms, and 0 otherwise.

Independent Variable

a. Managerial ownership, in this study is given the symbol Mngr.
This variable is measured by looking at the percentage of share ownership that is less than 5% (low_Mngr_Own), and ownership that is more than 25% (high_Mngr_Ownr).

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b. Institutional ownership, in research is given the symbol IO
Institutional Ownership is an institutional investor who because of their large wealth has voting rights to determine, or select a qualified auditor.

c. Company size in this study is given the symbol Size
The size of the company referred to in this study is the size of the company. The criteria for grouping the size of industrial companies are total assets, number of employees, equity and revenue.

d. Debt in this study is given the symbol DEBT
The measurement of this variable is formulated as follows:

$$\text{Debt} = \frac{\text{Long Term Debt}}{\text{Total Assets}}$$

III. DISCUSSION

Data regarding companies collected from company data listed on the Jakarta Stock Exchange. The data is for companies listed on the Jakarta Stock Exchange from 2018 to 2022, totaling 313 companies, while only 76 companies meet the criteria. Of the 76 companies, 42 companies use big four auditors and 34 companies do not use big four auditors. The following is the relationship between managerial ownership and the big four companies:

Table 3.1

Analysis of the Use of the Big Four at the Managerial Ownership Level

Company *Mgr Crosstabulation

			Mgr			Total
			1	2	3	
Company	non big 4	Count	21	6	7	34
		Expected Count	19,7	9,8	4,5	34,0
		% within Perusahaan	61,8%	17,6%	20,6%	100,0%
		%witin Mgr	47,7,%	27,3%	70,0%	44,7%
		%of total	27,7%	7,9%	9,2%	44,7%
	big4	Count	23	16	3	42
		Expected Count	24,3	12,2	5,5	42,0
		% within Perusahaan	54,8%	38,1%	7,1%	100,0%
		%witin Mgr	52,3%	72,7%	30,0%	55,3%
		%of total	30,3%	21,1%	3,9%	55,3%
Total		Count	44	22	10	76
		Expected Count	44,0%	22,0	10,0	76,0
		% within Perusahaan	57,9%	28,9%	13,2%	100%
		%witin Mgr	100,0%	100,0%	100,0%	100%
		%of total	57,9%	28,9%	13,2%	100%

Data source: Processed data, 2022

Based on crosstabulation data between companies using big four, and not with manager ownership, the following results are obtained: that for low managerial ownership (code: 1) there are 23 companies using big four auditors while those that do not use big four are 21 companies. For middle managerial ownership (code: 2) there are 16 companies that use big four auditors, while those that do not use big four are 6 companies. For high managerial ownership (code: 3), there are 3 companies that use big four auditors, while those that do not use big four are 7 companies.

Effect of Managerial Ownership Proportion on Demand for High Quality Auditing Services (H1)

The results of testing hypothesis 1 (H1) show that the effect value of managerial ownership (B) on high quality auditing services is -2.573 for Low-Mgr, and -4.109 for High_Mgr with a significant level below 0.05. The value of the proportion of managerial ownership which is negative, as shown above indicates that when managerial ownership is low (< 5%), there will be divergence of interests, and cause outside shareholders (Institutional ownership) to demand high quality auditing services to monitor management in the company. Likewise, when managerial ownership is high (> 25%), there is a divergence of interest effect so that high quality auditing services are needed. In other words, the influence of this divergence of interest causes a negative relationship between managerial ownership and audit quality.

The above findings are consistent with the findings of Kane and Velury (2005), Morck et al (1988), Shleifer and Vishny (1988), and Warfield (1955). The findings in this study also reinforce the statement of Jansen and Meckling (1976) which said that an increase in agency risk is caused by an increase in deviant (inefficient) behavior, such as negligence and perquisite-taking by

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managers. Morck et al. (1988), McConnell and Servaes (1990), Cho (1998), and Steiner (1996), Iturriaga and Sanz (1998), Max and Li (2000) in Eddy and Mas'ud (2003) also said that the behavior of managers will tend to try to align their interests with the interests of outside owners, by increasing their share ownership if the company value derived from investment increases. The same thing is explained by Kamin and Ronen (1978) and Smith (1976) in Dessy and Indra (2004) who say that companies controlled by managerial ownership are more likely to carry out earnings management to get bonuses, funds from investors, or debt from debtors.
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Effect of Institutional Ownership on Demand for High Quality Auditing Services (H2)

The findings of hypothesis 2 (H2) confirm the influence value of Institutional Ownership (B) on the demand for high quality auditing services of 0.265. with a significance value of 0.001. The direction of the positive sign is 0.265, indicating the influence of institutional ownership on high quality auditing services has a positive effect on high quality auditing services. Reflection of high quality auditing services is characterized by the demand for auditors with industry specialization.

The findings of this study are consistent with those of Velury et al. (2003) and Untung and Hartini (2006) which state that because of the large investment invested by institutional ownership in the company, the stronger the external control over the company. This will be seen in the selection of high-quality audits in the framework of monitoring activities, or supervisory activities against companies. This finding is also in line with Jarell and Poulsen (1987) in Velury et al. which states that institutional ownership tends to carry out the process of voting or voting on amendments that have a positive effect on the wealth of shareholders. Likewise research from Dunn, Mayhew, and Morsfield (2000) argues that companies that seek to improve the quality of information disclosure will use auditors with industry specialization. This of course will attract a lot of attention from institutional ownership.

The Effect of Size on Demand for High Quality Auditing Services (H3)

Hypothesis 3 testing confirms that the effect of firm size on demand for high quality auditing services is 0.516. with an insignificant value of 0.413 (greater than $\alpha = 0.05$). The positive and insignificant effect between size and audit quality proves that there is no effect of size on audit quality. This means that the size individually has no influence on audit quality. But together with the variables Low_Mgr, High_Mgr, and debt can affect audit quality.

Hasil uji hipotesis The results of this hypothesis test individually are not in accordance with the theory and research that has been built, namely the effect of size on the demand for high quality auditing services. However, conceptually according to Kane and Velury (2005) the relationship between size and audit quality is not well understood. He further said that size is more understandable if it is related to the level of managerial ownership even though the relationship is negative. The reason is that when the company grows (size), more equity capital is needed which causes the level of managerial ownership to actually decrease. From the results of the data, it was found that the number of companies that have a large or small size in using the big four is not much different. This hypothesis test is also different from research conducted by Chow (1982) which estimates that there is a direct relationship between the demand for high quality auditing services and the development of a company.

Effect of Debt on Demand for High Quality Auditing Services (H4)

Statistical tests show a positive relationship between debt and high quality auditing services. This is also supported by the value of the effect of debt on high quality auditing services of 8.724, with a significance value of 0.048. This finding indicates that the higher the debt that exists in companies on the JSX, it will also have an impact on the high desire to use high quality auditing services, and vice versa. This finding is consistent with research conducted by Chow (1982), and Peter et al. (2000) who found that the demand for audit services was influenced by debt. Likewise according to Crutchley (1999), who said a high debt policy causes companies to be monitored by debtholders. To monitor the debtholders will ask the company to have its financial statements audited by highly qualified auditors. This is a condition for obtaining additional funds (debt) for company development (investing) or for paying dividends (Fitri and Mamduh, 2003).

IV. CONCLUSION

Based on the data obtained and the results of the analysis carried out in this study, it can be concluded as follows:

1. The results of research on managerial ownership, institutional ownership, and debt have an effect on high quality audit services in order to increase public confidence in financial reports. Of the four hypotheses proposed, there are only three hypotheses. The hypotheses are hypothesis 1 (managerial ownership), hypothesis 2 (institutional ownership) and hypothesis 4 (debt) affect the demand for quality auditing services). while hypothesis 3 (size) has no effect on the demand for high quality auditing services
2. The higher the level of managerial ownership, the lower the desire to implement high quality audits. And the same thing if the level of managerial ownership is low, then there is a desire to carry out high quality auditing services because the agency risk faced by outside ownership continues to decrease. The findings in this study are consistent with research from Kane and Velury (2005), Morck et al (1988), Shleifer and Vishny (1988) in Velury et al. (2003).
3. The greater the ownership from the outside (institutional ownership) will affect the increase in the use of the big four KAP (high quality auditing services) because of the large amount of investment invested in the company. This study is in accordance with Jarell and Poulsen (1987) in Velury et al. (2003), and Dunn et al. (2000).
4. The amount of debt (debt) required by the company in order to make investments or to pay dividends, requires high quality auditing services so that the debt is not biased and can be paid off on time. These results confirm the statement from Jensen (1986) which says that debt can reduce agency conflict and is a control over managers for actions that are not optimal in using the company's free cash flow. The same thing was said by Sekar, 2003 saying that an audit is needed to control the actions of managers so that they become efficient so that bankruptcy and loss of control and reputation can be avoided.
5. Rejection of the 3rd hypothesis can be concluded that the effect of company size (size) on the use of high quality auditing services individually has no effect. This is in accordance with the statement of Kane and Velury (2005) that the relationship

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between size and audit quality is not well understood, and according to them, company size (size) can be understood if it is related to the level of managerial ownership.

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